

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

March 26, 2014

1:05 p.m.

**MEMBERS PRESENT**

Representative Eric Feige, Co-Chair  
Representative Dan Saddler, Co-Chair  
Representative Peggy Wilson, Vice Chair  
Representative Mike Hawker  
Representative Kurt Olson  
Representative Paul Seaton  
Representative Scott Kawasaki  
Representative Geran Tarr

**MEMBERS ABSENT**

Representative Craig Johnson

**OTHER LEGISLATORS PRESENT**

Representative Doug Isaacson

**COMMITTEE CALENDAR**

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 138(FIN) AM

"An Act relating to the purposes, powers, and duties of the Alaska Gasline Development Corporation; relating to an in-state natural gas pipeline, an Alaska liquefied natural gas project, and associated funds; requiring state agencies and other entities to expedite reviews and actions related to natural gas pipelines and projects; relating to the authorities and duties of the commissioner of natural resources relating to a North Slope natural gas project, oil and gas and gas only leases, and royalty gas and other gas received by the state including gas received as payment for the production tax on gas; relating to the tax on oil and gas production, on oil production, and on gas production; relating to the duties of the commissioner of revenue relating to a North Slope natural gas project and gas received as payment for tax; relating to confidential information and public record status of information provided to or in the custody of the Department of Natural Resources and the Department of Revenue; relating to apportionment factors of the Alaska Net Income Tax Act; amending the definition of gross value at the 'point of production' for gas for purposes of the oil and gas production tax; clarifying that the exploration

incentive credit, the oil or gas producer education credit, and the film production tax credit may not be taken against the gas production tax paid in gas; relating to the oil or gas producer education credit; requesting the governor to establish an interim advisory board to advise the governor on municipal involvement in a North Slope natural gas project; relating to the development of a plan by the Alaska Energy Authority for developing infrastructure to deliver affordable energy to areas of the state that will not have direct access to a North Slope natural gas pipeline and a recommendation of a funding source for energy infrastructure development; establishing the Alaska affordable energy fund; requiring the commissioner of revenue to develop a plan and suggest legislation for municipalities, regional corporations, and residents of the state to acquire ownership interests in a North Slope natural gas pipeline project; making conforming amendments; and providing for an effective date."

- HEARD & HELD

#### **PREVIOUS COMMITTEE ACTION**

BILL: SB 138

SHORT TITLE: GAS PIPELINE; AGDC; OIL & GAS PROD. TAX

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

01/24/14	(S)	READ THE FIRST TIME - REFERRALS
01/24/14	(S)	RES, FIN
02/07/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/07/14	(S)	Heard & Held
02/07/14	(S)	MINUTE(RES)
02/10/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/10/14	(S)	Heard & Held
02/10/14	(S)	MINUTE(RES)
02/12/14	(S)	RES WAIVED PUBLIC HEARING NOTICE, RULE 23
02/12/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/12/14	(S)	Heard & Held
02/12/14	(S)	MINUTE(RES)
02/13/14	(S)	RES AT 8:00 AM BUTROVICH 205
02/13/14	(S)	Heard & Held
02/13/14	(S)	MINUTE(RES)
02/14/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/14/14	(S)	Heard & Held
02/14/14	(S)	MINUTE(RES)
02/19/14	(S)	RES AT 3:30 PM BUTROVICH 205
02/19/14	(S)	Heard & Held

02/19/14 (S) MINUTE(RES)  
02/20/14 (S) RES AT 8:00 AM BUTROVICH 205  
02/20/14 (S) Heard & Held  
02/20/14 (S) MINUTE(RES)  
02/21/14 (S) RES AT 8:00 AM BUTROVICH 205  
02/21/14 (S) Heard & Held  
02/21/14 (S) MINUTE(RES)  
02/21/14 (S) RES AT 3:30 PM BUTROVICH 205  
02/21/14 (S) Heard & Held  
02/21/14 (S) MINUTE(RES)  
02/24/14 (S) RES RPT CS 2DP 4NR 1AM NEW TITLE  
02/24/14 (S) DP: GIESSEL, MCGUIRE  
02/24/14 (S) NR: FRENCH, MICCICHE, BISHOP,  
FAIRCLOUGH  
02/24/14 (S) AM: DYSON  
02/24/14 (S) RES AT 8:00 AM BUTROVICH 205  
02/24/14 (S) -- MEETING CANCELED --  
02/24/14 (S) RES AT 3:30 PM BUTROVICH 205  
02/24/14 (S) Moved CSSB 138(RES) Out of Committee  
02/24/14 (S) MINUTE(RES)  
02/25/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
02/25/14 (S) Heard & Held  
02/25/14 (S) MINUTE(FIN)  
02/25/14 (S) FIN AT 5:00 PM SENATE FINANCE 532  
02/25/14 (S) Heard & Held  
02/25/14 (S) MINUTE(FIN)  
02/26/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
02/26/14 (S) Heard & Held  
02/26/14 (S) MINUTE(FIN)  
02/27/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
02/27/14 (S) Heard & Held  
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02/28/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
02/28/14 (S) Heard & Held  
02/28/14 (S) MINUTE(FIN)  
03/03/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
03/03/14 (S) Heard & Held  
03/03/14 (S) MINUTE(FIN)  
03/04/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
03/04/14 (S) Heard & Held  
03/04/14 (S) MINUTE(FIN)  
03/05/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
03/05/14 (S) Heard & Held  
03/05/14 (S) MINUTE(FIN)  
03/05/14 (S) FIN AT 5:00 PM SENATE FINANCE 532  
03/05/14 (S) Scheduled But Not Heard  
03/06/14 (S) FIN AT 9:00 AM SENATE FINANCE 532

03/06/14 (S) Heard & Held  
 03/06/14 (S) MINUTE(FIN)  
 03/07/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/07/14 (S) -- MEETING CANCELED --  
 03/10/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/10/14 (S) Heard & Held  
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 03/10/14 (S) Heard & Held  
 03/10/14 (S) MINUTE(FIN)  
 03/11/14 (S) FIN AT 5:00 PM SENATE FINANCE 532  
 03/11/14 (S) Heard & Held  
 03/11/14 (S) MINUTE(FIN)  
 03/12/14 (H) RES AT 1:00 PM BARNES 124  
 03/12/14 (H) -- MEETING CANCELED --  
 03/14/14 (S) FIN RPT CS 6DP 1AM NEW TITLE  
 03/14/14 (S) LETTER OF INTENT WITH FINANCE REPORT  
 03/14/14 (S) DP: KELLY, MEYER, DUNLEAVY, FAIRCLOUGH,  
 BISHOP, HOFFMAN  
 03/14/14 (S) AM: OLSON  
 03/14/14 (S) FIN AT 9:00 AM SENATE FINANCE 532  
 03/14/14 (S) Moved CSSB 138(FIN) Out of Committee  
 03/14/14 (S) MINUTE(FIN)  
 03/14/14 (H) RES AT 1:00 PM BARNES 124  
 03/14/14 (H) <Pending Referral>  
 03/17/14 (H) RES AT 1:00 PM BARNES 124  
 03/17/14 (H) <Pending Referral>  
 03/18/14 (S) TRANSMITTED TO (H)  
 03/18/14 (S) VERSION: CSSB 138(FIN) AM  
 03/19/14 (H) READ THE FIRST TIME - REFERRALS  
 03/19/14 (H) RES, L&C, FIN  
 03/19/14 (H) RES AT 1:00 PM BARNES 124  
 03/19/14 (H) Heard & Held  
 03/19/14 (H) MINUTE(RES)  
 03/21/14 (H) RES AT 1:00 PM BARNES 124  
 03/21/14 (H) Heard & Held  
 03/21/14 (H) MINUTE(RES)  
 03/24/14 (H) RES AT 1:00 PM BARNES 124  
 03/24/14 (H) Heard & Held  
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 03/25/14 (H) RES AT 4:30 PM BARNES 124  
 03/25/14 (H) Heard & Held  
 03/25/14 (H) MINUTE(RES)  
 03/26/14 (H) RES AT 1:00 PM BARNES 124

**WITNESS REGISTER**

DEEPA PODUVAL, Principal  
Management Consulting Division  
Black & Veatch Corporation;  
Consultant, Department of Natural Resources (DNR)  
Houston, Texas

**POSITION STATEMENT:** In relation to CSSB 138(FIN) am, provided a PowerPoint presentation entitled, "TransCanada Participation in AKLNG Project."

PETER ABT, Management Director  
Management Consulting Division  
Black & Veatch Corporation;  
Consultant, Department of Natural Resources (DNR)  
Houston, Texas

**POSITION STATEMENT:** In relation to CSSB 138(FIN) am, assisted in providing a PowerPoint presentation entitled, "TransCanada Participation in AKLNG Project."

#### **ACTION NARRATIVE**

[1:05:50 PM](#)

**CO-CHAIR ERIC FEIGE** called the House Resources Standing Committee meeting to order at 1:05 p.m. Representatives Seaton, Tarr, Kawasaki, Hawker, Olson, Saddler, and Feige were present at the call to order. Representative P. Wilson arrived as the meeting was in progress. Representative Doug Isaacson was also present.

#### **SB 138-GAS PIPELINE; AGDC; OIL & GAS PROD. TAX**

[1:06:07 PM](#)

CO-CHAIR FEIGE announced that the only order of business is CS FOR SENATE BILL NO. 138(FIN) am, "An Act relating to the purposes, powers, and duties of the Alaska Gasline Development Corporation; relating to an in-state natural gas pipeline, an Alaska liquefied natural gas project, and associated funds; requiring state agencies and other entities to expedite reviews and actions related to natural gas pipelines and projects; relating to the authorities and duties of the commissioner of natural resources relating to a North Slope natural gas project, oil and gas and gas only leases, and royalty gas and other gas received by the state including gas received as payment for the production tax on gas; relating to the tax on oil and gas production, on oil production, and on gas production; relating

to the duties of the commissioner of revenue relating to a North Slope natural gas project and gas received as payment for tax; relating to confidential information and public record status of information provided to or in the custody of the Department of Natural Resources and the Department of Revenue; relating to apportionment factors of the Alaska Net Income Tax Act; amending the definition of gross value at the 'point of production' for gas for purposes of the oil and gas production tax; clarifying that the exploration incentive credit, the oil or gas producer education credit, and the film production tax credit may not be taken against the gas production tax paid in gas; relating to the oil or gas producer education credit; requesting the governor to establish an interim advisory board to advise the governor on municipal involvement in a North Slope natural gas project; relating to the development of a plan by the Alaska Energy Authority for developing infrastructure to deliver affordable energy to areas of the state that will not have direct access to a North Slope natural gas pipeline and a recommendation of a funding source for energy infrastructure development; establishing the Alaska affordable energy fund; requiring the commissioner of revenue to develop a plan and suggest legislation for municipalities, regional corporations, and residents of the state to acquire ownership interests in a North Slope natural gas pipeline project; making conforming amendments; and providing for an effective date."

CO-CHAIR FEIGE, in relation to CSSB 138(FIN) am, invited the administration's consultants from Black & Veatch Corporation to provide their presentation [entitled, "TransCanada Participation in AKLNG Project"].

1:06:58 PM

DEEPA PODUVAL, Principal, Management Consulting Division, Black & Veatch Corporation; Consultant, Department of Natural Resources (DNR), noted that yesterday's presentation was about the Heads of Agreement (HOA), the first of the two major agreements that the state has entered into [in regard to the proposed Alaska Liquefied Natural Gas (LNG) Project]. She said today's presentation is about TransCanada's participation in the Alaska LNG Project and the Memorandum of Understanding (MOU) that has been entered into between the state and TransCanada. Turning to slide 3, entitled "Memorandum of Understanding - Highlights of the Deal on the Table," she said it is anticipated in the MOU that TransCanada would hold the state's equity share in the gas treatment plant and pipeline components of the Alaska LNG Project. The state would have an option to buy back up to

40 percent of TransCanada's share at around initiation of the Front-End Engineering and Design (FEED) stage. The state would commit to a 25-year transportation services agreement with TransCanada. The agreement commits TransCanada, in turn, to a weighted average cost of capital (WACC) of 6.75 percent and that is driven by the capital structure as well as the return on equity and cost of debt that TransCanada has committed to as part of the commercial terms laid out in the MOU. Various milestones and off-ramps for the state and TransCanada are laid out in the MOU.

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MS. PODUVAL moved to slide 4, entitled "Options Identified by State for Equity Participation," to discuss the three alternatives available to the state. In the first option, the State of Alaska (SOA) would go it alone, taking 25 percent equity participation in the project. The state would hold 25 percent in the gas treatment plant (GTP), 25 percent in the pipeline, and 25 percent in the LNG plant. In the second option, the state would participate with TransCanada without exercising the state's buyback option. TransCanada would hold the state's equity portion of the GTP as well as the pipeline, so TransCanada would have the 25 percent in the GTP and pipeline, and the state would continue to hold 25 percent in the LNG plant. In the third option, the state would partner with TransCanada and would exercise the state's buyback option. As part of the buyback, the state can essentially buy back from TransCanada up to 40 percent of TransCanada's interest in the GTP and pipeline. She explained that 40 percent of 25 percent would give the state a 10 percent holding in the GTP and pipeline and TransCanada would hold 15 percent of the GTP and pipeline, and the state would have 25 percent of the LNG plant. Common through all alternatives is that the state will hold its 25 percent in the LNG plant, and TransCanada's participation essentially impacts the state's ownership or what portion it will hold in the GTP and pipeline components of the project.

[1:11:12 PM](#)

REPRESENTATIVE TARR surmised from slide 4 that everything [Black & Veatch] has worked on presupposes the tax and gas and the royalty-in-kind that keeps the State of Alaska at 25 percent.

MS. PODUVAL responded yes, everything in this presentation assumes that the state will take an equity participation in the project and that that equity would be between 20 and 25 percent,

and there will be a corresponding gross tax percent associated with that.

[1:11:45 PM](#)

MS. PODUVAL explained slide 5, entitled "Implications of Options and Potential Off Ramps," shows what the investment implications are as well as what the potential off-ramps are associated with these three different investment alternatives that the state has. She reminded members that yesterday she talked about the different project of allotment stages and the timeline associated with that, while today is just before what is hoped will be the Pre-Front-End Engineering and Development (Pre-FEED) stage that will get initiated in the second half of 2014. If the state chooses to go it alone, the investment that will be required of the state is expected to be about \$100 million through Pre-FEED, going up to about \$450 million getting through FEED, and a little over \$13 billion once the final investment decision (FID) has been made and construction gets kicked off on the project. The second alternative available to the state, where TransCanada participates in the project but the state does not exercise its buyback option, is the path where the state has the least investment of the three alternatives available to it. That is because in this option TransCanada will hold the 25 percent in the GTP and pipeline and the state will hold 25 percent in the LNG plant alone. The state's investment under this alternative would be about \$40 million or so through Pre-FEED, \$180 million going through FEED, and \$6.7 billion through the construction phase. All of these costs would be related to the state's investment in the LNG plant alone. In the third alternative where the state exercises its 40 percent buyback option from TransCanada and takes on 10 percent of the GTP and pipeline, the state's investment through Pre-FEED would be \$43 million. That is because the state would not exercise its buyback until the Pre-FEED is done. Going through FEED the state's investment is expected to be \$360 million, and through construction the state's investment would be a little over \$9 billion. So, from an investment perspective, the most expensive alternative for the state is the going-it-alone option. The least expensive would be for TransCanada to hold the 25 percent through the GTP and pipeline and the state not buying it back. The option in which the state buys back a portion of the GTP and pipeline falls in between the other two levels of investment.

[1:14:54 PM](#)

MS. PODUVAL noted the red boxes depicted on slide 5 indicate the points in time along the project's development where the state can exercise an off-ramp and end its relationship with TransCanada. The first point where this happens is at the end of the Pre-FEED stage. If the state exercises an off-ramp option at the end of Pre-FEED, the state would pay back to TransCanada the cost it has spent on the project, which is expected to be about \$70 million. That would be with and without the buyback because TransCanada would have spent the equivalent of 25 percent of the costs related to the GTP and the pipeline through the end of Pre-FEED. At the end of the FEED stage, the state would pay back development costs to TransCanada in the range of between \$230 million and about \$400 million. Ms. Poduval put into context the off-ramps and the payment of development costs to TransCanada by pointing out that the amount is essentially what the state would have been investing in the go-it-alone option. It is almost like TransCanada is carrying that cost up to the point where the state exercises its off-ramp, ending that relationship, and then the state goes back and pays the development cost that it would have paid anyway. A nuance around that is the \$5 million in allowance for funds used during construction (AFUDC). That can be thought of as interest cost or carrying cost of money for TransCanada. That interest rate is about 7 percent, so the approximately \$5-\$50 million of AFUDC is the incremental cost that the state is bearing relative to an alternative without TransCanada. Not all of that will be a completely incremental cost because the state will have its own carrying cost of money. To the extent it is not investing that money in this project, the state could be investing that money elsewhere and earning interest on it, so there is a lost opportunity cost associated with that. Another aspect covered by that cost is that the state is paying for the technical and commercial expertise that a partner brings to the table that the state would otherwise have to contract for, assuming the state can find somebody qualified to watch over this project on the state's behalf in a going-it-alone option. The decision in front of the committee today with these off-ramps available, the dollar amount being contemplated, is the \$5-\$50 million in carrying cost as well as what it would cost the state to replicate the expertise that TransCanada brings to watch over the project on the state's behalf.

[1:19:06 PM](#)

CO-CHAIR SADDLER inquired whether there is a direct nexus between the AFUDC and construction or whether it is simply a carrying cost for financing and expertise costs.

MS. PODUVAL replied it is carrying cost. Responding further, she explained it is a weighted, averaged cost of capital for TransCanada. It assumes a debt/equity structure of 70/30, a 12 percent return on equity, and a 5 percent cost of debt, which is what boils it down to a 7 percent weighted cost of capital or carrying cost for TransCanada.

CO-CHAIR SADDLER asked what amount that is calculated on since it is not a construction cost.

MS. PODUVAL answered it is calculated on the amount that TransCanada is investing in the project. Responding further, she confirmed it is a development cost, not a construction cost, and that AFUDC is simply a regulatory term.

CO-CHAIR SADDLER related that when he takes his car to the mechanic he is charged for the repair services, the parts, and for shop towels. Having an extra cost for expertise seems like paying for shop towels, he said. He asked whether the expertise is a standard over cost rather than a part of the package.

MS. PODUVAL responded that in thinking about the package, of the \$70 million in the first off ramp, \$65 million is what the state would have paid anyway to contractors for doing the Pre-FEED study for the state. The remaining \$5 million, which includes a 12 percent return on equity for the \$65 million that TransCanada has spent, is what the state is paying for TransCanada's expertise and efforts in the process.

[1:21:39 PM](#)

REPRESENTATIVE TARR noted that in this scenario the state is responsible for paying TransCanada if the state chooses not to move forward with the project, but there is no reciprocal relationship should TransCanada decide not to go forward. She inquired how members can assess whether that is a good deal for the state, given it seems there should be some equality in that relationship. She further asked why it would be more advantageous to pay a 7 percent [weighted cost] to TransCanada when the state could borrow that money at a lower interest rate, excluding that the state has other capital considerations.

MS. PODUVAL, regarding the first question, replied TransCanada is investing in the project by taking on a portion of the state's equity share. The state is not investing on behalf of TransCanada; in other words, the state is not spending any money

for TransCanada for them to pay the state back. Regarding the second question, she said it goes back to the role of TransCanada in this arrangement. One aspect of that role is the financial side, which is that TransCanada shares the upfront cost associated with this project. The other aspect of that role is the expertise and the experience that TransCanada brings into this project. Part of what the state is paying for is what the state would pay if it was trying to get a technical and a commercial expert to watch over the state's interest in a go-it-alone option. Strictly speaking, the state can probably finance it for less, but the state is also paying for having an experienced partner at the table that shares the state's interests and will watch out for those.

[1:24:14 PM](#)

REPRESENTATIVE TARR, regarding the answer that the state is not really spending on TransCanada's behalf, remarked that the state is moving forward as if that partnership will exist; for example, in this first year there is a commitment of \$80-\$100 million to move forward, so the state is spending something to get to the next step in the process. In that sense, it seems to be somewhat unbalanced in that the state must hope that TransCanada wants to move forward; for example, other opportunities could come up elsewhere in the world that seem better to TransCanada and the State of Alaska would have no way to push TransCanada in its favor.

MS. PODUVAL allowed that is probably right, as there is nothing that would necessarily hold TransCanada to this deal; it is something TransCanada has to want to do. She said she thinks TransCanada has demonstrated it wants to be here with everything it has done in getting to this stage. This is a fairly risky project for TransCanada as well as it is a project that is 10 years out in the future. Through the Alaska Gasline Inducement Act (AGIA), TransCanada has already spent about \$100 million in a project that is now recognized as likely uneconomic. TransCanada is going to participate in this project if it continues to make sense to the company and has agreed on terms with the state that will get codified in the transportation service agreement (TSA) coming forward. As with the producers, as with the state, so it is with TransCanada. All of the parties have to continue to believe that this is an economic project that will make them money. As each development stage is gone through, every party will have the option to stop and think about whether it wants to continue.

[1:26:45 PM](#)

MS. PODUVAL, returning to her presentation, said four questions surfaced when the value of TransCanada's participation was looked at (slide 6, entitled "Key Questions in Looking at Value of TransCanada's Participation"). The first question looks at the financial bottom line and whether there is an economic impact to the state from having TransCanada participate in the project. The second question is whether the state can go it alone and what the associated implications are with this. The third question, assuming the state wants to take a partner, is whether TransCanada is a good partner and what attributes TransCanada brings to the table and how TransCanada compares with the alternatives available to the state. The fourth question looks at things from TransCanada's point of view by asking what financial risks TransCanada would be exposed to, if any, in this agreement.

[1:27:58 PM](#)

MS. PODUVAL moved to slide 7, entitled "What is the Economic Impact to State From TransCanada's Participation?" She examined the first question of what the financial bottom line is for the state or what the economic impact is to the state from entering into this agreement with TransCanada and having TransCanada participate in the project. She explained that everything to the left of the vertical orange line on slide 7 is the project's development and construction and to the right of the orange line is when the project is in operation. The basic deal on the table says that during project development and construction, TransCanada, instead of the state, will invest 60-100 percent of the upfront capital cost that is associated with the GTP and the pipeline. Once the project is in operation, in return the state will pay TransCanada a negotiated tariff for that same 60-100 percent of the GTP and pipeline capacity that will be used to move the state's gas. The economic analysis will examine the net impact of putting those together -- the advantage of having TransCanada bear the upfront cost and the cost of a tariff to the state over the 25 years of this transportation service agreement with TransCanada. It will examine whether this is better or worse for the state than going it alone.

[1:29:45 PM](#)

MS. PODUVAL said slide 8, entitled "TransCanada's Participation Impacts SOA Up Front Cash Calls and Revenues From Project," puts numbers to the state's three different alternatives. The

project is anticipated to be in service in 2024, so all of the cash flows shown on the graph for before 2024 are the investment that the state is making in the project. The positive cash flows seen on the graph after 2024 are the state's revenues associated with the Alaska LNG Project. The blue line depicts the state's cash flows under the go-it-alone alternative. The blue line is the lowest line on the investment side of the timeline, reflecting that it is the alternative in which the state would be investing the most money. Once the revenues start to flow, the blue line is the highest, reflecting that the state is not paying TransCanada a tariff or a return. The green line is the alternative where the state involves TransCanada and does not buy back a portion of the GTP or the pipeline. It is the alternative where the state has the least investment up front and is also the alternative where the state has the lowest cash flows or revenues once the project is operational because the state is paying a tariff to TransCanada on all 25 percent of the GTP and the pipeline. The grey line is the alternative with TransCanada where the state exercises its buyback clause and this line falls between the other two. TransCanada's participation reduces the state's upfront cash calls by between \$1.5 and a little over \$2 billion, assuming that the state is able to finance its investment using up to 70 percent of debt. Once the project becomes operational, TransCanada's participation reduces the state's revenues by between \$200 and a little over \$350 million per year.

[1:32:03 PM](#)

REPRESENTATIVE HAWKER, regarding slide 8 and the alternative of TransCanada with no buyback, inquired whether the cash flow prior to 2024 is almost exclusively the LNG facility given the state would not be investing in the pipe system.

MS. PODUVAL confirmed that in the green line [the state's] investment is associated only with the LNG plant. TransCanada would be making all of the investment associated with the GTP as well as the pipeline.

[1:33:02 PM](#)

MS. PODUVAL explained that slide 9, entitled "What is the Economic Impact to State From TransCanada's Participation?", boils down the cash flows from slide 8 into one number, the net impact. Slide 9 looks at it in two different ways. The green bar graph on the left totals up all of the state's cash flows [for each of the three alternatives] with the investment up

front, which would be negative, and then the revenues that come subsequently over the first 25 years of the project's operation. This graph shows that TransCanada's participation, on a cash flow basis, comes at a cost to the state, although in context it is not a very large cost: the state's total cash flow in the 40 percent buyback option is \$110 billion as compared to \$114 in the go-it-alone option, a reduction of \$4 billion. The blue bar graph on the right takes the time value of money and shows the net present value (NPV) to the state for each of the three alternatives. This graph shows there is really not much difference between the three alternatives from a net present value perspective for the state. That is because the upfront money that TransCanada would be investing, rather than the state, carries a lot of weight -- much more than cash flows that the state would have over 25 years of the project's operation into 2040.

[1:34:45 PM](#)

CO-CHAIR SADDLER inquired whether the state's total cash flows depicted by the green bars are net cash flows.

MS. PODUVAL nodded yes.

CO-CHAIR SADDLER concluded it all mixes down to the net present value anyway.

MS. PODUVAL replied correct.

CO-CHAIR SADDLER asked whether total cash flow is total profit.

MS. PODUVAL answered it is the net total cash flow.

[1:35:12 PM](#)

REPRESENTATIVE HAWKER observed that the graph for total cash flows is in nominal dollars. He recalled it being said that this modeling is based on a 25-year timeframe, and calculated that when the difference of \$4 billion between the go-it-alone option and the 40-percent-buyback option is taken over 25 years, the result is a reduction of \$160 million a year. However, he observed, slide 8 states that TransCanada's participation reduces the state's revenues by \$200-\$360 million per year. He requested a reconciliation of the numbers from these two slides.

MS. PODUVAL responded that the \$114 billion and \$110 billion on slide 9 are the total net. They take the negative cash flows up

front, so it is not just starting at project operation, it is looking at the whole deal. Everything on slide 8 is totaled together to get to the numbers on slide 9.

[1:37:12 PM](#)

MS. PODUVAL returned to discussion of slide 9, pointing out that TransCanada's NPV is expected to be \$150-200 million [over the initial 25 year period], while the state will make \$13 billion out of the project.

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MS. PODUVAL moved to slide 10, entitled "Can the State Go It Alone?". She noted there are two different aspects of this to explore, the first being the capital cost and investment implications of going it alone. TransCanada reduces the state's upfront capital costs. The second aspect is the debt implications of going it alone. This helps with the questions that have been asked about whether the state can finance this cheaper and has a stronger balance sheet. Turning to slide 11, entitled "SOA Upfront Capital Cost Exposure is Reduced Through TransCanada Participation," she explained that the capital cost risk is highest to the state before the project is operational because there are no revenues to support any cash calls or expenses that the state would be obligated for in the project. There is potentially some value in TransCanada's participation because it reduces exposure for the state. TransCanada's participation allows the state to retain 20-25 percent of the gas while only being responsible for 13-18 percent of the upfront costs. That is important even assuming a baseline cost project, but if cost overruns start to creep in and there are unanticipated cash calls on the state, then having somebody to share this with can be important and valuable.

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CO-CHAIR FEIGE understood exposure to cost overruns is shared by all the owners proportionately. TransCanada having a minimum of 14 percent of the overall project will share the exposure even more from the state and hence will be motivated to keep cost overruns from occurring.

MS. PODUVAL concurred, saying all of the parties are going to be extremely motivated to manage the costs of this project very aggressively. The cost is high enough to start with and it is not wanted to have the cost get much higher.

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MS. PODUVAL drew attention to slide 12, entitled "SOA Upfront Capital Cost Exposure is Reduced Through TC Participation," which depicts two project scenarios in which the state has exercised its buyback option [at 30-40 percent]. One scenario assumes a project completed at \$45 billion and the other scenario assumes a 20 percent cost overrun for a project completed at \$54 billion. In a project completed at \$45 billion, TransCanada's participation reduces the state's investment by about \$3 billion. For a project with a cost overrun, TransCanada's participation reduces the state's upfront investment by about \$4 billion. If the state does not exercise its buyback option, its investment will fall even further with TransCanada's participation.

MS. PODUVAL turned to the graph on slide 13, entitled "SOA Investment for a 25% Ownership with TC is Expected to be \$1.3-\$B Lower Than for a 20% Ownership Going Alone." She compared the upfront investment that would be required from the state by going it alone and affording a 20 percent stake in the project with the upfront investment of going with a partner and affording a 25 percent stake in the project. The total investment for the state going it alone and affording a 20 percent stake in the project (blue dotted line) would be about \$11 billion. By partnering with someone, in this case TransCanada, the state is able to take a 25 percent stake in the project and the state's upfront investment would be reduced by between \$1.3 billion and \$4 billion, depending on whether the state exercises the buyback.

MS. PODUVAL brought attention to the graph on slide 14, entitled "SOA Revenues for a 25% Ownership with TC are Expected to be \$0.4-\$0.5B Per Year Higher than for a 20% Ownership Going Alone." She compared the revenues the state would receive from the aforementioned alternatives. Revenues from going it alone with a 20 percent equity share in the project would be lower than they would be from going with a partner and 25 percent equity share. Putting the facts together from slides 13 and 14 tell a story that the state can invest less and earn more by taking a greater share in the project with a partner than by affording a lower share in the project and trying to go alone. Boiling that down to a net present value in today's dollars, she related that going it alone with a lower share in the project has a value of \$2 billion less than the alternatives where the state has a partner and a higher stake in the project (slide 15,

entitled "25% Ownership with TC Increases State of Alaska NPV by \$2B Compared to a 20% Ownership Going Alone").

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MS. PODUVAL moved to slide 16, entitled "Can the State Go It Alone? - State's Debt Capacity." To address the concept of what the state's debt capacity is and how the state's obligations to the Alaska LNG Project would relate to that, she looked at three borrowing scenarios. She noted that two related factors become important when borrowing to pay for this project. First, at what cost of debt can the state borrow this money? Second, what portion of the state's revenues, or general fund unrestricted revenues (GFUR), would be needed to service the debt that is associated with only this project? Scenario 1 is the highest quality debt, meaning it will be the cheapest debt, or lowest interest rate, that the state can get. The cost of debt in Scenario 1 is approximated to be 4.6 percent and the debt service is limited to 3 percent of the GFUR. Scenario 3 is the lowest quality debt, meaning the state would be paying the highest interest rate. In Scenario 3, the interest is 5.6 percent and the debt service is limited to 6 percent of GFUR. She explained the relationship between these two scenarios as follows: A lender loaning money to Alaska would have the most comfort that its loan is going to get paid back if it only takes a small portion of Alaska's revenues to pay back the loan. The lower the portion of state revenues that is required to pay back the debt, the greater comfort the lender has in lending to Alaska and the lower the interest rate will be that is offered for that loan. On the flip side, if a greater portion of Alaska's revenues are needed to pay back the lender, then that becomes a more risky loan for the lender and the lender will charge a higher interest rate to make that loan. So, the highest quality is the one that only obligates the lowest portion of the state's GFUR to pay it back and the most expensive debt is the one where a larger portion of the state's revenues will be required to pay it back.

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REPRESENTATIVE HAWKER understood Ms. Poduval's point, but noted that in a project like this the state might be bonding for its participatory interest in the pipe project. He inquired whether that would be more project-specific revenue bonding, rather than bonding that is dependent upon the general fund for repayment.

MS. PODUVAL agreed it is quite possible that the debt would be in the form of a revenue bond, but said it is almost too early in the project's development to know what kind of financing arrangements would be available for this project.

REPRESENTATIVE HAWKER asked whether the interest spreads shown on slide 16 are presuming that these are full general obligation bonds of the State of Alaska. He further asked whether Ms. Poduval has a sense of what the cost of capital would be should the financing be through a project-specific revenue bond.

MS. PODUVAL confirmed slide 16 assumes general obligation funds rather than revenue bonds. She said she does not have a good sense for what the cost of capital would be for revenue bonds.

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CO-CHAIR SADDLER inquired whether the interest rate and debt service limit in a scenario are independent variables or whether the interest rate is conditioned on the proportion of state GFUR to the amount financed.

MS. PODUVAL replied those two are related. The lower the amount of the state's revenues that will be needed to pay back that loan, the lower the interest rate will be, and that relationship will be seen when the three scenarios are looked at.

[1:51:04 PM](#)

REPRESENTATIVE TARR inquired about the extent to which the state's substantial savings would influence its borrowing ability, rather than the state's unrestricted revenue which has a more limited opportunity.

MS. PODUVAL responded that the way she looks at it, the state's substantial permanent fund savings, as well as its other resources, support its credit rating and influence what the state can borrow for. She imagined there are other alternatives to leverage those resources for financing this project and she imagined that the various departments will be looking at those alternatives as they proceed in this process and more concrete information on what this project is becomes available to share with the financial market.

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MS. PODUVAL returned to her presentation, explaining slide 17, entitled "The Amount of Cheap Debt Available to the State Could be Limited," shows how much debt the state can borrow in each of the three aforementioned alternatives. In general, the state can borrow more at the higher cost of debt than it can at the lower cost of debt. This is because more lenders are going to step up if the state is willing to pay a higher interest rate. Each set of three bars on the chart represents one level of investment that is required from the state. The height of the bars in the go-it-alone option is the highest because that is where the state has the highest level of investment obligation. The bar height in the TransCanada-without-buyback option are the lowest overall because that is where the state would have the lowest level of investment required.

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CO-CHAIR FEIGE observed on slide 17 that the label for the three middle bars states 30 percent buyback. He asked whether that should be 40 percent.

MS. PODUVAL replied 25 percent state equity participation has notionally been picked throughout in the presentation, unless it is called out otherwise. That is because greater equity participation brings greater value to the state and that is what the state should be hoping to get from this project. For this analysis specifically, a 20 percent equity stake in the project was used. The reason for doing this is to first answer the question of whether the state can afford to borrow to take 20 percent equity in the project. If the answer is no, then it stops the analysis there and automatically gives an answer to whether the state can borrow to take a 25 percent stake in the project. If this analysis shows that, yes, the state can take a 20 percent stake in the project, then the analysis moves on to look at a 25 percent stake. The 30 percent buyback comes from TransCanada's need for a minimum 14 percent stake in the project. So, when looking at a 20 percent total stake in the project, assuming TransCanada keeps 14 percent, that leaves the remaining 6 percent for the state, which is equivalent to 30 percent of the total 20 percent.

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REPRESENTATIVE HAWKER offered his appreciation for the analyses being illustrative to show the issue rather than specifics as to the project itself. He recalled the dialogue on a previous slide about the illustrative debt being general obligation debt

rather than project-specific revenue bond financing. He inquired whether this chart is relevant in this conversation because it is talking about the treasury carrying the weight of the project rather than the project carrying its own weight.

MS. PODUVAL thanked Representative Hawker for understanding the perspective that is being offered in highlighting an issue rather than the specifics. From that same specific, she related that most helpful to her during the analysis was being able to put the obligations that would be associated with the Alaska LNG Project in the context of the state's financial resources and the state's debt servicing capacity. She acknowledged there are revenue bonds, the permanent fund savings, and other tools that will be examined and agreed that this is by no means the only way to be looking at the debt associated with this project.

REPRESENTATIVE HAWKER, given that Black & Veatch is working for the administration, asked whether Black & Veatch is preparing legislators for a serious consideration of general obligation debt to fund this project.

MS. PODUVAL answered no, she would not say that.

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REPRESENTATIVE P. WILSON requested further elaboration regarding TransCanada's 14 percent, the state's 6 percent, and 40 percent [as related to slide 17].

MS. PODUVAL responded the 30 and 40 percent she was referring to goes to the buyback option that the state would have where it purchases back from TransCanada a portion of the ownership in the GTP and pipeline. When the state holds a 25 percent equity stake in the entire project, then the state has the right to buy back 40 percent of that 25 percent share from TransCanada. That would leave TransCanada with 15 percent and the state with 10 percent. When the state takes a 20 percent equity share in the project, assuming TransCanada keeps 14 percent, then the state buys back 30 percent or 6 percent of the 20 percent.

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MS. PODUVAL resumed her review of slide 17, explaining it shows that, assuming the state is trying to finance this with general obligation debt, only in the TransCanada alternative, even without the buyback, can sufficient debt be borrowed by the state for this project to get to a 70 or 75 percent debt level.

In general, large LNG projects aim for a capital structure of about 70 percent debt/30 percent equity. They want to borrow as much as they can because debt is generally cheaper than is their own equity, but the financial market will also place some checks and balances on that and insist the companies or the project developers put in some of their own money, too, and where that balance is generally struck is in that 70/30 mix. If the state would like to achieve that level of debt in this project, at least with general obligation debt, the total investment level that can be supported is the one that corresponds to having a partner in the project and not exercising buyback.

MS. PODUVAL pointed out that DOR uses a watermark to prudently manage the state's debt capacity. The department tries to manage the state's total debt service obligation to fall under 8 percent of the total general fund unrestricted revenue. The three different scenarios presented here would require between 3 and 6 percent of general fund unrestricted revenue to support just the Alaska LNG Project. If this is the path of debt that is considered, that would leave as little as 2 percent of the state's general fund unrestricted revenue as the remaining borrowing capacity for the state to finance schools and everything else that the state does as a sovereign.

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MS. PODUVAL turned to slide 18, entitled "Is TransCanada a Good Partner for the State of Alaska in the AKLNG Project?" Should the state decide that having a partner is a good idea to help it afford a higher stake in the project, the first attribute of TransCanada is that it brings extensive experience in building, owning, and operating northern pipelines. TransCanada is extremely well skilled, is a good project manager, and has more activity with northern pipelines than any of the other major pipeline companies. Second, TransCanada has shown a long history of interest in the Alaska pipeline, most recently through its participation in the AGIA process. TransCanada's participation helps to retain momentum in the project and that is driven by several factors. Most obvious is all of TransCanada's work under AGIA in studying this pipeline and its route and being able to transfer that work product to give this project a kick start. The second aspect is that relations are involved here. People from TransCanada, the state, and the producers have sat around tables and negotiated various aspects of this to get to this point. Those things take time and if a new party is introduced there will be inefficiencies until everyone falls in sync again. A third aspect is that

TransCanada, or any third party, comes into this with the perspective of not being a producer. TransCanada is an infrastructure company and, as such, its earnings are linked to having more throughput - more customers - that it can provide these services to. From that perspective, TransCanada is aligned to the state's interest of facilitating access and expansion on the project, which is different from the producers' perspective whose primary interest is always going to be to maximize their own revenues by moving their gas to market. The producers, arguably, have a disincentive, not with any nefarious intent, but just out of fiduciary duty to their own stockholders, not to make it very easy for other oil and gas producers to explore on the North Slope and compete with them and use this project to monetize that gas. Having a third party that is aligned with the state's interest as a partner is definitely valuable.

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PETER ABT, Management Director, Management Consulting Division, Black & Veatch Corporation; Consultant, Department of Natural Resources (DNR), expanded upon why TransCanada [would be a good partner] as opposed to soliciting other prospective pipeline companies for whether they have interest in filling that role. TransCanada has a long history in Alaska and has developed a great deal of institutional knowledge of the unique challenges that are faced in developing, constructing, and operating pipelines in arctic environments. TransCanada arguably has the most experience with this of any company in the world, perhaps shared only by a Russian pipeline company. While there are several other very good pipeline companies that operate in the Lower 48, none of them have a portfolio as extensive as that of TransCanada in operating in the climate that is had in Alaska. Additionally, the process of soliciting interest from other pipeline companies would only delay the whole development of this project because it would probably take a significant amount of time to solicit these proposals, review them, evaluate them, select a winner, and then begin the negotiations of an agreement such as the one being contemplated here that has already been arrived at with TransCanada. Another factor is how the producers would feel about that. Would they be as welcoming of a new party that would have a steep learning curve that would only add additional time and money to the development of the project? Those are extremely important considerations to take into account when trying to decide whether TransCanada is an appropriate partner in this context.

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MS. PODUVAL moved to slide 19, entitled "Retaining Momentum on Project Could be More Valuable than Securing Better Commercial Terms." She addressed the question of what the state would hope to achieve by bringing in another partner, saying this is a reasonable question to ask since this has not been bid out to know whether the state has the best commercial terms. Black & Veatch ran analysis to understand what the impact to the state would be of improved commercial terms. The two key commercial terms to focus on are the capital structure that has been offered in the project and the return on equity that TransCanada is earning in this project from the state. TransCanada has offered a capital structure of 75 percent debt and 25 percent equity, and a 12 percent return on equity. In general, the cost of debt is 5 percent and given the way transportation service contracts are generally structured, that is a pass through. So, what really is being negotiated is the capital structure and the return on equity. In regard to trying to improve the capital structure, she said 75 percent debt is an excellent commercial term for capital structure. In looking at pipeline companies in the Lower 48 and a number of recent projects, the capital structure is much more equity heavy than the 25 percent in the negotiated deal with TransCanada. But, assuming that the 75/25 can be improved upon, the direction the state would want to go is more debt and less equity. The left-most panel of slide 19 shows that every 5 percent increase in equity, and increase in the debt of that capital structure, creates a value to the state of about \$200 million. Holding that number and moving to the middle panel, and assuming the state can find a different partner that will accept a lower return on equity, slide 19 shows that for every 1 percent decrease in the return on equity that the state is paying creates an additional \$100 million in value to the state. So, between those two commercial terms, the debt/equity mix is more impactful and improves the state's net present value by about \$200 million. The return on equity is less impactful but every percentage improvement can create another \$100 million in value to the state. The far right panel of slide 19 looks at the cost to the state if finding a different partner results in delay of the project. This panel shows that for each year's delay in the project, the state loses the equivalent of \$800 million in value. Thus, assuming an equally qualified and interested partner could be found, and assuming that partner will offer more competitive terms than those given by TransCanada, it can be seen that any improvement in commercial terms would be dwarfed by the value that the state would lose by losing time on the project.

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REPRESENTATIVE TARR related that in a report prepared by Roger Marks, consultant to the Legislative Budget and Audit Committee, it is suggested that the state will not miss a window of opportunity for the Asian markets and that a better project that begins in 2026 may be preferable to a sub-optimal one that starts in 2024. Saying she is trying to reconcile these comments by Mr. Marks with today's presentation, she asked whether Ms. Poduval agrees that a two-year window would not be very meaningful in terms of progress on the project.

MS. PODUVAL responded she thinks Mr. Marks is accurate in saying there is not necessarily a window in global energy that the state is trying to squeeze through. Regarding the premise that a 2024 project would be sub-optimal somehow, she said she does not understand the rationale behind that. It is very early in this project's development stage, she continued, the state is not committing to spend \$13 billion today. The state is not representing, nor should it represent, that this has been studied and everything negotiated that needs to be negotiated. All of that will happen next. All that is trying to be done here is kick start the project, get it out of the gate, get it through its first phase of Pre-FEED, and then FEED, where a lot more information is gathered. All of the negotiations with TransCanada, the producers, and AGDC will take a lot of deliberation and a lot of study and will happen over the next four to six years before construction starts. She offered her belief that the project is not being rushed by any means; work is starting on the project as it should be. Trying to time the market would be foolhardy and is impossible to do, especially in a large LNG project that has such a long lead time. There is simply not the luxury of being able to respond instantly to a market need. The process must be kicked off years in advance so the project will be ready for the market 10 years from now. Delaying the project through any factors that the state controls does not sound prudent. Money today is definitely, and will always be, worth more than that same amount of money tomorrow. In yesterday's presentation the state's revenue profile without this project was looked at and that in itself gives her a sense of urgency to do this while the state has more resources available.

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CO-CHAIR SADDLER noted attention is being paid to the State of Alaska's debt capacity as far as rules of thumb and ratios. He inquired about TransCanada's ability to finance this project and further asked whether there are other pipeline companies in the world that could meet the capital financing requirements that this project envisions.

MR. ABT replied there are probably six companies in North America that are equivalent or larger in size to TransCanada. Broadening that to other companies in the world, there is probably one, the Russian pipeline company Gazprom. In that peer group, he would say there are maybe eight companies that would have the financial capacity similar to TransCanada's. In further response, Mr. Abt confirmed it is not necessarily a company's size, but its financial strength. Of that group, only three immediately come to mind that operate in arctic conditions: TransCanada, Gazprom, and Enbridge. Enbridge's experience is primarily in liquids and oil pipelines, not necessarily gas pipelines.

MS. PODUVAL added that when making these commercial terms with the state, TransCanada is taking on the risk that its financial strength may not be the same in the future when it has to finance this project as it is today. She said she will later be addressing how TransCanada takes on this risk.

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REPRESENTATIVE SEATON, regarding that each year of delay is about \$800 million as shown on slide 19, inquired whether the delay is from extending construction a year so it is six years instead of five years, or is from moving the project out one year further.

MS. PODUVAL answered it was looked at both ways and the numbers do not change very much because it is really during construction where all of the dollars are being spent. This particular one, she said, may be looking at where the construction is spread out an extra year.

CO-CHAIR SADDLER understood Ms. Poduval to be saying there is not much difference between stretching out construction versus shifting it.

MS. PODUVAL responded correct and added that it is driven by two factors. First, to the extent that the construction is getting pushed back or stretched, the capital associated with the

project is going to increase because escalation starts building into that cost. Second, the revenue is delayed by a year, so all of the cash flows that would have been received are now going to be received a year later.

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MS. PODUVAL resumed her presentation, turning to slide 20, entitled "Does TransCanada Bear Any Financial Risk?", to look at the project from TransCanada's point of view. Given the MOU that TransCanada has committed to with the state and the anticipated transportation service agreement (TSA), the question is whether TransCanada is taking on risk by participating in this project with the State of Alaska. TransCanada has committed to commercial terms with a capital structure that reflects it can borrow up to 75 percent of what it is going to invest in this project in the financial market as debt. That is a fairly aggressive assumption, especially because today it is too early to know what financing arrangements will be available for this project at the time that TransCanada will actually try to procure this debt. She reminded members that 70/30 is the mix that seems to shake out in the financial market for large LNG projects where the companies feel like they have enough debt to keep their costs low but the lenders feel like the companies have enough of their own equity in the project to have skin in the game. Thus, 75/25 would be more aggressive than 70/30 and is a big assumption that TransCanada has made.

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MS. PODUVAL continued, saying a second assumption made by TransCanada is its cost of debt; that it will be able to borrow at 5 percent. Given the scale of this project and all the uncertainties associated with it, financing is a significant risk. So, these two commitments represent some risk to TransCanada. One caveat related to the cost of debt and the return on equity committed to by TransCanada is that TransCanada has offset part of that risk to the state. The part offset to the state works through what is captured as a rate tracker, which shifts to the state any risk associated with the general financial market changing between the point in time that the transportation service agreement is entered into and the point in time when the final investment decision (FID) is taken and TransCanada locks in its financing. That is a recognition that money is cheap today relative to what it has been historically. There is a general expectation that as the economy recovers these rates will start increasing. Through the rate tracker

mechanism, TransCanada has protected itself against that general market movement. The 12 percent and the 5 percent that TransCanada has committed to here will be added on to by the movement in interest rate between the point when the transportation service agreement is entered into and the point where the final investment decision is taken. The part of the risk that TransCanada has not offset to the state, and that TransCanada bears, is if its own borrowing capacity or financial strength changes from the assumption being made today. In today's market, TransCanada believes it can borrow 75 percent of what the project is going to need and that it can be borrowed at a 5 percent cost of interest. When looking at the state's general fund obligation to borrow for this project, it was seen that as the amount needing to be borrowed increased, the cost of that debt started going up to 5 and 6 percent. Without being in the financial market and knowing what it can borrow for this project, TransCanada's assumption that it can borrow up to 75 percent at 5 percent based on its financial strength is a fairly big leap for the company. If TransCanada is unable to match that, then it starts bearing that risk alone because the state will be paying TransCanada based on a formula that assumes that 75 percent of what TransCanada has invested is in the form of debt, and the state will be paying TransCanada based on a formula that assumes the cost of that debt is 5 percent in today's money.

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REPRESENTATIVE HAWKER said he is unsure he agrees with how Ms. Poduval has characterized things. He maintained that the debt/equity split of 75/25, which was stated as TransCanada's ability to go to the market and achieve that, is really just a stipulated number for rate making purposes and is not indicative of what TransCanada can get in the marketplace, unless somewhere inside the company that is a metric. He asked whether his understanding is correct.

MS. PODUVAL confirmed Representative Hawker is correct and added that this is what TransCanada has committed to recovering from the state in the formula that will determine what the state pays TransCanada. It may have nothing to do with how much TransCanada borrows in the real market, but to the extent that TransCanada borrows less than 75 percent and puts more equity in the project, then TransCanada is going to earn less than the 12 percent return on equity that the formula would give.

REPRESENTATIVE HAWKER said TransCanada's relationship with the state is not a market-driven factor, it is stipulated here.

MS. PODUVAL replied correct.

REPRESENTATIVE HAWKER added it is also stipulated that during development and construction, as he reads the MOU, "we are stipulated to a 70/30 debt/equity structure." If the state buys in and shares the debt/equity structure, the state is tying itself into a debt/equity level and that TransCanada can achieve that 70/30 debt/equity or TransCanada does take the financial risk of its inefficiency and ability to secure the debt.

MS. PODUVAL answered the 70/30 that is the capital structure during the development and construction part of the project is essentially what interest or carrying cost TransCanada will have for that period of time until the project is in operation. TransCanada is going to earn a return on its equity during the entire 25 years to come off of that. It is correct that during that period of time, before the project is operational, TransCanada is earning on 30 percent equity rather than 25 percent equity.

REPRESENTATIVE HAWKER reiterated that that is a stipulated number to the state for that calculation of what TransCanada is allowed to return and it is a different number during the construction period and that it actually commences on the second anniversary of the in-service date.

MS. PODUVAL concurred.

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REPRESENTATIVE HAWKER noted the rate tracker differential allows an adjustment for market within certain periods. But, also, that cost of debt for the whole initial financial system is a stipulated number of 5 percent and that is fixed at the date of final investment decision. If there is a huge market move between now and the final investment decision, there is still a commitment of 5 percent for debt to be used in the initial system, plus or minus that rate tracker differential that might occur in the marketplace.

MS. PODUVAL agreed.

REPRESENTATIVE HAWKER acknowledged that a skyrocketing of market rates would likely upset the whole project. The only thing that

would roll through in the calculations relevant to the State of Alaska would be the spread differential on the 30-year U.S. Treasury.

MS. PODUVAL agreed.

REPRESENTATIVE HAWKER understood the return on equity number of 12 percent is a fixed after-tax number.

MS. PODUVAL concurred.

REPRESENTATIVE HAWKER noted that because taxes are a substantial item, the pre-tax return must be relatively higher than the 12 percent after-tax return. He inquired whether that is a normal number in this sort of situation -- that it is an after-tax number rather than a 12 percent return on TransCanada's investment in this pre-tax.

MS. PODUVAL confirmed this is a fairly standard way of setting that return to be an after-tax number; that is how the Lower 48 pipelines will set their returns on equity as well. The 12 percent after-tax number as it is set here is similar to formula that would be used elsewhere.

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REPRESENTATIVE HAWKER asked whether the MOU would be interpreted to be the after-tax return on all of TransCanada's worldwide investments or the 12 percent after-tax strictly on this operation, which is set up as a limited liability partner that does not have taxes that go through a parent organization.

MS. PODUVAL answered it is for this specific project and TransCanada's investment in this specific project.

REPRESENTATIVE HAWKER inquired whether that would be the tax provision or the tax as paid -- the tax that shows up on TransCanada's financial statements or the tax as actually paid. He asked how the temporal differences are being dealt with between taxes paid and taxes accrued and recognized.

MS. PODUVAL responded she will get back with an answer.

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CO-CHAIR SADDLER recalled Ms. Poduval stating that a risk to TransCanada is that its borrowing capacity might not be as

robust at the final investment decision as it is right now when it is offering the state these terms. He inquired what mechanism is used by TransCanada to manage that risk aside from walking away from the deal.

MS. PODUVAL replied that, as the MOU is written now, there is not any mechanism beyond the rate tracker that offers TransCanada any protection from that perspective.

CO-CHAIR SADDLER understood it is a risk TransCanada accepts.

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REPRESENTATIVE KAWASAKI understood that if TransCanada does not get the expected commercial terms it has an off-ramp. He asked whether that off-ramp is a liability borne by the state.

MS. PODUVAL confirmed TransCanada has the option to walk away at any point in time that it does not make commercial sense for the company. If the actual terms that TransCanada is able to get in the financial market are vastly different from what it has agreed to use in this stipulated formula, TransCanada definitely can exercise this option.

REPRESENTATIVE KAWASAKI inquired what the potential exposure and risk are to the State of Alaska in terms of dollars.

MS. PODUVAL responded that from a dollar perspective the state would essentially be paying TransCanada the cost of funds used during construction, which would be somewhere between \$5 and \$50 million depending on when it is exercised and whether the state has exercised its buyback. It is the incremental cost and the ceiling of the incremental cost for the state; it could be a lot lower if one thinks about what the state might have spent anyway and the carrying cost associated with the state's own money.

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REPRESENTATIVE TARR, regarding the rate tracker, asked how much of a concern it is that responsibility will shift to the state for any market change between signing of the TSA and the FID. She surmised the two signings would be happening fairly close together and therefore substantial changes in the market would not be expected.

MS. PODUVAL replied TransCanada is trying to manage that risk with the rate tracker. The development and construction time

period is 10 years, which is atypical for pipeline projects that TransCanada would otherwise undertake. TransCanada is entering into a transportation service agreement with the state years in advance of when the final investment decision and the financing arrangements would be finalized, so TransCanada is trying to offset that risk. More commonly, she pointed out, the cost of debt is a pass through to the shipper rather than it being nailed down to a particular number like here. When the cost of debt is a pass through to the customer, it is really the return on equity that gets negotiated because that is what the company gets to keep, but there is still motivation to find the best cost of debt. Because a specific 5 percent cost of debt is a little unusual, she surmised TransCanada has the tracker to at least help it adjust for the market if not for its own financial strength.

REPRESENTATIVE TARR understood the transportation service agreements must be signed before TransCanada can get financing and that the FID is estimated to be in 2018-2019. She asked whether she is correct in thinking that the transportation service agreements are signed fairly closely before the FID.

MS. PODUVAL believed the TSA will be signed either during Pre-FEED or early in FEED and not as close to FID as thought by Representative Tarr.

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REPRESENTATIVE SEATON understood the transportation service tariffs for the different parties may all be stipulated differently. He further understood that this is a stipulation only for transportation of the state's gas and that it may or may not be offered to the other parties.

MS. PODUVAL answered correct, adding that what is being talked about here relates only specifically to the state transporting its share of the gas through the portion of the project that TransCanada will hold through the GTP and pipeline.

REPRESENTATIVE P. WILSON requested further elaboration regarding how [the cost of debt] is usually or not usually done.

MS. PODUVAL responded that the tariffs are set when the transportation service agreements are entered into. Generally, the cost of debt is a pass through that is borne by the shipper. It is a little unusual to commit to a certain cost of debt

without knowing whether that will be the actual cost at the time of going to the market.

REPRESENTATIVE HAWKER commented that that puts TransCanada in the position of not only having a financial risk but also of having a potential financial benefit if it can execute a more efficient transaction in the marketplace.

MS. PODUVAL agreed.

CO-CHAIR SADDLER inquired what the drive is behind having this provision in the [MOU].

MS. PODUVAL deferred to TransCanada for an answer.

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MS. PODUVAL returned to her presentation, addressing slide 21, entitled "Does TransCanada Bear Any Financial Risk?" She said this slide puts numbers to TransCanada's potential risks associated with the stipulated formula. She cautioned that there needs to be a separation of the general movement of the market versus a weakening of TransCanada's financial strength or miscalculation of what TransCanada can get this debt for and it ends up costing TransCanada more. An increase in the cost of debt from 5 percent to 6 or 7 percent erodes TransCanada's effective return on equity, given that the tariff and the earnings that TransCanada is going to get from the state are stipulated by a formula that uses 5 percent. The actual financial arrangements could also result in TransCanada not being able to borrow as much as anticipated, such that instead of 75 percent debt it is 70 or 65 percent. The blue line at the top of the graph represents the formula TransCanada is hoping to get: 75 percent debt, 25 percent equity, 5 percent cost of debt, and in which TransCanada would earn a 12 percent return on its equity. However, if TransCanada's cost of debt climbs to 6 percent, its effective return on equity would be reduced to 10 percent [green line], and a 7 percent cost of debt would reduce its effective return on equity to 8.5 percent [grey line]. The three lines on the graph also show that TransCanada's effective return on equity gets diluted if its capital structure changes as well, since the state would be paying TransCanada a 12 percent return on 25 percent of its investment. If TransCanada is actually contributing 30 or 35 percent equity, it is not earning that 12 percent return on equity on that additional contribution, which brings down the effective return on equity. Addressing slide 22, entitled "Does TC Bear Any Financial

Risk?", Ms. Poduval said the graph shows how TransCanada's anticipated net present value of about \$200 million under the formula is eroded by either a slippage in the anticipated cost of debt or a change in the anticipated capital structure

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REPRESENTATIVE HAWKER said he is struggling with trying to figure out how slide 22 was put together. He understood what is trying to be shown -- that if TransCanada's cost of debt goes up, its effective return on equity goes down. He offered his understanding that in the MOU the State of Alaska has guaranteed TransCanada a return on equity of 12 percent after tax, plus the rate tracker differential, regardless of how TransCanada's effective return on equity goes down.

MS. PODUVAL replied that, with the rate tracker issue set aside, the state had guaranteed that it will pay TransCanada a 12 percent return on equity for 25 percent of its investment in the project. A 5 percent cost of debt will be paid for 75 percent of its project investment.

REPRESENTATIVE P. WILSON requested Ms. Poduval to repeat her explanation.

MS. PODUVAL explained that the State of Alaska is committing to pay TransCanada a return on equity of 12 percent on 25 percent of the investment in the project, as well as a cost of debt of 5 percent on 75 percent of its investment in the project. That would be paid regardless of any change to the variables for TransCanada. Three of the four variables could change independently: the cost of debt, the amount of investment as debt, and the amount of investment as equity. Even should these three change, the State of Alaska will still pay to its agreed amount. The variable that would be impacted would be the return on equity. As long as the state did not change its agreed payment to TransCanada, a change to any of the other variables would bring a change to the return on equity.

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REPRESENTATIVE SEATON directed attention to slide 22 and asked for clarification that should the cost of debt increase to 6 or 7 percent, or the debt-equity structure actually change, the result could be a negative \$150 - \$200 million. At the time of investment, either change could affect the TransCanada decision to proceed, as TransCanada would be losing money.

MS. PODUVAL confirmed this is definitely an option that TransCanada would consider.

REPRESENTATIVE SEATON stated that this is even before construction costs or delays are considered, as these could also affect the long term net present value (NPV).

MS. PODUVAL concurred, stating that once the final investment decision (FID) is taken the off-ramps go away and everyone is committed. At that point "you're married and you're gonna live together whether you like it or not." She pointed out that each party would review its financing and its sales agreements, and determine whether to commit to the billions of dollars necessary.

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REPRESENTATIVE TARR pointed out that the State of Alaska has no control over other TransCanada investments and projects, which will ultimately be reviewed by the banks when financing is requested. She asked how the state should evaluate the project for these parameters which were out of the state's control but have the potential for an impact to the project and its financial obligations.

MS. PODUVAL replied that each of the different parties, including TransCanada, have to want to do this project. She noted that TransCanada will also be reviewing other investment alternatives and can exercise an off ramp if its financial strength is stretched thin by other projects. She said that it would be prudent for the state to be cognizant that these off-ramps exist, and to plan accordingly. She pointed out that the state can maintain its involvement, especially if it exercises its buyback.

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REPRESENTATIVE SEATON surmised that, should Alaska get to the stage where it exercises the buyback option from TransCanada, there will no longer be a pipeline builder. He questioned whether it is necessary that the full project state that TransCanada is the builder.

MR. ABT explained that, although TransCanada will not actually be the constructor of the project, it will be the project manager. There will be an additional decision for who will

operate the pipeline once service commences. He offered his understanding that the process will solicit bids from engineering, procurement, and construction (EPC) firms to construct the pipeline and the gas treatment plant (GTP). It is unclear as to which partner is responsible for each segment of the project, including the pipeline, the GTP, and the liquefaction project. There is recognition that TransCanada would be the best manager of the project segment, and this expertise would be lost should TransCanada withdraw. He pointed out that the constructor firm would still be in place, but a project partner would need to become the project manager.

REPRESENTATIVE SEATON noted TransCanada is also the operator.

MS. PODUVAL replied that this will only impact the state portion of the project for movement of its gas. The producers will have their own commercial terms for gas shipment, as they each own a percentage of the project equivalent to the amount of gas they need to liquefy and ship. She suggested the producers could create a midstream that would establish upstream commercial terms, or they could treat this as a completely integrated project with no commercial terms.

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REPRESENTATIVE HAWKER drew attention to the 12 percent after-tax return on equity provision in the MOU, Exhibit C, page 2, Key Item 6.6. He requested a definition of Initial System.

MS. PODUVAL deferred to the Department of Law, but offered her opinion that this distinguishes between the initial project and any subsequent expansions.

REPRESENTATIVE HAWKER requested the committee receive further clarification in this regard.

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MS. PODUVAL moved on to slide 23, entitled "Summary on 4 Key Questions," to summarize the discussion relating to TransCanada's participation in the project. Regarding the first question of whether there is an economic impact to the state from participation by TransCanada, she said there will be a net cost to the state, especially with regard to total cash flow and whether the state exercises its buyback option. From a net present value perspective, there is marginal impact from having TransCanada participate in the project. Regarding the second

question of whether the state can go it alone, she said that from an upfront capital investment perspective, TransCanada's participation and partnership in the project will reduce the state's investment between \$4 and \$7 billion, and would keep state money available for other purposes. A review of the state's ability to finance the project using general obligation debt shows that, because the project is so large, it will "really suck up a lot" of the state's borrowing capacity. By having a partner the state will spend less and make more by being able to afford a larger stake in the project than it would by going alone and taking a smaller stake in the project. In regard to whether TransCanada would be the right partner, there is good reason why TransCanada would be a good partner. TransCanada comes into this project as a third party that would be aligned with the state to create access and enable expansion on the project and allow other non-North Slope explorers and developers to enter the project. This is important because it is not a perspective that the producers will have.

MS. PODUVAL, continuing her summary of slide 23, addressed the question of whether TransCanada is assuming financial risks by being in partnership with the State of Alaska. TransCanada has made commitments to the state on the commercial terms that will be used to stipulate a formula to determine what the state will pay TransCanada. A change in the financing arrangements that TransCanada actually gets, relative to what it has assumed it will be able to get, could erode TransCanada's return from this project and create risk for the company.

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REPRESENTATIVE HAWKER offered his belief that, although these are benchmarked and established for purposes of rate making with the state, TransCanada could do anything it wants internally and could achieve a material improvement in its financial situation. Focusing on the negative for TransCanada is only half the story.

MS. PODUVAL agreed and said it only determines what the state is going to pay TransCanada, and to the extent that TransCanada can improve on that, it could earn more. She added that 75 percent debt is a fairly aggressive assumption, saying it is fairly unlikely TransCanada could improve on that term. Whether TransCanada can improve on the 5 percent cost of debt it has committed to is dependent on the market and TransCanada's financial strength at the time.

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MS. PODUVAL, in response to Representative Tarr, disagreed the state is taking on the most risk in the partnership with TransCanada; TransCanada bears some risk. Under the HOA, the producers are investing \$3-\$4 for every dollar that the state invests. Everyone has skin in this game which was almost by design with the creation of alignment.

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REPRESENTATIVE KAWASAKI, noting that Black & Veatch represents the administration in support of TransCanada's participation in the project, asked how legitimate the off-ramp is should the state decide not to maintain the partnership. Responding to Ms. Poduval's request for clarification, he agreed there is always an element of assumable risk. He asked for assurance as to the legitimacy of this off-ramp as presented, given the state is already committed for an investment of at least \$1 billion.

MS. PODUVAL responded there are two different perspectives -- legally and commercially. She said she hopes the agreements are well enough written to assure that legally the state has the availability of those off-ramps. Commercially, the question is whether the state can exercise that off-ramp and still be okay. This is something the state must be vigilant about, recognizing that TransCanada can exercise these off-ramps as well and not participate in the project. The state must be able to react and respond to continue its own participation in the project.

REPRESENTATIVE KAWASAKI understood the MOU requires that if the state goes with a new partner the terms must be substantially similar to those with TransCanada.

MS. PODUVAL deferred to the Department of Law to provide the nuance behind those terms.

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REPRESENTATIVE SEATON posed a scenario in which at the time of final investment decision the state decides to have someone else buy its 25 percent share of the gas, as well as the upstream and the liquefaction portions. He understood this is where the off-ramp option would be available to the state and the state would owe TransCanada its cost plus the interest. He further understood that TransCanada could also leave should it find it will be underwater because the terms have changed.

MS. PODUVAL believed there is a fairly good likelihood that the state will want to bring in more partners, and that there are many prospective parties that would be interested in participating in the project in addition to purchasing the state's share of the LNG. Of late, it is a fairly common structure for these LNG sales agreements to have the end user, the buyer, purchase the gas as well as an equity share in the project. She said she does not think there is anything in the MOU that would preclude the state from entering into that type of arrangement, and it is generally at the LNG plant.

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CO-CHAIR FEIGE noted the committee has not yet discussed how the overall operational costs are addressed by the state as well as by the other partners. He said he would like for the committee to get an idea of the general types of agreements and the level of complexity of the major agreements that the state will be signing at the end of Pre-FEED. He further noted the committee has not yet discussed the initial contract term of 25-years that will happen once the pipeline is built and operated. The MOU contains provisions pertaining specifically to what happens at the end of that initial contract term and he would like an update from the administration in this regard.

[CSSB 138(FIN) am was held over.]

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#### **ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:10 p.m.