

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

January 29, 2014

3:31 p.m.

MEMBERS PRESENT

Senator Cathy Giessel, Chair
Senator Fred Dyson, Vice Chair (via teleconference)
Senator Peter Micciche
Senator Click Bishop
Senator Lesil McGuire
Senator Anna Fairclough
Senator Hollis French

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

PRESENTATION: STATE/TRANSCANADA MEMORANDUM OF UNDERSTANDING

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

JOE BALASH, Commissioner
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: Presented overview of the State/TransCanada MOU.

ANGELA RODELL, Commissioner
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: Answered questions about financial arrangements in the State/TransCanada MOU.

TONY PALMER, Vice President
Major Projects Development
TransCanada Corp.

POSITION STATEMENT: Commented on the State/TransCanada MOU.

ACTION NARRATIVE

[3:31:48 PM](#)

CHAIR CATHY GIESSEL called the Senate Resources Standing Committee meeting to order at 3:31 p.m. Present at the call to order were Senators McGuire, Fairclough, French, Micciche, Bishop, Dyson (via-teleconference), and Chair Giessel.

Presentation: State/TransCanada Memorandum of Understanding

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CHAIR GIESSEL announced the first order of business to be a presentation on the State's Memorandum of Understanding (MOU) with TransCanada.

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JOE BALASH, Commissioner, Department of Natural Resources (DNR), Anchorage, Alaska said he would try to provide a fairly high level overview of the MOU that Commissioner Rodell and he struck with TransCanada last month and how that fits into the larger Heads Of Agreement (HOA) construct discussed on Monday. { He hoped to address the questions around why TransCanada, the benefits the state will gain from this particular arrangement and partnership, and start to familiarize the committee with some of the numbers that are associated with this project and what potentially will accrue to the state as a consequence of ANS commercialization.

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COMMISSIONER BALASH reviewed that the HOA is a method for the parties who have an interest in the gas or the infrastructure to work together in the pursuit of the AKLNG project. The major components of that project are the gas treatment plant (GTP), the pipeline and the LNG plant.

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He said the departments are looking for a way to align the state's interest in the royalty and production tax in an equity position in the components of the project. Each party would own its own share proportionate to its interest in the gas - the State of Alaska (SOA) at the bottom. Depending upon the state's percentage, each of the other three parties would vary depending upon 20-25 percent. This allows them to structure the financing

for the state's share of the components in a way that suits its interests.

On Monday he spoke about the state's strong interest in low tariffs, but noted that the other parties are not necessarily driven by the same concern. They may be seeking a higher return on equity for the capital invested in the infrastructure, or they may have a higher percentage of equity invested in it, and minimizing their debt exposure for whatever corporate reason they may have. Each of the three companies has very different perspectives on these questions. In thinking of some of the fights over tariffs charged on TAPS, he was not talking about differences in cost, but differences in how they are financed, the consequence on the tariff, and the resulting impact on the state's royalty value.

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COMMISSIONER BALASH said the MOU with TransCanada would provide for them to step into the state's shoes for the GTP and the pipeline. It's further expected that the subsidiary the legislature that is being asked to be established would be the entity to hold the interest in the liquefaction plant. The pipeline would have five offtake points to make sure Alaskans are able to receive North Slope gas; and in order to facilitate the movement of the state's share of the gas from the Slope to market the DOR and DNR need to enter into contracts for capacity in the GTP pipeline and LNP plant.

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SENATOR FRENCH asked him to explain more about TransCanada's supplanting the SOA. What happened? Did the state sell TransCanada its quarter?

COMMISSIONER BALASH answered that under the AGIA framework they contemplated having an operator owning all the components. In the course of time and discussions with the other parties, it became clear that a joint venture approach was needed. It fundamentally comes down to who has gas to move from the Slope to market. So wanting to preserve the capital investment proportions of the pre-FEED (Front End Engineering and Design) phase he just outlined, they progressed to the MOU where TransCanada would step into the state's shoes for the gas treatment plant (GTP) and pipeline and therefore would not have to pay its share of the development costs.

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SENATOR FRENCH said he had asked if the \$400 million under the HOA split out to about a quarter each and the commissioner had said yes. So, the state is on the hook for \$100 million. But he just heard him say that TransCanada will front that money and, therefore, the state would start building a debt to them.

COMMISSIONER BALASH said that was correct.

SENATOR FRENCH asked if that relationship would persist all through the project: TransCanada putting up the money and he would have to negotiate with them how to pay them back.

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ANGELA RODELL, Commissioner, Department of Revenue (DOR), Juneau, Alaska clarified that the \$400 million is the total project cost. So, here they are talking about the portion attributable to the midstream and the upstream costs (GTP and pipeline); at this point they are not talking about the amounts attributable to the liquefaction facility. So, the \$400 million is three things: liquefaction, pipeline and GTP. So, when the state has 25 percent of \$400 million the AGDC's subsidiary's portion will be at roughly \$100 million. In this presentation they are talking about TransCanada's role in stepping up and making those cash outlays for development costs associated with the GTP and the pipeline during the pre-FEED stage.

SENATOR FRENCH said he met with TransCanada and they are a fantastic, adept, and intelligent group of people who know what they are doing, but people are asking why them? AGIA didn't work. We may be at the end of that road. How did we get from that process to this one that is very different?

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COMMISSIONER BALASH answered that the reasons TransCanada as a partner in this arrangement makes sense for the state will be presented during the overview, and that many of the reasons the state found TransCanada to be a good partner in the AGIA license hold true in an LNG context. He said there is value to having an independent pipeline company operating a portion of this project in the state and in their pursuit of finding additional customers and gas beyond Prudhoe Bay and Pt. Thomson. It's one of the benefits they see to this particular arrangement.

SENATOR FRENCH asked where the state stands with AGIA.

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COMMISSIONER BALASH replied that the state expects to step out of the AGIA license, but certain terms and conditions to that license achieved some pretty important state interests, namely low tariffs, instate use of gas, and a favorable expansion principle. And those have all been achieved in this more traditional arrangement between a shipper and a transporter, but using some different tools and in the context of the other parties pursuing an aligned path together.

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He pointed out for the state's portion, TransCanada would be in the GTP, the pipeline, and the Alaska Gasline Development Corp. (AGDC) subsidiary in the LNG plant.

He showed a map of the oil and gas pipelines that TransCanada had constructed or operates in North America; they are the preeminent pipeline builder in North America and their ability and reputation for building pipelines on time and on budget for their customers is something that will serve Alaska well in the next several steps in the progress of this project. He said the state had aligned with them on a method for operation and expansion on terms that are in Alaska's interests, in particular the tariff terms, the commercial terms that will provide economic benefits to Alaskans, and the experience they have developed not only in Alaska's early stages of the other project, but of having developed their expertise in the Canadian Rockies. They are familiar with constructing in discontinuous permafrost and the mountainous areas and have overcome those challenges. That is experience that Alaska wants to have in this particular project.

COMMISSIONER BALASH said the data TransCanada generated during the term of the AGIA license to date is something the state has the ability to buy out under its terms, but that is not what they are going to do at this time. The cost of that under the statute would be in excess of \$100 million. However, TransCanada, along with the other Alaska Pipeline Project (APP) party are prepared to contribute that information to the AKLNG project, so that cost will not have to be incurred again or the effort duplicated. So, from Livengood north, pipeline information, GTP information, all of that is not going to need to be replicated.

Finally, he said they have an agreement that allows them to make a seamless transition out of the license and into a more traditional shipper transporter commercial arrangement that fits in with the larger HOA construct.

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SENATOR FAIRCLOUGH asked if the data he was referring to was that that ExxonMobil and TransCanada have a relationship with right now.

COMMISSIONER BALASH answered yes.

SENATOR FAIRCLOUGH said that ExxonMobil would already be at the table under the HOA and asked why put it on TransCanada's balance sheets as far as something to negotiate.

COMMISSIONER BALASH replied it's not something that is being negotiated; it is something TransCanada and ExxonMobil are bringing to the table without cost or additional cost. The other parties aren't paying TransCanada for that cost.

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COMMISSIONER BALASH said the definition of Memorandum of Understanding (MOU) was taken from Investopedia and he clarified that in this case the MOU is very clear. It is not binding on DNR and DOR until the legislature enacts enabling legislation. Today, under current law he does not have the authority to enter into a binding agreement with TransCanada or anybody else. That is one of the things they are seeking in the legislation he hopes to talk with the committee about next week.

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SENATOR FRENCH asked if the enabling legislation has to be agreeable to just TransCanada.

COMMISSIONER BALASH responded by noting Article 2.1(d) that says:

The Parties agree to support the approval of the Operative Terms in the Enabling Legislation, but acknowledge that the Enabling Legislation may include authorizations or conditions that vary from or conflict with the Operative Terms. In such event, and if Parties agree to accept the Enabling Legislation, then the Transition Agreements will reflect the Enabling Legislation terms and conditions notwithstanding the Parties acknowledge above.

Or simply put, both TransCanada and the commissioners recognize and appreciate the independent position that the legislature holds in this regard and they are not in a position to dictate

terms to the legislature. However, they have described the agreement they intend to enter into if given the authority they are seeking in the legislation.

So, whatever terms and conditions may apply through the course of the legislative process, there will be an opportunity for them to react and testify, and for the commissioners, too. Importantly, it is not just TransCanada who gets that option. If the conditions imposed in legislation cause a result that he or Commissioner Rodell find is no longer in the state's interest, they are not obligated to pursue these agreements either.

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SENATOR MICCICHE asked if there are two things that the state no longer has commitment through AGIA to TransCanada.

COMMISSIONER BALASH answered that was correct and it is explained in the Recitals, paragraphs 11 and 12. He said they are utilizing the no contest divorce provisions of that a statute and both agree they are done with the AGIA license; the trigger for that is passage of the enabling legislation.

SENATOR MICCICHE said that sometimes people stay together because of the children and he wanted to independently evaluate the value of having TransCanada involved and whether or not there is residual commitment under AGIA. He wanted the commissioner to help them understand those two issues.

COMMISSIONER BALASH answered that he believed they could show some of those benefits to this particular partnership and why it is in the state's interests and will provide value to Alaskans independent of AGIA considerations.

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SENATOR FRENCH said a no-contest divorce could have come about by several methods; the state could have decided to end it and pay TransCanada off, it could have given support to another project and paid TransCanada treble damages, or it could agree that the project (an overland pipeline to Alberta and into the North American market) was uneconomic. He asked who would really contest the idea that an overland route to Chicago is uneconomic.

COMMISSIONER BALASH responded that one of the issues that DNR had to evaluate was the course that Alaska was going to pursue in development of North Slope gas, and in examining AS 43.92.240 could assert that the project is uneconomic; the statute

provides a process to follow in the event the other party was to object. That statute is not entirely clear and so very likely the state would have had to avail itself of the arbitration provisions, which he submitted was a course either party could pursue and make it difficult on the other, exacting some toll - time, resources, and frustration - that, in itself, would put a cloud on things. However the state, and the DNR in particular, removed one cloud at Pt. Thomson to facility progress here and they aren't interested in creating another one (however short or long it would be).

He said they could start fresh, but that begs the question of if the state would still want to seek a partner, any partner, for this project. The process for going about selecting those partners would wind up looking very similar: who is prepared to offer terms that are acceptable to the SOA that achieve its goals as a resource owner and a party with an equity interest in the gas? So, how long would we want to invest in that process? What would that mean ultimately to the momentum of AKLNG? A construct is in front of them now that allows another field season to take place in 2014 and an opportunity to complete the pre-FEED process in 2015. That has some value.

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COMMISSIONER BALASH said the timeline that fits in with what he just described is if the legislature were to pass the enabling legislation in April of this year, within 90 days, they would seek to complete the precedent agreement (PA) and equity option agreement that would be in place and resolve the obligations associated with TransCanada's cash calls during this phase. If for some reason at any point that PA was terminated, the state would, like any shipper, pay TransCanada their development costs and part company. If, however, the project is progressing, the PA would be matured into a firm transportation services agreement (TSA) that would come forward for public review and legislative approval as part of the body of contracts that will come forward in the HOA process, in all likelihood in the fall of 2015.

The equity option would be available to the state during this period (until the end of 2015) or the entry in the FEED, whichever happens first. Then, ideally, they would see all of the parties progress into FEED sometime in the winter of 2015/16.

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COMMISSIONER BALASH said apart from the MOU, itself, there are two exhibits: Exhibit "B" contains a term sheet that would form the basis of an agreement to enter into this summer whereby the state would be able to buy back a portion up to 40 percent of its equity in the GTP and pipeline. If that option were exercised, he illustrated what it would look like: TransCanada would remain an equity player and transporter in the GTP and pipeline, but the same subsidiary that would be holding the state's interest in the liquefaction plant would be able to come into the pipeline and GTP. It doesn't necessarily mean it would be that subsidiary, but it is the most likely scenario. Some other form could be used.

He explained that it is possible that as they enter into efforts to market the state's LNG in the next 18 months that they would find a buyer who would be interested in holding equity in the liquefaction plant and/or the associated pipeline and GTP. So, there is some flexibility to be able to engage the market and the LNG buyers on terms and on grounds that they are seeking in other places in other jurisdictions. It is not unusual to see the likes of Mitsubishi acquiring an equity stake in a liquefaction facility as part of their purchase agreement for the LNG, itself.

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SENATOR FRENCH remarked that the equity option term sheet was complicated and provided how the state can buy back its portion of the GTP and the pipeline from TransCanada through royalty gas and taxed gas.

COMMISSIONER BALASH said that was right; the state would have to "belly up" and pay its portion of the cost. If they took the full 40 percent option, they would need to pay TransCanada back 40 percent of their costs incurred to date and going forward the state would have to meet its share of the cash calls as the project progresses through FEED and into construction.

SENATOR FRENCH asked if they would be getting some analysis from their consultants about how those cash flows look under each scenario.

CHAIR GIESSEL said yes.

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SENATOR DYSON joined the committee

SENATOR FRENCH asked on Exhibit "B," if Condition 7(a) says the state can't sell any of its portions to someone who essentially is in competition with TransCanada and if there is any restriction on their ability to sell their portion to say BP, Encana, or to Gazprom.

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COMMISSIONER BALASH replied that he believed that there was a limitation on their assignment or end sale, but he didn't know exactly where in the agreements it was located.

SENATOR FRENCH said the state's conditions on transferring its interest were described in page 2 of Exhibit B, 7A, and he wondered if it was a one way restriction.

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COMMISSIONER BALASH replied he would get the specific reference on the parties' rights for assignment or sale.

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SENATOR FAIRCLOUGH clarified that the state starts out as an equal owner: so that we don't have to pay cash up front we're letting someone else do that for us with an option to buy-back accrued costs up to a limited amount. So, she assumed, that buy back would carry interest and wanted to know what that rate would be.

COMMISSIONER BALASH replied she was right and it was 7.1 percent, which is AFUDC that accrues for this period of development. In looking at the 70/30 structure for construction with an ROE and the debt blended it's 7.1 percent.

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SENATOR FAIRCLOUGH asked what TransCanada's bond rating is. She noted that Alaska is rated AAA.

COMMISSIONER BALASH replied that he did not know, but he knew that TransCanada's ratings were fairly high.

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SENATOR FAIRCLOUGH asked Commissioner Rodell for that comparison, so they could see the difference in the borrowing rate is and how that might work out on \$100 million or the estimated pre-FEED costs.

She said she had heard concerns about opportunities to enter the pipeline and asked if the state exercises the 40 percent right,

would TransCanada retain 15 percent share (and the SOA would actually have the smallest share in the pipeline, which has some of the most secure rates of return (ROR) in the area of investment).

COMMISSIONER BALASH answered that her math was correct. In terms of the way the splits would occur if the tax rate and royalty combination were set so that state was at 25 percent overall and it exercised the full 40 percent option, it would be a 15/10 split in the pipeline and the GTP.

SENATOR FAIRCLOUGH asked if a certain level of information will be available to different partners or are partners becoming silent or cut off from information depending on their percentage of ownership they have in particular components of the project.

COMMISSIONER BALASH replied that the access to information that any party gets depends on their role overall. As a customer in every one of the components, the state has secured in an HOA some specific provisions that allow its service providers to provide information, so that we get it from all of the components in one way or another.

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SENATOR FRENCH said Exhibit "B" 3 describes a limited partnership, a general partner that makes all the decisions on behalf of the limited partnership and asked who the general is in this paragraph. TransCanada?

COMMISSIONER BALASH nodded yes.

SENATOR FRENCH asked who the limited partner is.

COMMISSIONER BALASH replied that the state is one of the other partners in the limited partnership agreement, and this section is about its revenue interest in this transaction. This would give us access to the returns Senator Fairclough asked about a while ago. But, if all we were interested in was the revenue interest, if we weren't particularly concerned about providing access to third parties and developing gas beyond Prudhoe Bay and Pt. Thomson, we probably wouldn't want to deal with a partner in this particular fashion. We would be looking for something different. But the benefits that will potential accrue to the state if additional gas is found and produced and moved through this infrastructure to market are pretty incredible and well worth preserving and pursuing.

He explained that the nature of this partnership really calls out the differences between them and us; we both have money and credit. The difference is they know what they are doing; they have built pipelines that have withstood severe earthquakes in this continent and the one south of us. They know how to operate these pipelines in the event of a disruption and get them back running with very limited down time. That's their core business; they do it every day and all over this hemisphere. The state would have a hard time replicating that on its own.

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SENATOR BISHOP said he assumed that in protecting our positions along the pipe he was referencing discoveries in Middle Earth and other areas so they can get their gas in the pipe.

COMMISSIONER BALASH answered that was correct. The opportunities for interconnections on this pipeline are ones that they will have to pay attention to. Five offtakes might not be enough, but one will certainly be in Nenana in order for the Interior to take gas off. But potentially the gas resource in the Nenana Basin could be monetized and moved into the system as well, although they have issues there around gas quality and gas spec that go back to the access terms in the HOA. But having a company like TransCanada whose business is based on moving people's gas, they are going to be interested in moving more gas and will be driven by that particular motive. That will serve the state's larger interests in the long run.

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SENATOR FAIRCLOUGH asked for the specific place in the MOU that protects or limits TransCanada's ability to buy everyone else's interests out. She said they don't know if one of the partners that state is going forward with isn't acquiring other relationships that will not aligned with Alaska's interests, at least on lower tariffs. She also asked why 60/40 versus 50/50 or Alaska taking the 60 percent share.

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COMMISSIONER BALASH answered that the conversation didn't start at 60/40 and that a couple of things were driving TransCanada's perspective as well as the state's; the desire to see an independent pipeline company in a position to play a lead role on this component of the project in particular and that is driven in part by the overall position among and relative to the other parties. The state did not initially start out to provide all of its equity to TransCanada, but over the course of conversations with and among all the parties, it became clear

that TransCanada's position would impact whether or not they got to be the lead on the pipeline, and while that question isn't settled finally, if the state's position is 25 percent in the gas and TransCanada steps into a 25 percent position in the pipeline, they would be the number two party in the percentages for the pipeline: ExxonMobil would be the top, then TransCanada followed by ConocoPhillips and BP. So, they would have a much stronger argument to be the lead on the pipeline during construction and ultimately hopefully, operation.

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SENATOR DYSON said everyone worries about conflicts of interest. When he worked in the industry he found that the parent company would have other divisions that were doing things and he would ask if he was supposed to give them a special leg up if he needed their type of services. The answer was often no, that they were a separate enterprise that had to compete with everyone else. So, each of these producers has competing energy delivery interests at various places in the world and critics of what they are trying to do can ask how they know they are not going to put those interests there and delay this one under the table so the other one can get to market first. TransCanada has significant interest in several other pipelines on this continent and the horse race of getting the molecules to the best market at the right time could be argued.

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COMMISSIONER BALASH replied that he couldn't answer for the other parties, but from the state's point of view he was concerned about it. Why would any of the companies work to advance this project on terms that meet the state's interests? Ultimately the state had to satisfy itself as to the motivations of everybody. He had observed in the larger construct of the HOA, being a direct participant, especially in the marketing side of this, the state would get a window into the marketplace that it has never had before. It will inform us about all of the parties and all of the opportunities. Specifically with regard to TransCanada there are opportunities for the state to terminate the agreement with them if they are ever in breach, if they are not pursuing the project in the manner agreed to in a positive direction: meeting the cash obligations in the venture agreements and so forth. In such event, that interest reverts back to the state. That marketing opportunity will tell the state whether they have a real game here. In the LNG business it's all about the SPAs and whether you have buyers at the other end that are prepared to pay for 20-plus years to get the energy.

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SENATOR DYSON said in his limited experience, the case could be made that various components of the industry get together to work on lots of projects all over the world that arguably are competitive and that there is lots of precedent for them working on the individual ones, but he worried as much about the major producers that have very different interests than TransCanada.

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COMMISSIONER BALASH responded that the state and the other parties in this venture will have to compete in the marketplace on cost of supply, they will have to compete for capital inside their companies, and in some cases that capital is quite scarce; and he wouldn't be surprised to see some of the other parties bring in partners, as well, because they may have to.

[4:25:02 PM](#)

SENATOR GIESSEL welcomed Mr. Palmer and asked him TransCanada's bonding rating and why this project would be prioritized over other pipeline projects.

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TONY PALMER, Vice President, Major Projects Development, TransCanada, said he is also president of TransCanada's Alaska interests. He said TransCanada's bond rating is A- and clarified that at this stage of development costs are funded with equity, not debt. No bank would be willing to lend money at this stage of a project. In fact, debt for a project usually comes at the time of final investment: after pre-FEED and FEED. He assured them that 7.1 percent is below TransCanada's cost of equity.

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MR. PALMER said being involved in other projects is one of TransCanada's strengths; they are an energy infrastructure company. They build, own, and operate pipeline projects across North America. They own 10,000 miles of pipeline in the U.S. and 30,000 of gas pipeline in Canada, and they have owned them for 60 years. It's what they do for a living. They also have a large oil pipeline business, a large gas storage business, and a power generation business.

He elaborated that if TransCanada was only seeking to do one thing in the next 10 years (approximate timeframe for this project to be in service), they should be looked at with some suspicion, that they were not successful in attracting other businesses. They have potential projects to build pipelines in

Canada to LNG projects, to build oil pipeline projects south (one in particular) in the Lower 48, and they have a project to build an oil pipeline to the East Coast of Canada. They are all in the order of \$35 billion portfolio to be constructed in the next 5-10 years, and TransCanada has competed vigorously for that business.

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MR. PALMER said that TransCanada doesn't win all of the competitions, but they win their fair share and bring a great deal of value to any party that wants to build a major pipeline in North America. They are sponsors of two pipelines to the British Columbia coast for LNG sponsors: one to Kitimat for the Shell/Kogas, CNPC Mitsubishi Consortium, for which they competed vigorously and successfully obtain a year and a half ago based on their expertise and commercial terms, and the second project to Prince Rupert for the PETRONAS Company, which they also competed vigorously for and captured. They also competed for the business under AGIA six years ago and succeeded.

He said the MOU and the HOA are the result of more than a year of hard work by the administration, the three producers and TransCanada and there were compromises by all parties. He said TransCanada absolutely wishes to pursue infrastructure projects across North America and has done large projects in Mexico as well and has one underway there today.

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SENATOR DYSON said the layman may look at that and say that all three projects may not be economically viable and asked how that would work.

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MR. PALMER replied that TransCanada is capable of doing multiple projects; that is the nature of their business. They build about 625 miles of gas pipelines per year across North America; this project would be approximately 800 miles to be constructed over four years. So, if you consider what they are building every year and multiply that by four, they build about 2400-2500 miles of pipe in four years.

This project is substantial as are the projects in Canada at 400-500 miles a piece (on an earlier timeframe than the others). The PETRONAS has final investment decision this December and will be in service by the end of 2018; the Shell project has a final investment decision in 2015 and is scheduled to be in service in 2019. The proposed schedule for this project actually

fits well, because people would be completing those other projects and moving onto construction of this one, in the event that is successful.

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SENATOR DYSON said he didn't think all three projects would make it, because the market for North American gas wouldn't support all three. He hears TransCanada saying they don't care; whichever one does it they will perform for them.

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MR. PALMER replied that TransCanada absolutely intends to build all three projects for their customers if they decide to proceed. TransCanada did not market gas, but he thought the global LNG market in Asia has an opportunity north of 20-22 bcf/day in 2025 after existing projects in Papua New Guinea and Australia take their share of the market. Many more projects are proposed: the Lower 48 has announced projects something north of 30 bcf/day and Canada has announced something north of 20 bcf/day. Africa, Mozambique, Tanzania, Australia and Russia, you get another 10 or 20 for a total of 70 bcf/day - into a 20 bcf/day market. It isn't unusual. In the LNG business you will always see more projects announced than actually get completed. They do have to compete and there are some fundamentals that determine whether or not you have a chance to win the game.

SENATOR DYSON said he wanted Mr. Palmer to be able to defend that his participation in several different projects is the kind of thing that happens often in the industry and that his personal position is that all three of these may indeed reach the home stretch.

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MR. PALMER responded that it is common in the industry. TransCanada is cautious about what projects they participate in and have been invited to participate in more than these three, but these have fundamentals that are critical to be able to compete. They all have equity supply - certainly Alaska has sufficient gas supply and it's available to this project if sanctioned by the legislature; secondly, a capable pipeline company is needed to get the permits and get across that mountain range - TransCanada provides that.

Thirdly, a capable company is needed to build a liquefaction plant and clearly the three major producers have done that many times. You also need access into those markets; the Asian markets are not like domestic markets where you have thousands

of players buying and selling gas in liquid markets and you can turn on a screen and find out what the price of gas is by the day. That's not the case in Asia, and Alaska has three major producers that sell gas into that market every day - and the state has the opportunity to participate with them in the HOA.

Finally, Mr. Palmer said credit is needed to be able to support a \$45-65 billion project, a huge amount of money for any one party. So these five parties together have that credit. And you must be cost competitive, but the cost competitiveness of Alaska gas relative to the Gulf Coast and B.C. is not the critical factor here. They are all in the same range; everyone has to solve issues so they can compete in the marketplace. This project as currently coordinated has an opportunity to compete in the market and win. That is why TransCanada is participating.

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SENATOR BISHOP emphasized that he heard the Asian market was going to grow by 40 percent and that TransCanada had said other companies approached them, so they were kicking the tires and looking at the projects that could get over the top.

MR. PALMER agreed and reiterated that TransCanada doesn't always win every competition, but they have been relatively successful. They decided that other projects didn't have the necessary components and didn't pursue them.

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COMMISSIONER BALASH said he would next talk about the terms in Exhibit "C" of the MOU that lay out the terms in the midstream services agreement. The terms are lengthy, but the major ones are the "Favorable Debt to Equity Ratio" that does a lot for the state in terms of cash flow for making the North Slope an attractive place to explore for gas and commercialize it, and the role of cash contributions - the capital TransCanada will employ means the state will not have to front cash during project development. Further, they have committed to a particular cost of debt that is attractive.

Because the state has ongoing obligations and assets in the treasury that have an opportunity to earn returns, when you consider the opportunity cost of capital in combination with what TransCanada is providing, the state's net present value (NPV) is improved overall the commissioner said.

TransCanada has committed to offer new customers tariff terms that are premised on a 70/30 capital structure. It's difficult

if not impossible to predict what the appropriate ROE and cost of debt will be when those expansions occur, but the leverage associated with that particular capital structure is going to be attractive and incentivize additional exploration efforts.

Finally, they have planned for five offtake points for gas to Alaskans and secured distance sensitive rates with three zones for those instate deliveries.

COMMISSIONER BALASH said when you look at the favorable debt to equity ratio slide; from the middle to the left you see the ratio of debt to equity with the terms assumed in this arrangement 75/25 with 12/5 percent as the ROE/cost of debt. To the right is a figure of 12 percent ROE premised on the 75/25 structure and then the ROE is varied down to 10 and up to 14 to illustrate the impact of that change. One sees for the GTP and pipeline services the state's tariff is impacted far more by the ratio of debt to equity than the ROE.

He said they expect some tough questions on why 12 percent ROE in this contract with TransCanada, but he ultimately thought they had struck a fair balance in the combination of debt to equity in the ROE. TransCanada was open to having a lower ROE, but they wanted a higher equity component in the capitalization structure. So, they wound up with 75/25 and 12 and 5.

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Continuing on the same theme, Commissioner Balash said slide 11 used the same calibration of the debt to equity ratio and the ROEs and showed the impact ultimately on the state's NPV: the higher the tariff the lower the state's net back and its ultimate revenue. The far left indicated a 55/45 split resulted in \$6.9 billion and to the far right a 95/5 split would get us up to \$7.8 billion. The impacts of going from 12 down to 11 for the ROE are measured within \$100 million. So, in the tug and pull negotiation with Mr. Palmer, the commissioner said the state satisfied itself that that combination serves the state's long term needs quite well.

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COMMISSIONER BALASH said regarding the cash needs to go to construction on this project he had three combinations of information paired according to the boundaries of the HOA for the state's overall share (20 or 25 percent). On the left hand side, that pair looks at a situation of SOA ownership period; no TransCanada involvement in any component. In the middle

TransCanada carries the state's interest in the GTP and the pipeline; and in the far right, it shows what happens if the state exercises its equity call-back option in Exhibit "B." Taking into account the CAPEX the state would have to contribute and the debt assumed getting past FID, the combination of those two is reflected in the bar charts. In the 100 percent state ownership scenario at 25 percent, the state needs to come up with approximately \$11.4 billion for our share of the GTP, pipeline and liquefaction. With TransCanada standing in our shoes for the GTP and pipeline, that same 25 percent position requires just under \$6 billion for our share of the liquefaction plant and marine facilities.

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He next illustrated the impacts of the question of TransCanada or no TransCanada on the state's revenues (corporate income and property taxes) and explained that annually the state would have competing needs and draws on its assets, but they are not impacted by this question, so they weren't included.

With no TransCanada involvement the state's cash calls aren't really that big moving through the initial stages of project development, in the 10s or 100 millions of dollars. However, those cash calls ramp up considerably in the construction phase or FID, to the point that the state would need to come up with more \$1 billion annually for a period of years starting in 2019 and progressing through 2023. Then the project hits in-service, ramps up production, and the revenues start coming in.

COMMISSIONER BALASH emphasized that there would be competition for dollars in the next decade if the state goes it alone without a partner and that the state would have some heavy water to carry.

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SENATOR FRENCH asked him to talk a little bit more about some of the other assumptions associated with the price of LNG: transportation costs, tanker fees, and other moving parts.

COMMISSIONER BALASH replied that the full range of assumptions he used in the models are in the Black & Veatch royalty study that was released in November, but broadly speaking the LNG pricing that is assumed for these numbers are continuing to rely on an oil linked price (but the oil price forecast here is \$90), so they are being fairly conservative. That study assumes about \$1 for tanker costs to move from the liquefaction facility to market and the costs of transportation are as reflected in the

25 percent scenario with the 75/25 debt equity split and the 12 percent ROE and 5 percent cost of debt. The chart (slide 13) reflects the revenues associated with the production of gas and sale of LNG from the proven resources at Prudhoe Bay and Pt. Thomson. So, in 2043 a drop in revenues is seen, which reflects the finite resource in those places, but they expect that additional gas will be found that will complete the trajectory on out in the years beyond 2043.

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SENATOR FRENCH said the state's projected oil prices are always wrong, and asked for every \$5 increment we are off (either high or low) what the change in the graph is. In other words, when would the state's revenues go down to nothing?

COMMISSIONER BALASH said he could run a break-even analysis; however, he observed that until they know what the terms for the SPA are going to be, it's hard to say what the break-even price is.

He explained that it is not unusual for buyers to seek an "S curve" where the seller of the LNG is protected on the low side to make sure they are going to cover their costs; the buyer is naturally going to seek some sort of cap on the high side. Here they expect a linear linkage not an S curve. They could look at what an S curve would need to look like to make sure the state doesn't go below zero, but he could also do just a price sensitivity.

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SENATOR FRENCH said he wanted to know the downside.

COMMISSIONER BALASH agreed.

SENATOR BISHOP asked what the payback on this model is.

COMMISSIONER BALASH replied that the payback factor depends on the prices that are assumed and when project start up actually hits. He thought payback could come within the decade and maybe within five or six years or less.

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He said the Division of Treasury has a pretty good record of long term earning power; the investments they make have a 10-year return that hovers around 6 percent. So, when you take into account the opportunity cost associated with the use of our own equity, one sees the same pairings of no TransCanada, with

TransCanada, and the 40 percent buy back reflected in the state's total cash flows on slide 14. In the 25 percent scenario one sees total cash flows being the highest with TransCanada as a partner, because the state is not having to sacrifice the opportunity to earn a return on its capital in the near term.

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COMMISSIONER BALASH noted the gas potential and cash flow possibilities indicated on slide 15 and stated that there is in excess of 200 tcf/gas of undiscovered technically recoverable resource on the North Slope, enough to add another train of liquefaction capacity in Nikiski with a corresponding additional train for treatment at the Slope. He said there is no guarantee that the North Slope gas that is found will require the same kind of treatment as Prudhoe Bay and Pt. Thomson gas, but he assumed that for this illustration.

COMMISSIONER BALASH said you see a "step-change" in state revenues in the out years reflecting the progression or revenue from the yet-to-find resource as well as the expanded volumes of gas. He said the comparison showed different combinations of revenue streams and that is where the value of a company, like TransCanada, that is pursuing the business of moving more gas comes into the picture. He said he thinks Alaska's long term future is going to benefit from those expansions and increments of capacity in the liquefaction terminal, itself.

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COMMISSIONER BALASH said the distance sensitive rates, for the Nenana zone in particular, is just common sense. The farther you have to move your gas, the more you have to pay; the shorter you move your gas the less you pay. The \$1.82 treatment of the gas doesn't change regardless of where it goes. The pipeline charge is what varies.

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SENATOR MICCICHE asked what he used for a delivery location in South Central.

COMMISSIONER BALASH answered Big Lake, the first opportunity to tie into the Enstar system.

SENATOR BISHOP asked if the \$3.70 was the cost delivered to Fairbanks.

COMMISSIONER BALASH answered that was cost of transport to the city gate and does not include the cost of the commodity.

5:00:40 PM

SENATOR BISHOP remarked that was a good number.

COMMISSIONER BALASH added that one of the provisions is the ability to utilize backhaul service, so that if the commodity is cheaper in Cook Inlet than it is on the North Slope, folks in Fairbanks will get the benefit of that price either way; however they will have to make some choices as far as signing up for service and supply.

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SENATOR FRENCH asked Senator Bishop to explain page 5 of Exhibit "C" that says: "You can take gas off for non-LNG consumption."

COMMISSIONER BALASH answered that makes sure they have full utilization of the pipe from the North Slope all the way to the LNG plant. That is the basis for the system and the five instate offtake points are for points exclusive of the end point. In other words, between Prudhoe Bay and Nikiski there would be five points; Nikiski doesn't count as one of the five.

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SENATOR FRENCH said there is no prohibition if Yukon River, for instance, wanted to make a little LNG and ship it down the river to a village.

COMMISSIONER BALASH answered no.

SENATOR MICCICHE said folks were expecting them to ask why TransCanada? It's a great company; they have an incredible safety and environmental record and their pipeline operations are some of the best on the planet. But the MOU and the Recitals lean very heavy on an implied commitment under AGIA and he wished they weren't there. Their job is to get the best deal for Alaskans going forward and he wanted to see that consideration separated. He asked why the state had not considered an RFP option for the company partnering on the midstream side of this project.

5:04:29 PM

COMMISSIONER BALASH answered that a couple of things flow into that issue and that the state could have gone down the RFP road. However, in order to do that, they would have needed to step out of the present arrangement with TransCanada and a number of questions come out of that: who will determine the basis for awarding that RFP? The AGIA process has a statutory directive

that the departments followed to issue a request for applications with a deadline and then evaluate those responses, develop a finding, forward that to the legislature, and have it approved. That process all told took nearly two years. So, one of the things they wanted to achieve here was to maintain momentum in the progress of AKLNG, and the terms offered by TransCanada were compared against others in North America, but in particular taking into account the competition that took place between the Alaska Pipeline Project (APP) and Denali back in to 2010 when they were both conducting open seasons. That was for service to Alberta, in some ways not the best comparison, but one that they accounted for. While they could consider a competitive award process, his question would be of all the things that come into the picture, how do they equalize one company versus another? How is the expertise compared, the familiarity with one versus another? Those would require some subjective decision making that would be just as susceptible to second guessing as this set of decisions.

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SENATOR MICCICHE said he appreciated that answer.

SENATOR GIESSEL thanked the commissioners and Mr. Palmer. She summarized that this is a complex process and there is no rush. She wanted all their questions answered.

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Finding no further business to come before the committee, Chair Giessel adjourned the Senate Resources Committee meeting at 5:08 p.m.