ALASKA STATE LEGISLATURE
LEGISLATIVE BUDGET AND AUDIT COMMITTEE
February 12, 2015
3:04 p.m.

MEMBERS PRESENT

Representative Mike Hawker, Chair
Representative Kurt Olson
Representative Lance Pruitt
Representative Steve Thompson
Representative Sam Kito

Senator Anna MacKinnon, Vice Chair
Senator Cathy Giessel
Senator Bert Stedman
Senator Click Bishop

MEMBERS ABSENT

Representative Mark Neuman (alternate)

Senator Lyman Hoffman
Senator Pete Kelly (alternate)

OTHER LEGISLATORS PRESENT

Representative Mike Chenault
Representative Craig Johnson

COMMITTEE CALENDAR

PRESENTATION: MWH INFRASTRUCTURE DEVELOPMENT, INC.
PRESENTATION: ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

RICK ADCOCK, Managing Director
MWH Infrastructure Development, Inc.
MWH Global
Broomfield, Colorado
POSITION STATEMENT: Testified during discussion of the Interior Energy Project.

TED LEONARD, Executive Director
Alaska Industrial Development and Export Authority (AIDEA)
Department of Commerce, Community & Economic Development
Anchorage, Alaska
POSITION STATEMENT: Presented a PowerPoint titled "Overview of Interior Energy Project and Potential Purchase of Pentex Alaska Natural Gas Company, LLC."

BOB SHEFCHIK, Development Officer
Interior Energy Project (IEP)
Alaska Industrial Development and Export Authority
Department of Commerce, Community & Economic Development
Anchorage, Alaska
POSITION STATEMENT: Answered questions during the AIDEA PowerPoint presentation on the Interior Energy Project.

NICK SZYMONIAK, Development Officer
Energy Infrastructure
Alaska Industrial Development and Export Authority
Department of Commerce, Community & Economic Development
Anchorage, Alaska
POSITION STATEMENT: Answered questions during the overview presentation by AIDEA.

ACTION NARRATIVE

3:04:04 PM

CHAIR MIKE HAWKER called the Legislative Budget and Audit Committee meeting to order at 3:04 p.m. Representatives Hawker, Pruitt, Thompson, Olson, and Kito and Senators MacKinnon, Giessel, Bishop, and Stedman were present at the call to order. Also in attendance were Representatives Chenault and Johnson.

PRESENTATION: MWH Infrastructure Development, Inc.

3:05:18 PM

CHAIR HAWKER announced that the first order of business would be a presentation by MWH Infrastructure Development, Inc. He relayed that the hearing was being conducted under the statutory authority granted the Legislative Budget and Audit Committee to review the expenditure of state funds, and the relationship between state agency program accomplishments and the legislative intent. He spoke about the challenges to reduce the costs of energy to Interior Alaska, specifically through the Interior Energy Project. He reported that, in December, 2014, a legislatively approved project had been discontinued and was no longer being pursued. He explained that this hearing was to review the facts and circumstances surrounding this decision, and to discuss future direction with legislative desire and intent to facilitate interior energy cost relief. He reiterated that the committee would honor the commitment to Interior Alaska to focus a major legislative effort on energy cost relief. He referenced Senate Bill 23, which had included the merger of components of legislation and provided authority to the Alaska Industrial Development and Export Authority (AIDEA) to commence work on a gas trucking operation relying on North Slope natural gas for distribution in Fairbanks. He reported that this legislation had provided authority for $275 million in support, comprised of bonding for $150 million and potential cash assistance for another $125 million. He noted that Senate Bill 18, the capital budget, had also appropriated $57.5 million to AIDEA to facilitate progress on these investments. He stated that this committee meeting would discuss "what happened to the old plan" and would then discuss the origins and direction for a new plan.

3:10:07 PM

RICK ADCOCK, Managing Director, MWH Infrastructure Development, Inc., MWH Global, read from a prepared statement [Included in members' packets]:

> Mr. Chairman, Members of the Committee, thank you for the invitation to speak to you today.
>
> My name is Rick Adcock, and I am Managing Director of MWH Infrastructure Development, Inc. MWH Global, our parent company, is a global engineering and construction firm. We have served Alaska for over 35 years, and our Anchorage office has 30 employees working on infrastructure and other projects throughout the State. Just over one year ago, AIDEA selected MWH as the Concessionaire to the Interior Energy Project (IEP), to develop and bring private financing to the Northern Gas Supply Plant (NGSP) project.
>
> The State’s investment in the IEP, through AIDEA, was intended to attract private-sector partners to finance and develop the supply and delivery of liquefied

natural gas (LNG) from the North Slope to Interior Alaska. The expectation was that the State funds would be supplemented by private capital, and that the private sector would execute and operate the NGSP project on the North Slope.

Over the course of last year, we made significant progress toward the goal of delivering gas to the Interior in 2016. I will summarize our accomplishments in the next 15 minutes, but what you will hear is that: There is a large gas supply under contract and available to the project through GVEA, which can meet all expected long-term demand from the Fairbanks utilities, and which has significant additional capacity to meet new demand from other Interior communities, mines, the military, and other future Interior economic development activities.

3:12:01 PM

MR. ADCOCK continued with his presentation:

A highly-qualified, private-sector team was assembled to develop, finance, build, and operate the NGSP, in order to utilize that gas supply to produce LNG for delivery to Fairbanks.

Other elements of the supply chain were under development in parallel, and most of the commercial contracts required for the overall project were either executed, or in advanced stages of development.

The project is real and viable. MWH remains committed to this project and we are ready to pick up where we left off.

As of mid-December, we had assembled the pieces to meet the goal of delivering gas to Fairbanks in 2016. In addition to a signed Concession Agreement with AIDEA, we had achieved a joint venture to utilize GVEA's long-term gas supply agreement; an EPC contract; an operating and maintenance agreement; initial commitments, pending final due diligence, for over $100 million of capital from institutional infrastructure fund managers; and nearly final terms for off-take agreements with GVEA and FNG.

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CHAIR HAWKER asked for a description of the EPC contract.

MR. ADCOCK explained that this was an engineering, procurement, and construction contract, which included design and construction of the plant.

3:13:38 PM

MR. ADCOCK stated:

> Despite the progress on the project, it became clear that we would need an extension of the December 30, 2014 deadline for financial closing, in order to complete documentation on these arrangements and to allow our funding partners to complete their due diligence. An extension to March 31, 2015 would have been adequate for these purposes, and the extension would not have delayed first gas to Fairbanks in 2016.
>
> On December 22, 2014, AIDEA informed us by letter that they were not prepared to extend the financial closing deadline under the Concession Agreement unless MWH agreed to certain new terms under that agreement. MWH and AIDEA did not reach agreement on these changes and the CA was terminated in January 5, 2015.
>
> Now, I will turn to summarizing our private-sector approach over the last year to deliver the project on a schedule and at a cost aligned with the goals of the IEP.

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MR. ADCOCK reported:

> The IEP was originally conceived of as a public-private partnership, or P3. In the P3 model, a single private entity is responsible for bringing together a team to provide the services needed to design, construct, finance, and operate a project. The public sponsor may retain certain traditional government functions like dealing with regulators, but the general purpose of a P3 is to enable the public sector to harness the expertise, resources, and efficiencies

> that the private sector can bring to the financing and delivery of projects like the IEP.
>
> A key feature of any P3 project is the transfer of much of the risk generally taken by the public sector, over to the private entity. This is often accomplished through a concession that grants the private entity the right to perform what is typically a government function for a specified period.
>
> On September 19, 2014, after seven months of negotiations, AIDEA and Northern Lights Energy, LLC (NLE), a subsidiary of MWH, entered into a Concession Agreement, which granted NLE the exclusive right to develop the NGSP project. The Concession Agreement did not, however, confer ownership of the project to NLE. Rather, it allowed for the exclusive use of the assets for 30 years, after which time the assets would revert to AIDEA control. Under the Concession Agreement, NLE agreed to contract for the design and construction of the plant, the operation and maintenance of the plant, and to source the private financing for the project.
>
> The Concession Agreement was very prescriptive in how the private financing could be structured. Even though the project required well over $100,000,000 in private capital, the Concession Agreement capped the amount of equity that could be invested at $50,000,000, thereby creating the need for additional private debt. Moreover, equity returns were capped at 12.5% and, in the event this cap was exceeded, some of those additional returns would be used to lower the price of gas to the utilities.

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MR. ADCOCK explained that any profits over 12.5 percent would be used to rebate the utilities to lower the tariffs paid by customers. He continued:

> In addition to the capped upside on its equity participation, NLE was required to bear considerable risk under the Concession Agreement. If the cost to construct the project exceeded the available overrun reserves, NLE would be required to pay the additional costs associated with completing the project. Also,

all technical and financial risks of operation were to be borne by NLE.

Although the Concession Agreement granted NLE certain exclusive rights, it was not a monopoly. Alternative gas supplies, hydropower, and other competitive pressures would have constantly put NLE returns at risk. NLE also took financing risk because it would bear any increase in interest rates or insurance premiums. Finally, NLE assumed the credit risk of off-takers -- AIDEA did not backstop off-taker default risk, and the SETS subordination provided only limited protection.

So, NLE was willing to take a significant amount of risk that would normally be borne by AIDEA in a traditional procurement, including completion risk, financing risk, operations risk, competition risk, and credit risk. However, the project was not without some risk to AIDEA, including the risk of a State-sponsored alternative gas supply, the risk of repayment of the SETs funds by subordinating them to the equity, permitting risks, and site risks.

In delivering the project, MWH assembled a committed team of more than 40 professionals to execute the IEP, including partners and consultants who are recognized experts in the commercial, legal, financial, and technical aspects of the project. In order to facilitate decision making, throughout the project we worked very closely with AIDEA management, staff, and technical advisors by coordinating and collaborating on project activities on a daily basis.

Developing a successful project required clarity around, and confidence in, the cost of a safe, efficient, and well-constructed North Slope plant. The EPC contractor activities associated with developing a cost estimate are typically a closed-door process performed in support of competitive or lump-sum bid proposals, but MWH and AIDEA requested an open-book approach by our contractor.

3:19:14 PM

MR. ADCOCK relayed:

In a demonstration of commitment to the project, our contractor accepted this higher level of scrutiny on their estimating process, opening their doors to AIDEA, MWH, and their corresponding technical teams.

During the period from June through December 2014, the EPC contractor worked diligently with MWH and AIDEA staff to define and refine the project. The construction cost estimate and plant configuration process included working sessions to evaluate scope, demand, project assumptions, technical needs, logistics, detailed equipment specifications, and costs. From the onset of the project, the EPC contractor hosted weekly coordination calls and working sessions, which included participants from AIDEA and their technical advisors, MWH and their technical advisors, operations specialists, and third-party estimate reviewers.

At the conclusion of this effort, MWH had confidence in the configuration of the project and pad, and in the cost estimate that was developed. The estimating process was reviewed by a third-party entity with 30 years of experience estimating oil and gas projects on the North Slope. Their summary report of findings indicated that the estimate basis utilized by our EPC contractor was sound.

The development of the project site on the North Slope was included as a scope of work to be executed by the EPC contractor under a cost-reimbursable contract to AIDEA. The contractor completed pre-work on the North Slope pad in September 2014. All permits necessary to support the pad construction were obtained by AIDEA.

Engaging, informing, and securing commitment from the key Fairbanks off-takers was another critical step in developing the project. Throughout 2014, MWH met regularly with the three Fairbanks utilities: FNG, IGU, and GVEA. The Concession Agreement identified those utilities as *Preferred Customers,* and granted priority of supply in accordance with North Slope LNG availability. Frequently, MWH scheduled meetings in Fairbanks to apprise the utilities of our progress, solicit input on the project, discuss off-take contract structures, review demand curves, and generally assess the developing IEP supply chain. The project required ongoing participation and contributions from the utilities.

3:21:38 PM

MR. ADCOCK explained that:

MWH established a collaborative environment where all could engage constructively, even though the utilities have very different business models.

MWH developed a real project. There was, and is, a deep understanding of the site, the plant, the market, and the costs. We have a project that can deliver natural gas from the North Slope at a competitive price, significantly reducing the cost of energy in the Interior.

MWH and GVEA were partners in the development of the North Slope LNG project. The terms of our joint venture agreement provided for (1) making natural gas for the NGSP available through GVEA's existing gas supply agreement with a North Slope producer, and (2) ongoing marketing of gas to the Interior utilities on a preferred basis, as well as to other Interior users.

The existing gas supply agreement originally allowed GVEA to serve as the aggregator of Interior natural gas demand. The contract contains numerous attractive terms for a utility gas supply, including the contract length, an attractive raw gas price, the security that comes from an abundant supply of natural gas, proximity of gas infrastructure to the LNG plant, and a large volume available for purchase to meet future Interior energy demand. The contract is a logical and compelling natural gas source for the Interior Energy Project, because it is a secure and adequate gas supply to cover the requirements of the initial project, as well as several plant expansions, at an attractive price. GVEA had stated its willingness to provide gas to the utilities with no markup, other than to cover general administrative costs, and the cost of obtaining the original gas contract. These costs would amount to a few pennies per Mcf in the delivered price of gas.

As part of our development efforts, MWH met with many other potential off-takers, including industrial entities, mining companies, institutions, and military bases. Most expressed sincere interest in seeing the project successfully completed, so that they would have the fuel option of natural gas in Interior Alaska. Preliminary findings suggest a longer-term market for natural gas that far exceeds the supply provided by the initial 6 Bcf plant production capacity.

3:23:50 PM

MR. ADCOCK mentioned that Bcf was billion cubic feet, and continued with his presentation:

The NGSP would not only provide energy to these consumers, but the Concession Agreement required that a percentage of the profits from these non-utility sales be used to reduce the cost of LNG sold to the preferred utilities: IGU, FNG, and GVEA.

By mid-December 2014, our team had a high degree of LNG cost certainty. We had advanced the NGSP from a study-level concept and cost estimate, well into the design phase with site plans, process & instrumentation diagrams, and bid quotations on major pieces of equipment. These, in turn, led to a cost estimate and firm construction schedule by the EPC contractor. The team had achieved substantial agreement on the terms and conditions of a guaranteed maximum-price EPC contract.

NLE awarded an operations and maintenance contract for the NGSP, and executed the joint development agreement with our investor partner to provide over $100 million of private investment capital for the NGSP.

After several months of discussions, our team confirmed LNG demand estimates with the Fairbanks utilities. We had agreement, in principle, subject to board approval, for an off-take agreement with GVEA and, with similar conditions, for an agreement with FNG that met its forecast demand.

MWH worked in close collaboration with GVEA, FNG, and IGU to analyze and assess storage and trucking costs in an effort to reduce uncertainty around other supply chain costs. AIDEA's proposal to provide $10M in grant funding to a utility trucking consortium helped to lower those costs further.

As a result of this effort by our team and partners, NLE was able to offer agreements to the three Fairbanks utilities to supply LNG, delivered to Fairbanks, at a preliminary price in the range of $13 per Mcf. Though some areas of cost uncertainty remained, NLE was confident in the numbers presented.

3:26:04 PM

MR. ADCOCK concluded by stating:

We continue to maintain our interest in moving forward with our work on the IEP, and we have indicated this to AIDEA on several occasions. We believe that the work performed over the last year demonstrates that LNG can be delivered from the North Slope at a price that can address the Interior's economic challenges resulting from the high cost of energy.

Natural gas resources on the North Slope can be procured at prices that are well below the reported prices available from other sources. The total amount of gas available through the existing North Slope contract that would supply the NGSP is more than adequate to meet the Interior's energy needs for years to come. Interior utility customers, as well as industrial users, would have long-term access to affordable LNG, in quantities sufficient to support investments in the Interior's economic growth. And, the region's air quality would benefit greatly from substitution of natural gas for the fuels that are currently used.

At this point, the North Slope option for supplying LNG to the Interior has been thoroughly assessed. Once the Administration and the Legislature investigate the other alternatives just as thoroughly, if the North Slope option is found to be the best option for delivering affordable energy to the Interior, then the private-sector team led by MWH stands ready to revive the project.

3:27:24 PM

MR. ADCOCK added that MWH understood that energy cost and availability was "really about Alaskans, their communities, and their future." He declared support for working together with the government, local communities and the private sector for the best possible solution for energy costs. He noted that, with the Interior Energy Project (IEP), MWH had taken on the responsibility to address this problem, and, although no solution was simple, there were several proposed viable solutions advanced for North Slope gas. He emphasized that MWH believed there were compelling reasons to consider the North Slope LNG project, and that MWH recognized that the community needed a solution which worked technically, financially, economically, and politically. He expressed understanding for the desire to consider alternatives. He offered that MWH would like to continue to contribute private sector capabilities in a constructive, collaborative, and professional manner.

3:28:36 PM

CHAIR HAWKER asked to clarify the benchmarks for discussion of the cost for gas delivery, whether it was cost to the consumer, "the burner tip," or cost to the utility, "the city gate." He asked for clarification to the aforementioned preliminary price delivery to Fairbanks of $13 per Mcf.

MR. ADCOCK explained that this price was city gate.

CHAIR HAWKER asked if Mr. Adcock could share how much MWH had currently invested in the project.

MR. ADCOCK replied that the MWH investment was close to $3 million.

3:29:57 PM

MR. ADCOCK directed attention to slide 1, "Model View of NGSP," which depicted the plant model designed by its contractor. He explained that it was designed as a 6 Bcf plant. He moved on to slide 2, "Plant Siting with Future Expansion Considerations," and noted that the proposed plant could be expanded to 12 Bcf as demand grew, while allowing the first 6 Bcf to continue operation during expansion. Directing attention to slide 3, "Constructed Gravel Pad," he noted that this was the North Slope pad constructed during the previous summer, as well as a gas supply plant where the tie-in for the gas arriving from the North Slope would occur.

CHAIR HAWKER asked who owned the depicted pad.

MR. ADCOCK replied that the State of Alaska owned the pad.

CHAIR HAWKER asked how much the state had invested in the pad.

MR. ADCOCK offered his belief that it was several million dollars.

3:31:09 PM

MR. ADCOCK concluded with slide 4, "Component Costs of the IEP Supply Chain," noting that MWH had put together a very sophisticated financial model which was refined daily to model the entire supply chain. This slide showed the probabilities of outcomes given the uncertainties in the supply chain, which included the gas itself subject to energy market changes, the liquefaction in the plant, property tax on the North Slope, and the possible costs of the trucking component. He explained that, as these variables were stacked together, the projected cost during the past December, was $12.50 - $13.50 per Mcf.

3:32:13 PM

CHAIR HAWKER asked whether MWH felt that the project was economically viable, if they would have been willing to continue with the project, and the reason Mr. Adcock had been given for the termination of the project.

3:32:52 PM

MR. ADCOCK offered his understanding that the project was terminated because there was not community or political alignment behind the project. He stated that, although MWH did consider this an economically viable project, the politics were not there to close it. He declared that MWH was willing to continue to work on the project; however, the terms required by AIDEA to extend the concession agreement would have made it financially impractical for MWH to continue.

CHAIR HAWKER pointed out that these documents were available on BASIS.

3:34:00 PM

SENATOR MACKINNON highlighted that, in a P3 environment, private partners were sought for capitalization to some of the investment. She directed attention to comments by Mr. Adcock for a required investment range of $50 - $100 million with an interest rate of return capped at 12.5 percent. She offered her belief that this rate of return may have been reviewed politically, and determined that there were better deals elsewhere.

MR. ADCOCK, in response, explained that the capital structure of the project brought the Alaska Industrial Development and Export Authority (AIDEA) grant funding at a 0 - 3 percent interest rate, as well as private equity and private debt. He stated that, as AIDEA had allowed 12.5 percent return on the equity component of the capital, this was the return that MWH requested. As the debt component was in addition to this, he offered an example for the need to raise $120 million of private capital, which would have required $50 million in equity and $70 million in debt. He noted that the debt would "come in at a lower rate" and that the lenders were the last financial entity to enter the picture as it was necessary for them to review the entire project and its contracts in order to perform due diligence. He shared that, although MWH had spoken to many lenders, they had not yet finalized terms, which would have been at a much lower rate than the equity capital. He pointed out that this equity was typically at a higher rate of return, as it was "the first line of fire, if there's any losses, equity's gone." He shared that, with a weighted average cost of capital, the capital cost would be significantly lower for a project, especially if the AIDEA capital was blended in. He emphasized that the public policy goal by the state was to make the project happen, with rates to consumers that were lower than if the project had been totally financed by the private sector. He pointed out that blending in the public sector component of the capital allowed a lower weighted average cost of capital, which directly translated to lower consumer rates.

3:36:56 PM

The committee took a brief at-ease.

PRESENTATION: Alaska Industrial Development and Export Authority

3:38:12 PM

CHAIR HAWKER announced that the next order of business would be a presentation by the Alaska Industrial Development and Export Authority (AIDEA) regarding the Interior Energy Project (IEP).

CHAIR HAWKER, noting that there had been a transition in the project during December for a new conceptual direction, asked if the decision process at AIDEA could be segued into the presentation.

3:41:03 PM

TED LEONARD, Executive Director, Alaska Industrial Development and Export Authority (AIDEA), Department of Commerce, Community & Economic Development, Presented a PowerPoint titled "Overview of Interior Energy Project and Potential Purchase of Pentex Alaska Natural Gas Company, LLC." [Included in members' packets]. In response to Chair Hawker, he relayed that AIDEA was still in contact with MWH Infrastructure Development, Inc. and that AIDEA was still looking for a North Slope solution. Based on cost, changing conditions, and associated risk, AIDEA was still working to review all sources of gas and to provide the lowest cost of energy to Fairbanks.

CHAIR HAWKER directed attention to the written answers submitted by AIDEA [Included in members' packets.] He declared that his desire was to have a clear record for the points of difference between community expectations and the partnership between MWH and AIDEA, and the specific data point which brought about the change of direction.

MR. LEONARD moved on to slide 2, "IEP Goals," declaring that the goal was to supply natural gas to as many customers as possible in Interior Alaska, as soon as possible, and at the lowest cost possible. He relayed that AIDEA understood that the North Slope facility, and any other investments for LNG capacity, would be complementary to the natural gas pipeline. He acknowledged that the State of Alaska was looking at a project to replace this current project. He pointed to another goal for lower PM2.5 in nonattainment areas of the Interior, such as the North Pole. He stated that the IEP goals and the targeted community expectation was $15 per Mcf delivered to the burner tip.

CHAIR HAWKER relayed that the earlier testimony by MWH had been for a price of $13 per Mcf delivered to the city gate. He asked for a comparison of this to the burner tip price expectations.

MR. LEONARD replied that this was a moving target. He referred to earlier presentations two years prior for the feasibility cost, with a distribution cost of approximately $4 [per Mcf]. He stated that this estimate had changed.

CHAIR HAWKER summarized that the community was expecting no more than $11 [to the city gate] and that this $2 differential was what changed the direction of the program.

3:45:57 PM

BOB SHEFCHIK, Development Officer, Interior Energy Project (IEP), Alaska Industrial Development and Export Authority, Department of Commerce, Community & Economic Development, said that, although he was newly the IEP team leader, he had worked with interior gas utilities for the past 2.5 years and consequently had some background for expectations and the potential price for delivery to the city gate. He shared that there had been similar presentations for the range of pricing during the process, with a price ranging from $13.42 up into the $14.00s. He expressed disagreement with that portion of the presentation by Mr. Adcock for the cost and risk to the utilities.

3:47:12 PM

CHAIR HAWKER suggested that a reason for the termination of the project was that the meter price did not meet the community goals, and he asked what were those goal expectations.

MR. SHEFCHIK replied "you bet I can. The expectation was pricing in the range of $15 per thousand cubic feet [Mcf] delivered to the home, to the meter, the burner."

CHAIR HAWKER asked if this translated to roughly $11 [to the city gate].

MR. SHEFCHIK replied that this was not a direct linear question, as the higher the cost of the North Slope plant and the more low cost money used to fund that plant, it was then necessary to use more high cost money for distribution and storage. He pointed out that as the cost of the plant would grow, the cost of distribution would increase. He offered an example that the use of the low cost money approved by the legislature for building the plant meant that the cost of money was higher for building the distribution system. This would result in higher distribution costs, which were in addition to the already higher cost of gas. He noted that a review of the entire supply chain had revealed an increase of distribution cost due to the higher cost of that money, hence an increase to the storage cost, resulting in cost to the burner tip of $20.50 - $22.00.

CHAIR HAWKER asked for clarification that the cost reflected a division of the funding in the state subsidy for the project.

MR. SHEFCHIK expressed his agreement. He said that, in January, 2014, there had been a projected cost of $170 million for a 6 Bcf (billion cubic feet) plant; then, when the plant cost was significantly higher, additional money was necessary, which subsequently increased the cost of money for distribution.

3:50:02 PM

SENATOR MACKINNON asked about the changing criteria referenced by MWH when there was a request for an extension of the contract.

MR. LEONARD, in response, said that there were several requirements necessary, in order to move forward with the contract extension. The main requirement had been for MWH to waive exclusivity of the contract, thereby allowing the state to talk with other parties for alternative sources. He said that the original concession agreement was based on a North Slope facility which AIDEA and MWH would work on exclusively, while AIDEA was not allowed to talk with others about the development of other sources of gas for Fairbanks. This agreement would have given MWH the exclusive market for gas delivery into Fairbanks. He reported that exclusivity needed to be waived in order for AIDEA to take the step to look at alternative sources. He added that other requirements were desired by the attorneys to ensure there would not be any other pitfalls in the concession agreement. He relayed that the AIDEA attorneys and financial advisors believed that a review of the other alternatives and discussion of financing could not be done under the existing concession agreement.

3:52:42 PM

SENATOR MACKINNON directed attention to page 4 of the prepared remarks by Mr. Adcock, and read: "Although the Concession Agreement granted NLE certain exclusive rights, it was not a monopoly. Alternative gas supplies, hydropower, and other competitive pressures would have constantly put NLE returns at risk." She asked if he was referring to this.

MR. LEONARD replied that, in actuality, the alternative gas written into the concession agreement was the natural gas pipeline. In the contract, it was specifically stated that AIDEA would only work with MWH to bring gas to Fairbanks.

CHAIR HAWKER, asking about the aforementioned $280 million facility cost on the North Slope, offered his belief that it was $220 - $230 million.

MR. SHEFCHIK replied that the facility had a $228 million target price, with a $20 million do not exceed. Along with this total of $248 million, there was capitalized interest, operations during construction, and confidential fees to MWH and other parties, which had resulted in the aforementioned $280 million total capitalized costs for the plant. He pointed out that this had "choked the community reaction on a plant that had come in in pre-FEED estimates of $170 million."

CHAIR HAWKER offered his belief that a very excessive number was used, as opposed to the EPC (engineering, procurement, and construction) estimate of $228 million that had been validated by knowledgeable North Slope construction experts. He acknowledged that "there is no knowable answer here. It is some place between $228 and $280, depending where the thing lands."

MR. SHEFCHIK expressed his disagreement, stating that the price could be about $20 million less than $280 million, but he emphasized that the price would not be between $228 million and $280 million. He declared that the only unknown was "the not to exceed price."

CHAIR HAWKER offered his belief that Mr. Shefchik was misinterpreting his comment. He opined that this had been a viable project, but asked if there had not been enough subsidy from the state to reach the community's economic goals. He suggested that AIDEA could have come back to the legislature and ask for more support, instead of cancelling the project.

MR. LEONARD opined that, although asking for more funding from the legislature was an alternative, AIDEA wanted to first look at other alternative sources.

3:57:45 PM

MR. LEONARD returned attention to the PowerPoint, slide 3, "Focus on Full Supply Chain." He stated that the IEP project was not solely concentrating on plant construction and distribution, but was instead focusing on the full supply chain, from gas supply, to plant, to transportation, to storage, to distribution, and to conversion to utilize the increased distribution for the LNG. He declared that AIDEA needed to "take a pause" and review ways to reduce the cost of distribution and lower the price to city gate. He reiterated that there was an AIDEA team looking at all sources, in order to quickly move the project forward to meet the goals of the IEP.

CHAIR HAWKER, acknowledging that the project focus had changed to the full supply chain, reported that testimony indicated that the state had not put forward enough financial subsidy to reduce the prices to meet the community expectations. He asked if the current list indicated that AIDEA and the state were now looking at direct involvement for subsidizing each and all of the supply chain elements.

MR. LEONARD explained that the discussion for financing to the original IEP had always included research for ways to invest in all the aspects of the supply chain. He noted that review of the supply chain during the project had identified ways to better optimize through investment. He offered his belief that the presentation would clarify the elements necessary to make the project move forward. He stated that it was necessary to focus on some identified areas to bring down the costs.

4:02:07 PM

CHAIR HAWKER asked how AIDEA intended to achieve that. He questioned whether it was necessary for the state to be in competition with the private sector, in order to use the lower costs from state capital, or whether the state should encourage private sector development.

MR. LEONARD, in response to Chair Hawker, said that he would discuss this, as he moved on to slide 4, "Work Performed Under the Concession Agreement." He relayed that, under the concession agreement, MWH was the project developer. As the parties worked toward financial closure, there were still several items necessary for completion. He listed that it was necessary for AIDEA to agree to the project costs and the commercial terms, that MWH would provide the construction and operating agreements, that MWH would negotiate and secure LNG supply agreements with the utilities, and that a financial model, with an agreed upon LNG price, would be developed to meet the financial needs of the community. He offered his belief that, as AIDEA was performing its due diligence, the capital costs were much higher than the projected costs, slide 5 "Termination of the Concession Agreement." He reiterated that the project would have required more capital from the private sector and from the state. He shared that, as there were many moving targets, the cost rose to $13 - $14 to city gate, and with additional distribution costs based on the utilization of the capital, this brought the cost to $19 - $20 [to the burner tip].

CHAIR HAWKER asked whether or not the utilities would commit to purchase gas based on the model prices, and if not, at what price would the utilities have committed to purchase gas.

MR. SHEFCHIK, in response, explained that during negotiations with Golden Valley Electric Association, Inc. (GVEA), Fairbanks Natural Gas, LLC (FNG), Interior Gas Utility (IGU), and Northern Lights Energy (NLE), specific issues for each of the utilities had been discussed. He reported that throughout the discussions, the price would change based on assumptions, with a range of $13.42 to more than $14.00 at city gate. He offered his belief that GVEA would have accepted a higher dollar, as distribution was not necessary. He relayed that IGU and FNG had concerns, and he opined that it would have been necessary for the price to be $10 - $11 for IGU, or for distribution financing to be available to drop that cost from $5.50 to $3.50. He stated that the utilities would have signed up for a price of $11 - $12 to the city gate. He offered his belief that there was willingness for $11 and under, uncertainty between $11 - $12, and much more difficulty for agreement above $12.

CHAIR HAWKER asked for the current actual cost of gas to the city gate, to use as a benchmark in comparison with the target numbers.

MR. SHEFCHIK replied that it was unclear, as FNG was a combined supply chain which separated out its utilities; as the supply plant was owned by Titan Energy LNG, LLC and the distribution was owned by FNG, FNG charged themselves $15.02 to the city gate.

CHAIR HAWKER acknowledged that there were transfer pricing issues, and he asked for current retail burner tip prices.

REPRESENTATIVE THOMPSON relayed that he was currently paying $23.35 per mcf (thousand cubic feet).

MR. LEONARD said that the facility charges ranged from $23.44 to $24.00.

CHAIR HAWKER commended the persuasive arguments presented earlier by Representative Thompson for the need to lower utility prices.

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SENATOR STEDMAN asked for a conversion from Mcf to kilowatt hours (kWh) for electricity.

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NICK SZYMONIAK, Development Officer, Energy Infrastructure, Alaska Industrial Development and Export Authority, Department of Commerce, Community & Economic Development, replied that a conversion chart had been provided earlier to the Senate Special Committee on Energy. He said that this price would be equivalent to a little more than $.08 kWh, if heated by $25 per million Btu natural gas.

SENATOR STEDMAN asked if this was also comparable to a heating fuel cost of $3.00 per gallon.

MR. SZYMONIAK expressed his agreement.

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CHAIR HAWKER asked where AIDEA was going with regard to the value chain it was reviewing for investment. He asked what AIDEA was doing in lieu of this project it had set aside.

MR. LEONARD said that although the project had not been set aside as an alternative, the one LNG facility project had been put on pause in order to ensure that all the alternatives were reviewed. He offered his belief that the utilities would not commit to the price presented through the North Slope Project. He declared a necessity for review of the alternative sources in conjunction with a review of the other aspects in the supply chain, in order to bring the total cost to a workable price.

CHAIR HAWKER asked about the alternatives under review, and if there was assurance that any of these alternatives would meet the desired prices.

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MR. SHEFCHIK offered an overview for his vision to the next three months and the expected actions for the project. He relayed that the cost of heating oil was currently benchmarked at $25 - $30 per million Btu. He declared that the goal for every action was to bring down that cost. He pointed out that the first step would be to convert from heating oil to trucked gas and then possibly to train-supplied gas, and finally to a big pipeline for gas supply. He stated that the goal was to build an infrastructure to lower the price of energy in the Interior, and maintain the opportunity for service to the road system. He referenced the aforementioned slide 3, "Focus on Full Supply Chain," and noted natural gas supply, liquefaction, transportation, storage, distribution, and conversions as the areas of investigation for the most effective gas supply. He added that teams from Department of Natural Resources (DNR), Department of Revenue (DOR), and AIDEA would look for solutions to lower gas cost for all the utilities, as well as a specific contract for gas that would fill a liquefaction train from Southcentral Alaska. He declared that there were a number of liquefaction opportunities. He assured the committee that the project would look at propane and, as due diligence for the Pentex Alaska Natural Gas Company, LLC (Pentex) acquisition was performed, would winnow this down to a specific narrow range of options for comparison to the North Slope benchmark. He pointed out that although the community was indifferent to its source of gas, it was highly sensitive to the price and the timeframe for delivery. He opined that by summer there would be a project "back on the rails that is consistent with Senate Bill 23" and would optimize all the components of the supply chain. He added that, if after this review AIDEA could not make the project work, they would come back to the legislature.

CHAIR HAWKER summarized that the plan for the project was to review everything for the next six months.

MR. SHEFCHIK replied that there would be an assessment of progress to the legislature every three weeks, as there would be concurrent actions on multiple paths. He declared that he had a singular goal with a singular focus and if there were not sufficient tools to attain the goal, they would return to the committee for further support.

CHAIR HAWKER reiterated that the objective was for an identified project which met the expectations of the utilities, within six months. He reviewed the direction of the project, either south to north, or north to south. He acknowledged that there was a market for gas in Southcentral, although that demand had been somewhat alleviated for the short term. He asked how much expansion was necessary from the Cook Inlet for the project.

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MR. SHEFCHIK, in response, said that he had agreed to lead the supply chain starting at LNG, and that he would facilitate the gas supply, although there would be DOR and DNR representatives on the team who were expert on the Cook Inlet energy market to look at gas acquisition. He stated that the governor had made this a priority of his administration and was putting resources toward the project. He suggested that there could be a large combined buyers' club in anticipation of the 2018 time frame. He stated that the success of the IEP should not be dependent on solutions for the energy issues in the rest of Alaska. He noted that a smaller project team would be reviewing the producers without large shares of the market who could meet their needs. He acknowledged that this was the extent of his knowledge on Cook Inlet gas.

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CHAIR HAWKER asked if the state was considering the purchase of a smaller producer as a source of gas for the project.

MR. SHEFCHIK replied that they were looking for a gas supply contract to fill the 3 to 6 billion expected known demand for the upcoming five years, noting that this was a small demand relative to that from Southcentral Alaska and Cook Inlet.

CHAIR HAWKER relayed that an announcement by the governor that the state was going to acquire Pentex had prompted this dialogue. He asked where the Pentex acquisition would fit into the project, and about earlier comments regarding rail cars and competition for the acquisition of the Pentex LNG plant.

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MR. LEONARD, in response, relayed that the acquisition of Pentex was to reduce cost and to assist on the distribution side, slide 7, "Decision to Begin Negotiations to Purchase Pentex." He offered his belief that the ability of AIDEA to look long term could be of assistance for reducing the cost of current distribution by 8 - 14 percent, and by 15 - 20 percent in 2019. He based this projection on the costs of capital and the willingness by AIDEA to concentrate on an integrated system.

This type of investment would require that AIDEA live up to all the Pentex obligations in regard to selling the LNG facility at Cook Inlet. He offered his belief that it was possible to work with Hilcorp for that commitment demand of 3.5 - 4 Bcf from the Fairbanks area. He stated that this would move forward the ability to bring gas to Fairbanks by promoting LNG capacity either on the North Slope on in the south. He declared that it was important to have the demand in Fairbanks in order to move forward to incentivize the private sector for the LNG capacity section of the chain.

CHAIR HAWKER opined that the purchase of a private sector entity, Pentex, by the state was not necessarily incentivizing. He asked for the proposed dates and times, directing attention to the letter of intent to purchase Pentex, which stated that the transaction would be closed no later than February 28, 2015. He asked how this acquisition could be reconciled, as it was before the proposed assessment to the economic viability of the various projects.

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MR. LEONARD replied that the letter of intent clarified that this was a non-binding agreement in order to move forward with due diligence. He noted that the February date reflected completion of the initial due diligence, with approval by the board estimated to be at the end of April, and closing to be in June or July. He estimated that the due diligence process would take three to four months. As there was a concentration on the distribution side, this was an important component for forward movement from either the north or the south, and that optimizing this part of the chain was critical for the Interior Energy Project.

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CHAIR HAWKER asked if it was the AIDEA intent to hold and operate the Pentex assets, or to dispose of Pentex to another entity.

MR. LEONARD replied that the goal was to hold the asset for a short transition period, work with the community for creation of an integrated operations system, and then sell it, with a return of the investment, to another entity. He stated that it was not a goal of AIDEA to own the project long term.

MR. SHEFCHIK relayed that his directions from the AIDEA board chair had been to focus on the integration of the system and the development of options for the transition from AIDEA to another ownership structure, a joint venture partnership, or management from outside. He acknowledged that this was near the top of his task list while performing the due diligence. He was to develop a physical plan, as well as an organizational and ownership plan, to transition AIDEA out of ownership after recovery of its investments.

CHAIR HAWKER asked why the state needed to be in the middle of this even for a short period, instead of a free market transaction that did not require the state to hold the asset.

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MR. LEONARD directed attention to slide 8, "Benefits of Utility Coordination & Integrated Distribution System," and offered his belief that moving forward with the project required AIDEA ownership for a portion of the time. He said that no private entity had come forward to purchase FNG, noting that it had been for sale in past years. He opined that this investment would serve a public purpose, and, based on the preliminary due diligence, this was a safe investment. Directing attention to the two independent utilities depicted on slide 8, he offered his belief that AIDEA involvement in this investment would reduce operating costs, allow for efficient capital investment, restart needs for the storage necessary for demand capacity, and bring a unified demand to the market to purchase gas.

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CHAIR HAWKER reiterated that the state supported the project and intended to maintain its commitment to lowering costs in Interior Alaska. He pointed out that this was clarification for "what we're doing, where we're putting our investments." He offered his belief that the intent, as there was only one obvious purchaser, was to facilitate the acquisition of FNG by IGU.

MR. LEONARD replied that this would be one of the main options. He reiterated that this investment would be short term and that it was critical for meeting the mission of the Interior Energy Project.

CHAIR HAWKER asked again why AIDEA did not directly support IGU in acquiring the Pentex assets.

MR. LEONARD replied that, after due diligence, the exit strategy would include all these options in its finance plan before the board would move forward with a presentation to the legislature.

CHAIR HAWKER pointed out that the purchase of Pentex would include its existing contract to sell the Point Mackenzie LNG plant to a subsidiary of Hilcorp, as well as a long term LNG sales agreement with FNG to sell 100 percent of the plant output for a period of five years at $15 per Mcf to the city gate. He noted that this was substantially higher than the figure expressed as acceptable to the utilities. He acknowledged that after this five year period the price could be adjusted to match any comparable sales of LNG by another seller into the Fairbanks area; however, if there was not another seller, the city would not have any other option but to pay $15 at the city gate.

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MR. LEONARD expressed agreement that this issue was being addressed during the due diligence process. He said that, as this current FNG contract was about 15 - 20 percent of the total supply, it would be blended with additional contracts.

CHAIR HAWKER asked for clarification of the commitment, that the FNG contract was for 100 percent of the need of active gas customers in Fairbanks. He stated that this was 20 percent of the anticipated build out when the Interior Gas Utility (IGU), currently without any customers, gets the system built out for delivery to the rest of Fairbanks.

MR. LEONARD expressed his agreement that the current contract, about 0.95 Bcf between Hilcorp Energy Company (Hilcorp) and FNG, was for the existing customers. He reported that the IEP had funded about 33 miles of new pipe for FNG, with an additional 26 miles to be built. This would make another 1.5 Bcf available based on conversions. He stated that, based on total demand need in the future, this was the aforementioned 20 percent. He shared that with the proposed build out of North Pole by IGU, as well as the proposed build out by FNG in 2016, the actual pipes across structures would be 7200 instead of the current 1100.

CHAIR HAWKER asked for clarification that this was 100 percent of current demand and 20 percent of anticipated FNG full build out demand.

MR. SHEFCHIK clarified that this was 100 percent of the plant capacity and that, as FNG had two interruptible customers, the hospital and the university which had LNG service turned off when it was cold, 100 percent of demand would allow these customers to maintain service.

CHAIR HAWKER stated that it was agreed "to meet all FNG current requirements by delivering to FNG the entire maximum output of the existing facility." He relayed that the state was looking at acquiring FNG, currently a privately held entity. He asked, "Who is IGU?"

MR. SHEFCHIK replied that the Interior Gas Utility (IGU) was a public entity wholly owned by the Fairbanks North Star Borough.

CHAIR HAWKER asked if it currently had business operations.

MR. SHEFCHIK replied that it was a development company and did not have any business operations.

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SENATOR MACKINNON expressed her concern that there was dependence on "a reliable supply from the Cook Inlet region from a small explorer that may or may not have proven production." She asked if Mr. Shefchik had more information on this availability and new discoveries.

MR. SHEFCHIK reiterated that, as he had shared all of his knowledge of the Cook Inlet energy supply, there was a team lead by DOR and DNR for the Cook Inlet contract acquisition. He shared that a focus of the current administration was to develop a gas supply contract for this project.

SENATOR MACKINNON expressed her understanding that the current utility contracts in Anchorage were short term, and that the city had just stopped its brownout drills to reduce usage. She acknowledged that, although there was a lot of activity in the Cook Inlet, there were proven reserves on the North Slope. She questioned whether this was a chase under the auspice of "build it and they will come." She directed attention to the ferry [MV Susitna] as just such an example.

MR. SHEFCHIK replied that there was not any desire to build a supply chain with no gas, and that the direction of the supply chain would be determined by the availability of gas.

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SENATOR MACKINNON expressed her concern for the criteria of a supplier to this project, if this was for finding a smaller supplier. She stated a desire to provide a lower cost for reliable, cleaner energy to Interior Alaska. She expressed her interest for the formula of the purchase price to the various facilities. She pointed out that a declaration of price allowed little option for negotiations. She offered her belief that there had been overpayment for the product, and that the state would be required to pay the difference in a subsidy.

MR. LEONARD replied that the purchase price stated in the letter of interest was a negotiated proposed price based on preliminary information, and was not a set price. He reminded that it was necessary to perform due diligence, and that financial advisors and a utility evaluation company would be consulted. He explained that if, after valuation, the price was too high then AIDEA would attempt to negotiate a fair value price or the deal would be terminated. He stated that AIDEA would only pay a fair price based on asset value.

SENATOR MACKINNON expressed her interest in the determination of cost value, remarking that, as it had been on the market for multiple years at that price, everyone else thought that price was too high.

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REPRESENTATIVE THOMPSON stated that he had copies of the formal request from 1954 entreating the federal government to build a gas line from the National Petroleum Reserve to Fairbanks to help relieve the cost of energy, and "it's 61 years later and we're still waiting."

CHAIR HAWKER reflected on the historical records he had in his possession.

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SENATOR STEDMAN offered his understanding that, as it was necessary to make a good business decision, a lack of purchasers indicated something wrong with the price or the market. He expressed his concern for the state making a purchase of good value. He pointed out that there had been situations where "the state ends up holding the bag," while other investors behind the corporation "end up sitting fairly well." He declared a need for due diligence, regardless of the time frame, and the need for a prudent decision.

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SENATOR BISHOP expressed his gratitude to AIDEA for its diligence, attention, and commitment for bringing gas to the interior. He asked if there had been full due diligence for the purchase of FNG. He declared that there had been reverse engineering for this project from the beginning, and that front end engineering would have resulted in completion of this project.

CHAIR HAWKER reflected on the Pentex purchase, noting that, while it currently provided 100 percent of the current need, this would only be 20 percent of future need. He pointed out a need to add four times the current capacity in the foreseeable future. He stated that often a used and in-place asset offered a more cost effective price than building new. He suggested that it was necessary to compare this with the cost of building a new facility with four times the capacity.

MR. LEONARD asked for clarification that the reference was for a distribution system and not an LNG facility.

CHAIR HAWKER replied that he was referencing the value chain model, with the need to add an additional 80 percent by building new capacity: finding the gas, building the LNG plant, and building the delivery and distribution systems. He noted that it was also necessary to pay for the LNG conversion in the homes. He asked if it was possible, after the Pentex purchase and building for the new capacity, to still meet the $10 - $11 city gate cost objective.

MR. SHEFCHIK replied that this was an accurate description of the situation and would be a part of the due diligence decision process.

CHAIR HAWKER referenced Senate Bill 23, which empowered Alaska Industrial Development and Export Authority to provide the financial support to a North Slope sourced gas project. He questioned whether this gave carte blanche to the build out in Fairbanks. He asked what AIDEA currently required from the Alaska State Legislature during this session in order to have the free rein to move forward and execute this value chain grand plan.

MR. LEONARD said that, in order to utilize the full strength of Senate Bill 23, removal of the wording "North Slope" would be necessary to allow the funding to be used for assistance in lowering the cost of gas in Southcentral Alaska, if that route became available. He said that it was necessary to review all sources of gas in order to bring the lowest possible cost to Fairbanks.

CHAIR HAWKER asked for clarification that the funding appropriation mentioned by Mr. Leonard was the $57.5 million authorized in Senate Bill 18.

MR. LEONARD expressed his agreement, noting that approximately $45 million was still available, and this would allow the flexibility for an alternative source, other than a North Slope plant, that could utilize those monies to bring down the cost, reduce the risk, and meet the goals of the Interior Energy Project. He stated that the investment by the state for the North Slope plant had brought the cost to $13 - $14, and without those state funds, the price would have been much higher. He declared that utilization of the tools granted by the legislature for analyzing alternatives down south would be beneficial.

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CHAIR HAWKER offered his belief that AIDEA had not received adequate financial support from the legislature for the original North to South project to allow the build out by IGU, as well as the necessary support at the LNG plant level to achieve a low enough cost of gas throughout the entire system. He questioned whether a South to North route would change the analysis. He asked if the legislature should increase funding or debt capacity, or replace the funds already spent.

MR. LEONARD opined that an analysis would show the impact for more funding and more bonding authority, although bonding authority on the North Slope may not be beneficial to the project. He said that bonding for distribution was easier than bonding for a plant.

CHAIR HAWKER suggested that AIDEA not "cut yourself short," and that AIDEA should ask for more funding so the legislature could make that decision to provide the additional support that was necessary to make the project move forward, while judging it against the other competing interests in the state.

5:00:05 PM

SENATOR STEDMAN said that the target range for getting energy delivered to Fairbanks was reasonable. He offered his belief that it was not possible to bring the cost to Fairbanks to the same range as the cost to Anchorage. He suggested that the Fairbanks target numbers should be reasonable numbers to bring other area energy costs into alignment, noting that this would also include Southeast Alaska.

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REPRESENTATIVE THOMPSON expressed his pleasure for the pursuit of other alternatives. He declared a desire for reasonably priced energy, and he acknowledged that Fairbanks consumers recognized the costs and did not "have our hands out." He pointed out that this could create economic development which could enhance the entire state.

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ADJOURNMENT

There being no further business before the committee, the Legislative Budget and Audit Committee meeting was adjourned at 5:02 p.m.