

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

May 27, 2016

11:06 a.m.

MEMBERS PRESENT

Representative Benjamin Nageak, Co-Chair
Representative David Talerico, Co-Chair
Representative Bob Herron
Representative Craig Johnson
Representative Paul Seaton
Representative Andy Josephson
Representative Geran Tarr
Representative Mike Chenault (alternate)

MEMBERS ABSENT

Representative Mike Hawker, Vice Chair
Representative Kurt Olson

COMMITTEE CALENDAR

HOUSE BILL NO. 246

"An Act creating the oil and gas infrastructure development program and the oil and gas infrastructure development fund in the Alaska Industrial Development and Export Authority; relating to the interest rates of the Alaska Industrial Development and Export Authority; relating to the sustainable energy transmission and supply development and Arctic infrastructure development programs of the Alaska Industrial Development and Export Authority; relating to dividends from the Alaska Industrial Development and Export Authority; and adding definitions for 'oil and gas development infrastructure' and 'proven reserves.'"

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 246

SHORT TITLE: AIDEA: FUNDS; LOANS; PROGRAMS; DIVIDEND

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

01/19/16	(H)	READ THE FIRST TIME - REFERRALS
01/19/16	(H)	RES, FIN
02/12/16	(H)	RES AT 1:00 PM BARNES 124

02/12/16	(H)	<Bill Hearing Canceled>
03/10/16	(H)	RES AT 1:00 PM BARNES 124
03/10/16	(H)	-- MEETING CANCELED --
03/16/16	(H)	RES AT 1:00 PM BARNES 124
03/16/16	(H)	Heard & Held
03/16/16	(H)	MINUTE(RES)
05/23/16	(H)	FOURTH SPECIAL SESSION BILL
05/23/16	(S)	FOURTH SPECIAL SESSION BILL - WITH PASSAGE OF HCR 401
05/27/16	(H)	RES AT 11:00 AM BILL RAY CENTER 208

WITNESS REGISTER

FRED PARADY, Deputy Commissioner
Office of the Commissioner
Department of Commerce, Community & Economic Development (DCCED)
Juneau, Alaska

POSITION STATEMENT: On behalf of the governor, provided a PowerPoint presentation, "AIDEA Oil and Gas Infrastructure Development Fund, HB 246," dated March 16, 2016.

GENE THERRIAULT, Energy Policy and Outreach Director
Alaska Energy Authority (AEA)
Alaska Industrial Development and Export Authority (AIDEA)
Department of Commerce, Community & Economic Development (DCCED)
Anchorage, Alaska

POSITION STATEMENT: On behalf of the governor, provided a sectional analysis of HB 246.

JOHN SPRINGSTEEN, Executive Director
Alaska Industrial Development and Export Authority (AIDEA)
Department of Commerce, Community & Economic Development (DCCED)
Anchorage, Alaska

POSITION STATEMENT: On behalf of the governor, answered questions related to HB 246.

JERRY BURNETT, Deputy Commissioner
Office of the Commissioner
Department of Revenue (DOR)
Juneau, Alaska

POSITION STATEMENT: On behalf of the governor, answered questions related to HB 246.

ACTION NARRATIVE

[11:06:13 AM](#)

CO-CHAIR BENJAMIN NAGEAK called the House Resources Standing Committee meeting to order at 11:06 a.m. Representatives Tarr, Seaton, Chenault (alternate), Johnson, Josephson, Herron, Talerico, and Nageak were present at the call to order.

HB 246-AIDEA: FUNDS; LOANS; PROGRAMS; DIVIDEND

[11:07:06 AM](#)

CO-CHAIR NAGEAK announced that the only order of business would be HOUSE BILL NO. 246, "An Act creating the oil and gas infrastructure development program and the oil and gas infrastructure development fund in the Alaska Industrial Development and Export Authority; relating to the interest rates of the Alaska Industrial Development and Export Authority; relating to the sustainable energy transmission and supply development and Arctic infrastructure development programs of the Alaska Industrial Development and Export Authority; relating to dividends from the Alaska Industrial Development and Export Authority; and adding definitions for 'oil and gas development infrastructure' and 'proven reserves.'"

[11:08:08 AM](#)

FRED PARADY, Deputy Commissioner, Office of the Commissioner, Department of Commerce, Community & Economic Development (DCCED), noted he is the designee for the DCCED commissioner on the board of directors of the Alaska Industrial Development and Export Authority (AIDEA). He provided a PowerPoint presentation titled, "AIDEA Oil and Gas Infrastructure Development Fund, HB 246," that he had previously begun on 3/16/16. Turning to slide 2, "Current AIDEA Financing Tools," he said HB 246 is an opportunity to build out AIDEA's toolkit on behalf of the 735,000 shareholders that are the citizens of Alaska. Serving on AIDEA's board are the commissioners of DCCED and the Department of Revenue (DOR), and five successful Alaska business people appointed by the governor. In addition to the board is AIDEA's staff. Three funds are currently set up under AIDEA: [the revolving fund] consisting of economic enterprise and development accounts; [the sustainable energy transmission and supply (SETS)] fund, and the Arctic infrastructure fund. In addition to those three funds are two special appropriations projects: the Interior energy project (IEP) and the Ambler mining district industrial access project.

MR. PARADY noted that slide 3, "Geographic Project Diversity," is a snapshot of the geographic project diversity that is

monitored by the AIDEA board. He pointed out that the Northern Region, depicted in purple, is the Ambler road, and the other colors represent the distribution across the rest of the state. He said AIDEA's duty is to serve the entire breadth and width of the state.

MR. PARADY explained that slide 4, "Industry Diversification," is the source of HB 246. The pie chart on the slide represents the total existing and approved capacity projects and loans as of 10/31/15. Oil and gas, and oil and gas support, represent 14 percent or \$110 million of AIDEA's financing. He said the board is concerned that AIDEA is becoming concentrated in that area of finance and recognizes that the oil and gas sector is capital intensive. At 20 percent the mining sector is AIDEA's largest but also longest standing investment, he said, and is the Ambler road which has been in place for over 20 years and is a stable, long-term investment with a stable, long-term return.

[11:10:59 AM](#)

MR. PARADY drew attention to slide 5, "AIDEA Financing Tools after HB 246," noting it is a picture of the bill before the committee. He said the proposed legislation would add a fourth fund, the oil and gas infrastructure development fund. Displaying slide 6, "Intent of HB 246," he explained that the intent of this new fund is to continue infrastructure financing by allowing AIDEA to have a dedicated fund so that AIDEA's portfolio does not become unduly weighted to oil and gas. The fund's intention is to: support small- and medium-sized oil and gas developers statewide, increase production, bring new fields online, attract new investment, increase future revenues, and support investment for energy security.

MR. PARADY showed slide 7, "Eligible Oil and Gas Infrastructure Projects," and said the infrastructure is defined as investment and the projects themselves. Investment can be acquisition, construction, or installation (including engineering). Projects can be roads, pads, camps, processing facilities, gathering systems, or other site improvement or equipment. The bill is focused on above ground investment, he noted, not below ground facilities. Projects must support fields that have proven reserves, which is vital safeguard in the bill. Proven reserves are defined as: analysis of geological and engineering data; commercially recoverable under current economic conditions, operating methods, and government regulations; and categorized as developed or undeveloped.

MR. PARADY turned to slide 8, "Financing and Tax Credits," and stressed that under the bill a developer opting to use AIDEA financing for a project would no longer be able to use the exploration and development tax credit [AS 43.20.043], the production tax credit [AS 43.55.023], or the production tax credit for exploration expenditures [AS 43.55.025]. However, he pointed out, projects with past tax credits would still be eligible for AIDEA financing.

[11:13:15 AM](#)

MR. PARADY moved to slide 9, "Market Based Interest Rates," and said AIDEA would base interest rates on project risk; borrower creditworthiness, which speaks to the borrower's experience in the kind of project that is being developed; the owner and financing partner commitments, which is the strength of the financials; and the benefit to the state. Interest rates may be higher for these oil and gas infrastructure projects due to the inherent risk associated with the oil and gas industry.

MR. PARADY addressed slide 10, "Other Bill Components," stating that HB 246 is an opportunity for AIDEA to standardize the terms that are set in statute across all four of its funds. The bill proposes that the three existing funds be allowed to loan up to 50 percent of an eligible project (currently 30 percent) or offer a loan guarantee of up to \$25 million (currently \$20 million). These increased would strengthen AIDEA's ability to participate in a project. The proposal would limit it to 50 percent so that AIDEA would not be in a controlling position. As in current statute, amounts in excess of those limits would require prior legislative approval.

MR. PARADY noted that the deputy commissioner of the Department of Revenue (DOR), Jerry Burnett, is present and available to answer questions and that Mr. Burnett serves on the AIDEA board as the designee for the DOR commissioner.

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GENE THERRIAULT, Energy Policy and Outreach Director, Alaska Energy Authority (AEA), Alaska Industrial Development and Export Authority (AIDEA), Department of Commerce, Community & Economic Development (DCCED), reviewed the sectional analysis for HB 246. He said Sections 1-3 of the bill reference AIDEA's net income and how a dividend is paid to the state. These sections ensure that the new fund being created would track the same mechanism

attached to the other funds for determining net income and calculating the profit that goes back to the state.

MR. THERRIAULT explained that Sections 4-9 would add references to the new fund to the existing statutes that detail the level of interest that is to be levied on loans from the SETS and Arctic infrastructure funds. Both of these existing funds were established by the legislature within the past few years. The mechanics of the existing language would not be altered by adding the new fund into those existing sections of statute.

MR. THERRIAULT noted Sections 10-11 propose to make adjustments to the existing participation limits for the SETS and Arctic infrastructure funds. The value in keeping the participation levels consistent across all the different funds is that it would be more easily understood by enterprises interacting with AIDEA for funding.

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MR. THERRIAULT said Section 12 is the new section of statute that would create the new fund. The mechanism is a copy of the structure that was used by the legislature to create the SETS fund and the Arctic infrastructure fund. So, if the legislature decides to provide AIDEA with a new tool, HB 246 copies the sections of statute that are required to put a new tool into place and have it operate under the same basic constructs as the SETS and Arctic infrastructure funds. The language specific to the new fund is on page 8, lines 3-4, and would mandate that AIDEA develop a process to verify the existence of proven reserves. That is a requirement that is very specific to this fund and it would not apply to the other funds. The language on page 8, lines 15-22, would require a project developer to choose between securing infrastructure financing from this new fund or apply for oil and gas development credits. The developer would be free to choose one or the other, but would not be able to take advantage of both means of state assistance once financing is secured from the new fund. If a developer has taken advantage of tax credits when exploring the reserve, proving up the reserve, the developer would still be able to take advantage of those. But, at the point when the developer locks in this funding, the developer could no longer apply for continued credits. That is a policy call for legislators to consider, he said, and whether legislators want to recast that restriction in a different way.

MR. THERRIAULT noted that page 8, lines 11-14, contain the program limits above which legislative approval must be secured prior to participation. The limits that would be established here allow for project financing of up to one-half of the development and a cap on a loan guarantee from the fund at no more than \$25 million. He reiterated that those limits are being suggested by AIDEA and in Sections 10-11 AIDEA is suggesting that the limits for the SETS and Arctic infrastructure funds be adjusted upward to match that.

MR. THERRIAULT stated that Section 13 proposes a new statutory definition for oil and gas development, including a link to a proven reserve and a definition for proven reserve itself.

[11:19:46 AM](#)

MR. PARADY resumed the PowerPoint presentation. Addressing slide 12, "AIDEA Due Diligence," he said that under AIDEA's technical due diligence process, AIDEA sets out its procedures [for verifying proven reserves]. Under AIDEA's financial due diligence, AIDEA reviews creditworthiness and the financing partner commitments and analyzes the economics, including stress testing the project. The process also includes looking at the benefits to the state. The process is managed by AIDEA's internal staff along with hired consultants and specialists, and the final decision rests with the AIDEA board.

MR. PARADY said slide 13, "Analysis & Decision-Making," depicts AIDEA's decision making process. Phase 1 is the project suitability assessment. Phase 2 is the feasibility analysis which looks at whether the business plan and financing plans are complete and whether there is local community support. Phase 3 is the deal structuring and due diligence where AIDEA tests the business case, its technical aspects, management, and financial approach, and looks at equity, security, and so forth. Phase 4 is finalization and close. He said AIDEA's staff is fiercely devoted to this process and a look at AIDEA's history shows it has been successful at managing project risk and securing its assets even when it has hit turbulence.

[11:21:31 AM](#)

MR. PARADY reviewed slide 14, "Financing Repayment," stating that AIDEA finances at market-based rates to reflect individual project risk. Loans are repaid with interest. The interest is where AIDEA earns revenue, that revenue is shared back to the state in AIDEA's dividend, and some of the earnings are retained

to fund future projects. He said the graphic at the bottom of the slide is a simplified view: AIDEA is asking the legislature to establish the oil and gas infrastructure development fund, AIDEA would finance projects, those would return revenue to AIDEA, and AIDEA would pay dividends to the state.

MR. PARADY explained that the graph on slide 15, "AIDEA Entry Point & Criteria," is a snapshot of where AIDEA's sweet spot is. He pointed out that the vertical axis of the graph, "Risk and Cost of Capital," goes from low to high, and the horizontal axis, "Project Stage," goes from concept to development to construction to operation. He noted that AIDEA is not in the high risk seed capital business, not in venture finance, and not in private equity. Rather, AIDEA comes in in that sweet spot in the center where there is the operating experience, the capital contribution, the final design has plans and specifications, the permits are completed, the purchase agreements are signed, and the sales agreements are signed. Once these are complete, AIDEA helps move that project forward into construction and into long-term financing.

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MR. PARADY displayed slide 16, "Summary," and summarized the provisions of HB 246. He said the bill would add to AIDEA's toolkit by giving AIDEA a specific program to finance oil and gas infrastructure, which is a critical need for the state's small- and mid-sized developers in this price environment. Under the bill eligible oil and gas infrastructure would have to have proven reserves and undergo AIDEA's established due diligence review. The bill would require that the finance terms be market based.

MR. PARADY concluded with slide 17, "Implementation Cost," explaining that implementing the program would require some minor modification of regulations, which can be done in-house. The program implementation cost and program management cost would be absorbed by AIDEA. The modified fiscal note was submitted to acknowledge the potential for fund capitalization pending the legislature's decision to do so.

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REPRESENTATIVE SEATON asked whether the intention is to roll that 14 percent of AIDEA's investment currently in oil and gas into the new fund or whether that 14 percent would remain in addition to the new fund.

MR. PARADY deferred the question to Mr. Springsteen.

JOHN SPRINGSTEEN, Executive Director, Alaska Industrial Development and Export Authority (AIDEA), Department of Commerce, Community & Economic Development (DCCED), replied the intent is for anything that is in the revolving fund to remain in the revolving fund. So, anything in the oil and gas infrastructure development fund would be separate, apart, and new development. [Note to the reader: Mr. Springsteen was speaking via teleconference and due to audio difficulties his testimony was often difficult to discern and, at times, could not be discerned.]

REPRESENTATIVE SEATON inquired as to the anticipated percent of AIDEA's portfolio once the oil and gas infrastructure is combined with the rest.

MR. SPRINGSTEEN responded it depends on what the capitalization of the fund would be. If the fund were capitalized with \$200 million then it would raise the 14 percent to one-third [33 percent]. But, he reiterated, it would be in a program and fund separate and apart from AIDEA's relatively more conservative revolving fund.

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REPRESENTATIVE TARR observed on slide 14 that a loan is repaid with interest and the earned revenue comes back to the state in the form of a dividend. She asked whether AIDEA has a standard return on investment for accepted projects; for example, the permanent fund tries to have a 7 percent return on investment.

MR. SPRINGSTEEN answered that AIDEA's core mission revolves around providing funding which will support jobs creation and retention, and economic development in the state. Over the long term AIDEA has had a rate of return of roughly 5 percent when looking at the initial \$380 million of capitalization, then growing the assets within AIDEA, and then returning \$381 [million] of dividends to the state over that time.

[11:28:01 AM](#)

REPRESENTATIVE HERRON requested an explanation of the language on page 8, line 24, of the bill that states, "but may not be more than 30 years."

MR. THERRIAULT replied 30 years was selected because it was felt that the infrastructure that would be loaned for would have a 30-year life. It is not wanted to make a loan for a period of time that is beyond the expected life of the asset.

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REPRESENTATIVE JOHNSON referred to page 8, lines 11-[14], of the bill which state, "(1) provide financing that constitutes more than one-half of the capital cost of the oil and gas infrastructure development; or (2) guarantee a loan for an oil and gas infrastructure development if the amount of the guarantee exceeds \$25,000,000." He understood this would mean \$25 million could be loaned and therefore it would only be projects that are under \$50 million.

MR. PARADY believed the key word is "or" on line 12, so AIDEA would be limited to \$25 million or to 50 percent. He deferred to Mr. Springsteen to answer further.

MR. SPRINGSTEEN responded that his interpretation is the same as Mr. Parady's.

REPRESENTATIVE JOHNSON inquired whether a project would have to be \$50 million or under in order for AIDEA to provide a loan or loan guarantee. He further inquired whether there would be a maximum that AIDEA could loan. He presumed the state would own more than half the project and would have a better leverage position in terms of the equity in a project.

MR. THERRIAULT pointed out that page 8, line 8, states, "Unless the authority has obtained legislative approval". So, he said, those are the limits that AIDEA itself can go up to. If there is a project that exceeds those limits AIDEA would have to come back and get specific legislative approval.

[11:30:38 AM](#)

REPRESENTATIVE CHENAULT understood that unless AIDEA had authority from the legislature it could not exceed those limits. He said he has concerns about attorney general approval and about the other funds and how they are currently set up and whether the bill is matching language. He requested a response.

MR. THERRIAULT drew attention to the document in the committee packet titled, "Proposed ways to address concerns expressed on HB 246." He recounted that after briefing the committee about

the bill during regular session, he and his colleagues talked to several committee members individually, heard the concerns, and worked on potential ways of addressing those concerns, all of which are detailed in this document.

[11:32:10 AM](#)

REPRESENTATIVE TARR returned to page 8, lines 11-14, of the bill. She understood AIDEA [would not be allowed to] provide financing that constituted more than one-half of the capital or provide a loan guarantee that exceeded \$25 million. She understood Representative Johnson's question to be that he was linking those two as if half would mean that that was \$50 million. But, she continued, one is project financing and one is the loan guarantee. She asked whether she is correct in understanding that a loan guarantee for \$25 million could be a much more substantial loan than a \$50 million loan.

MR. THERRIAULT deferred the question to Mr. Springsteen.

REPRESENTATIVE TARR reiterated her understanding regarding page 8, lines 11-14. She understood that a loan guarantee of \$25 million represents some portion of a loan and therefore that loan could exceed \$50 million.

MR. SPRINGSTEEN confirmed Representative Tarr is correct in her understanding. For example, he said, a third party could provide a loan of \$100 million, but the maximum amount that AIDEA could guarantee would be \$25 million. Regarding the question of a loan from AIDEA to a developer, he said AIDEA would be limited to not more than 50 percent, and this would be separate and apart from the guarantee.

[11:34:48 AM](#)

REPRESENTATIVE SEATON noted that if the project financing can be 50 percent of, say, \$400 million, then a loan of \$200 million would be authorized under the bill's existing language, given that no legislative approval comes in with the bill's current language. The language needs to be changed, he posited, if the intent is that an individual loan is limited other than by the 50 percent without legislative approval.

MR. SPRINGSTEEN answered that part of what AIDEA is trying to address is the scale of some of these new developments, but also to gauge the appetite of the legislature for what type of participation AIDEA should have. These new developments could

be in the hundreds of millions of dollars when looking at the top side, bottom side, reservoir, and the infrastructure.

MR. PARADY offered his understanding that the difference between those lines is that the financing might include bonding tools or other tools, and line 13, paragraph (2), is guaranteeing a loan.

MR. SPRINGSTEEN agreed.

MR. THERRIAULT clarified that this proposed mechanism is the same as what the legislature established for the SETS and Arctic infrastructure funds. The difference is that the percentage is up to 50 percent, [and the loan guarantee] is \$25 million. The SETS and Arctic infrastructure funds were originally listed at \$20 million for the loan guarantee. So, the mechanism is the same, but the dollar amounts are different.

REPRESENTATIVE SEATON said it is legislative approval that is being talked about. He held that there is no cutoff, there is no legislative approval, as long as it is under 50 percent of the project. He added he does not think that is what was meant if it is being said that there is some limit before the legislature must approve something, because the way it is written here the \$25 million only applies to a loan guarantee, it does not apply to direct financing and direct financing is only limited by 50 percent of the billion dollars if AIDEA had \$500 million in the fund.

MR. PARADY confirmed that is correct with the caveat that AIDEA cannot take three-quarters, or 60 percent, or 100 percent of a project, the maximum it can go is 50. The limitation comes from the strength of AIDEA's balance sheet and what the bond market will do. If it is a flat-out loan where AIDEA is loaning its funds, then AIDEA is limited to the \$25 million. The limitation on financing would stem from the bond evaluation in the market.

[11:38:33 AM](#)

REPRESENTATIVE TARR posited that the alternative to the proposed language would be something on page 8, line 12, where it would say "cost of the oil and gas infrastructure development not to exceed a certain amount". This way there would still be those two limitations - 50 percent of the capital or not to exceed \$300 million or some appropriate number. She asked whether AIDEA has thought about what that appropriate number would be if that were to be under consideration.

MR. SPRINGSTEEN replied that AIDEA's guiding principle is the Prudent Investor Rule, so AIDEA looks for diversifying its investment. To have a concentration in one project, given the tools that are available, is not the intent. The goal is seeking diversity in AIDEA's entire portfolio across all Alaska and its industries.

REPRESENTATIVE TARR posed a scenario of being in a low price environment without a lot of activity, making it so there is more interest or desperation for wanting someone to start a large project. She asked whether limited activity in a low price environment could influence or skew what Mr. Springsteen was just suggesting in regard to diversity within AIDEA's portfolio and the Prudent Investor Rule.

MR. SPRINGSTEEN responded that when looking at any opportunity AIDEA goes in first with the idea that it is protecting the interests of its 735,000 shareholders. When AIDEA is making a loan or making another form of investment, there are protections to secure the investment and repay the shareholders with interest in the form of dividends to the state.

[11:41:31 AM](#)

REPRESENTATIVE JOSEPHSON said he wants to ensure Representative Chenault's question gets answered.

MR. THERRIAULT returned attention to the document titled, "Proposed ways to address concerns expressed on HB 246." He said Concern 1 was expressed by Representative Hawker regarding the word "reserves" on page 7, line 17, of the bill. Because evaluating the oil and gas reserves is being talked about, there is some potential for confusion on whether this line is talking about financial reserves or oil and gas reserves. He said this could be clarified by adding the word "financial" [after the word "established"].

MR. THERRIAULT noted Concern 2 was brought up by Representative Seaton and was regarding whether AIDEA financing might leave AIDEA and the state responsible for dismantlement, removal, or remediation of the infrastructure. This can be clarified and some protection put in the bill, he said, by inserting a new subsection on page 8, line 25, [which states: "(d) The authority may provide financing for an oil and gas development only if the authority will not be responsible for the dismantlement, removal or remediation cost of the oil and gas development."] He said this could be offered as an amendment or rolled into a committee

substitute. He added AIDEA does not intend to take on that responsibility and appreciates the opportunity to clarify that.

11:43:25 AM

REPRESENTATIVE HERRON said he appreciates the proposed language for addressing Concern 2, but inquired whether AIDEA has talked with the Department of Natural Resources (DNR), Department of Law (DOL), or the Alaska Oil and Gas Conservation Commission (AOGCC) about this language. He asked whether it is clear as to who is responsible for dismantlement, removal, and remediation, and, if so, where those funds are located.

MR. THERRIAULT answered that AIDEA worked with the Department of Law on this language. He said he thinks the existing system that assigns responsibility for that would exist, and AIDEA is just clarifying that as it comes in it is not suggesting to take on any of that responsibility. He added that AIDEA is not proposing anything that would disrupt the existing system that makes those determinations.

REPRESENTATIVE HERRON surmised, then, that there is in statute a system that specifically says there is going to be someone responsible and there is a mechanism to pay for it.

MR. THERRIAULT replied he believes so and that it is in the oil and gas leasing regulations. He said AIDEA will check with DNR to get a specific answer.

REPRESENTATIVE HERRON suggested there should be a reference within the bill so it is clear during debate along the way that this is known.

11:44:56 AM

REPRESENTATIVE JOHNSON inquired how that would be handled in a bankruptcy situation where the company defaults and the state is, basically, a 50 percent owner. He offered his belief that in such a situation the state would be unable to dodge this.

MR. SPRINGSTEEN responded that in prior activity that AIDEA has engaged in and future activity that AIDEA will engage in, when AIDEA looks at a project it has three major "legs to the stool." One is the project cash flow and the ability to recover any type of investment that AIDEA made. Another is the level of collateralization, the market value, a projected future potential sale - an orderly sale - and making sure that there is

coverage there. Then, to the extent that AIDEA needs additional coverage, AIDEA would also look to an independent guarantee that AIDEA would want from the different parties.

MR. THERRIAULT stated that the suggested language to be added is basically giving instruction to AIDEA to get proper indemnification against that potential responsibility before the lending could take place.

[11:46:40 AM](#)

MR. THERRIAULT addressed Concern 3, noting it was brought up by Representative Hawker in regard to "proven reserves" and the definition of commercially recoverable. He said AIDEA worked with the representative and his staff to come up with suggested language that would be added at the end of the existing sentence on page 8, line 24, of the bill. [This language would state: "In providing financing under AS 44.88.880, the authority shall require a loan to value ratio of 75 percent or greater and, if proven reserves constitute a portion of the value, the proven reserves shall be reduced by ten percent in calculating the value of the proven reserves and the reduced quantity shall be valued based on the average price of oil or gas actually paid during the preceding 12 month period, or if less, the price the Department of Revenue forecasts for the next succeeding 12 month period."]

MR. THERRIAULT noted that as AIDEA loans money out or participates in this kind of lending, AIDEA would be secured in the assets themselves, but another line of security for the lending would also be the reserves that are being proven up or that are being proposed to be produced. Given that the values in commodity prices can swing tremendously, AIDEA has come up with language to evaluate those that would require looking at the average price of the oil and gas actually paid during the preceding 12-month period and comparing it to the expected price going forward and taking the lesser of those two. This would be a conservative way of evaluating those reserves, if they are to be considered part of the collateral at all. He offered his belief that AIDEA has come up with language that is acceptable to Representative Hawker and his staff.

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REPRESENTATIVE JOHNSON offered his understanding that only the ground up would be looked at. He concluded that the state could

end up owning its own reserves if those are part of the collateral.

MR. SPRINGSTEEN answered that just in terms of securing any type of investment, AIDEA would ensure some form of collateral. So, AIDEA could be in a situation where it does not have an asset that is under ownership, and then it would look toward an orderly sale to another party for future development in that asset. He reiterated that AIDEA would not want to be without access to various forms of collateral.

MR. THERRIAULT added that Representative Johnson is correct that this lending is only for surface infrastructure, it is not for any of the investment down the hole. But it is a realization that the potential hydrocarbon to be produced from that surface infrastructure is a potential asset that AIDEA could have secure part of the loan or be pledged, and AIDEA would not want to limit its ability to use that to secure the state's position.

[11:49:57 AM](#)

REPRESENTATIVE JOHNSON said he is looking at a worst-case scenario in which there is a default. He continued:

And so as part of our collateral, that would come back to us because it'd be in violation of their leases. So we're using our own resource as collateral for a loan that we're going to end up getting back anyway. So ... I can't see using the resource or the oil or the gas, whatever is there, as collateral. We're going to end up owning that anyway in a bankruptcy because of the fault of the lease. So, I don't see where that has a lot of value to us in terms of collateral, we need to resell it anyway.

MR. THERRIAULT replied that if it defaults back to the state, it is correct that DNR could resell that asset and that money would come into the general fund. He explained that AIDEA is looking to make sure to its financial advisors that AIDEA is securing the assets of AIDEA and ensuring that the economic enterprise of AIDEA is secure.

[11:51:07 AM](#)

REPRESENTATIVE JOHNSON understood, then, that AIDEA would own oil and gas reserves in a default situation.

MR. THERRIAULT replied that, as indicated by Mr. Springsteen, AIDEA would look to sell those.

MR. PARADY offered his understanding that that is existing authority within AIDEA's present structure, only in a collateral sense. Regarding default of the lease during bankruptcy, he offered his understanding that that lease does not automatically default back to DNR. He requested Mr. Springsteen to further clarify this.

MR. SPRINGSTEEN responded that that is correct. He said the scenario posed by Representative Johnson is an extreme situation in terms of everything absolutely going to pot. One of the occupations of AIDEA is to be able to provide patient capital funds in order to support development within the state and act in the interest of AIDEA's 735,000 shareholders. He stated his belief that collateral that is made available to help secure any type of investment that is made is not "the type of thing we should refuse." He added, "We've also taken that collateral in terms of circumstances where there's a (indisc.) within the state, and that's simply because we need to over-collateralize in the interest of our shareholders."

[11:52:53 AM](#)

REPRESENTATIVE SEATON allowed that this is beyond his level of expertise here, but posited that when getting into a bankruptcy situation where a well has been drilled that is capable of commercial production, then that lease does not expire. Thus, that would be a collateral that would go to the secured creditors in a bankruptcy situation and so he is unsure that the state would automatically get back that lease. The lease would fall as an asset through the bankruptcy court, he continued to posit, so it would be prudent for [AIDEA] as an investor to have it be a secured asset so it does not fall to some investment company someplace else. He requested AIDEA to provide the committee with a legal analysis of bankruptcy situations and what happens to leases, especially if a lease has had a well drilled on it. He offered his belief that if a well has been drilled, the lease would be held in perpetuity at that point in time as an asset.

[11:54:17 AM](#)

REPRESENTATIVE SEATON then addressed the language being proposed under Concern 3 that would add at the end of the existing sentence on page 8, line 24, of the bill: "In providing

financing under AS 44.88.880, the authority shall require a loan to value ratio of 75 percent or greater and, if proven reserves constitute a portion of the value" In regard to 75 percent or greater, he posited that that would be over the 50 percent valuation of the project and he is unsure whether it is 75 percent or greater, or 75 percent or less. He requested a clarification of the restriction of 50 percent valuation to the loan project versus the 75 percent talked about under Concern 3.

MR. SPRINGSTEEN answered that if there were a loan made and it is 50 percent with a partner, then in terms of securing any type of investment, AIDEA would have to meet that 75 percent criteria. He said, "So, it ultimately goes for collateralizing an investment." For example, he said it would take, at a minimum, \$100 million of assets and value to secure a \$75 million investment.

[11:55:54 AM](#)

REPRESENTATIVE SEATON said that is over 50 percent of the valuation if talking about 75 percent. He allowed he may be confused with the way the language is here, but if it is being said that AIDEA shall require a loan value ratio of 75 percent, then it seems like that is beyond the 50 percent.

MR. THERRIAULT clarified that the 50 percent is the level of investment in the specific project, the surface infrastructure that is being talked about. The language related to Concern 3 is talking about what collateral AIDEA gets. An enterprise, a business, could pledge other assets that it has, such as office buildings, as collateral. Collateral can be things outside of the infrastructure that is being financed. So, AIDEA is looking to over-collateralize the loan. For example, when a person gets a home loan, the house itself is pledged as an asset but the bank may require the borrower to pledge another piece of property as additional collateral against the loan.

MR. PARADY pointed out that apples and oranges are being mixed here - the 50 percent is the participation rate, the 75 percent is the collateralization rate, and they are not related to each other.

[11:57:33 AM](#)

REPRESENTATIVE TARR noted that in the bill this proposed new language would be placed in subsection (c), which is the limitation of not to exceed 30 years, and the proposed new

language would be the collateral portion of it. Given how the proposed language is currently written, she said she is trying to figure out whether it would have to be to a company that is actually in production or just has proven reserves, because of the language that states, "and the reduced quantity shall be valued based on the average price of oil or gas actually paid during the preceding 12 month period". She inquired whether that is the average price "as we use it and not relative to economic activity of the company seeking the loan."

MR. THERRIAULT replied it is just the prevailing prices. If the reserves that will be produced by this infrastructure are going to be used as any component of the collateral, this speaks to how those are going to be valued. He said AIDEA tried to come up with something that Representative Hawker and his staff felt was adequate and on the conservative side.

[11:58:46 AM](#)

REPRESENTATIVE SEATON inquired whether the language "shall be reduced by ten percent" is talking about the value of the oil but not the economics of the extraction. Posing a scenario of a project needing financing that is fairly expensive, he asked whether it is the Trans-Alaska Pipeline System (TAPS) average oil price or the Alaska North Slope West Coast (ANS WC) average oil price. He posited that a highly expensive project may be way over valued if it is only the ANS WC price and not the economics of the project. He requested that the committee receive a "white paper" with further explanation in this regard.

MR. THERRIAULT drew attention to the portion of the proposed new language that states "in calculating the value of the proven reserves". He said the cost of actually producing would be subtracted from that so the economics of producing from that potential field would be taken into account.

MR. SPRINGSTEEN added that in any circumstance, through its due diligence process AIDEA is examining the economics of the development in relation to price fluctuations.

REPRESENTATIVE SEATON stated that, while he appreciates this discussion, he would like for language to be added that makes it clear that it is not just ANS West Coast prices, it is the economics of the project as well, because they could be significantly different than just a generalized pricing.

MR. SPRINGSTEEN agreed to do so.

12:00:48 PM

MR. THERRIAULT addressed Concern 4, which was brought up by Representative Chenault. He recounted that when the SETS fund was set up there was a concern that somehow it would become a mechanism that could come into play to finance a large diameter pipeline across the state to deliver oil or gas for export. He said that is not the intent here and so AIDEA could insert similar language that makes it clear that AIDEA is financing infrastructure to get oil and gas into production and it would be wanted for that production to be delivered. Precluding delivery into the ENSTAR Natural Gas Company system is not wanted, so AIDEA worked with Representative Chenault's staff to come up with suggested language that would be added to page 8, line 30, after the word "established" [and which states ", but excluding a natural gas pipeline project, thirty inches in diameter or larger, for transporting natural gas from the North Slope or Cook Inlet to market"].

12:01:47 PM

MR. THERRIAULT explained that Concern 5 deals with the transfer of assets [between funds]. The language [on page 6, lines 25-29, of the bill] talks about AIDEA having the latitude to transfer assets, and AIDEA believes the existing latitude in the suggested language is preferred. It mirrors what is granted for the SETS fund and the Arctic infrastructure fund and AIDEA would suggest that the proposed oil and gas fund should operate in the same manner.

12:02:21 PM

REPRESENTATIVE HERRON observed that for Concern 5 AIDEA wants to stay with the same language and does not propose a potential solution as was done for the other concerns. He said he is very concerned that this provision may allow AIDEA to transfer funds that may be negative to the other two funds. He therefore suggested that AIDEA come up with a solution rather than sticking with its present position.

MR. THERRIAULT replied that there is no suggestion that the existing \$110 million in the revolving loan fund would be transferred to capitalize the [proposed oil and gas infrastructure development] fund. However, he explained, within each fund there needs to be the latitude that if giving a loan guarantee or doing financing with bonding, a subaccount can be

set up and assets can be transferred into that subaccount to assure that as funds come back, as bonds are paid back, there is the flexibility to do that type of thing. He deferred to Mr. Springsteen to address whether there is any anticipation that there would be transfer between the funds.

[12:04:00 PM](#)

MR. SPRINGSTEEN said he is having difficulty hearing what is being said and requested Mr. Therriault to restate the question.

MR. THERRIAULT reiterated he is speaking in regard to Concern 5 which is in regard to AIDEA having the ability to transfer funds. He noted the proposed language mirrors the mechanism established in the SETS and Arctic infrastructure funds and [AIDEA's] suggestion is that there is not a problem here that needs to be fixed and that AIDEA needs to maintain some flexibility to set up subaccounts within the fund to assure lenders, bond holders, that they get repaid. There is no intent on AIDEA's part to transfer money from this fund into the revolving loan fund or vice versa, he said. He requested Mr. Springsteen to speak to that.

MR. SPRINGSTEEN explained there is the ability with the SETS and Arctic infrastructure funds to move funds in between - to "interfund" - and this would mirror that same type of language. He said he understands the legislature's desire to limit that and maintain funds solely within the oil and gas infrastructure development funds. He said AIDEA can work toward a solution for that.

[12:05:57 PM](#)

REPRESENTATIVE HERRON stated he can support the transfer of monies between the other three funds, but when it comes to oil and gas infrastructure he fears that this fund potentially could become the big boy on the block and the other three would be on the back bench. He requested that AIDEA propose a solution to Concern 5 rather than keeping the language as proposed in the bill.

MR. SPRINGSTEEN agreed to get back to the committee.

[12:07:06 PM](#)

MR. THERRIAULT discussed Concern 6, which was brought up by Representative Chenault. He noted that HB 246 speaks about

contracting for outside services and in regard to hiring outside legal counsel the bill speaks specifically about getting the approval of the attorney general. He related that initially he had thought the bill copied the same language from the SETS and Arctic infrastructure funds, but instead the language in the bill is slightly different. He said AIDEA's proposal here is to go back and use the same language that is in the SETS and Arctic infrastructure funds so that it mirrors the same mechanism the legislature put into those other two funds.

REPRESENTATIVE CHENAULT said he thinks the proposed language works, but his concern is why put one more step in there of having the attorney general approving oil and gas issues for AIDEA. He posited that the AIDEA board has the expertise and the ability if it needs counsel, to go out and get counsel. Since AIDEA has proven this in the past, he asked why put that extra step in there on oil and gas issues.

MR. THERRIAULT agreed and said AIDEA's proposal is to default back to the language used in the other two funds.

[12:08:37 PM](#)

MR. THERRIAULT lastly addressed Concern 7, stating AIDEA has no suggested fix for this concern. He recounted that there were some questions about whether it is appropriate to adjust the participation limits for the SETS and Arctic infrastructure funds so they mirror the suggested limits for the proposed new oil and gas infrastructure development fund. He said AIDEA believes it would be easier for the enterprises seeking AIDEA's support to understand if those limits are the same across the different financial tools. However, he continued, that is a separate policy call of the committee's.

[12:09:22 PM](#)

REPRESENTATIVE TARR said it makes sense in the context of the new fund because those would be more expensive projects potentially. She asked what the thinking was in making the adjustments to the other two funds.

MR. THERRIAULT responded it is just so they are consistent. The other funds are currently one-third and \$20 million. The loan guarantee [proposed in the bill] would be an adjustment of \$5 million [raising it to \$25 million] before AIDEA would have to get legislative approval and the 33 percent would be raised to 50 percent.

REPRESENTATIVE TARR inquired whether the current boundaries on the other two funds have limited AIDEA's ability to invest in any projects under those funds.

MR. THERRIAULT answered that the other two funds have not been capitalized, so there has not been activity.

[12:10:26 PM](#)

REPRESENTATIVE JOSEPHSON said his sense of HB 246 is that "it's designed to soften the fact that the administration doesn't think the tax credit portfolio can be sustained." Given the policy call on that is as unclear as anything he has ever seen, he inquired whether this bill is something that the administration wants to advance if there is not reform of the credit system.

MR. PARADY replied he will leave the coming decision on oil and gas tax credits to the appropriate body. He said HB 246 stands alone. The bill would add a tool into AIDEA's toolkit to support the small- and medium-sized sectors of Alaska's oil and gas industry and is irrespective of the tax credit issue.

MR. THERRIAULT brought attention to the pie chart on slide 4, saying it depicts the investment out of the "economic activity fund" and shows that the [oil and gas account] is up to 14 percent. He said HB 246 was initiated by the board's concern that AIDEA has approached, or will soon approach, the limit for investing in oil and gas infrastructure; AIDEA is no longer able to do that and keep a blended portfolio in this economic development portfolio.

[12:12:26 PM](#)

REPRESENTATIVE SEATON asked whether it is anticipated that the credit certificates [that have already been] issued for projects would provide a basis for a loan as far as infrastructure and the cost of a project. There would be an interaction between something that has gone forward and a new program here, he said. He understood the current proposal is that if a borrower had received credits those would still be there. He asked whether AIDEA would use those as a financing mechanism or a financing collateral base for a loan from AIDEA.

MR. SPRINGSTEEN responded that in the past AIDEA has used tax credits as collateral for loans. He said there is some

consternation around double dipping, and he offered his understanding that this language was put in to resolve some of the thoughts around double dipping in the state programs. He said there is language in state statute regarding a preference to make loans to projects that do not have other forms of state support, but he stated his understanding that modifications could be made for effectiveness.

[12:14:16 PM](#)

REPRESENTATIVE SEATON said he is not hearing an answer and that he is not trying to put himself on one side of the answer or another. But, he continued, if people have tax credits that are not the basis of the loan amount that AIDEA is going for, the committee should have an answer as to whether those tax credits can be used for the collateral for financing. He posited that that is something the committee should determine as the bill is considered.

MR. SPRINGSTEEN answered that AIDEA's revolving funds program can take tax credits as collateral, but under this program AIDEA would not be able to.

REPRESENTATIVE SEATON said that is the clarity he wanted to find out.

[12:15:20 PM](#)

MR. THERRIAULT drew attention to the fiscal note dated 2/5/16 and pointed out that page 2 makes reference to the potential of the loan fund being capitalized. He explained that that would be tied to passage of a separate piece of legislation and it is up to policymakers to make the determination of whether that does pass. However, he continued, there is value to creating the loan fund even if it is not capitalized because setting up the mechanism would allow AIDEA to do some conduit financing utilizing the direction that is given for this fund. If the other legislation is passed and dollars are put in to capitalize the fund, it just becomes a more valuable tool, but that is a separate policy call for legislators.

[12:16:45 PM](#)

REPRESENTATIVE SEATON returned to page 8, lines 11-13, of the bill and asked whether AIDEA will be coming back to the committee with a proposal for a dollar limit on line 12 for not more than half of the capital cost of the above ground

infrastructure development and put a limit on that before it requires additional legislative approval.

MR. PARADY replied that AIDEA could do so, but that as an AIDEA board member he would note that that language is the existing language in the other funds and AIDEA's management to that limit stems from AIDEA's ability to bond. He offered his belief that the necessary conservative fiscal constraints are in place and that they have been adhered to by the board. He said the committee could pick a number, say, \$500 million or something, to require that if something scales to that size the legislature wants to see it first. But, he continued, AIDEA's ability to finance in those levels is limited by AIDEA's balance sheet and the bond market's assessment of AIDEA's balance sheet. He deferred to Mr. Springsteen to elaborate further.

MR. SPRINGSTEEN, in regard to the scale of these types of investments and being able to leverage and the strength of the different types of tools and attracting outside capital, stated that he is concerned about them not being able to provide the access to the capital that is sufficient to work alongside some of these development projects.

[12:18:50 PM](#)

REPRESENTATIVE SEATON inquired as to what "providing financing" means, such as whether that is direct AIDEA money or strictly AIDEA oil and gas money. He presumed that that is what Mr. Springsteen's answer meant and not bringing other financial partners into a financing package. For example, he understood [AIDEA] has \$25 million in Buccaneer Energy's Endeavour [jack-up rig], but that the whole package had other partners.

[12:19:39 PM](#)

MR. SPRINGSTEEN responded that in terms of the Red Dog Mine road and port system that supports the Red Dog Mine, for a portion of the capital for that infrastructure, AIDEA did access the bond markets for some of the money that would need to be invested to build out the road and the port conveyor and warehouse system that is in Northern Alaska. So, AIDEA would request to continue to have access to those types of bonding tools to support infrastructure development in the state, especially when there are some limitations on the capital for this type of infrastructure.

[12:20:32 PM](#)

REPRESENTATIVE SEATON, in regard to providing financing that constitutes more than one-half of the capital cost for a development, asked whether providing capital under this bill would be limited to money from the fund or to the whole package that AIDEA might put together with external financiers, whether they are foreign financiers, hedge funds, or whatever. If bonding is being exercised in addition to the capital from here, whether it is being said that the limit is 50 percent of the project funding coming directly from the oil and gas infrastructure development fund, but that AIDEA could utilize bonding and take the other 50 percent of the funding and be 100 percent supplier of the capitalization for a project. He presumed that is beyond where AIDEA would be, but said he is trying to determine what the structure would be in the statute and what that would allow.

[12:21:49 PM](#)

MR. SPRINGSTEEN answered it would be a 50 percent participation limit for any tool that AIDEA brings to bear for a project; a combination of an AIDEA investment, whether a loan or similar type of equity investment, in addition to any bonding that would be done. For example, a 50 percent participation for a \$400 million project would be \$200 million facilitated by AIDEA, and that \$200 million could potentially consist of \$30 million of AIDEA capital plus \$170 million in bonding. He said that is just an example of how each type of new investment has its own terms, conditions, and structure.

[12:22:49 PM](#)

REPRESENTATIVE TARR observed that slide 4 shows the projects and loans through 10/31/15. She presumed that even though AIDEA uses many steps along the way before involving itself in a project, oil and gas projects would be riskier investments than manufacturing, healthcare, or restaurant opportunities. She asked whether that would be a reason to be concerned relative to the other investments.

[12:23:26 PM](#)

MR. SPRINGSTEEN replied that AIDEA looks at the cash flow coverage, the collateral, and the guarantees that would need to be in place in order to protect AIDEA's 735,000 shareholders. There could be a slightly higher risk profile, but AIDEA is looking to get back the original investment plus interest for

its shareholders. Also, he said the board discussed having a separate program so that the revolving fund can continue being a general supporter of all Alaska businesses and industries. This program and fund would be a little more toward the single objective of supporting oil and gas industry in Alaska.

MR. THERRIAULT pointed out that the interest rate that would go with this fund would be a little bit higher because it is a little bit higher risk.

[12:24:31 PM](#)

REPRESENTATIVE CHENAULT inquired whether the legislature has limited the actual bonding capacity of AIDEA. He understood it was \$400 million or something like that.

[12:25:01 PM](#)

MR. SPRINGSTEEN responded that AIDEA may need to request volume capital allocation for a project - a revenue bond through AIDEA versus a conduit bond that relies solely on project cash flow. He said he would have to engage bond counsel to get an answer.

[12:25:38 PM](#)

REPRESENTATIVE CHENAULT understood there are many instruments and many different bonding capacities that can be done, but said he thought that the legislature had at one time set a limit on total bonding capacity and that may mean all the instruments or all the bonding pieces that AIDEA has. Continuing, he said he does not know if AIDEA is unlimited where it can bond for anything it wants to.

JERRY BURNETT, Deputy Commissioner, Office of the Commissioner, Department of Revenue (DOR), regarding the question of total bonding authority, said there is legislation before the House of Representatives this year that references the \$400 million annual cap on bonding authority. It is not a total cap on bonding authority, he stated, but an annual cap of \$400 million.

[12:26:47 PM](#)

REPRESENTATIVE JOSEPHSON related that Mr. Springsteen said something that gives him some pause, although it may have been a hypothetical. He recalled that when Representative Seaton asked about a financing package under [page 8], line 11, paragraph (1), Mr. Springsteen mentioned maybe \$170 million would be

financed through third parties and maybe [AIDEA] would put up \$30 million. He observed that [page 8], line 13, paragraph (2), would cap the guarantee of a loan at \$25 million and stated that that things seem counter-intuitive. He said it seems like it is riskier to actually provide \$30 million than to guarantee a loan of \$25 million. He requested Mr. Springsteen to clarify this.

[12:27:29 PM](#)

MR. SPRINGSTEEN answered that in a direct investment AIDEA looks to the cash flow, the collateral, and the guarantee. In the circumstance of a \$25 million guarantee, AIDEA would be the guarantor for another investor. So, it is a different risk profile and could potentially be a higher risk, and that's the reason for the guarantee amount of \$25 million, he indicated.

[12:28:15 PM](#)

REPRESENTATIVE SEATON drew attention to page 7, line 17, of the bill regarding the financial reserves. He said he understands the financial reserves for bonding or for loan guarantees. He inquired about the purpose of reserves for actual loans; for example, whether they are for defaulting on loans.

[12:29:05 PM](#)

MR. SPRINGSTEEN replied that the establishing of reserves would be for issuing bonds, and by establishing a reserve AIDEA could work with a lower interest rate for the project.

[12:29:35 PM](#)

CO-CHAIR NAGEAK stated the committee will meet tomorrow, 5/28/16, to take public testimony on HB 246.

[HB 246 was held over.]

[12:30:54 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 12:31 p.m.