

HOUSE FINANCE COMMITTEE
THIRD SPECIAL SESSION
October 29, 2015
1:36 p.m.

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CALL TO ORDER

Co-Chair Neuman called the House Finance Committee meeting to order at 1:36 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 Lance Pruitt
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Janak Mayer, Chairman and Chief Technologist, enalytica;
Nikos Tsafos, President and Chief Analyst, enalytica;
Representative Paul Seaton; Representative Lora Reinbold;
Representative Liz Vazquez; Representative Andy Josephson;
Representative Benjamin Nageak; Representative Shelley
Hughes; Representative Geran Tarr; Representative Matt
Claman.

SUMMARY

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

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

ENALYTICA PRESENTATION: INITIAL ANALYSIS OF THE TRANSCANADA BUYOUT PROPOSAL

Co-Chair Neuman reviewed the agenda for the day.

#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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^ENALYTICA PRESENTATION: INITIAL ANALYSIS OF THE TRANSCANADA BUYOUT PROPOSAL

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JANAK MAYER, CHAIRMAN AND CHIEF TECHNOLOGIST, ENALYTICA, introduced himself and relayed that it was his fourth year advising the legislature on oil and gas economics and fiscal issues. Additionally, he had advised on questions related to natural gas commercialization and the project to commercialize North Slope reserves.

NIKOS TSAFOS, PRESIDENT AND CHIEF ANALYST, ENALYTICA, introduced himself. His background was in natural gas commercialization strategy and project development; it was his third year advising the legislature on topics related to North Slope natural gas.

Mr. Mayer introduced the PowerPoint Presentation: "TransCanada's Participation in AK LNG: Key Issues" dated October 29 [2015] (copy on file). He reported that he and Mr. Tsafos had been present for all House and Senate committee meetings during the current special session. He relayed that at the beginning of the special session they had circulated an extensive report providing enalytica's take on the key issues. He expressed intent to summarize their view of things in their role of providing due diligence.

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Mr. Mayer slide 2: "Back To 2014: View From 2014: Why TransCanada?" He noted that in 2014, session had largely been devoted to debate on SB 138 [legislation passed in 2014 related to a gas pipeline, AGDC, and oil and gas production tax], including the Heads of Agreement (HOA) and the Memorandum of Understanding (MOU). He addressed that TransCanada's participation in the project was perhaps the most contentious aspect of the proposal throughout that time. He discussed that there had been an impassioned and at times compelling argument by the former administration [Parnell Administration] in support of TransCanada's participation. Additionally, there had been a degree of scrutiny and skepticism from the legislature about the idea. He intended to think about the situation and skepticism from the past to frame the current status and arguments put to the committee.

Mr. Mayer noted that in 2014 the Parnell Administration had argued for TransCanada's involvement in the project based on various strong points. he cited TransCanada's experience as a large, highly capable and experienced pipeline company, particularly on northern pipelines and Alaskan natural gas pipeline projects (especially through the Alaska Gasline Inducement Act (AGIA) process). Additionally, there had been a significant emphasis on questions of continuity and momentum. He elaborated that TransCanada had conducted work during the AGIA process and it had a significant amount of intellectual property data as a result. During the transition period, TransCanada and the other parties worked well together and there was a desire to ensure the transition of the work product over to the new AKLNG team in a seamless way and to dissolve the AGIA partnership cooperatively.

Mr. Mayer addressed governance on slide 2. He relayed that the Parnell Administration had put forward a strong argument that it had appreciated the participation of a company that made money by moving gas rather than commercializing particular reserves. The thought had been that TransCanada would help the state negotiate terms to make the pipeline infrastructure as expandable as possible and that the state's interest was not necessarily just monetizing the existing resources at Prudhoe Bay and Point Thomson. The former administration had also believed that TransCanada would be a commercially minded partner when

there was potential new gas to bring into the project in a post construction and operation. Additionally, it had argued that TransCanada's experience would potentially make a successful project more likely. Finally, the former administration had argued that TransCanada would relieve the state from cash calls during the development phase, which was the assertion enalytica had been the most skeptical of. The idea had been that TransCanada's involvement would help with the state's overall debt capacity. He believed there had been significant recognition that compared to potential cost of capital to the state through debt that the agreement with TransCanada could be expensive.

Mr. Mayer believed the legislature rightly had skepticism about particular points raised by the former administration in 2014. There had been a question about whether TransCanada tariff costs would be competitive to market norms and how it would compare to the state's cost of debt. In response to the concern the legislature had included a provision in SB 138 that an extensive report would be conducted on the various financing options for the state. He believed in terms of risk and reward there had been concern that the arrangement with TransCanada may be slightly one-sided. In particular that TransCanada had earned an equity rate of return on its participation in the project, but almost all of the equity risk remained with the state. For example, if there had been an increase in the capital requirement of the project it would pass on to the state through the TransCanada tariff. Additionally, if TransCanada was not able to arrange financing for the project, it could walk away at any point and be reimbursed with interest. TransCanada's risk profile looked more like the risk profile of debt rather than the risk profile of equity. He furthered that by fronting the capital to the state, TransCanada also received the voting rights within the project partnership. There would be certain crucial items over which the state would have the right of veto including things like approval of the work plan and budget. Ultimately TransCanada would be free to make its own vote in its own interests which may align with the state and may not.

Mr. Mayer addressed the final point on slide 2 related to back-in rights. He discussed that the MOU and original deal contained numerous off-ramps. He noted that many legislators had observed that some of the off-ramps

appeared to lead straight back to an on-ramp. He elaborated that the state could terminate [the agreement with TransCanada] for numerous reasons at various times, but the MOU included a clause specifying that if the state proceeded with the project or a substantially similar project within 5 years of termination, the state had to offer TransCanada the right to participate. Due to the areas of concern, the state wanted to ensure there was at least one solid off-ramp. He explained that TransCanada had clarified that the back-in-right would be put into an eventual Firm Transportation Services Agreement (FTSA), but not into the Precedent Agreement (PA) that would govern the relationship with TransCanada until the end of 2015. He furthered that the end of 2015 was the key point in the contractual relationship with TransCanada where there was one clean off-ramp; it was the one time the state could opt to sever the relationship without incurring an ongoing commitment.

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Mr. Tsafos turned to slide 3. He relayed that the consultants planned to walk the committee through their process in approaching the question [related to the partnership with TransCanada]. The consultants had worked to develop a report on their assessment of Governor Walker's proposal and saw their role as conducting due diligence on behalf of the legislature. He relayed that they had worked with Black and Veatch [financial consultant to the state] to understand its model and assumptions. He relayed that enalytica was very comfortable with the Black and Veatch numbers. He noted that enalytica did not try to replicate the numbers given time constraints. He relayed that enalytica had a number of conversations and an in person meeting with the Black and Veatch team to discuss its numbers.

Mr. Tsafos relayed that enalytica had the opportunity to have some good discussions with the state's financial advisors Greengate LLC and FirstSouthwest to understand their perspective on the financial options available to the state including understanding some of the assumptions around the state's cost of debt going forward. Additionally, enalytica had spoken with the Department of Natural Resources (DNR) to understand its perspective. He noted that he and Mr. Mayer had been present for all of the legislative hearings on the topic. He relayed that they

felt comfortable with the majority of the case put forward by the administration including the numbers and many of the statements that had been made. Slide 3 included a list of statements from various members of the administration and its consultants that analytica largely agreed with; it also included a couple of statements that analytica differed on. Mr. Tsafos read slide 3: "Summary: Where We Agree with Administration and Where Not:"

Where we agree with administration statements

- The State of Alaska (SOA) will pay TransCanada (TC) no matter what
- SOA retains risk, but TC retains most decision making (TC's only risk is deterioration of SOA credit)
- SOA credit rating will be hit regardless of whether TC is in the project or not
- SOA has several financing options—no need to panic about having higher cash calls

Mr. Tsafos elaborated that while TransCanada would retain much of the decision making, there were some exceptions in terms of voting on the work plan and budget. He stated that the termination of the agreement with TransCanada would not mean the state would have to come up with \$15 billion any time soon.

Co-Chair Neuman asked for detail on options.

Mr. Tsafos replied that there were a number of things the state could do, which he divided into three or four buckets. First, the state would take back its 25 percent share of the project if the deal with TransCanada was terminated. One way partners around the world financed their projects was to possibly sell some of that share down the road to raise immediate funds. He detailed that companies paid hundreds of millions to billions of dollars to get into a project once it was underway in the development phase. Second, the state could obtain financing from the official sector (i.e. state financial institutions and export/import banks), which had a long established role to play in developing LNG projects and were usually able to provide substantial sums of money at or below market rates. A third option was project finance, the idea that the state would raise debt at the level of the project and the debt would be guaranteed by the revenues of the project. He detailed that under the option the interest the state would

pay would be determined by the risk of the project rather than the sovereign. For example, there were places in Papua New Guinea where a lender may be more comfortable lending to Papua New Guinea LNG than lending to Papua New Guinea; therefore, a structure could be created to insulate the project from some of the sovereign level risk, which would enable the receipt of more attractive financing. Fourth, there were all of the options available to a sovereign in general (i.e. general obligation bonds, other bonds, and equity options). For example, the state had an enormous asset base that could be deployed in a number of ways in support of the project. He remarked that even though the state would go from \$7 billion to \$15 billion, it was a very early development phase and the state had numerous options. Lastly, he relayed that it was pretty unusual at the development phase to have a very detailed financial blueprint. He expounded that projects typically took care of financing during the FEED stage and may sign at FID [final investment decision] or sometimes slightly after provided the financing had been agreed upon. He reiterated that the absence of a detailed financial blueprint did not concern them at the time because it was generally premature at the current stage of development.

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Mr. Tsafos continued to address the points on slide 3:

- This is the only clean off-ramp that SOA has; failure to pass this bill means harder to sever ties with TC

Mr. Tsafos elaborated that if the state entered into an FTSA with TransCanada it would provide TransCanada with back-in rights in the event of a substantially similar project in the event of a termination. The current off-ramp was the only time the state could sever the relationship cleanly. He continued with slide 3:

- Not having Alaska Gasline Inducement Act (AGIA) makes a big difference in SOA calculations
- Non-alignment in voting and non-visibility of information undermine original case for TC in AK LNG

Mr. Tsafos expounded that the decision making the previous year had been in some ways done under the "cloud of AGIA" and the leverage of the two parties had been different because of AGIA. He discussed the final point above;

analytica believed that if they were true it would seriously undermine the original case for including TransCanada in the AKLNG project.

Mr. Tsafos remarked that it was not clear the state had a large set of compelling options and alternatives. He referred to testimony the previous day by Vincent Lee [director of major projects development, TransCanada] that TransCanada would likely vote no at the December 4 meeting if the legislation was not passed. He relayed that the presentation would focus on the financial case that had been made by the administration. He stated that he and Mr. Mayer largely agreed with the numbers, but they wanted to provide further detail on the assumptions behind the data. Secondly, analytica believed the decision should focus on strategic, not financial considerations. He relayed that they would discuss why it was not obvious at present that the absence of TransCanada would make a huge difference financially. He and Mr. Mayer intended to address the implications of terminating the agreement with TransCanada. For example, if TransCanada was not around to advance the state's interests in certain ways a new plan to advance the state's interests was needed.

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Mr. Mayer turned to slide 4 titled "Admin Case: Is the Financial Upside Truly Compelling?" The slide focused on two key statements frequently made by the administration, which analytica did not dispute, but wanted to put into context. He referred to the statements:

"The State could potentially achieve up to \$400 million incremental annual cash flows, based on the State's expected lower cost of capital."

"Under all scenarios of State credit rating downgrade down to A-A3, the State cost of debt remains below the TC cost of capital."

Mr. Mayer noted that analytica agreed with the administration that it was necessary to look at the cost of financing in a success and failure case. In a project failure scenario, he believed it was fairly unambiguous that the cost of financing to the state was significantly less without TransCanada. He remarked that in a scenario where TransCanada financed the state's share, the interest

rate the state would pay on all costs TransCanada was currently incurring would be 7.1 percent; it would be fixed at 7.1 percent until FID. He stated that the expenses could currently be met by the state from its assets and bonding capacity; the state was currently AAA rated sovereign that could raise debt very cheaply if desired. He did not believe there was any question that financing the project on its own was a cheaper option for the state.

Mr. Mayer addressed a project success case. Enalytica agreed with the administration that it was very hard to see a case in which the state could be better off strictly financially through the TransCanada deal. He believed that at best it was a wash. Enalytica also believed it was important not to oversell the strictly financial case and that some of the statements the administration had made about up to \$400 million in additional cash flows needed to be contextualized. He relayed intent to come back to the slide later in the presentation.

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Mr. Mayer moved on to slide 5 and addressed the administration's modelling that showed the state could receive up to \$360 million in additional annual cash flows without TransCanada. He relayed that the modelling did not necessarily compare apples to apples; an additional \$2 billion in upfront investment would be required by the state. The basic idea underlying the model was that the investment that was otherwise taken by TransCanada would be financed 70 percent debt/30 percent equity by the state; 30 percent of \$7 billion equaled \$2 billion. He continued that if the state assumed a 5 percent cost of debt it would receive around \$360 million in annual cash flow depending on the assumptions. He furthered that on a net present value basis it was worth slightly over zero to greater amounts depending on the discount rate. He stressed that it was important to use a commercial discount rate in weighing the time value of money. He intended to discuss how the lower annual cash flows shown on slide 5 had been determined.

Representative Gara remarked that Black and Veatch had also testified that \$2 billion should be subtracted from the amount [of additional revenue brought in without TransCanada participation].

Mr. Mayer clarified that they were not trying to contradict Black and Veatch. The intent was to reemphasize the point.

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Mr. Mayer scrolled to slide 6 titled "Cost of Debt: SOA Cost of Debt Likely Higher than Today." He addressed what it would cost the state if it were to replace TransCanada's loan entirely with debt and what rates the state could achieve through general obligation bonding. He relayed that analytica had not done any of its own analysis; they had looked at the numbers provided by FirstSouthwest, which were used on the chart on slide 6. He questioned what ratio level could be reached at a particular credit rating when considering debt service as a portion of unrestricted general funds at any given credit rating. The idea that underlay the chart's assumptions, was that the state could maintain a AAA credit rating if its debt service ratio was 5 percent or lower. At a debt service limit between 5 and 8 percent the state could maintain a AA+ rating; a 10 percent limit would mean a AA rating, and a 20 percent limit would mean an A rating. He stated that the model was not based on pessimistic assumptions; it was based on financial projection of the Revenue Sources Book from the prior spring, which assumed a return to a per barrel oil price of \$110 by 2020 and slightly increasing oil prices after that time until 2024 where there would be a flat continuation of revenues. The projection was for the state to be back to \$4 billion annual revenues by the latter part of the current decade and continuing indefinitely. He considered how much the state could raise if it had one single tranche of bond issuance. He elaborated that the state had many financing strategies, but it would not pay for the project through a single tranche of bond issuance. However, if it did finance the project in that way and had to raise \$15 billion, it would mean a credit rating reduction to A, which based on the chart would mean an interest rate of 5.34 percent.

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Mr. Mayer relayed that the interest rates shown on slide 6 also underlay the gray bars in the chart shown on the right of slide 5. He agreed that at a AAA credit rating it was good to see that the state had a much lower cost of debt than with TransCanada. However, once debt was raised with either a single issuance or general obligation bond, it was important to realize that interest rates in a success case

with TransCanada could be 5.8 percent (based on current 30-year Treasuries) compared to interest rates for general obligation bonds of 5.34 to 5.5 percent. He agreed that it was still less. He also relayed that analytica could not see a case in which it was worse than the TransCanada option for the sole reason that the financing the state received through TransCanada was effectively obtained by providing the state's full faith in credit to the market. He continued that if it did not raise capital at the required rate, TransCanada would always have the ability to leave the project anyway. He relayed that analytica did not see a financial scenario where the state was better off with TransCanada; however, there were many scenarios where the spread in the numbers was much narrower than could appear at first sight.

Mr. Mayer returned to the question of comparing like with like and what the additional annual revenues in the non-TransCanada case may look like. He pointed to the chart on the right of slide 5 and relayed that other than the \$360 million all of the other numbers were derived comparing like with like (assuming 100 percent debt). He considered how the benefit would appear with no additional investment of equity capital and how a number of different debt interest rates would look. For example, at a debt interest rate of 5.5 percent, the state would receive \$130 million in additional annual revenue [without TransCanada] rather than \$400 million. He stated that it was still a substantial amount of money and important to consider. Additionally, the analysis assumed that the TransCanada financing option would include 7.1 percent interest during construction and 6.75 percent during operation. He referred to a bar graph on the right of slide 4 and noted that the comparison was between 5.8 percent and 5.34 percent. He explained that in an environment with higher Treasury rates, the spread would remain the same but everything would move up or down. He relayed that analytica believed the upper limit of the benefit would be \$100 million to \$130 million if the state financed the project entirely through general obligation bonds. He added that there were scenarios where they could imagine the benefit would be less. He remarked that there had not been significant discussion over the past week that there had been an equity option agreement as part of the deal with TransCanada. Looking at the situation based only on financial terms, the exposure could be reduced by taking back 40 percent to cut the additional expensing by close to half.

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Mr. Mayer stressed that he and Mr. Tsafos did not disagree with the numbers that had been presented by the administration, but they believed it was important to put them in context. Enalytica believed the financial case was important, but that the decision was also strategic and strategic costs and benefits needed to be weighed against the financial case.

Mr. Tsafos discussed slide 7 titled "What's The Plan: TC Inflection point opens up broader questions":

- How can SOA best protect its interests in AK LNG?
 - No AGDC secondee in 135-strong project management team
 - Unclear decision-making / division of labor within SOA
 - AK LNG can back-fill TC exit; can AGDC step up?
- How will SOA ensure expansions / a full pipeline?
 - AGDC plan to pursue expansions is unclear
 - Need not just technical but chiefly commercial expertise
- What is the optimal capitalization structure for SOA?
 - Should SOA rely so heavily on debt (e.g. 100% debt)?
 - What are the merits of equity and what form might it take?
- What is SOA's vision for AK LNG?
 - What if partners withdraw (strengthens case for TC)
 - How much do withdrawal agreements raise risks for SOA?

Mr. Tsafos noted that the decision before the legislature was narrower than the list of questions posed on slide 7. The list was meant as "food for thought" going forward into the process. He noted that the project was still at a very early stage of development. He remarked that the

more questions that could be considered up front, the better the project outcome would be. He focused on four areas based primarily on testimony. He remarked that analytica would like to confer with AGDC, but had not yet had an opportunity to do so. He spoke to the project staffing (the project management team had 135 staff) and addressed how the different pieces were coming together (i.e. the sponsors group, management committee, steering committee, project management team) and the different organizations in charge of different things. He asked how to ensure that at the highest level the sponsors group set the broad direction for the interest of the state and that people down the chain were making decisions that reinforced the strategic vision. He believed it was an evolving process. He reiterated that the more everyone could get comfortable about where the state was headed, the better the outcome for the state would be.

Mr. Tsafos stated that one particular question was framed by TransCanada. He referred to past discussions on SB 138 and noted that one of the big attractions of having TransCanada at the table was the state's belief that TransCanada would "have its back" when it came to expansion. The state and producers were not aligned on the question of expansions; the producers had a resource base they would like to optimally develop and the state wanted to open up the basin. Therefore, the state determined that it would be helpful to have someone at the table who understood expansions and the commercial terms of putting a pipeline together.

Mr. Tsafos discussed that there had been a significant number of discussions the previous year related to the HOA and the clauses that allowed each party on its own to trigger an expansion as long as it did not adversely affect the other parties. Analytica believed the former administration saw TransCanada as helpful related to these clauses and provisions. Relative to the future, he questioned how the state would backfill the positions and expertise TransCanada had provided. He qualified that analytica had not been "in the room" for the past 18 months and did not know to what extent it had been the case from the beginning of 2014 to present. He understood that it was a bit premature to talk about how to expand the pipe that had not been built, but he asserted that how the foundation was set up made a difference. He stated that a pipe for one purpose would be built in one

way, whereas, a pipe for a different purpose would be constructed in a different way. The question was how the state would be able to do the things that TransCanada was supposed to do. He restated that he could not say whether TransCanada had or had not done those things.

Mr. Tsafos spoke to the future when the project would be in operation in 2026. The idea had been that TransCanada would be the one talking to the explorers to determine who had gas, how much they had, how far they were from the pipe, what it would cost to bring the gas to the pipe, and the tariff the owners would charge. The case was that "they'd like to have more molecules" so let them find the explorers to determine whether it would make sense. He stated that without TransCanada's involvement, someone else would have to take on the role for the state.

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Mr. Tsafos clarified that it did not mean the state needed to hire someone immediately; however, the need to begin thinking about the questions was an implication of going with the decision from a governance and project structure perspective and aligning the different parts of the state behind the goals. He noted that it may be necessary for the state to budget for more people in 2026.

Mr. Tsafos addressed that it was currently a good opportunity to begin talking more about the state's financing structure. He considered whether the state should rely on 100 percent debt. He stated that debt and leverage would expose the state to more volatility. For example, if a person put zero percent down on a home, most of their rent would go to the bank. He explained that in no way did the question change the decision on TransCanada, but it was part of the conversation that analytica believed would be helpful to have about the optimal capitalization structure for the state. For example, he questioned whether the state want to go heavy on debt or think about equity options. He detailed that if the state did want to think about equity options, it may be hard in seven years to write a \$10 billion equity check; however, if the state knew it had to write the check in the future, it may do things at present to prepare.

Mr. Tsafos addressed the final points on slide 7 and remarked that how the state made the decisions ultimately depended on where it wanted to end up. He discussed that it appeared that the state was heading down the path of terminating the agreement with TransCanada, but at the same time there was discussion about withdrawal agreements where if one or two parties decided to withdraw from the project, it would be nice to have TransCanada around because it was the kind of company that would like to invest in infrastructure. He spoke to the importance of aligning the individual detailed decisions with the broad strategic question. Enalytica believed it was important for the state to have as many conversations as possible about how to align decision making at present in order to influence where it ended up.

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Mr. Mayer stated that when thinking about the state's options, he was reminded of Representative Kawasaki's question in a previous meeting about whether the current situation with TransCanada was a messy divorce or an amicable dissolution. He stated that based on testimony it was an amicable dissolution on all sides. He remarked that "we'd like to keep it that way." He reasoned that in current times when two people want an amicable dissolution, by in large they were typically not forced to stay together. He believed the current situation was similar. He reasoned that perhaps some of the conversation was academic. He referred to the questions on slide 7 and relayed that enalytica wanted people to start thinking about the degree of capability the state required to truly defend its interests in the project going forward.

Mr. Mayer detailed that ExxonMobil and the project leadership had communicated that the project schedule would not slip if TransCanada was no longer involved. He stated that it would also be nice if the state had enough of its own employees involved in the project that it could independently reach the conclusion for itself. In particular, enalytica did not have any great concern about the project's ability to proceed in terms of optimization and development of the existing resource base (the state had three strong partners that could move

the project forward), but they wanted to ensure that the state had the capability to express differences of strategic interest. He referred to recent discussion related to a 42-inch versus a 48-inch pipeline and the merits of each. He stated that it played itself out on a detailed level in every possible discussion that occurred around the project. He addressed the minute sizing of different components of the liquefaction trains of the gas treatment plant and the future capacity for debottlenecking of trains. He continued that it was not always a foregone conclusion that the state's interest would align perfectly with the producers' interests on some of the questions. Therefore, it would be crucial that the state had people at every level of the organization deeply integrated and working on the issues to understand the technical and commercial backgrounds and how the state's strategic interests play out in terms of agreements that govern expansion terms down to the minute details of the sizing of individual components. He urged the legislature and others involved to think about the organization and what it looked like.

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Co-Chair Neuman commented that the information and conversation around slide 7 had been beneficial. He remarked that in the past Mr. Tsafos had stated that if or when a project went to FEED that it would be a very good sign because most projects that made it to the FEED stage ultimately moved forward. He wondered about Mr. Tsafos' opinion on what it meant that some of the work plan and budget for the AKLNG project would move money from FEED into pre-FEED. He stated that there had been an expansion of the time and request for funds. He wondered if the situation was typical of a project like AKLNG.

Mr. Tsafos answered that when he looked at the project with a cost range publicly quoted of \$45 billion to \$65 billion, he believed where the project ended up in the price range was the most important question that would determine the viability of the project. He stated that if the project was closer to \$65 billion it would be tough, but if it was closer to \$45 billion something could get done. He relayed that it would not be possible to get a better number until the pre-feasibility study was finished. He emphasized that it was a very serious effort by the project sponsors. He referred to the \$694 million

pre-feasibility budget and relayed that 10 years earlier there were LNG projects that had been built for \$1 billion. He believed that it spoke to how important it was for the project sponsors (including the state) to feel comfortable that the project could be economically viable. In that context, he thought of the specific question of shifting some of the FEED work to the pre-FEED stage. He stated that the project may get to FEED, which was a \$1.5 billion to \$2 billion decision. He elaborated that one did not gamble on an amount of that significance. He stressed that it was a very serious decision that required being comfortable about the technical, regulatory, and commercial aspects. He believed it was an effort by the project to bring forward some work streams and reduce the level of uncertainty and risk in order to get to the end of FEED at a much better decision point. In some ways he believed that the shifting of costs reflected the challenges facing a project, but it also provided comfort that when pre-FEED was concluded it would be much clearer where the project stood. At that point, he would take it as a very positive step if the state and its partners elected to take the project to its next stage; it would mean that everyone involved had done substantial work and the willingness to continue on to the next stage would be a significant milestone for the project.

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Co-Chair Neuman asked if the costs included in HB 3001 were in line with similar projects. He had heard comments that the costs were not low or high enough.

Mr. Tsafos replied that broadly speaking, the costs were in line. He furthered that people in the oil and gas business were paid well and if the state wanted the "A team," it meant the state would need to pay for the expertise. He relayed that it was not uncommon for individuals working in the industry in cities like Houston, Singapore, or London to hop jobs for substantial salary increases. He elaborated that experts in the oil and gas industry were paid serious amounts of money. He stated that salaries in excess of \$200,000 were not uncommon. He furthered that an LNG marketing position was a very specific type of expertise where the state would want people to have gained expertise in serious marketing organizations. He saw the AKLNG costs as "par for the

course." He hoped that Alaska was willing to pay to have the best people represent its interests in the negotiations. He stated that most sovereigns got to negotiate with one of the partners and found it tough; whereas, the state had to negotiate with three of them. He relayed the negotiation would be very complex and the state should expect to spend money to have the ability to defend its interests upfront.

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Co-Chair Neuman discussed that Mr. Tsafos had also mentioned the value to the state as it moved into FEED; that generally if a project moved to FEED it would move forward. He reasoned that it had value to the state because it there may be entities that wanted to partner with the state. He referenced slide 4 related to various scenarios of state debt and credit ratings. He spoke to the value of the high likelihood that the gasline would move forward, which would add substantial amounts of money back into the state's budget at a time when it was looking to expand its revenue base. He asked if the value had been taken into consideration in the data on slide 4.

Mr. Tsafos replied that the figures on slide 4 did not incorporate a dilution of the state's interest. He discussed that value was generated as a project was developed. He explained that in a successful project, if an entity wanted to join the project in 2017, 2018, or 2019, it would have to pay hundreds of millions or billions of dollars depending on the share they took. Usually when entities came in at that level of development they were paying the expenses incurred by the project and a discounted future cash flow of expected project earnings. He explained that under the scenario the state would be cashing out a little of the value. He detailed that instead of maintaining its 25 percent share, the state could reduce its risk slightly by bringing in another partner and potentially make a few billion dollars at the point it needed. He furthered that it was not something the state would necessarily capture; the value would be unrealized unless the state sold down. He continued that it would enlarge the options the state had to finance its share of the project, but it was not something that could be captured as part of the financial baseline. However, if in five years the state elected to decrease its ownership from 25 to 20 percent, the value

could be determined. He elaborated that the state would have a large cash inflow at that time and would have less expenditure and less revenue going forward because of the reduced ownership percentage.

Co-Chair Neuman asked if it would be advantageous to the state in terms of the state's credit rating. Mr. Tsafos believed Wall Street and all financial institutions would look at the forecasted revenue and how far along the project was, when evaluating the state's credit rating and credit health. He expounded that if the entities believed the project would be successful, in a good cost environment with good revenues, they would take it into consideration.

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Co-Chair Neuman stated that members of the legislature had concerns about future projects in Alaska and the state's ability to bond. Knowing that the option to reduce the state's ownership and bring in another partner was a value he understood. He asked if the producers had value in partnering with the state. He remarked that the state also happened to be the entity responsible for permitting and regulations.

Mr. Mayer responded that there was value to everyone involved having the state's involvement. He elaborated that it was particularly the case when looking at the entire history of the North Slope and Trans-Alaska Pipeline System (TAPS) and the long history of dispute and litigation over the asset. A big part of the reason for the current structure was to avoid building things according to one set of interests and instead to have alignment between partners from the outset and to create value for everyone involved in the same way. He believe it was particularly important because ultimately no one could do anything in sovereign jurisdiction without the full support of the sovereign; in the case of the project, the sovereign had full support and was actively involved and generating value from the project in the same way the companies were.

Co-Chair Neuman believed that HB 4 [legislation passed in 2013 related to the Alaska Gasline Development Corporation and the Regulatory Commission of Alaska] instructed state agencies (DNR and Department of

Environmental Conservation) to expedite permits received from the project. He believed it would be a value and probably considered on AKLNG.

Co-Chair Thompson thanked the presenters for their work and perspective. He was excited that three of the largest oil companies wanted make money on the project. He reasoned that if the other companies made money it meant the state would make money in its 25 percent ownership as well. He believed that by FID the state would know if the project was going to make some money. He was not concerned about the financing because he believed it would come along easily if the project reached that point. His concern was the alignment with the three producers and the state, as well as the alignment within the state itself. For example, he was concerned about not knowing who would take over for TransCanada. He did not know whether it would be DNR or AGDC and which entity had the most expertise. Additionally, there was the issue of determining the state's decision making. He asked the presenters how they saw the state moving forward. He wondered if the project would be jeopardized by indecision from the administration.

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Mr. Mayer reiterated that to truly pursue the state's interests as best as possible would be a monumental effort that would require an enormous amount of capability and alignment within the state between entities such as DOR and AGDC. He detailed that there needed to be a very clear commercially driven strategic picture of what the state's interests are and where they differed from the producers and how to secure the right high level agreements (particularly related to expansion). He continued that there would need to be an ability to take the high level considerations and commercial interests and imbed them in the governance agreements and at every level of the implementation of the project. For example, there could be key decisions made on sizing of different components of the liquefaction trains or the GTP trains and there would be a particular cost-benefit analysis if a party was trying to monetize the existing resource base, but there may be a different analysis if the concern was ensuring debottlenecking expansion capability. Alignment of the items was also important to drive down project cost and

risk; at the same time maintaining a clear commercial strategic interest for the state. He believed parties were justified in emphasizing the importance of the concepts in particular the coordination across all state entities involved in the project.

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Mr. Tsafos expounded on the conversation. He expressed his appreciation for a slide presented by AGDC that outlined the decision making of the project. The chart included the project management team headed by Steve Butt, which reported to the project steering committee, which reported to the management committee, which reported to the sponsors committee. Additionally, the chart had included bullet points outlining who was responsible for what. He believed the clarity shown in the chart was needed in order to develop a project of the magnitude of AKLNG. He stressed that the project was a massive undertaking. He remarked on communication challenges he had experienced in teams of 10 in one location. He asked the committee to think about the project that involved multiple cities, organizations, and hundreds of millions of dollars. He stressed that it was a monumental task organizationally for anyone. He stated that the project was a work in progress, "but the closer you can aspire to that, I think the better off you're going to be."

Co-Chair Neuman stated that the committee had seen an organizational chart of the State of Alaska and the project management team. He asked if the state's assurances that the project would stay on track and on budget was fortified by the existence of the professional management team that included the three major producers making decisions on what had to be done and what got spent.

Mr. Tsafos replied that he generally took comfort by the number of people and the competency of the people that the project management team consists of. For example, it was obvious that someone like Steve Butt was coming from very clear goals and objectives. He emphasized the large size of the project; 800 miles of pipe and a liquefaction facility. He stated that it would be tough for everyone due to the difficulty of the project. He believed the state should take comfort that the people trying to

"crack the code" were some of the best in the industry. Additionally, he believed each of the project players took comfort that the other players were involved because they could feed off of each other and benefit from each other's expertise. He believed it was a major asset for the project. He remarked that Mr. Butt liked to say that there was no single person with all of the required expertise for the GTP, pipe, and LNG because a similar project had not been done before.

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Co-Chair Thompson noted that SB 138 gave AGDC the authority to take over the project work that TransCanada was currently doing. He remarked that AGDC did not have employees on the 135-person project management team. He wondered if that showed a lack of expertise. He wondered if AGDC would have employees with the knowledge to get involved.

Mr. Tsafos replied that he had heard the explanation from AGDC in front of the House Finance Committee and in the Senate. He stated that there was no reason to doubt the explanation that at the time of the openings AGDC had been focused on the ASAP [Alaska Stand Alone Pipeline] gasline and had not been able to bid for the positions. He stated that he did not have knowledge of the resumes from those at AGDC and could not speak to the number of positions the agency could fill and who could fill the positions. Enalytica had heard a number of names of people with impressive resumes, but had no firsthand knowledge of their expertise. He relayed that he would take comfort if there were a few AGDC employees on the project management team after a few months. He continued that it was important to ensure that at the micro-project level there were people who could keep the information flowing at all levels to ensure the state's interest.

Mr. Mayer elaborated that the role AGDC needed to take was greater than what it had been initially assigned; it had a new level of challenge to rise to in order to effectively advance the state's interests in the project. He reasoned that if AGDC was not capable of that, there were three very strong producers that would produce a great project. However, the question would remain on how effectively the state would be represented. He remarked that a person would not expect AGDC to completely fill

the role, given that the role had not been handed to AGDC as of yet. He was hoping to sit down with AGDC to understand its thought processes more thoroughly. He explained that seeing a clear assessment of AGDC's current capabilities, the required capabilities for the new role, and how it would acquire the capabilities, would provide reassurance.

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Vice-Chair Saddler clarified for the benefit of the public that the decision facing the legislature was not to authorize construction of an LNG line, which would occur at FID. The project was still in the process of developing the information necessary to make a decision to proceed to the next stage. He had told people that in order to win the lottery it was necessary to buy a ticket. He explained that the current project was an expensive lottery and there was still no surety, but he hoped the state would win. He stated that the governor had expressed an interest to disaggregate the state's current partnership with the producers and TransCanada and to possibly substitute new equity partners if he did not get the commitments to commit gas under the withdrawal agreements he was currently negotiating. He asked how TransCanada's involvement going forward may continue to be valuable in a scenario in which the state and three producers were no longer the only equity partners or involved at all. He asked about the risks to project success without TransCanada.

Mr. Tsafos offered that he hoped the odds were better than the lottery. He first addressed the risks of success. He stated that TransCanada had clearly brought a significant number of assets, people, and expertise to the table. He had no independent way to verify the argument that the producers and the state could backfill the expertise; however, he believed it was quite possible. He believed it was possible that state could end up with the exact same costs or perhaps TransCanada could have made some contributions down the line that would have led to a lower cost or a less risky project. He stated that it was unknowable at the present time. He remarked on the assumption that if the state had very smart people working with it that a better outcome may develop; however, it was not possible to know what the

state would be giving up without TransCanada's continual engagement in the project.

Mr. Tsafos continued to address Vice-Chair Saddler's questions. He addressed the issue of withdrawal agreements. In the possibility that the state reached a point of agreement with the producers that if the producers did not want to proceed with the project, the governor wanted the state to have two different options. First, for the producers to sell their gas at the wellhead to presumably the state. Second, for the producers to toll their gas through the infrastructure that someone else would construct. In the event that one of the producers did not want to participate and the state wanted to build infrastructure that the producers tolled through, the state would probably be looking for companies like TransCanada that liked to build infrastructure and charge tariffs to get paid back for the infrastructure. He continued that if the producers were no longer interested in owning or participating in the infrastructure, the state would be searching for other parties to fill the role; large pipeline companies would be one of the obvious candidates. Under the scenario, it would make sense to either bring back TransCanada; he thought it may be too late to keep them in the project at present. He stated that it was a project structure where a third-party infrastructure owner would make sense to facilitate the project development.

Mr. Tsafos addressed the question of buyers coming into the project. The buyers tended to like to focus on the upstream or the liquefaction. He communicated that he could not speak about the market's appetite for taking a large portion of a GTP and pipe, but it was fairly unusual. He added that at the current stage it was difficult to say what that would look like and what the implications would be with or without TransCanada's involvement. Lastly, there was a possible risk to the state related to the agreements. He elaborated that at the end of the day the only circumstance under which ExxonMobil, BP, and ConocoPhillips would sell gas at the wellhead was if they determined that participating fully in the project was not economic. At that point, the state would only end up with the gas if it did not have quite as much value or it was harder to monetize. He reiterated that there were some risks to the state depending on how

the agreements were developed and what kind of rights and obligations the different parties had. He relayed that if the state had a significant amount of gas and possibly a slightly larger piece of the pie, it would likely be looking to shed some of the risk, especially because the only circumstance under which it may happen would be in a higher risk project where it was slightly more difficult for the economics to work out. He clarified that the only time the state would be in the position was if it was a difficult position; the producers would not sell the gas to the state if they thought there was tons of money to be made and would not let the state make the money itself.

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Vice-Chair Saddler wondered if there was any indication of whether "that might be the way this is being tracked, is to disaggregate the current partnership agreement." He remarked that analytica would know the signs, whereas the legislature would not.

Mr. Tsafos responded that it was not uncommon to try to come up with a different structure if a project got stuck. For example, if the state realized that one or more of the parties was not interested in the current structure, it would try to determine another structure that would work for everyone. He continued that if a partner decided that they did not want to invest \$15 billion into the project, the state could wait, help them reduce their share, or offer for them to remain in the upstream only with the risk being taken on by the state. He reiterated that it was not uncommon to tweak the project structure in order for every party to have the risk/reward relationship it desired. Specifically regarding AKLNG, he could not say definitively whether or not the project was moving towards a different path. He remarked that the state had a set of interests and there were different ways to meet those interests. He continued that the state was currently part of the group and was making cash calls, which did not indicate to him that the state was not participating in the project as currently envisioned. He reasoned that there were also occasions where there were statements made that looked like a slightly different project. He could not conclude that there was a very different project structure definitively

being pursued. He believed there was just "thinking and wavering."

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Mr. Mayer agreed with Mr. Tsafos' assessment in its entirety. He relayed that they had worked very closely with the administration to understand its numbers. He particularly appreciated some of the access analytics had been given to the state gas team under DNR. He elaborated that in speaking with the team, they had the impression there were many very smart and capable people who were making good progress down the HOA track (that framed everything in SB 138) despite difficult negotiations on contentious issues. He stated that every now and then there were comments made on a higher political level that were confusing and caused him to wonder how the statements squared [with the current path]. He elaborated that "we see these two things, we don't know how they come together, we'll see how this all plays out." He added that they had a huge amount of respect for the technical capability and commitment of the teams working to advance the project under the structure set out by the legislature.

Vice-Chair Saddler commented that part of the progress of the current hearings was to determine if there were hang-ups in the process that militate towards changing the structure. He had not seen evidence that TransCanada or the producers were holding things up. He was uncertain where the hang-ups were and why they existed.

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Representative Edgmon remarked that it seemed apparent to him that in the process it was possible to have organizational clarity and confusion with the leadership hierarchy at the same time. As a policy maker, he wanted to do everything he could to make sure that Alaska received the best value for the long-term business relationship required to make the project happen; however, he worried that if the legislature and executive branch were at odds with each other that it could have a detrimental impact (during a period of low commodity prices and thin margins) to a project that was just getting off the ground. He remarked that it was a concern that seemed to build more and more every day. He hoped

that when the special session concluded that from a policy standpoint, the legislature would positively influence the situation in order for Alaska to be unified when it exercised its 25 percent voting rights in the future. He believed it was a critical component to the overall project going forward in lieu of all of the economic analysis and the financial numbers the state would be party to. He referred to Alaska Oil and Gas Conservation Commission's (AOGCC) recent ruling about gas offtakes and the fact that there had not been uniformity amongst producers in terms of the 3.7 billion cubic feet (bcf) figure that AOGCC had ultimately arrived at. He asked the presenters to talk about the decision in relation to a commercially viable project and a 42-inch versus a 48-inch pipeline.

Mr. Tsafos replied with detail on enalytica's evolution on the topic. He addressed the 42-inch versus 48-inch pipeline. He began by discussing a graph showed by Mr. Butt to a Joint Resources Committee hearing in Palmer related to the production profile for Prudhoe Bay and Point Thomson. He detailed that the graph had depicted that there was gas in the two fields to maintain a plateau level for about 16 to 17 years and after that point the fields would begin to decline. He continued that if the desire was to keep the AKLNG project going for another 10 years (in absence of an expansion scenario), another source of gas approximately the size of Point Thomson would be needed. Before getting into the details, enalytica's understanding had been that the current design of the 42-inch pipe would have about 1 bcf per day of additional capacity if compression was added. He noted that 1 bcf per day was roughly the size of Point Thomson. Enalytica had determined that at the current design, if there were two Point Thompsons, the pipe should be able to meet the state's needs. He elaborated that one field would be needed for expansion and the second would be needed to backfill the decline in production from Prudhoe Bay and Point Thomson after year 16. He relayed that the viewpoint related to the macro-picture.

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Mr. Tsafos explained that he and Mr. Mayer had begun to appreciate that to have the 1 bcf per day of expansion, it would be necessary to add a significant amount of

compression, which would be costly and use a lot of fuel; and there would need to be very good expansion terms in the contract. Essentially, the pipe would have a little extra capacity. He provided a scenario were BP made a [new field] discovery. He questioned whether under the scenario the state could offer the 1 bcf per day on its own to a third-party or if BP could decide they wanted to expand because it was their discovery. He questioned what the rights would be to use the extra 1 bcf per day related to governance and economics (i.e. how much the state would contribute and the economic implications of the fuel use).

Mr. Mayer believed it was important to think about how the costs of expansion were borne when thinking about governance over expansion. He stated that if there was substantial cost to the addition of substantial compression (in terms of capital costs and operating costs - specifically related to fuel), the governance terms would determine if the costs were entirely borne by an expanding party or whether others would contribute. Some of the tradeoff would be largely determinative for the state in terms of the risk versus reward of a 42-inch or 48-inch pipeline.

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Mr. Tsafos believed there was a question about how much expansion was anticipated and how easy it would be. He relayed that the HOA had specified that any party could basically do whatever it wanted as long as it did not adversely impact the other parties. However, when looking at the "nitty gritty" details, he questioned whether the state would have exactly those rights, how the rights would be codified and protected, and the costs. He relayed that in that context, enalytica had no independent view of the cost/benefit analysis of a 42-inch versus 48-inch line. He stated that it was apparent from the governor's AKLNG project review that some work had happened with numbers including the payback period, and it was not just an arbitrary reason for specifying the administration's preference for a 48-inch line. He believed it was very positive that the project had decided to put on the extra cost. He remarked that the previous administration [Parnell Administration] had also felt strongly about the concept in terms of examining the case for a 48-inch pipe. He opined that everyone would

have to wait to see what the commercial pros and cons would be. He did not have an answer on that topic and noted that the project would save \$30 million in pre-FEED costs if the answer was known at present.

Mr. Tsafos continued responding to Representative Edgmon's questions, specifically related to the Prudhoe Bay decision and the different parties. He addressed the supply for the gas and relayed that one party (ExxonMobil) had a much larger chunk of Point Thomson; whereas ConocoPhillips had a much smaller exposure relative to its ownership in Prudhoe Bay. He furthered that it was a significant question related to how to balance the items, how much flexibility the state wanted to offer to Prudhoe Bay, and whether the state wanted the field to have the ability to "go to 4.1 or 3.6." He believed there was an effort to make two streams of gas balanced over time in a way that everyone was happy with. He viewed the topic as part of the negotiations to make sure the project came up with a stream of gas that both parties felt comfortable about the two fields coming together. He continued that different parties saw the contribution of the two fields and the flexibility that should come from each field differently due to their differing ownership positions in the assets. He did not know that it presented a significant risk for the project; it was just something that would come naturally as part of the negotiation process. He recalled that the AOGCC ruling determined that there would not be a huge difference in terms of the ultimate resource recovery in either of the two production scenarios. He did not see the ruling as having a huge impact on the amount of gas produced; the issue was more about the timing and the costs.

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Representative Wilson remarked on being asked to fill a position for \$800,000 and wondered if the state should be looking at the qualifications of everyone who would be on the project in AGDC, DOR, DNR, and DOL. She wondered why the focus should be only on the one position.

Mr. Tsafos answered that it made a lot of sense to look at all of the individuals the state team was putting forward from AGDC, the departments, and everyone involved in the process in order to make sure the state had the

best people possible. He stated that based on salaries made by former clients he did not think the \$800,000 salary was an outrageous ceiling. He believed it was probably a fair salary. He referenced testimony by the DNR commissioner that the position would not receive stock options or bonuses; it was necessary to use a higher base salary in order to attract individuals [with expertise] to the positions in Alaska. He did not know whether the individual that would ultimately be hired for the position was worth the particular amount of money, but "to play at this level" it was the type of salary the state may be expected to offer. He did not believe the focus should be solely on that position. He thought it was important to look across the board at the team and to ensure that the state had the best people for the job. He believed the principle provided by the project management team that "the best people play" was a good principle for the state as well.

Representative Wilson referred to testimony by the presenters and wanted to ensure that the state was not telling private industry that it should expect more issues when they were seeking permits than if they became partners with the state. She did not think the presenters meant that permitting would be easier because the state was a partner compared to a private entity wanting to go through the process.

Mr. Mayer clarified that he and Mr. Tsafos had not made any statements about permitting. He discussed that the state had certain interests and there were certain things that having a sovereign involved could make happen more easily. One of the challenges of the project was the importance of differentiating between the sovereign's role as dispassionate regulator and its role as resource owner with a commercial interest. He furthered that things had been put into place in the organizational structure to try to make the division clear, which was part of the division between AGDC and DNR and even more so with regulatory agencies like AOGCC. He detailed that it was important in any arrangement like the one at hand for the regulatory functions of the state to be kept separate from the commercial interests of the state.

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Representative Wilson commented that she did not want to send the wrong message and hoped the state's permitting was "right on and quick" no matter who the applicant is. She asked how advantageous it would have been for the administration to bring the current issue before the legislature versus back in May when "we've heard kind of everything started going south." She remarked that the legislature had been in special session in May and June. She wondered about the advantages to addressing the issues currently versus in May. She remarked that the state was currently up against a timeline, but would not have been in May. She asked if the presenters would have elected to address the issue earlier if they were in the situation.

Mr. Mayer responded that it took time to do the analysis. He detailed that a new administration had come in at the end of 2014 and had faced a legislative session and working to understand the enormous complexities of the AKLNG project. Under the scenario someone new to the issues may come in questioning some aspects and not others and may try to get more detail. Additionally, in any new administration there were early struggles of determining who was doing what, the appropriate structure, and the interests that are represented. He explained that it took time to figure those things out. He continued that from an analytical and dispassionate perspective it took time to staff up, to hire consultants and internal resources, and to think about available options. He stated that the current time was always the critical point under the agreements when a decision would be required on signing the Firm Transportation Services Agreement (FTSA) or not; in that sense, the current timing was logical. He stated that it would be nice if numerous agreements could be addressed presently, but it was completely understandable that they took time and had intractable issues involved.

Representative Wilson believed the question should be directed to Ms. Pitney. She stated that it was her understanding that a decision had been made and there had been a state of transition ever since. She opined that it would have been nicer to address the issues before the budget had been closed out; the money would have been allocated at that point versus at present.

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Representative Kawasaki thanked the presenters for their work over the past several years. He discussed that there were many unanswered questions that had arisen over SB 138, many of which were included in the presenter's documents. He appreciated the consistency in their information and believed the questions should be answered by the appropriate agencies. He believed dealing with the "new money" would be something of an issue for the committees to discuss. He addressed changes in the [project] work plan that cost more money so that some of FEED would go into pre-FEED. He remarked on the presenters' earlier testimony that generally the concept was looked favorably on as a risk reducer.

Mr. Tsafos responded that his interpretation was that the state saw risks and wanted to bring the work forward to make sure it grappled with the risks. He did not see it as favorable that the state needed to do more work because it meant there were more issues to deal with; however, it would give comfort that if the project moved to the FEED stage it would be easier to make a better decision because the issues had been brought forward and the state would be more comfortable with its ability to manage the risks it had foreseen.

Representative Kawasaki referred to the question related to expansions on slide 7. The committee had discussed a lot about expansions and having a third-party pipeline company versus a producer-owned pipeline company and the fact that if a third party wanted to expand it would be a great benefit for the state, which he agreed with. He wondered under what conditions the state/AGDC did not want to pursue expansions. He could not think of a time where that would be the case.

Mr. Mayer responded that there was not a specific scenario he and Mr. Tsafos had in mind. The bullet point had been included in response to questions from both legislative finance committees about what future expansions would look like, how they would be managed, and if AGDC would have the capacity. He relayed that they had not had an opportunity to discuss the issue with AGDC, but would like to do so. At the time, they had been concerned to hear a response that the project would look a lot like TAPS (i.e. there would be a project company

and all of "that" would be the function and responsibility of the project company). He relayed that enalytica had been very clear in the discussion the previous year that the intention around negotiating the HOA was the idea of a project within a project and pipe within a pipe and that any party could do things in its interests independent of the others. He continued that the issue had been particularly clear in the expansion principles under the HOA, which stated that any party wanting to expand could do so provided that it did not negatively impact the other parties. However, taking the approach meant that an entity could not rely on everyone agreeing on the concept together or guarantee unanimity at the voting committee. He discussed a scenario where there was an entity that wanted to pursue expansion aggressively and had all of the technical and commercial capability required to make the case to determine the new resource base, tariff, and the level of resources required to make expansion economic. He continued that the entity would be responsible for determining how to build the commercial case bearing in mind that the other partners would not necessarily want to do the expansion. He wanted to ensure that the tension was clear and that moving forward everyone involved on the state's level was thinking in those terms.

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Representative Kawasaki asked if it would be more effective for the state to pursue expansion without TransCanada. He surmised that with a third-party in that particular case, there may be disagreements between TransCanada and the state. He believed the HOA spelled out the ways in which an expansion would happen if the state wanted it but TransCanada did not.

Mr. Mayer stated that in many ways he agreed with Representative Kawasaki. He elaborated that they looked over the past two years and saw them as a chance to test some of the assumptions: whether the state had a partner that it was perfectly aligned with on all of the issues by bringing in an independent company or if the entities would sometimes disagree and have to negotiate against each other and whether it was positive or not. He stated that many of the details surrounding the issue were confidential and would never be known. However, looking forward it was obvious the state did need to have the

capability. He remarked that they would never know whether the capability existed under the previous arrangement, but it took a lot to have the capability. He stated that it was important to think about the capability currently. He reasoned that the fact that everyone could agree the state wanted the capability did not make it so; it was necessary to plan at present in order to ensure that it was secured.

Representative Gara believed that in the past one of the problems with TransCanada owning 25 percent of things the state did not own (i.e. the pipeline or GTP), there would be areas where the state had no access to information, which presented some problem. He requested an example of an area where it would be a problem for the state.

Mr. Tsafos responded that he and Mr. Mayer could not speak on specifics because they were not on the project team. He could see that with layers of confidentiality that as the project sponsor it the state would like to know that "nitty gritty" decisions were being made with expansion in mind and to gain access to some of the technical information. He could see how that flow back to AGDC or the departments may not be seamless. He relayed that he had worked in enough organizations where non-confidential information was hard to come by; it was not hard for him to imagine that once three or four layers of confidentiality were added it would get harder and harder to access the information and in a timely way prior to decision points or votes.

Mr. Mayer added that Marty Rutherford (deputy commissioner, Department of Natural Resources) and Deepa Poduval (principal consultant, Black and Veatch) had provided an example when they had presented to the committee recently. The example had been related to existing arrangements with TransCanada related to byproduct disposal. He continued that a significant portion of the function of the GTP was the removal of carbon dioxide and its eventual disposal. How the economics of the removal and disposal worked was a complex issue that allowed all sorts of costs to be allocated in all sorts of places. He stated that it was easy to see from the state's perspective that there were particular interests in seeing the issue handled in particular ways and that if there was not visibility into how the issue was being handled it has neither

transparency and visibility nor direct control over voting, which would create some issues.

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Representative Gara believed everyone agreed that it would cost the state more if TransCanada remained in the project (as opposed to the state buying TransCanada's portion) and the project eventually did not move forward. He asked for verification that the lower the state's financing costs compared to TransCanada, the greater the state's revenue would be over the long-term if TransCanada's portion was bought out.

Mr. Mayer concurred.

Representative Gara referred to financial consultant FirstSouthwest's statement on page 36 of the Black and Veatch report that state financing would result in a materially lower interest cost to the state than under the TransCanada agreement. He asked if the presenters disagreed with the statement.

Mr. Mayer responded that they did not disagree with the statement "as it stands," but they wanted to put some of the numbers in context. They believed that from a precautionary perspective it was important to think about that the numbers on the higher end of the spectrum were some of the things that were presented rather than the lower.

Mr. Tsafos added that it depended on what was meant by the word "material." He elaborated that if "materially" was interpreted as 2 or 3 percentage point delta he thought that was hard to see. He believed the spread he and Mr. Mayer had talked about was much more reasonable at the higher end or lower end of the credit rating.

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Representative Gara referred to slide 5. He stated that Ms. Poduval had testified that the 5.5 percent financing rate could increase the state's revenue by an additional \$130 million per year. He stated that 5.5 percent was about where the state would be if it was at the state's historically worst credit rating. He asked if the presenters recalled the testimony.

Mr. Tsafos answered in the affirmative.

Representative Gara reasoned that no one knew which of the bars on slide 5 represented the right number. He continued that with current market conditions and the worst financing level the state had ever been, Ms. Poduval had testified that the state would bring in \$130 million extra per year. He asked for verification that the annual additional revenue could be higher or lower if the state got its fiscal house in order hopefully before 2017, that any of the scenarios [on slide 5] were reasonable assumptions, and more would be known as time passed.

Mr. Tsafos commented that he realized the irony of having a Greek tell the committee about state finances. He remarked that Greece's credit rating had never been as bad until it was. He stated that "these are unknown things." He referenced the 5.5 percent figure and pointed to a chart from FirstSouthwest on slide 6. He detailed that if the state were to issue everything overnight (which it would not) and if it had "this kind of downgrade" the interest rate would be close to 5.5 percent. He referred back to slide 5 and stated that the \$130 million in additional revenue brought in with an interest rate of 5.5 percent was compared to the baseline tariff from TransCanada and was not adjusted for the equity tracker. He explained that it compared 5.5 percent, which represented current conditions, against 6.8 percent, which were the conditions of December 2013. He furthered that under current conditions the tariff from TransCanada was more like 5.8 percent in the operational phase. The comparison was really between 5.5 percent and 5.8 or 6 percent; therefore, the delta was much smaller. He explained that it was a little messy because of the need to compare time and interest rates. He furthered that the delta was really between 5.3 and 5.8 (a 50 basis point delta) and detailed that at a 50 basis point delta the revenue was closer to \$60 million [slide 5]. He was not trying to characterize the issue as good or bad, but to contextualize it.

Mr. Mayer clarified that over the past several days there had been a presentation by the state finance team (Lazard, FirstSouthwest, and Greengate) related to historical credit ratings with A- as the worst the state

had experienced. Additionally, there had been a presentation by Black and Veatch, which had presented the analysis on slide 5. He believed Black and Veatch had been clear to defer any questions the committee had about specific interest rates to the state finance team. He noted that Black and Veatch was solely presenting the numbers as a range of outcomes.

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Representative Gara asked if it was fair to say that the chart on slide 5 represented a range of reasonable potential outcomes and what would actually occur was not yet known. Mr. Mayer believed it was a reasonable statement. Particularly given that the beginning premise was that there was no circumstance under which the state is worse off without TransCanada from a financial perspective; the additional revenue was a random variable that would go from zero to some positive number.

Representative Gara commented that there had been some focus on the \$130 million range [slide 5], which was the reason he wanted to make analytica's view on the issue clear.

Representative Gattis returned to the well-paid \$840,000 per year position. She asked if there was a need to hire the (gas marketer) position currently. Alternatively, she wondered if the state could hire the position at the start of session [January 2016] or after December 4 [2015] when the state would know whether it had gas to market.

Mr. Tsafos answered that he struggled with the question because he did not know the material difference between approving the funds for the position at present or in a few months. He relayed that the state did need a gas marketer at present in the sense that the decision to take royalty in kind (RIK) was premised on the state being comfortable that it would know what to do with the gas once the state had it. He believed that to gain that comfort, the state would need people who had expertise to assess the risks to the state of taking possession of the gas. The preceding year there had been a big emphasis on the state possibly negotiating joint venture agreements with individual partners in the project to market the gas jointly and having the partners make offers to the state

to market their gas. All of the things were eventualities that are factoring in the decision to take the gas in kind; therefore, he did believe it was important to have a gas marketer at present. He reiterated he did not know exactly where the negotiations were and therefore could not speak to the difference of appropriating the money at present versus in a few months. However, based on experience, it took time between the appropriation of the money and when the person started working. For example, if the money was appropriated under the normal legislative budget in April [2016], the search to fill the position would begin in May, and then it would be summer when perhaps no one would want to come for interviews. The items were the types of things he recommended thinking about (i.e. would the state inadvertently delay the date the person would actually join the gas team and help with negotiations).

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Vice-Chair Saddler referenced the financials on slide 5 and clarified that it was not accurate to say that there was up to \$360 million in additional revenue for the state without TransCanada's involvement. He noted that the top of the slide indicated that it was a wash. He continued that given the consideration of the net present value (NPV), the state would buy the \$360 million in additional cash flow later by the upfront investment of \$2 billion.

Mr. Mayer responded that in NPV terms, the number was not large. At a 10 percent discount rate Black and Veatch showed the NPV at zero, but in its report he believed the figure was about \$30 million (the difference was due to rounding). He reasoned that it was possible to have many arguments related to the appropriate discount rate to use. He believed the it was useful in showing that there was not some overwhelming piece of value the state would miss out on if it continued in partnership with TransCanada. He opined that it was useful to compare apples to apples and he appreciated that Black and Veatch hand included the chart to enable the comparison. For example, if the state fully funded the replacement of TransCanada through debt, the state would not receive the \$360 million, but was somewhere on the continuum [slide 5]. At 5.5 percent financing the state would receive \$130 million [per year], bearing in mind that it reflected a

larger spread than the current reality. He continued that where the state would fall on the spectrum [of additional revenue] was not known. There was some value between zero and a positive amount in the \$100 million range. He relayed that he and Mr. Tsafos were happiest with the right side of the chart [lower additional revenue to the state] in terms of what the benefit may be, bearing in mind that there could be other financing strategies the state was considering that would move the additional revenues further to the left [on the chart]. There was likely some positive benefit in annual cash flows that would come from the state financing its portion of the project on its own. He relayed that in analytica's viewpoint the benefit by itself (absent strategic considerations) was not dispositive.

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Vice-Chair Saddler appreciated the clarification. He turned to slide 3 that included a reference to the non-visibility of information. Additionally, slide 7 referred to unclear decision making and division of labor in the state. He wondered if it was usual or unusual to have unclear decision making and a lack of visibility. He wondered if the confusion had any consequences to the likelihood of success for the project.

Mr. Tsafos responded that in general, confusion did not help the advancement of a project. For example, how people interacted when it was unclear who was in charge. He could not speak to the extent of that in the current project because they were not in the organization. He addressed whether it was typical for this kind of megaproject and reasoned that it was unlikely to be typical of successful megaprojects. He explained that it was hard "to stumble your way into a \$55 billion project"; an entity needed to have its act together to "play at this level." He clarified that he was not speaking about the specific circumstances of the state. In general, when an organization had decision making and informational barriers it always got in the way of getting things done; it was true for any endeavor and was particularly true when trying to do one of the hardest and most complicated infrastructure projects in the history of the world.

Vice-Chair Saddler wanted to better understand the "intangibles" of the project. He asked if it was possible to quantify TransCanada's benefit to the project absent the financials. He believed analytica had referred to the concept as continuity in its original slides. Mr. Tsafos answered that it was possible, but he cautioned against attaching a great deal of certainty to the numbers. He believed there were ways to weigh the benefits; for example, it was possible to attach probabilities of a more expensive project or slower development. There was math that could be done, but he believed it would be purely conjecture.

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Mr. Mayer referred to the list on slide 3 and relayed that there were some key items the state had successfully received the benefit from in terms of continuity, momentum, AGIA dissolution, and having TransCanada at the table during long-term negotiations. He continued that it was possible to look back at the past 1.5 years and see it as a very good decision at the time and that a different point in the relationship had been reached at present.

Vice-Chair Saddler remarked that there was a subjective component to the information and it was nice to know if some precision could be brought to the metrics of the decision.

Co-Chair Thompson remarked that if the state did not terminate the agreement with TransCanada that the company intended to vote "no" on December 4, which would end the project completely. He believed it could be quantified that the outcome would not be to the best advantage of the state, especially with a project that may end up being successful.

Mr. Tsafos suggested thinking about what the state was receiving from the partnership with TransCanada (i.e. AGIA, continuity, and other) compared to what it paid. He noted that the state had paid about \$3 million in interest to TransCanada. He relayed that the state had received some expertise out of the partnership. He did not know what the numbers would have looked like absent TransCanada.

Representative Guttenberg remarked on Co-Chair Thompson's statement that if TransCanada was still involved, the company would vote "no" during the meeting on December 4. He did not believe he would ask any additional questions beyond that statement.

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Representative Munoz asked about forcing gas to the project, whether or not the partner was involved in the ownership of the project and setting a December deadline for the commitments. She wondered if it was a feasible expectation on the part of the state and if it was in the state's best interest to demand those kind of agreements at the current stage.

Mr. Tsafos addressed Representative Munoz's question related to feasibility. He explained that he had no idea because he did not know how far the two sides were in terms of what the state was requesting and what the producers were willing to offer. He detailed that all he had was the three letters from the producers, which the legislators also had, stating that subject to certain items they were willing to talk to the state and sign an agreement. He did not know how close the two sides were or what the terms were. He addressed Representative Munoz's question related to desirability. He could see a circumstance where if one or more of the parties decided to exit the project, one of the solutions the state could explore was to buy their gas at the wellhead. He relayed that in other LNG projects it was fairly common for companies to adjust their exposure to the project as they learn more about the project and as they did a thorough assessment to determine the portion of the project they wanted. He believed it made it made sense to explore a different structure to solve the non-commitment of a party; the process had occurred in many projects. He and Mr. Mayer were concerned about the state making too much of a commitment up front because it did not have a lot of the information. Their overall approach had been that if ExxonMobil [or another producer] was willing to sell the state gas at the wellhead, it was probably at a price the state should not pay. He continued that if a producer was willing to sell the state gas at Henry Hub pricing, it meant that the producer did not think it could make more by participating in the project; therefore, it meant that

the state would probably not make more than that by doing the project.

Mr. Tsafos continued to address Representative Munoz's questions. He relayed that he would like to understand how specific the discussions were and how exactly the terms were playing out. He reasoned that if the state locked itself in a deal, it could end up with liabilities, which could be a problem. He relayed that it was slightly worrisome to give the companies a way out. He elaborated that the project was very complicated and he would not want half of those involved thinking that they would just exit the project. He explained that in that sense the state would not be spending time solving anything and would be designing its exit strategy. He referred to testimony from Vincent Lee with TransCanada that once people thought TransCanada was out of the project it was harder to get people to spend time on TransCanada's issues. He explained that once people started thinking they may have a way out, a muddling of the negotiations and the progress would begin. He was not sold on the necessity of entering the agreements at present versus over time. He added that it was his gut feeling, without having significant visibility into the specifics.

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Representative Munoz asked if the requirement or demand could jeopardize the project and its momentum.

Mr. Mayer strongly agreed with Mr. Tsafos' answer. He addressed discussions related to the idea of a successful project scenario versus a failed project scenario and what the costs looked like in both cases. He relayed that when they spoke about withdrawal agreements they were referring to some iteration of the failure scenario. Not necessarily the failure case of any project, but the failure of the project as it was currently designed. He furthered that there were aspects of the failure scenario the state needed to think about and plan for. However, everyone involved in the project had limited time and resources. He remarked that due to the size of the companies it was easy to think that they had unlimited staff to put on the project and that they could respond to anything the state asked from them. The reality was that everyone involved in the process had limited time

and resources. He continued that whenever one set of problems were focused on, there were another set of problems that did not receive focus. To the extent that the goal was to advance further towards project success as envisioned under the HOA, work that went into withdrawal agreements was work that took away from that goal.

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Representative Munoz asked the presenters to provide their comments on the SB 138 template and how it worked as a positive model for the State of Alaska.

Mr. Tsafos suspected she was asking about the merits for the state of becoming a 25 percent equity partner and taking ownership of the gas. He did not want to "get into the weeds of SB 138" because he did not recall all of the specifics. Broadly speaking, there was one major challenge in developing the gas in a different way. He elaborated that if the state taxed the gas at the wellhead and generated its revenue as a state (the same as oil) it would face two fundamental challenges. First, the state made its money completely differently than the producers. Second, there was not a significant amount of value at the wellhead to tax. For example, at current prices or under a scenario where prices were \$10 to \$11 in Japan, if it cost the state \$9 or \$10 to transport the gas to Japan, the state could tax that remaining \$1 as much as it liked, but the earnings would not be significant. The additional challenge in the pre-SB 138 structure was that not only was there very little value to tax, but there was no way to decide if the number to subtract from the \$11 price in Japan should be anywhere from \$5 to \$11 because TAPS (over which the state had experienced significant conflict with producers) was a federally regulated pipeline. He detailed that TAPS had very clear jurisdiction and tariff setting, but there had been significant challenges. He asked members to think about a gas pipeline where the tariff was \$60 per barrel instead of \$4 or \$5 and where there was no regulatory structure because Federal Energy Regulatory Commission (FERC) generally did not regulate the tariff of export projects. He continued that there were substantial challenges to overcome to be able to make any money. One of the reasons he and Mr. Mayer liked SB 138 in what it tried to accomplish was to say "that's too much...let's

not go down this path." He stated that it was like reentering a lengthy marriage and thinking about how much arguing there had been along the way. He stressed that the state and producers did not want to do that.

Mr. Tsafos explained that the merit of the state taking equity was that there would be no valuation questions and the state would take 25 percent of the gas, its royalty, and would turn its tax into gas. Therefore, the state and producers would each have their ownership of the gas, pipe, and LNG. He and Mr. Mayer had been surprised the most to learn that because of the way the valuation process worked, the state was actually better protected on the downside by taking ownership in the project. For example, with a price in Japan of \$11 and a cost to the state of \$10, if the state taxed the amount it would only receive the tax times \$1. However, if the price in Japan dropped to \$10, the state's earnings would be zero. Under the scenario, the state was subjected to a much bigger swing. He noted that there were many additional issues that could be discussed on the topic.

Mr. Mayer turned to slide 7. He addressed Mr. Tsafos' point related to revenue volatility, price, and commodity risk. He relayed that Mr. Tsafos' statements were particularly true in a scenario where the state was able to fully fund its capital commitment with equity. He detailed that the state could say that it built and paid for the infrastructure up front and going forward it would simply receive revenue for its LNG. Additionally, there would be no impact of leverage; there would be no fixed cost the state would need to meet for every mmbtu of LNG that it sold to Japan. Whether the price was \$18 or \$6, the state would receive that amount. The fundamental question under the scenario was whether the state achieved the desired rate of return over the 20-year project time horizon. He referred to significant discussion about financing the project through high levels of debt, which was concerning to them. He explained that it was like purchasing a house with a down payment of less than 5 percent; it massively increased the purchaser's exposure to volatility when prices increased or decreased. He relayed that the same was true for the value at the wellhead model; if the state paid for its portion with significant leverage, it would be exposed to high commodity risks. The question had been included on slide 7 to stress the point about beginning

to think more broadly about the capitalization structure for the project and all of the things the state could do to minimize its exposure to price volatility. For example, through capital structure, LNG contracts, and considering a different risk tolerance than the producers. He stressed that the thinking about the items would become very critical moving forward.

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Co-Chair Thompson thanked the presenters. He reviewed the agenda for the following day.

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

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ADJOURNMENT

[4:11:27 PM](#)

The meeting was adjourned at 4:11 p.m.