

SENATE FINANCE COMMITTEE  
February 17, 2015  
9:05 a.m.

[9:05:56 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:05 a.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair  
Senator Peter Micciche, Vice-Chair  
Senator Click Bishop

MEMBERS ABSENT

Senator Pete Kelly, Co-Chair  
Senator Mike Dunleavy  
Senator Lyman Hoffman  
Senator Donny Olson

ALSO PRESENT

Randall Randall Hoffbeck, Commissioner, Department of Revenue; George W. Bilicic, Vice-Chairman of Investment Banking, Lazard Freres and Co., LLC.

SUMMARY

^PRESENTATION: LAZARD INTERIM REPORT

[9:06:59 AM](#)

RANDALL RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, testified that the passage of SB 138 had created a requirement for identifying financing options for a gasline project on the North Slope, as well as a plan for municipalities, regional corporations, and other individuals within the state to be able to participate in the project. He said that Lazard had been hired as the financial consultant for the state and to help create a report detailing the various available options. He added

that a second and final report would be available later in 2016 and would be more project specific.

9:07:50 AM

Co-Chair MacKinnon asked whether the administration had given the Lazard group any information that would affect how the presentation was delivered to the legislature. She asked whether TransCanada had been included in the project, were there debt considerations, and had the administration changed the intent of SB 138.

Mr. Hoffbeck responded that there had been no changes made to the legislation. He reiterated that the report was a general report on financing options, and was not specific to any particular aspect of the project.

9:08:38 AM

GEORGE W. BILICIC, VICE-CHAIRMAN OF INVESTMENT BANKING, LAZARD FRERES AND CO., LLC, presented the presentation, "Lazard Interim Report Overview - Discussion Materials". He spoke to the disclaimer and shared that he would be summarizing the majority of the report in an immediately useful manner.

9:10:11 AM

He referred to Slide 1, "Introduction", which provided a table of contents listing the topics that would be covered during the meeting:

### **Introduction**

Today's meeting will cover the following topics:

- An introduction to Lazard and its AKLNG Project (the "Project") Team
- An overview of Lazard's role on the Project
- A discussion of selected topics from the Interim Report, including the following:
  - o Project objectives and background
  - o Preliminary Project financing considerations for the State
  - o Preliminary criteria for evaluating potential Project financing plans

- A discussion of recommended next steps in preparation for the delivery of the Final Report in Fall 2015
- Appendix materials, including the following:
  - o Selected additional Lazard professionals
  - o Selected Lazard team member biographies

[9:10:51 AM](#)

Mr. Bilicic presented Slide 2, "The Lazard Tradition," which outlined the history of the company and its founding. Lazard has been providing independent financial advice to select clients globally for over 150 years under the tenants of Global Scope, Relationships, Experience, Creativity, Advice, and Independence. He shared that Lazard, founded in 1850, was well known in the investment banking community, and had consisted of three houses spread across the globe until the late 1990s. He relayed that the company was publicly traded with a market capitalization of approximately \$6.5 billion. He related that the firm was a client focused global firm, and was conflict-free - providing only advice. He offered that a large part of the firm's heritage was in representing governments.

[9:12:11 AM](#)

Mr. Bilicic referred to Slide 3, "Lazard's Global Presence," and noted that the firm operated in major business capitals worldwide and provided both domestic and cross-border advisory services. He asserted that the firm would be bringing all of its expertise, from across the globe, to work for the state.

[9:12:52 AM](#)

Mr. Bilicic presented Slide 4, "The Lazard Team," which offered Lazard's core execution team for the AKLNG Project and reiterated that the team would draw on the experience and expertise of Lazard's global network of professionals, on an as-needed basis.

[9:13:17 AM](#)

Mr. Bilicic reviewed Slide 5, "Role of Lazard," and explained as the state's financial consultant, Lazard would analyze and report on potential financing alternatives for state participation in the project, including potential

direct participation on behalf of residents, municipalities and/or regional corporations. He explained that the role of the firm had been mandated by SB 138 and Department of Revenue request for proposals for an advisor. The role of Lazard was as follows:

- **Formulate a range of potential financing alternatives and evaluative criteria**
  - Analyze, for example, key potential risks, potential impact on the State's debt capacity and long-term debt rating, potential for participation of various Alaska stakeholders and tax implications associated with each alternative
- **Collaborate with stakeholders, including the State, Alaska Gasline Development Corporation, ExxonMobil, ConocoPhillips, BP, TransCanada, State advisors and other constituents**
- **Develop specific recommendations designed to maximize benefits to the State**
- **Deliver Interim Report by January 20, 2015**
- **Deliver Final Report in Fall 2015**
- **Participate in State Legislative sessions**

[9:15:08 AM](#)

Co-Chair MacKinnon understood that the final report was supposed to be delivered simultaneously with long-term contract options.

Mr. Bilicic responded that the report would contain project viability assumptions.

Commissioner Hoffbeck interjected that Co-Chair MacKinnon was correct in her understanding.

Co-Chair MacKinnon expressed concern for the timeline on the report. She wondered how any delays would affect financing contracts for the project.

Commissioner Hoffbeck responded that the project would continue to move forward even in the absence of the ADGC board members. He anticipated that the appointees to the board would be before the committee soon. He shared that Lazard would be engaging in the process more highly towards

the end of the legislative session, with the bulk of the work occurring over the summer of 2015.

Mr. Bilicic added that that report would be delivered in 2015, but given the timeline for construction and completion, many things would change as time passed. He said that an objective of the firm's work product would be to create a modular analysis of the financing, so that financial adjustments would be made in concurrence with any changes in the construction plans.

[9:18:24 AM](#)

Co-Chair MacKinnon asked whether the report could be expected regardless of the contract options.

Mr. Bilicic stated that the firm would be on-time in delivering the report. He believed that the firm could write a report that would make certain assumptions about contract terms, and would still be informative for the state.

Co-Chair MacKinnon stated that the legislature wanted to assure that the integrity of the timeline remained intact.

Commissioner Hoffbeck said that the department had the same goal.

[9:19:29 AM](#)

Mr. Bilicic presented slide 6, "Lazard Assignment - High-level Process Timeline," which had been designed to reflect the final report timeline.

[9:20:16 AM](#)

Mr. Bilicic explained that the next section of the presentation was intended to give a brief overview of the topics covered in the interim report: preliminary financing considerations for the state in evaluating its potential investment in a project, and preliminary evaluative criteria. He acknowledged the long history of attempts to commercialize North Slope natural gas and the project's potential impacts on the state, including from a financial and budget perspective, and a resource perspective. He added that the firm would continue to follow the state of global LNG market dynamics.

[9:21:58 AM](#)

Mr. Bilicic presented Slide 7, "AKLNG Project - State Objectives," which reflected that the state's participation in the project was motivated by its desire to meet a variety of different objectives; how each of these objectives would eventually be realized would depend on a variety of different factors. The slide listed the states objectives as follows:

- Develop Natural Resources for Maximum benefit to the state
- Replenish Reserve Accounts
- Realize Investment Returns
- Support State Budget
- Stimulate in-state Job Growth
- Provide Investment Opportunity for in-state Individuals and Entities
- Provide Natural Gas to Alaskans
- Support Local Municipalities

[9:23:14 AM](#)

Vice-Chair Micciche asked whether moving stranded gas as encouraging additional production in the North Slope could be considered an objective.

Mr. Bilicic replied that the issue would be taken into account and had been referenced in the report.

[9:23:58 AM](#)

Mr. Bilicic presented Slide 8, "AKLNG Project Economic Overview," and noted that the project had an expected overall cost of \$45 - \$65 billion (midpoint estimate of \$55 billion), while the state's portion (assuming 25 percent participation) was expected to cost \$11.3 - \$16.3 billion (midpoint estimate of \$13.7 billion). The slide reflected \$400 million for the pre-front end engineering and design (2014-2015), \$1.8 billion for front end engineering and design (2016-2018), and \$52.8 billion for engineering, procurement, and construction (2019-2003). He reiterated that the project costs were subject to change due to changes in underlying costs and market dynamics. He explained that the firm had relied on a report prepared by the engineering firm Black and Veatch, and their model for

cost estimates and project cash flows, when examining the economics of the project.

[9:25:46 AM](#)

Senator Bishop asked whether the firm had taken the Black and Veatch models at face value, or had corresponding models been run.

Mr. Bilicic responded that the Black and Veatch model was a sufficient model on which the firm could base advice.

[9:26:40 AM](#)

Mr. Bilicic moved to Slide 9, which examined the cumulative projected cash flows to the state over time. While the state's upfront investment to fund construction of the project was considerable, the investment was also projected to generate material future cash flows. He shared that during operations the project's revenues would be off-set by operation maintenance expenses and overhead. He noted that in 2026, positive cash flows were projected and would off-set initial spending. He furthered that when the project became operational the financial position of the state and other owners would be materially de-risked.

[9:28:30 AM](#)

Vice-Chair Micciche asked whether the graph included loss earning opportunity prior to 2027, and investment earnings post 2027.

Mr. Bilicic replied that the graph only reflected the project itself, and did not account for other investments. He relayed that the evaluative criteria for the returns to the state would be discussed later in the presentation.

[9:29:56 AM](#)

Vice-Chair Micciche assumed that the X and Y axis on the slide would require a more extreme scale if the lost opportunity and earning potential were included.

Mr. Bilicic replied that if all of the factors, both positive and negative, were taken into account, the scale would be different. He said that there would be a slide presented at the end of the presentation that would reflect

the factors through the lens of the evaluative criteria. He reiterated that the slide contained a very high-level economic overview of the project.

[9:31:23 AM](#)

Co-Chair MacKinnon pointed out to the committee that the projections did not include TransCanada as part of the project through fruition. She wondered how the slide would look with the debt being purchased by someone else.

Mr. Bilicic replied that the analysis on the slides assumed the state had all of 25 percent, and did not take into account having a partner or sharing ownership interest. He asserted that the slide was not intended to suggest anything about arrangements with TransCanada.

Co-Chair MacKinnon understood that the legislature had passed a bill including TransCanada as a partner. She asked why that information was not part of the analysis.

Mr. Bilicic stated that the final report would take into account the different financing alternatives, which would include the potential of partnering with TransCanada and finding other financing sources.

Co-Chair MacKinnon expressed concern that the December 2015 deadline for the involvement of TransCanada was quickly approaching.

Mr. Bilicic replied that the TransCanada arrangement would be examined in detail, but that the firm had yet to establish a point of view on the matter.

[9:34:23 AM](#)

Co-Chair MacKinnon argued that legislation had passed establishing TransCanada as a partner; therefore, TransCanada should be included in the firm's evaluation.

Mr. Bilicic said that in the interim report the firm had tried to outline all of the possibilities for potential financing, including the TransCanada arrangement.

Co-Chair MacKinnon asked whether the administration had instructed Lazard not to include TransCanada in the high-level overviews.

Mr. Bilicic responded that no one had restricted the firm in any respect. He relayed that the firm intended to give an independent view of the project.

[9:36:10 AM](#)

Vice-Chair Micciche offered that it would be helpful for the report to evaluate a range of partnership possibilities.

Mr. Bilicic assured the committee that the final report would make clear all of the options and the evaluations, and the pros and cons of those options. He felt certain that the conclusion of the final report would include more than one financing plan.

Co-Chair MacKinnon asserted that the committee wanted to understand the different dynamics that could affect the profitability of the project and the state's expenditures for the project.

Mr. Bilicic responded that that was the firm's objective for creating the report.

[9:38:16 AM](#)

Mr. Bilicic presented Slide 10, "State of Alaska Financial Overview":

- As of FY 2014, the State had ~\$15.8 billion in its budget reserve funds (i.e., the Congressional Budget Reserve Fund and the Statutory Budget Reserve Fund)
- Over 2015 - 2017, the State's unrestricted general fund expenses are projected to exceed unrestricted general fund revenues by an average of ~\$3.0 billion
- Over 2018 - 2024, annual expenses of \$5.6 billion are projected; revenue projections assume long-term oil price of ~\$118.58/barrel (vs. January 2015 spot price of \$48.87/barrel)
- By 2023, the State projects it will fully deplete its budget reserve funds, creating a fund deficit

Mr. Bilicic relayed that the chart illustrated the need for the state to have a new revenue source in the future. He

furthered that the chart depicted a material weakening of the state's financial position in the coming years, which was the period in which the project would need to be financed. He noted that the projections were sensitive to the assumed price of oil.

[9:39:33 AM](#)

Co-Chair MacKinnon asked which budget forecast the firm had used in their projections.

Mr. Bilicic believed that the firm had used the December 2014 DOR budget forecast.

[9:40:25 AM](#)

Senator Bishop commented that the firm would stand behind the information presented in the final report.

Mr. Bilicic agreed. He thought that the state was looking to affect real change with the project, and that Lazard was eager to assist.

[9:41:34 AM](#)

Vice-Chair Micciche referred to Slide 10, and relayed that there was doubt surrounding the survival of the state's reserve accounts.

Mr. Bilicic agreed and noted that Lazard was mindful of the need for an updated financial overview that would take into account the shifting market.

[9:42:57 AM](#)

Co-Chair MacKinnon said that the volatility of the price of oil made the assumptions on Slide 10 particularly valuable.

[9:43:23 AM](#)

Mr. Bilicic presented Slide 11, which he explained was a simplified view of the areas of risks and potential mitigants within the project:

**Potential Areas Of Risk**

- Development
- Cost overruns

- Commercial
- Regulatory
- Commodity price
- Over-supply/competing projects
- Demand
- Other

**Potential Mitigants**

- Ongoing/iterative assessment of Project feasibility
- Risk transfer provisions/third-party contracts
- Partner/sponsor marketing
- Political support and strategy
- Take-or-pay contracts/hedging strategy
- In-depth market analysis
- Delivery flexibility
- Other

[9:45:16 AM](#)

Co-Chair MacKinnon asked whether the firm had identified both short-term and long-term risks.

Mr. Bilicic explained that there was not usually a lot of capital available in the early stages of development for big projects, and smaller infrastructure projects. He said that the capital that was available for those projects was expensive; sponsors usually handled the capital for themselves for such projects, or through equity partners. He furthered that when it then became clear that a project was going to be to be built, the value proposition swung dramatically. He relayed that there was a value gap between "green field" and "brown field" projects; brown field projects had a lot of investors, green field projects did not. He said that a later slide would illustrate how risk in the project was higher for the state in the beginning because there were so many unknown variables.

[9:48:01 AM](#)

Vice-Chair Micciche referred to several recently cancelled LNG projects, and surmised it was due to the retraction of capital from investors who were reassessing their finances due to the value of oil. He asked how much current oil

prices figured into projections, versus assumptions projected 25 years forward.

Mr. Bilicic related that the firm would advise the state to examine the long-term average prices, the current price of oil did not matter. He believed that the project could provide the opportunity to reconsider the underlying commodity price driver because of the nature of the resource. He cited an LNG project in the Lower 48, which applied Lower 48 gas prices to its index. He said that the global oil price might not be a significant driver. He added that in the LNG market the user was generally using the product for gas distribution customers in a gas utility, or burning the LNG in a gas power plant. He thought that it would be difficult for nuclear power plants to be built in the future and sustained as a resource, and that a 24/7 renewable energy solution had yet to exist, which he believed would drive the market in the future. He related that oil was not a great generation resource going into the future.

[9:51:27 AM](#)

Vice-Chair Micciche wondered what safeguards the state should put in place during the project's evaluation phase in order to ensure against overexposure.

Mr. Bilicic opined that it would be impossible to eliminate risk, but risk could be mitigated, which was primarily done through rigorous independent analysis such as what Lazard was currently formulating.

[9:54:18 AM](#)

Senator Bishop asked whether the risk would be weighted in the final report.

Mr. Bilicic responded that he did not know. He shared that the factors involved were typically difficult to weight, and weighting them could create confusion or be misleading. He said that the firm would identify the areas that they believed were the most important areas of risk.

[9:54:59 AM](#)

Mr. Bilicic explained that the next section had been intended to provide an overview of the framework with which

Lazard believed the state should use when thinking about the projects and was meant to identify options in an "outcome agnostic" manner.

[9:55:44 AM](#)

Mr. Bilicic presented Slide 12, "Preliminary Financing Considerations". The state's financing strategy with respect to the project would be largely determined by the state's overall project funding requirement, its available sources of funds and the "optimal" capital structure (e.g., debt/equity mix); these determinations are interrelated and should be evaluated together, as illustrated on the slide:

1. The State must identify sources of funds (internal and/or external) to provide the capital required to invest in the Project

**Source of Funds**

**State of Alaska**

Permanent Fund

Power Cost Equalization Endowment (PCE) Fund

Other Funds

Balance Sheet/Borrowing Capacity

**Alaska Entities & Individuals**

Alaska Retirement Management Funds

Native Corporations

Municipalities

Residents

**External Sources**

Third-Party Equity Investors

Third-Party Lenders

Public Equity/Debt

Export Credit Agencies

2. The State can structure its economic interest in the Project via a mix of debt and equity financing structures

**State Structuring Alternatives**

Debt

Equity

3. Construction of the Project is expected to require ~\$13.7 billion of capital in the scenario in which the State invests in the Project on its own

**State Financing Need**

**Gas Treatment Plant**

\$3.1 billion

**Pipeline**

\$3.7 billion

**LNG Plant**

\$7.0 billion

**Total**

\$13.7 billion

[9:57:43 AM](#)

Co-Chair MacKinnon asked for further explanation about PCE as a funding source.

Mr. Bilicic said that PCE had simply been listed as an option.

Co-Chair MacKinnon noted that there were potential statutory issues related to using PCE funds for the project.

[9:58:28 AM](#)

Mr. Bilicic moved to Slide 13, "Potential Project Funding Sources", which further highlighted the various funding sources potentially available to the state. He shared that Lazard would be examining and evaluating the fund sources in their final report.

[9:59:37 AM](#)

Senator Bishop asked whether federal loan guarantees could be incorporated into the report.

Mr. Bilicic replied that support from governmental entities should be considered, but he was not currently aware of anything specifically available to the state.

Senator Bishop noted that he was referring to the 2004 Defense Military Authorization Spending Bill where a loan for a different pipeline had been guaranteed.

[10:01:09 AM](#)

Mr. Bilicic moved to Slide 14, "Description of Structuring Alternatives":

The State will need to evaluate the optimal financing structure via which potential sources of funds are invested in the Project. In general, the State could structure these funds as either debt or equity interests in the Project. More specifically, a spectrum of structuring alternatives exists for both debt and equity; each alternative offers different risk and return profiles, as well as other characteristics related to seniority/priority, payout structure, governance rights and other features.

[10:01:45 AM](#)

Senator Bishop clarified that the "recourse debt" listed in the slide would be considered the lowest cost debt. He queried which of the equities would be the least expensive.

Mr. Bilicic replied that recourse would be the least expensive, but would involve recourse to the state. He suggested that recourse debt might not be the best course of action for the state. He furthered that contingent rights to equity tended to be cheaper, and that common equity ownership could be the best way forward.

[10:03:35 AM](#)

Co-Chair MacKinnon asked whether Lazard would be providing an all-cash scenario under which the proposals could be evaluated.

Mr. Bilicic responded that such a scenario would be done. He added that the least expensive scenario would be to finance the entire project with debt, but that the project would need equity for support.

[10:04:22 AM](#)

Mr. Bilicic moved to Slide 15, "Illustrative Financing Cost - Project Lifecycle":

The risk related to the Project's expected cash flows will vary over time. In the early stages of the Project's development lifecycle, financing costs are likely to be highest, due to the perceived risks associated with realization of the Project and, therefore, future Project cash flows. As the Project advances in its development lifecycle, the certainty

of future Project cash flows should increase and the perceived risk associated with the Project should decrease accordingly, leading to lower financing costs.

[10:05:36 AM](#)

Mr. Bilicic moved to Slide 16, "Other Considerations":

The State might consider other alternatives to lower its cost of capital, shift/mitigate risk, or otherwise achieve its financing objectives. These alternatives could include the following:

- **Credit Support**
  - Guarantees by financially strong third parties could potentially lower the overall cost of debt associated with financing
- **Insurance/Risk Mitigation**
  - The State could purchase insurance to provide downside protection for various aspects of the Project to shift certain risks to third parties
- **Equity/Debt Syndication**
  - The State could syndicate (i.e., market to third parties) its interest in the Project to spread risks posed by the Project to other parties and to provide liquidity to the State at later stages of Project development

[10:06:36 AM](#)

Mr. Bilicic explained Slide 17, "Preliminary Selected Evaluative Criteria." The slide noted that the final report would provide specific analysis and recommendations with respect to the project funding sources and capital structure alternatives available to the state. The various funding sources and capital structure alternatives would be evaluated against the following criteria, among others, to develop a recommended financing approach to the state: potential impact on debt capacity/opportunity cost, potential impact on Alaska credit rating, key risks, cost, execution flexibility/feasibility, alignment of interests among key parties.

[10:08:00 AM](#)

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Vice-Chair Micciche spoke of the natural gas produced in the Lower 48 due to fracking. He wondered how the state would deal with the politics of the gasline, once it became involved.

Mr. Bilicic replied that conversations concerning the sequencing of finding customers for the LNG, and when construction should start, were important. He said that the structure of the state's ownership interest would need to be clearly defined.

10:13:29 AM

Mr. Bilicic moved to Slide 18, "Recommended Next Steps":

In preparation for the delivery of the Final Report in Fall 2015, Lazard will focus on the following areas of analysis and interaction, among others:

- Continued participation in State legislative session during Spring 2015, as required/requested
- Continued monitoring of global LNG market dynamics  
Update of Black & Veatch Model to reflect, among other items, current commodity pricing environment
- Continued monitoring of Project developments (e.g., marketing agreements, offtake agreements, partnership agreement, etc.) and potential impacts on analysis of financing alternatives
- Further analysis of potential sources of funds  
Interaction with various State and external fund providers to gauge interest in and return expectations for Project participation  
Identification of preferred sources of funds via analysis and interaction with key stakeholders, including the Alaska Legislature
- Further analysis of potential capital structure alternatives  
Identification of preferred capital structure alternatives via analysis and interaction with key stakeholders, including the Alaska Legislature
- Further refinement of evaluative criteria
- Formation of potential financing alternatives (i.e., combinations of sources of funds and structuring alternatives)

- Analysis of implementation issues associated with potential financing alternatives
  - Legislative
  - Regulatory
  - Legal
  - Execution
  - Other
- Assessment of financing alternatives against evaluative criteria
- Identification of optimal financing alternatives via iterative process (i.e., in consideration of evaluative criteria, implementation issues and other factors)
- Drafting of Final Report
  - Continued iteration and interaction with the Department of Revenue and State advisors

[10:15:07 AM](#)

Senator Bishop asked how imperative it was for the state to maintain its AAA credit rating.

Mr. Bilicic replied that he did not want to comment on what the state's rating should be. He did not think that the project would require AAA credit from any of the involved parties. He shared that the issue would be commented on in the final report.

[10:16:32 AM](#)

Vice-Chair Micciche wondered how complicated it would be to consider a sliding scale of through put, and whether smaller diameter options would be part of the report.

Mr. Bilicic responded that Lazard had not been contemplating a downsized project, but that capital and cash-flow movement would be examined and guidance from the legislature on the information covered in the report was welcomed.

Co-Chair MacKinnon interjected that she had an interest in exploring the AKLNG project versus the ASAP project.

[10:18:46 AM](#)

Mr. Bilicic moved to Slide 19, "Illustrative Process Overview":

In preparing the Final Report, Lazard will identify a range of potential discrete financing plans for State investment in the Project; among other things, these financing plans will consist of recommendations for how the State should fund and structure its investment. To determine the optimal financing plan for the State, these alternatives will be iteratively refined in consideration of the evaluative criteria (as further developed) and potential implementation issues (e.g., legal, regulatory, etc.)

Mr. Bilicic concluded that he could answer any remaining questions.

[10:20:55 AM](#)

Co-Chair MacKinnon discussed housekeeping.

#

ADJOURNMENT

[10:21:37 AM](#)

The meeting was adjourned at 10:21 a.m.