

HOUSE FINANCE COMMITTEE
THIRD SPECIAL SESSION
October 24, 2015
1:01 p.m.

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CALL TO ORDER

Co-Chair Neuman called the House Finance Committee meeting to order at 1:02 p.m.

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair
Representative Steve Thompson, Co-Chair
Representative Dan Saddler, Vice-Chair
Representative Bryce Edgmon
Representative Les Gara
Representative Lynn Gattis
Representative David Guttenberg
Representative Scott Kawasaki
Representative Cathy Munoz
Representative Tammie Wilson

MEMBERS ABSENT

Representative Lance Pruitt

ALSO PRESENT

Pat Pitney, Director, Office of Management and Budget, Office of the Governor; Radislov Shipkoff, Director, Greengate LLC; Steven Kantor, Managing Director, First Southwest Company; Justin Palfreyman, Director, Lazard; Representative Lora Reinbold; Representative Shelley Hughes; Representative Liz Vazquez; Representative Cathy Tilton; Senator Peter Micciche; Representative Andy Josephson; Representative Chris Tuck; Representative Jim Colver; Representative Dan Ortiz; Representative Geran Tarr; Representative Sam Kito III; Representative Dave Talerico; Representative Louise Stutes; Representative Gabriel LeDoux; Representative Mike Chenault; Representative Paul Seaton; Representative Neil Foster; Representative Bob Lynn.

SUMMARY

HB 3001 APPROP: LNG PROJECT & FUND/AGDC/SUPP.

HB 3001 was HEARD and HELD in committee for further consideration.

PRESENTATION: TRANSCANADA'S AKLNG PARTICIPATION: FINANCING ISSUES

Co-Chair Neuman reviewed the agenda for the day.

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RECONVENED

#hb3001

House Bill No. 3001

An Act making supplemental appropriations; making appropriations to capitalize funds; making appropriations to the general fund from the budget reserve fund (art. IX, sec. 17, Constitution of the State of Alaska) in accordance with sec. 12(c), ch. 1, SSSLA 2015; and providing for an effective date.

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PAT PITNEY, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF THE GOVERNOR, stated that the bill was only two pages in length. Section 1 contained three components, beginning with \$144,045,000 to capitalize the Alaska Liquid Natural Gas (AKLNG) project fund. The appropriation would fund the state's equity participation in the AKLNG portion and pay for the TransCanada contract when the state bought the partner out. Approximately \$68 million would go to the TransCanada buyout and the remainder would go to cash calls for the remainder of the pre-FEED [Front End Engineering and Design] stage of the gas pipeline project. The previous number had been \$108 million; the difference related to an increase in the overall FEED project cost from \$511 million for all partners to \$694 million. The cost increase had come out recently when review of the work plan and budget for November 15 [2015] had begun. Second, \$13.6 million would be appropriated from the General Fund (GF) to AKLNG project fund; the funds would then be appropriated to agencies supporting the project. The Department of Natural Resources (DNR) would receive \$2 million. She noted that

the governor's FY 16 budget request for the component for DNR had been \$13 million, but only \$9 million had been funded. She remarked that with the \$2 million appropriation, the increment for DNR was still below the governor's initial request the prior session. The Department of Law (DOL) would receive \$10 million for legal contracts. She detailed that the state was taking a much more active role in driving the project. The funds would help the state move more aggressively on the commercialization aspects and completion of contracts. The Department of Revenue (DOR) would receive just under \$1.4 million for personnel and contractual services for the bankability studies.

Ms. Pitney addressed Section 2, which provided the ability for Alaska Gasline Development Corporation (AGDC) to collect and deposit reimbursements for use towards the project. She elaborated that AGDC had done work on behalf of all of the AKLNG partners; the provision would allow the funds to go back into the project. Section 3 specified that the capitalization into the AKLNG project fund would not lapse. Section 4 was a reminder that the appropriations bill passed the prior session included a factor recognizing there would be supplemental appropriations that could be used from the Constitutional Budget Reserve (CBR).

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RADISLOV SHIPKOFF, DIRECTOR, GREENGATE LLC, shared that Greengate was an independent financial advisory firm specializing in project finance for energy projects (i.e. oil and gas, LNG, pipelines, and downstream industries such as refineries or petrochemicals, power plants, transportation sectors such as toll roads, and other). He relayed that within the LNG sector the company's experience covered a wide range of large scale projects around the world. He detailed that going back more than ten years the company had worked on a number of the Qatari LNG deals including Qatargas 2, which at the time had been the largest project financing worldwide; Qatargas 3, which was the third expansion of the Qatargas project; RasGas 2, which was another Qatari project implemented by a different company; Peru LNG; the PNG LNG project in Papua New Guinea,

which consisted of an upstream development for associated and non-associated gas, a pipeline, and a multi-train LNG facility; and Australia Pacific LNG, an Australian project developed by ConocoPhillips, which used an upstream gas supply provided by the nonconventional gas supply source coal-bed methane. He relayed that most recently Greengate had been advising lenders on the Russian Arctic gas development Yamal LNG until the U.S. government imposed sanctions on Russia.

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STEVEN KANTOR, MANAGING DIRECTOR, FIRST SOUTHWEST COMPANY, communicated that First Southwest was a financial advisor to DOR. He detailed that he had been involved in municipal finance for over 40 years and had worked in Alaska for over 20 years. The company served as a financial advisor to many of Alaska's state agencies such as the Alaska Housing Finance Corporation, the Alaska Student Loan Corporation, the Municipality of Anchorage, the University of Alaska, and more.

JUSTIN PALFREYMAN, DIRECTOR, LAZARD, relayed that Lazard was the largest independent investment bank in the world. The company advised governments and corporations on a variety of strategic and financial matters. The company was advising the State of Alaska, pursuant to SB 138 [legislation passed in 2014 related to a gas pipeline, AGDC, and oil and gas production tax], on the state's financing alternatives with respect to the AKLNG project.

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^PRESENTATION: TRANSCANADA'S AKLNG PARTICIPATION: FINANCING ISSUES

Mr. Shipkoff introduced the PowerPoint presentation titled "TransCanada's AKLNG Participation: Financing Issues" dated October 24, 2015 (copy on file). He explained that the presentation would focus on how the termination of the contractual relationship with TransCanada would financially impact the state. He noted that Marty Rutherford, Deputy Commissioner, Department of Natural Resources would address the strategic reasons the state was making the recommendation. He addressed slide 2 and discussed the immediate financial obligation for the state to fund the reimbursement of TransCanada's development costs with interest as required under the Precedent Agreement (PA) with TransCanada. Additionally, the state would be responsible

for funding the midstream project costs, which would have been funded by TransCanada. He listed three questions from slide 2 pertaining to TransCanada's exit from the project:

- What will be the impact on the State's credit rating and borrowing capacity?
- At what cost is the State expected to finance its share of Midstream costs, and how does such cost compare with the cost of financing provided by TC under the PA?
- How can the State fund its share of Midstream project costs?

Mr. Shipkoff turned to slide 3 and listed four potential concerns that needed to be addressed in relation to the first question:

- Will the State's requirement to fund Midstream costs result in increased State funding commitments?
- Will TC's exit erode the State's borrowing capacity?
- Will the State's credit rating be adversely affected by TC's exit?
- Will the long-term impact of the TC buyout be viewed as credit positive?

Mr. Shipkoff addressed the first potential concern on slide 4:

Will the State's direct funding of Midstream costs result in increased State commitments?

Under the arrangement with TC, the State is already committed to pay the costs associated with the Midstream components:

- If the Project fails to complete Pre-FEED: State obligated to reimburse TC, with interest
- If the Project fails to complete FEED: Under the expected terms of the Firm Transportation Services Agreement (FTSA) with TC, the State would be obligated to reimburse TC, with interest

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Mr. Shipkoff continued to address slide 4:

- If the Project fails to complete construction: Under the expected terms of the FTSA with TC, the State would be obligated to reimburse TC, with interest
State assumes Midstream development and construction risks

- If the Project achieves operations: Under the expected terms of the FTSA with TC, the State would be obligated to pay TC fixed capacity reservation charge, including repayment of TC capital through annual depreciation charge, and pass-through of Midstream costs, regardless of throughput volumes
- State assumes Midstream cost-overrun and throughput risks

Mr. Shipkoff elaborated that unsuccessful completion of construction would be a very bad outcome for the project. He continued that under the firm transportation services agreement (FTSA) the state would also be obligated to reimburse TransCanada with interest under the scenario. He noted that in each of the scenarios the state would be obligated to reimburse TransCanada. In other words, the state would be taking on the risk of the development and construction stages of the project. He relayed that if the project was not successful, the development capital invested into the project by the other partners (ExxonMobil, BP, and ConocoPhillips) during the pre-FEED, FEED, or construction stages would be lost. He noted the situation was similar to how the state's capital would be at risk for the midstream component funded by TransCanada. He discussed that TransCanada's role was more akin to a lender, given that the state was the one retaining the risks typically taken on by an equity investor.

Mr. Shipkoff addressed what would happen if the project was successful in advancing past the development and construction stages and successfully entered into operations. Under the expected terms of the FTSA the state would be obligated to repay TransCanada's capital invested during the development and construction periods over time through a transportation tariff. The tariff would include a capacity reservation charge, which would include a repayment of TransCanada's capital invested with return. He likened the repayment of capital to repaying principal on a loan. The repayment of TransCanada's capital through the capacity reservation charge would occur as an annual depreciation charge, which was similar to the periodic principal installment of a loan (with the return on TransCanada's capital being the interest). As part of the tariff the state would be obligated to pay TransCanada's operating cost of the midstream segment; if the state owned the segment it would pay directly on its own. He reiterated that under the development, construction, and operational period, the state was obligated to repay the capital invested into the midstream; there was no incremental commitment by the state to fund the midstream capital that would result from the decision to terminate the relationship with TransCanada. He explained that a direct form of financing would be

substituted with an indirect form; in each case the state ultimately bore all of the risk and had all of the obligations for repaying and funding the segment.

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Mr. Kantor advanced to slide 5: "State Borrowing Capacity effectively the same with or without TC":

Will TC's exit erode the State's borrowing capacity?

TC's exit will not create incremental State debt obligations; the State is already obligated to pay the Midstream costs.

- Under the PA and the anticipated terms of the FTSA, the State's payment obligations to TC require payments to TC to be "supported with the full faith and credit of the State" or a dedicated funding source acceptable to TC
- TC would be relying on the State's credit for reimbursement of its funding of Midstream costs
- First Southwest has noted that the credit ratings agencies will, in all likelihood, consider the State's long-term fixed payment obligations to TC under the FTSA as analogous to a State debt obligation for purposes of analyzing State debt capacity

Mr. Kantor elaborated that all three ratings agencies had rated Alaska's credit as AAA. He expounded that there would be no difference in terms of analyzing for the state's capacity because the state would either owe TransCanada or finance it directly.

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Mr. Kantor turned to slide 6: Example: "Credit Rating Agency Treatment of "Take-or-Pay" PPAs." He detailed that Moody's Investor Service was one of the three major rating agencies that rated the state AAA; however, Moody's had raised questions about how the state would handle its financial challenges. He explained that a power purchase agreement (PPA) was very similar to a FTSA; the ratings agencies would view the commitment under the PA and TransCanada as the same as virtual debt. Subsequently, there would be no difference in the analysis whether TransCanada was involved or not.

Mr. Kantor pointed to slide 7 titled "State Credit Rating not Adversely Affected by TC Exit":

Will the State's credit rating be adversely affected by TC's exit?

FirstSouthwest advises that a decision to terminate the TC's participation will not, in and of itself, result in a downgrade of the State's credit rating:

- No incremental commitments by the State
- As the State's overall costs related to the Project are projected to be reduced without TC (B&V estimates a reduction of up to \$400 million per year), the termination should be viewed by the credit ratings agencies as a net positive for the State
- With or without TC, the State should anticipate a reduction in the State's credit rating during the construction period (when no gas sale revenues are being generated) absent a significant increase in revenue generated from existing sources
- Credit rating should recover once gas sale revenues become established
- TC's exit, by itself, should not result in a credit downgrade during the construction period that is greater than any downgrade if TC remained in AKLNG. The State's credit could instead be improved by the lower costs to the State as a result of TC's exit

Mr. Kantor elaborated that the state's credit rating would undergo credit rating pressure with or without TransCanada because the state would have to finance a tremendous amount of money in a period where there would not be corresponding revenues.

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Mr. Kantor discussed slide 8: "Financial Risks to the State of Maintaining TC Funding." In addition to anticipated savings, there was also a risk to maintaining the TransCanada agreement. He detailed that TransCanada was acting as a lender to the financing under the current agreement; should anything happen, TransCanada had the right to end the arrangement. He elaborated that if TransCanada chose to end the arrangement, the state would owe the company all of the money TransCanada had expended in addition to all of the fees and costs. Subsequently, the state would have to borrow the money to pay for TransCanada under a quick timeframe because it was unlikely the state would have the cash in reserves. He continued that it could be very expensive to borrow money in the event of a failed partner and potentially a failed project. He discussed that the situation should be avoided for the state and was another advantage to the termination of the arrangement with TransCanada.

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Mr. Shipkoff advanced to slide 9:

At what cost is the State expected to finance its share of Midstream costs?

How does such cost compare with the cost of the financing provided by TC?

Mr. Shipkoff pointed out that in order to address the first question it was helpful to do an overview of capital costs under the existing arrangement.

- If the PA is terminated:
 - TC's costs reimbursed with interest at rate of 7.1%
 - higher rate applies if payment is not made within the required period under the PA
- If the Project proceeds to operations:
 - the State would pay a return on TC's rate base calculated on the basis of deemed weighted average cost of debt and cost of equity
 - cost of debt and return on equity adjusted for changes in the yield on 30-year Treasury bonds over time
 - debt to equity ratio: different during the construction and operating periods
 - 70:30 through the second anniversary of the in-service date and in respect of expansions and maintenance capital additions
 - 75:25 after the second anniversary of the in-service date on capital other than capital additions for expansions and maintenance

Mr. Shipkoff elaborated that the weighted average cost of capital (WACC) was calculated by applying the 75 percent debt to the deemed cost of debt (which had been set at the time of the execution of the Memorandum of Understanding (MOU) with TransCanada in 2013 at a rate of 5 percent) and applying the 25 percent to the 12 percent equity component.

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Mr. Shipkoff turned to an illustration of the WACC on slide 11: "Sample TC Deemed Weighted Average Cost of Capital under the PA." The table showed two snapshots in time of TransCanada's cost of capital under the arrangement. He stressed that the cost of capital under the arrangement was not fixed; it changed with variations in the yield of the 30-year Treasury bond. On December 12, 2013 (the date of the

MOU) the 30-year Treasury yield was 3.91 percent, which resulted in a WACC during the construction period and the first two operating years of 7.10 percent; once the debt to equity ratio switched from 70/30 to 75/25 the WACC reduced to 6.75 percent. He relayed that Treasury rates had declined and had ranged from 2.90 to 3.00 percent in recent months. Assuming a 2.95 percent 30-year Treasury yield resulted in a WACC of 6.15 percent during the construction period and the first two operating years of 6.15 percent; once the debt to equity ratio switched from 70/30 to 75/25 the WACC reduced to 5.80 percent. He summarized that the WACC had declined under the TransCanada arrangement because it was linked to Treasury rates that had declined.

Mr. Kantor discussed slide 12: "TC Cost of Capital vs. State Debt Interest Rate." He restated Mr. Shipkoff's statement that the financing rates changed daily with the yield on the 30-year Treasury. The table on slide 12 compared the TransCanada WACC under the PA (as of September 11, 2015) with the interest rates on taxable State general obligation bonds (estimated by First Southwest as of September 11, 2015). The red lines on the table represented the construction and operating periods; the gray lines represented estimated costs to the state to assume the same obligations with its own financing. He discussed that the state's credit rating may decline as it issued so much debt without any corresponding revenues; therefore, the table illustrated different scenarios at different ratings. The state was currently rated AAA by the three major rating agencies, but the table showed that even if the rating declined to A-/A3, the interest rates on the state's borrowing would still be less than those under the PA. He reminded the committee that the state had not received such a low rating since 1974 (right before Trans-Alaska Pipeline System (TAPS) began). Given the state's more sophisticated financial position, it was unlikely the rating would fall to a level that low. The purpose of the table was to demonstrate the resiliency of the state in terms of obtaining financing. He reiterated that under all of the credit rating scenarios the cost would be less than what it would be under the PA agreement with TransCanada.

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Mr. Kantor asked "How will the State fund its share of Midstream project costs?" on slide 13. First, it was important to understand the costs, which had been divided in three stages shown on slide 14. The pre-FEED stage from 2014 to 2016 would cost approximately \$144 million, the FEED stage from 2016 to 2018 would cost approximately \$675 million, and the construction phase from 2019 to 2026 would cost approximately \$13 billion.

Mr. Kantor discussed four funding options the state could consider listed in slide 15: "State Funding Options":

- The Legislature could appropriate from existing State funds, e.g., the Constitutional Budget Reserve Fund (CBRF), Earnings Reserve Fund
- The Legislature could authorize the issuance of State debt
- The Legislature could authorize pursuit of project financing
- The Legislature could authorize the pursuit of funding from other sources: LNG buyers and other potential equity investors

Mr. Kantor addressed the state funding option on slide 16. The firm estimated that if the legislature elected to use the CBR, the fund would be depleted in 2018 or 2019 given the current funding requirements. He detailed that utilizing the CBR to finance the TransCanada reimbursement and midstream financing would accelerate the depletion of the CBR by approximately 3 to 5 months. Given that the CBR was dependent on the price of oil, some oil price scenarios had been generated by the firm. The analysis concluded that the CBR could be used to fund pre-FEED and at least a portion of FEED costs, but not construction costs. Ultimately, it was anticipated that as the short-term funding for pre-FEED and FEED was taken out, the CBR would be reimbursed for the expenditures.

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Mr. Kantor advanced to slide 17: "Potential Funding Sources: State Debt." He discussed that the legislature could authorize the issuance of state debt in many different forms including a general obligation bond or an appropriation-backed bond. He detailed that bonds could be used to finance FEED and construction costs. There was generally a long-term repayment consistent with the life of the project; the firm recommended a 20 to 30-year cost amortization period. There were timing implications associated with issuing state debt; authorization to issue general obligation bonds would require a vote of the people, whereas the issuance of appropriation bond would not.

Mr. Palfreyman addressed project finance as a third potential funding source (slide 18):

The Legislature could authorize the pursuit of project financing:

- Lenders would look primarily to the Project-level cash flows and assets as security for repayment, rather than State funds
- Common form of debt for LNG projects
- Requires the Project commercial structure to be in place:
 - All key project agreements must be executed
 - Commercial structure must be "bankable"
- Requires that FID is reached; not available to fund FEED costs
- May require constitutional amendment to allow the pledging of LNG sales proceeds as lender collateral as the Lenders will demand that funds will be dedicated to repayment, which is currently not permitted by the State's Constitution

As the Project's commercial structure has not yet been agreed, it is premature to evaluate the extent to which project finance could be a viable source of funding

Mr. Palfreyman elaborated that all key agreements with producers, LNG buyers, contractors, and others, had to be executed in order for project financing to be implemented. Additionally, project lenders would need visibility on project cash flows and clarity on the security package.

Mr. Palfreyman discussed LNG buyers and other equity investors (such as infrastructure investors) on slide 19:

The Legislature could authorize pursuit of investment from LNG buyers or other equity investors:

- Offtakers have often acquired equity in LNG projects
- Approach by the State would need to be made in coordination with marketing plan
- New equity investors could share Project development risk
- Could provide sources of funding in the event a Producer withdraws

At this stage of the Project's development, it is premature to evaluate the extent to which LNG buyers or other equity investors could be viable sources of funding

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Mr. Palfreyman slide 20: "Example Funding Scenario (For Illustrative Purposes Only)." The scenario demonstrated that the ultimate financing plan would likely include a

combination of funding sources and would need to be sequenced appropriately based on the phase of the project. For example, the state could use short-term funding sources such as the CBR to fund the state's share of the project through FEED and could arrange its long-term financing such as general obligation debt or project financing or a combination of the two. He continued that if the state utilized the CBR through FEED it could use the proceeds from the long-term financing to repay funds to the CBR.

Mr. Shipkoff summarized the findings provided in the presentation (slide 21). First, the exit of TransCanada would require the state to fund the reimbursement to TransCanada's midstream development costs plus interest in a relatively short timeframe. However, TransCanada's exit would not result in any incremental financial commitments by the state because the state was already committed to paying the midstream costs indirectly. He noted the arrangement was not dissimilar to a situation where TransCanada was the lender (as opposed to the state going directly to the lending market). There would be no incremental impact on the state's long-term credit rating and borrowing capacity because the financial community and rating agencies would perceive the obligations as essentially equivalent to already having borrowed the funds from TransCanada. He stated that cost at which the state could fund its share of the midstream costs directly should be no greater and potentially better than borrowing indirectly through TransCanada. He pointed to First Southwest's projection that the interest rate would be lower if the state were to borrow directly rather than indirectly. Lastly, the state had a range of financing options available to fund its share of the midstream project costs directly. He remarked that the state was still in negotiations with the producers on what the commercial structure would look like. Any financing plan would have to be carefully tailored to the commercial structure; therefore, it was currently premature to craft a specific financing plan. He continued that when the state was ready to create a detailed financing plan, the plan would have to be carefully considered, appropriately sequenced (short-term funding was implemented and utilized before long-term funding was available), and the appropriate risk allocation and the state's preferences were taken into consideration.

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Vice-Chair Saddler asked how long the companies had been on contract with the State of Alaska.

Mr. Shipkoff responded that Greengate LLC had been under contract regarding LNG since July 2015.

Mr. Kantor replied that the First Southwest Company was retained through a request for proposal (RFP) process through the Department of Revenue in October 2014.

Mr. Palfreyman answered that Lazard had been retained by the state as of September 2014.

Vice-Chair Saddler asked how much time had been spent on the TransCanada buyout provisions and the resulting financial decisions.

Mr. Shipkoff responded that he did not have a precise figure, but estimated Greengate had spent the past few weeks looking at the issue and financing implications.

Mr. Kantor responded that the arrangement with TransCanada had offered certain off-ramps that were logical points in the time schedule for the state to end the agreement. One of the off-ramps was approaching; therefore, the companies had focused on the opportunity and had provided an analysis of how much it would take for the state to take the off-ramp.

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Vice-Chair Saddler asked how much time the companies had been focusing on the off-ramps. Mr. Kantor responded that there had been focus on the off-ramps for the past 12 weeks.

Mr. Shipkoff added that the recommendation for the state to make a choice on whether or not to terminate its agreement with TransCanada had been considered and evaluated by the state team over time. However, the financing implications was a narrower topic that the companies had reviewed relatively recently. He explained that the companies were not focusing on the strategic considerations on whether it was a good idea to terminate the agreement with TransCanada and when.

Vice-Chair Saddler wanted to know how much of the companies' expertise had been focused on the off-ramps and the financing and implications of the buyouts versus a success case on how to make the agreement work. He referenced prior statements about a few weeks and 12 weeks.

Mr. Palfreyman replied that the companies had spent the majority of the past couple of months on the issue. Lazard had been engaged in the process for slightly over one year; most of its focus had been more broadly on the financing alternatives for the state (long-term financing in particular).

Mr. Shipkoff replied that the recommendation to terminate the relationship with TransCanada, which would be explained from a strategic perspective by DNR, was entirely consistent with a successful project outcome. Additionally, it was consistent with the view that the state would be in a more cost advantageous position if it pursued direct ownership of the midstream component. He stated that it was a matter of cost of financing rather than success or lack of success.

Vice-Chair Saddler asked if the companies were relying on a recommendation or an actual decision that had been made.

Mr. Shipkoff responded that the companies had been asked to provide advice on what the potential implications to the state could be if the agreement with TransCanada was terminated.

Vice-Chair Saddler asked for verification that the decision had not yet been solidified. Mr. Shipkoff replied in the affirmative.

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Co-Chair Thompson asked if it was prudent for the state to address its risk exposure in the short-term, mid-term, or long-term, given the current oil prices.

Mr. Kantor answered that the state had a number of financing needs. There was a substantial risk in the state budget due to oil prices. The company believed that it was one small component of the decisions facing the legislature in terms of how to allocate its resources.

Representative Wilson asked if the companies had considered whether the project would qualify for Alaska Permanent Fund Corporation financing. She noted that the corporation looked at commercial buildings and other investments. She detailed that the money was a resource of the state and a certain percentage would go back into the Permanent Fund.

She wondered how it would impact the state's credit rating if the funds came from the Permanent Fund versus the CBR.

Mr. Kantor affirmed that the Permanent Fund could be used as a source of financing and its use would reduce the cost of financing to the state. Additionally, the Permanent Fund would be provided with capital. The analysis fell under the broader category of "state funds."

Representative Wilson asked for verification that a reduction to the state's credit rating would impact any of the state's projects financed with variable rates.

Mr. Kantor agreed that a reduction to the state's credit rating would affect all of the projects the state had borrowed money to fund. He affirmed that if the Permanent Fund financed the entire project there would be no impact on the state's credit rating.

Representative Wilson asked why the project would or would not be considered for financing by the Permanent Fund. She believed one of the largest complaints was that the Permanent Fund invested its funds outside of Alaska. She reasoned that the Permanent Fund would want to be a part of the project if it was a good one.

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Co-Chair Neuman requested copies of any reports the companies had provided to the administration. Additionally, he requested information on the baseline the companies had used for their financial assumptions.

Representative Guttenberg commented that the state was approaching a milestone on the contract. He remarked that the due diligence was necessary to determine the best course of action for the project. He observed that based on the information presented to the committee it appeared that under every option it was beneficial for the state to buyout TransCanada. He believed that could be seen as raising a flag. He questioned whether it was permissible for TransCanada to charge interest on money the company was borrowing on. He remarked that the state was paying double interest and it was still financially in the state's best interest to buyout TransCanada. He wondered what would have to change to make the buyout a less advantageous option.

Mr. Shipkoff thought it would be beneficial for the committee to consider the broader picture rather than the narrowly focused financial aspects. He believed DNR Deputy Commissioner Marty Rutherford's presentation on the broader aspects would be helpful. The presentation would consider from a strategic standpoint why it was a good idea to terminate the relationship with TransCanada. He remarked that there were pros and cons to the arrangement with TransCanada and the evaluation needed to take them all into account.

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Representative Guttenberg asked whether the situation was as black and white as the presenters had depicted when considering the financial position on its own.

Mr. Shipkoff replied that there were many strong arguments to confirm that exiting the agreement with TransCanada would be beneficial to the state in terms of costs the state would incur by funding indirectly through TransCanada or directly on its own credit. He hesitated to classify something as a black and white question; however, the arguments that could be made in favor of a termination of the TransCanada arrangement from a financing perspective were very strong.

Co-Chair Neuman asked about the contract with TransCanada was or was not standard. Mr. Shipkoff answered that the type of tariff that would be paid by the state to TransCanada was consistent with other similar arrangements. However, the financing aspects of the existing arrangement where TransCanada was funding the state's share of the midstream, was somewhat uniquely tailored to the project.

Co-Chair Neuman was interested in measuring risk. He believed it was necessary to consider the issue further given that a portion of the funding arrangement was not standard. He wondered if the risk was proportionate for all parties involved.

Mr. Shipkoff answered that the risk allocation under the existing arrangement with TransCanada was such that the state was committed to paying the cost of the midstream project under practically every scenario about success or failure of the project throughout its stages of development, construction, and operation. In that sense,

the risk allocation was very one-sided (the state was taking almost all of the risks).

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Co-Chair Neuman asked the companies to follow up with information on the risks and how to measure them. He wondered why the state was taking on more risk than its other partners and how it could be managed.

Mr. Kantor clarified that the state was taking all of the risk under the TransCanada agreement. The other partners (BP, ConocoPhillips, and ExxonMobil) were also taking the same risks as the state.

Representative Gara wanted to quantify the value of buying out TransCanada. He asked for verification that the state was taking a risk if it did not buyout TransCanada because the state would owe the company all of its money plus a 7 percent profit if the project failed. Mr. Shipkoff responded in the affirmative.

Representative Gara asked how to quantify the difference between buying out TransCanada and financing at a favorable rate compared to leaving TransCanada in the project and paying the company through the tariff charge. Based on past pipeline hearings, he understood that a pipeline owner received a 12 to 14 percent rate of return. He did not know if the same was true under the current project.

Mr. Shipkoff answered that the rate of return the state would pay to TransCanada via the tariff was a function of the WACC specified in the contractual arrangement with the company. He confirmed that the equity component of the WACC, which was typically around 12 percent, was set as of December 2013 at 12 percent. He detailed that the rate varied with the yield on 30-year Treasury bonds (currently it was about 11 percent). However, the equity component could not be viewed in isolation. There was a weighted average debt and equity component; the debt component was weighted between 70 and 75 percent and the equity component was weighted between 25 and 30 percent. As of December 2013, the WACC was 7.10 percent in the construction period and 6.75 percent during the operating period. As a result of the lower Treasury yields at present the rates were 6.15 and 5.80 respectively. He pointed out that an increase or decrease in Treasury rates would impact the return the

state was committing to pay TransCanada and the state's cost of capital.

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Mr. Kantor added that the companies had estimated that the annual savings would be up to approximately \$400 million per year. He noted that Black and Veatch and Ms. Rutherford would speak to the issue during their presentations.

Representative Gara discussed that under the current contract with TransCanada, the state would owe the partner 7 percent plus everything the partner paid if the project failed after pre-FEED and FEED. He elaborated that the state would avoid the penalty if it bought TransCanada out. He wondered about how much the state would save under the two scenarios.

Mr. Kantor answered that he would follow up with the number.

Mr. Shipkoff pointed out that the magnitude of the obligation and savings depended on the timing of the potential reimbursement; the later in the development or construction stage that a buyout occurred, the greater the magnitude of the reimbursement and accompanying interest. Consequently the savings associated with the interest component of the reimbursement would be greater. Therefore, it was necessary to consider a range of timing scenarios.

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Representative Gara spoke to working to understand the difference in the cost implications for the two scenarios. Assuming the estimated timeframes were accurate, he wondered whether the 7 percent payment would be on the rough estimate of \$820 million over the four-year period.

Mr. Shipkoff responded that several factors had to be taken into account in the scenario outlined by Representative Gara. The first factor was the differential interest cost the state would pay on the interest portion of the reimbursement versus what the state would have paid if it had financed the same costs directly. The second factor was that if the termination occurred at a sufficiently late stage, borrowing to fund a one-time, lump sum, large payment may have to be incurred by the state at a time of

adverse credit conditions to the state because at that point in time the lending community would be aware of a potentially failed project; therefore the costs to the state of borrowing to fund the reimbursement were currently unknown (it was not possible to know the underlying cause of a project failure and circumstances in the future). He relayed that the state's credit could be impacted quite negatively. He summarized that it was difficult to predict what the credit conditions would be under a range of failure scenarios in the future; however, the credit environment would not be as positive as it was at present where there was an expectation that the project would hopefully succeed.

Mr. Kantor added that the amount at any one time would be based on many factors and the nature of the cash flow. The state may be spending a larger amount earlier or later in the FEED process. TransCanada would advance the funds and the state would reimburse the company. He relayed that they [the consultants] could provide an analysis and detail the assumptions, but he hesitated without going through all of the assumptions to ensure he was responding to Representative Gara's question.

[2:09:43 PM](#)

Representative Kawasaki recalled that during discussion on SB 138 the consideration to involve TransCanada was that it brought something materially to the table being a \$40 billion company and having credit backing. He surmised that the consultants were currently testifying that the state's credit rating would not be impacted. He noted that the information was different than what had been provided by the preceding administration.

Mr. Kantor replied that they [Greengate, First Southwest, and Lazard] only addressed finances. He suggested taking up the issue with Black and Veatch and Deputy Commissioner Rutherford. From a financial perspective, the companies strongly believed that the state could finance obligation at a lower cost on its own.

Representative Kawasaki stated that part of the purpose of the partnership with TransCanada was that it would take up any cost overruns. He asked if a credit agency would have difficulty saying that cost overruns would be borne directly by the state.

Mr. Shipkoff answered that the cost overruns were borne by the state with or without TransCanada. The state was obligated to reimburse TransCanada in the event of a project failure for all of the company's capital invested (even in the event of cost overruns) or if the project successfully entered into the operational stage the tariff the state would pay to TransCanada would adjust upwards to account for the actual cost spent. Therefore, the state was bearing the risk of cost overruns.

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Representative Kawasaki reasoned that one of the scenarios was more immediate versus a long-term pipeline contract. He surmised a credit agency would take into consideration that cash would be out sooner rather than later.

Mr. Kantor agreed; however, the state had very little control about whether TransCanada would decide to participate in the project and at any time the company could decide to exit. Meaning that the state would be forced to come up with a tremendous amount of money over time. One of the underlying items under the original agreement was that TransCanada would fund the early parts of the project and the state would repay the funding over time, making a more level stream. However, there was a cost associated and the state would take all of the risk paying the cost to TransCanada as a lender. From a purely financial standpoint, it was more expensive than having the state acquire direct financing.

Mr. Shipkoff referenced Mr. Kantor's overview of the potential funding options the legislature could authorize going forwards. A key element of the analysis was that if existing funds such as the CBR were used, the CBR could not be used necessarily for the long-term investment throughout the construction period because the funds were not there. Therefore, the state would have to borrow the funds through state debt or project financing in order to fund its share of the project costs. However, the state was already borrowing from TransCanada under the existing arrangement, so the net effect to the state was very similar. He detailed that if the state was borrowing directly on its own credit, the lenders were providing the funds to the state; therefore, not affecting the state's cash position. Ultimately the state would be obligated to repay the

lenders just like the state was effectively borrowing funds from TransCanada and committing to repaying them.

Representative Kawasaki referenced examples of large LNG projects in the back of the Lazard report. For example, the Gorgon project was comprised of 47 percent Chevron, 25 percent Exxon, 25 percent Royal Dutch Shell, and a handful of Japanese gas companies. He observed that the project profiles were all similar. Similarly, he wondered if the state would have to negotiate with a couple of large players and numerous small players to get LNG buyers and equity investors.

Mr. Palfreyman responded that it was too early to tell exactly how the financing would play out. The reason the presentation had included LNG buyers as a potential funding source was due to their participation in other LNG projects globally. He referenced Representative Kawasaki's question related to the participation of other producers or strategic partners in the projects and relayed that everything addressed in the presentation was related to the state's roughly 25 percent interest in the overall project. The presentation assumed the three other producers partnered with the state would fund their portion of the project.

[2:15:57 PM](#)

Representative Munoz asked the presenters to speak to the cash flow on the project if the state moved forward with TransCanada. She observed that the state's cash flow was much greater under the scenario in the presentation compared to its cash flow under the current agreement with TransCanada. She asked for a breakdown of percentage of potential cash flow between the partners.

Mr. Shipkoff recommended taking the presentation that would be provided by Black and Veatch into consideration. He elaborated that Black and Veatch had performed modelling on the topic.

Representative Munoz stated that in relation to the Black and Veatch presentation, she understood that the potential cash flow to TransCanada was relatively small compared to its investment of \$7 billion to \$8 billion. She asked if Mr. Shipkoff agreed with the assumption.

Mr. Shipkoff asked for clarification on the question.

Representative Munoz restated her question. Relative to the \$8 billion in upfront cost (25 percent of the pipeline and 25 percent of the gas treatment plant), the cash flow percentage was between 1 and 7 percent. She asked if the deal was fair for the state and TransCanada. She wondered if the structure was overly favorable to TransCanada.

Mr. Shipkoff responded that the cash flow paid to TransCanada depended on the scenario. He elaborated that if the project was successful in reaching operations the state would pay TransCanada a tariff in exchange for transportation services provided on the midstream component; the tariff would be set by a number of items including the amount of capital spent, the cost of capital to TransCanada, the operating costs of the pipeline, etcetera. The net effect on the state's cash flow position of the state's revenue receipts from selling the share of its gas, net of all of the state's costs including the cost of funding and paying the tariff payment to TransCanada under the existing agreement or paying the state's debt service if the state were to directly finance its share, had been estimated by Black and Veatch as up to \$400 million per year.

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Representative Munoz asked about what portion of the \$400 million was associated with transportation cost. Mr. Shipkoff deferred the question to Black and Veatch.

Representative Munoz asked about TransCanada's reputation as a pipeline builder. She wondered if there were examples where TransCanada had pulled back on a project at a relatively developed stage. Mr. Shipkoff answered that TransCanada was a well-known pipeline company with significant experience. The role of the construction contractor for the pipeline segment had not yet been determined and would not necessarily be TransCanada. He detailed that TransCanada's role was to essentially provide a financing vehicle to the state. He noted that the presentation by Ms. Rutherford and Black and Veatch would elaborate on the strategic aspects of TransCanada's presence or absence from the project.

Representative Edgmon surmised that from a financing perspective the three presenters recommended terminating the TransCanada contract. He asked for verification that his understanding was accurate.

Mr. Kantor agreed that from a financial standpoint the companies would recommend the termination of the agreement with TransCanada to the administration.

[2:21:41 PM](#)

Representative Edgmon referred to slide 12. He referred to earlier testimony that a worst case scenario would take the state back to 1974 when the TAPS pipeline was under construction and the state's bond rating was A-/A3. He spoke to a hypothetical time in the distant future where the state's financial position deteriorated given its long-term deficits and other. He wondered what probability the consultants would assign to the cost of the state's capital. He stated that in his limited view of all things global and the natural gas industry, there was a pretty good scenario that the pipeline would not get built (especially in the immediate future). He spoke to the state's deficit situation and that two of the three credit rating agencies had put the state on watch. He observed that there would be some dire consequences if certain actions were not taken by the state. He thought the bottom line on slide 12 could extend farther out if it was assigned certain assumptions.

Mr. Kantor replied in the affirmative. The companies' set of likely scenarios did not encompass all possibilities. The spread between the ratings and the cost were a function of a number of factors including the overall interest rate at the time and the spread that the market perceived in terms of credit quality. The spread widened and narrowed over time depending on the market interest rate and a variety of financial factors. He believed that as interest rates went up and down and if credit spreads remained the same, the same relationship would hold true and the state would be able to finance at a less expensive cost on its own rather than through TransCanada.

Mr. Shipkoff added that while there were a number of factors that went into the determination of the state's credit position, it was conceivable that the state's credit position may be worse than as contemplated by the chart on

slide 12 due to a variety of factors (e.g. the absence of a project due to precipitous oil revenue declines). However, the impact on the state of such a scenario would be the same with or without TransCanada's participation. He detailed that in such an adverse scenario, whether the state had chosen to fund the midstream portion of the project directly or indirectly, would still leave the state in the same position. The state would not be adversely effected solely as a result of going forward with or without TransCanada.

[2:25:51 PM](#)

Representative Edgmon wondered if the companies could put a scenario together with assumptions that may put the state in a situation where the 7.1 percent cost of capital by TransCanada may be attractive. Mr. Kantor did not want to prejudice the analysis, but he could try additional scenarios at the committee's direction.

Vice-Chair Saddler wanted to better understand Mr. Shipkoff's "careful conditioning" of his prior answer to Representative Edgmon. He was concerned that the presentation only focused on the cost of TransCanada's participation in the project as currently envisioned, the cost to the state with or without TransCanada's participation in the future, and by implication the benefits of a higher State of Alaska equity position. He believed a full assessment of the implications of the TransCanada buyout demanded a full analysis of the state's increased risk as an expanded equity partner. He queried the risks involved if the state took a larger piece of the project. Additionally, he wondered if there had every been a discussion by any of the parties (i.e. the administration, legislators, departments, or consultants) about using a portion of the Permanent Fund corpus or using the fund in any way to finance the project. He pointed to the first bullet on slide 5 "a dedicated funding source acceptable to TC."

Mr. Kantor believed that given the magnitude of the project and the financial situation of the state, it would be fool-hearty to reject any possible solution. Therefore, the consultants had tried to provide a broad outline of ways for the state to finance the termination payment for TransCanada and the state's continuing participation in the project. There were a number of different alternatives

within the broad categories and the Permanent Fund could be one of them, but the consultants had not specifically offered it as a solution to anyone. He relayed that at the legislature's direction the consultants could do more research on the option.

Co-Chair Neuman relayed that he would pass the question to DNR and the administration to get an answer as soon as possible.

[2:29:15 PM](#)

Co-Chair Neuman referred back to slide 6 related to take-or-pay and power purchase agreements (similar to firm transportation agreements) to obligate the buyer to make the capacity charge payments regardless of output. He remarked that the agreements were scrutinized by the credit agencies. He expressed his concern about the issue. He believed that some of the 20 to 30-year contracts for the purchase of gas, particularly in the Asian market, were starting to decline. He detailed that buyers were purchasing out of spot market prices and negotiating out of long-term contracts. He wondered how the state would measure out on the issue. He asked how rating agencies would analyze the state's project that looked at a 30-year financing plan. However, the state did not know the price of its gas, how it would sell it, or who would purchase it. He wondered how to analyze the purchasing agreements or the credit ratings of the buyers; he believed that information was the basis of what the state was leaning on. He observed that the state was put at risk if the items were not proper or in place. He added that the state had to cover the cost even if it could not sell the gas.

Mr. Kantor responded to what the rating agencies would do and how they would examine the buyers. The rating agencies would carefully examine whatever the agreements were to repay the bonds. They would also analyze the credit nature and financial position of the purchasers. He detailed that findings and the particular nature of the contract would all be factors in the rating. The more financially secure the buyer, the less risk there would be for the state. He stated that part of the issue was that it would be a negotiation process, which would take time. He believed it was a bit too early to analyze exactly what would happen because the process was in the beginning stages. However, the consultants were focused on the issue and would

continue to examine it as the project continued to move forward.

Co-Chair Neuman asked for possible alternatives the state could face. He referenced Mr. Kantor's statement that several options could be available. He requested information on the potential implications for the state in the future. Mr. Kantor replied in the affirmative.

Co-Chair Neuman asked about the market in the future. He wondered if the Asian market was moving away from long-term [gas] contracts.

Mr. Shipkoff replied that based on expert opinions and the consultants' own observations, for the most part LNG projects continued to be implemented and financed on the basis of long-term sales and purchase agreements; however, there was the perception that there was pressure on the model and that a greater portion of sales contracts in the future may be shorter-term. Additionally, the buyers may become more fragmented and their credit ratings may be different than the rating historically associated with LNG buyers (typically strong, large Asian utility purchasers). He reported that there was a perception that the market was moving in that direction, but the shift had not yet materialized. He relayed that the state and its partners would monitor and assess the issue as the project continued to determine the appropriate steps to manage the situation.

Co-Chair Neuman asked if the shift would increase the state's risk. Mr. Shipkoff replied in the affirmative, to the extent the state's buyers had a lower credit rating than alternative buyers with a higher rating. However, simply because the LNG market may look different in the future did not necessarily mean that the state would automatically have the worst buyers or those with the lowest credit rating. He explained that it was a matter of carefully managing the marketing strategy, which was something the state and its partners would focus on in the years to come.

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Vice-Chair Saddler understood that SB 138 established a clear process towards the sanctioning of an AKLNG project. He believed credit rating agencies had considered that the state had the process in place. He continued that the

process he had expected to see towards a firm transportation services agreement in the past 1.5 years. He asked if the failure to pursue the process and hit benchmarks had any implications for the state's credit rating and project financing. He wondered if the project appeared less reliable at present and would convert into a higher demand for a higher return on investment and higher financing interest rates.

Mr. Kantor stated that the rating agencies were concerned with many prospects, which included the state's overall financial health. He affirmed that there were some challenges the rating agencies had recognized in terms of what was going forward and how the state would handle its finances. To the extent that AKLNG had been offered as a possible solution to the finances, he believed the rating agencies recognized that the increase in revenue from the project was in the distant future. There was not an immediate impact on the state's current financial situation. He believed the state was frustrated with the progress that had been made; however, slower progress meant a slower outlay of cash. One of the issues raised in the presentation was that the state had been able to finance the expenditure of funds through existing funds of the state. He detailed that as the CBR became depleted (and the state may have other uses for the CBR outside of the project) the issue would have to be monitored. He relayed that rating agencies would really become involved when the state went to the bond market.

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Co-Chair Neuman asked members to phrase their questions clearly.

Representative Gara commented that many of the committee members had been through years of pipeline discussions. He discussed that the state would be a shipper of gas and would ship through TransCanada's portion of the pipeline if the company remained a part of the project. He addressed that a shipper promised to send a certain amount of gas through the pipe and if they sent less gas they still had to pay for the portion of the pipe they were supposed to send the gas through. He provided an example. He asked if the issue remained a risk to the state.

Mr. Shipkoff replied that the commercial arrangements in the AKLNG project and the nature of the relationship between a participant's share of the gas and capacity of the project would be addressed by the Black and Veatch and DNR presentations. The concept of alignment in the AKLNG project was such that the share of the gas the participant had was supposed to be reflected into the share of the capacity. In a scenario without TransCanada's involvement, the state would own its share of capacity throughout all of the project components; therefore, there would be no one to pay the tariff to. In a scenario with TransCanada involvement, the state would be committed to paying a tariff to TransCanada to move the state's gas through the midstream components (i.e. the transmission lines from the fields, the gas treatment plant on the North Slope, and the main pipeline from the North Slope). He relayed that the state's obligation to pay the tariff to TransCanada was fixed (regardless of price, throughput, and generated revenue). Consequently, the consultants equated the obligation as a debt commitment because the fixed payment would have to be made no matter what, which was the reason they had concluded that the state's credit would not be affected solely by whether TransCanada was involved or not. He reiterated his earlier testimony that if the state financed directly on its own credit it would carry a debt service obligation, while under the current agreement the state would be committed to paying the fixed payment no matter what.

[2:41:32 PM](#)

Representative Gara asked for verification the current partnership with TransCanada would include the risk that the state would have to pay for gas that was not available, whereas, the state's risk would be lower if the state moved forward without TransCanada.

Mr. Shipkoff responded that if the state directly financed its share of the midstream with debt, it would incur a debt service obligation that would be similar to the one under the TransCanada arrangement. The question became about which one of the options carried a higher payment obligation. Based on the analysis performed by First Southwest, the level of obligation for the state would be lower if the state financed its debt directly, given the estimated borrowing costs of the state; therefore, the risk to the state would be lower. He elaborated that in the

event of lower revenues (from which the costs to the state had to be paid) if the costs were less the risk to the state of being in a net negative position was lower. The Black and Veatch presentation would address that the state was potentially exposed to a greater risk that the costs to the state would exceed the revenues received from the sale of the state's gas. He furthered that if the analysis concluded that the potential cost to the state of maintaining the agreement with TransCanada was greater than the cost to the state if it was to directly finance its share (which was the conclusion by the consultants), the risk to the state would be greater from an economic perspective.

Co-Chair Neuman addressed potential risk to the state's bond ratings. He referenced the consultants' testimony that the buyout with TransCanada put the state at more risk. He wondered if the risk was sufficient to change the credit agencies' assessment of Alaska.

Mr. Kantor clarified that the consultants did not believe the buyout of TransCanada would affect the state's credit rating. He addressed that the pipeline was a large undertaking. Additionally, the project was in the preliminary stages of putting together the transaction - the project would take many years. He relayed that it would be the focus of the working group to examine what the risks to the state would be over time and how to mitigate the risk going forward. He explained that it was very difficult to predict what the state's risk on the pipeline would be because many agreements with shippers, producers, and various equity partners had to be negotiated.

[2:45:16 PM](#)

Co-Chair Neuman asked what the credit rating agencies used to evaluate the state's rating (e.g. the state's assets). He recently had heard the governor report that the governor had \$100 billion in total assets (including the Permanent Fund, Power Cost Equalization Fund, and others). He noted that all of the funds would not be available should the state be unable to make the payments. He relayed that the committee had heard in past finance meetings that the courts would find that the state would pay its debt with the Permanent Fund or other sources. He furthered that the credit agencies looked at the value of the state's assets and its ability to make payments. He remarked that the

previous year the state's debt service was approximately \$228 million. He wondered if the rating agencies cared about the state's politics if it had \$70 billion in assets to cover its debt and only \$228 million in debt service. He wondered why the agencies would care about the state's politics and whether it went forward with the gas pipeline or if their concern was strictly financial.

Mr. Kantor replied that it was difficult to boil down the rating agencies' analysis of the state into a finite box. First, each rating agency valued different characteristics differently. Broadly, the rating agencies looked at two factors: 1) the ability to pay; 2) the willingness to pay. He relayed that there had been circumstances where people with money had decided not to pay, which resulted in a poor credit rating. He furthered that there were a variety of factors that went into the financial analysis of the ability to pay, but there were also a number of factors that went into the willingness to pay in terms of analysis of past commitments, future commitments, and the willingness of the government to acknowledge the commitments and provide for them in the future.

Co-Chair Neuman surmised that it was about the money.

Mr. Kantor replied that it was not only about the money. He reiterated that it was an entity's ability to pay. He remarked on the state's excellent record on its ability and willingness to pay, which had resulted in its AAA rating.

[2:48:30 PM](#)

Co-Chair Neuman spoke to discussions on the use of the Permanent Fund to fund state government. He noted that legislators had heard that if it did not use the funds it could have an impact on the state's credit rating. He wondered if rating agencies looked at the state's ability to pay its debt.

Mr. Kantor responded with an example. He explained that when the federal government had budget deficits and a government shutdown, Standard and Poor's had lowered the government's rating from AAA to A+, not because the federal government lacked the ability to pay, but because the agency questioned its willingness to pay. He furthered that when the government did not have the willingness to come to

a political solution to fund the government it had caused a credit rating drop.

Co-Chair Neuman referred back to Mr. Kantor's testimony that the State of Alaska had a very good record of paying its bills. Mr. Kantor agreed.

Representative Wilson believed the consultants had stated that TransCanada could pull out of the project at any time. She asked for verification that the state would be obligated to pay TransCanada for its participation in the project up to its departure date if the company chose to exit the agreement.

Mr. Shipkoff stated that Ms. Rutherford could address more detailed questions related to the agreement with TransCanada from a non-financial perspective. From a purely financial perspective, there was a specified period of time during which the state would be required to make the payments upon the triggering of the reimbursement obligation; during the period of time the applicable interest rate was 7.1 percent (beyond the time period the interest rate increased by several percentage points).

Representative Wilson asked what would happen if TransCanada exited the project and the state had to borrow money to pay the company. She surmised that it would be much more difficult because it would raise questions about why the state did not have the money and other.

Mr. Shipkoff answered in the affirmative. He elaborated that the presentation included the possibility as a significant potential risk to the state as a result of keeping TransCanada in the project. He furthered that if the state had to reimburse TransCanada because the project was not advancing for any reason at a late stage in the process, everyone in the lending community would know there was a problem with the project. Therefore, it would be well known that the state would not be expected to receive the revenues that would have come from the project any time soon. He confirmed that the state would be forced potentially to borrow funds in adverse credit conditions where lenders would know the state would not have a project and its subsequent revenue. He agreed that it was a risk. The consultants believed it was beneficial to the state to fund the midstream costs directly before a potential problem was known; if the state borrowed to fund the

midstream costs it would be doing so in a time where the project was still advancing and had an expectation of success. He stressed that if the state funded indirectly through TransCanada, it could not escape the obligation to pay the costs in the event of a project failure. He emphasized that the state would not want to have to repay the costs if failure was a known fact.

[2:53:17 PM](#)

Vice-Chair Saddler stated that the governor may or may not make the policy decision to terminate TransCanada; if and when the decision was made the legislature would be on the hook to pay for the buyout. He remarked that the governor had proposed going to Asian buyers as equity owners. He wondered about the implications for the project finances if the state turned to buyers who had the ability to look at both sides of the ledger sheet (as equity owners and customers).

Mr. Kantor replied that part of the issue would be the nature of the agreement. One of the important factors was the nature of the funding and the credit behind the buyer entering into the equity agreement, in addition to the distribution of risk under the contract. He noted that it could run the spectrum depending on the financial arrangements and a number of different factors. The presentation examined all of the possible sources; a more in depth analysis of the positives of the arrangement and risks assumed by the state would be provided by the consultants as the project neared. He believed it would be pure conjecture to comment on the arrangements at present because so much of the project needed to be fully developed and structured over time.

Vice-Chair Saddler asked for verification that in large LNG projects customers frequently took some equity. Mr. Shipkoff agreed that it was customary to see LNG buyers take equity positions in LNG projects.

[2:55:38 PM](#)

Representative Gara remarked that he had hoped that the special session went as smoothly as possible. He asked if the presenters would be available to respond by phone or in person if the Legislative Budget and Audit staff disagreed with items in their analysis. Mr. Kantor answered in the

affirmative. He relayed that the consultants were under contract with DOR and were available to return if needed.

Co-Chair Neuman thanked the presenters. He asked committee members to provide written questions.

Co-Chair Thompson asked that questions be given to Co-Chair Neuman. He encouraged other legislators to submit their questions as well.

HB 3001 was HEARD and HELD in committee for further consideration.

Co-Chair Thompson reviewed the agenda for the following day.

Co-Chair Neuman thanked committee members for their time and dedication.

#

ADJOURNMENT

[2:58:10 PM](#)

The meeting was adjourned at 2:58 p.m.