

SENATE FINANCE COMMITTEE
THIRD SPECIAL SESSION
October 31, 2015
10:08 a.m.

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CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 10:08 a.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair
Senator Pete Kelly, Co-Chair
Senator Peter Micciche, Vice-Chair (via teleconference)
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Janak Mayer, Chairman, enalytica; Nikos Tsafos, President, enalytica; Laura Pierre, Staff, Senator Anna MacKinnon; Senator Kevin Meyer; Senator Cathy Giessel; Senator Mia Costello; Senator John Coghill; Senator Gary Stevens; Representative Liz Vasquez; Representative Lora Reinbold; Representative Mike Chenault.

SUMMARY

SB 3001 APPROP: LNG PROJECT and FUND/AGDC/SUPP.

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

#sb3001

SENATE BILL NO. 3001

"An Act making supplemental appropriations; making appropriations to capitalize funds; making

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

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Co-Chair MacKinnon discussed the bill before the committee. She relayed that SB 3001 was an appropriation bill for the AKLNG project. The bill included a work plan increase and would buy out Alaska's partner TransCanada. Additionally, the bill included a \$13 million supplemental request to support the Department of Law (DOL), the Department of Natural Resources (DNR), and the Department of Revenue (DOR) in advancing a gasline project. She introduced the legislators present in the room. She relayed that legislative consultants enalytica would address the committee and would speak specifically to the Alaska participation in gas and sales agreements.

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JANAK MAYER, CHAIRMAN, ENALYTICA, introduced himself. He stated that enalytica had been contracted as a consultant to the legislature through the Legislative Budget and Audit Committee. The company had been advising the Alaska State Legislature on oil and gas issues for the past four or more years.

NIKOS TSAFOS, PRESIDENT, ENALYTICA, introduced himself. He relayed that his background was as a natural gas consultant; he had worked with organizations, companies, and governments around the world on buying and selling gas. He introduced a PowerPoint presentation titled "TransCanada's Participation in AKLNG: Key Issues" dated October 31, 2015 (copy on file). He explained that the presentation would address the components of the TransCanada buyout proposal. At the end of the presentation he planned to address what it would take to sign a sales of purchase agreement and risks to the state.

Mr. Mayer looked at slide 2, "View from 2014: Why TransCanada." He relayed intent to frame TransCanada's participation in the AKLNG project by looking legislative debate on the Heads of Agreement (HOA) and the Memorandum of Understanding (MOU) discussed during legislative session 2014, which had ultimately led to the passage of SB 138

[legislation passed in 2014 related to a gas pipeline, AGDC, and oil and gas production tax]. He noted that in 2014 the Parnell Administration had argued for TransCanada's involvement in the project based on various strong points. He believed it would be useful to think through the prior arguments, the associated strengths and weaknesses, and what had fundamentally changed. He detailed it had been argued that TransCanada's participation would provide substantial strategic and non-financial benefits to the state. For example, he cited TransCanada's experience as a large, highly capable and experienced pipeline company, particularly on northern pipelines and Alaskan natural gas pipeline projects (especially through the Alaska Gasline Inducement Act (AGIA) process). Additionally, there had been a significant emphasis on questions of continuity and momentum. He elaborated that TransCanada had conducted work during the AGIA process and it had a significant amount of intellectual property data as a result. During the transition period, TransCanada had been working well with the other AKLNG sponsors, but there had been a desire to ensure the transition of the work product over to the new AKLNG team in a seamless way.

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Mr. Mayer continued to address slide 2. He spoke to the state's obligations under AGIA and the question of what damages may be payable if the state was to terminate AGIA in a unilateral way (including discussions over treble damages clauses in the contracts). Given the issues, it had been determined that a desirable trajectory would be creating a smooth commercial transition that was agreeable to all parties. He believed the issue had been influential for many when thinking through the MOU and everything proposed in the SB 138 debate. Additionally, there had been a strong argument made that involving an independent, highly experienced pipeline company in the project would provide significant benefits from a governance and expansion perspective. He noted that the three producing partners had an interest in achieving the most efficient, lowest cost means of monetizing the existing resource base at Prudhoe Bay and Point Thomson. He elaborated that the state had the same interest, but it also had a broader interest in opening up the basin and ensuring that new discoveries would have access to the pipeline, which would take significant experience and capability. He expounded that it would take experience and understanding in the

negotiation of the governance agreements to ensure expansion rights for the state. The Parnell Administration had believed the negotiation on the state's expansion principles in the HOA was possible due to TransCanada's participation. The Parnell Administration had felt that TransCanada would be beneficial in negotiating the next round of agreements and doing much of the technical work product (i.e. the sizing of individual components in a gas treatment plant (GTP), future development capacity of the facility, and other).

Mr. Mayer discussed that the Parnell Administration had pointed to the importance of partnering with a company with the technical, commercial, and financial capability. He continued to address the importance the Parnell Administration had placed on involving a company that the state could be in touch with once the project was operational and new discoveries were made. He discussed that if the work to determine potential commercial terms and what may be commercialized was not done by an independent pipeline company, the work would have to be conducted by the state. He reasoned that many of the items listed on slide 2 remained valid. He noted the importance of ensuring the state did have some of the capabilities if it seemed likely that the roles would be taken on by the state (i.e. Alaska Gasline Development Corporation (AGDC)).

Mr. Mayer relayed that the Parnell Administration had made an argument of finance, specifically about the cost of capital and the state's bonding capability. He remarked that enalytica had many questions about the argument when it had been made. He noted that it had been discussed that the overall cost of capital through the deal with TransCanada could be higher to the state than the state's own cost of capital. It had been argued that TransCanada may relieve the state from a portion of the cash calls during the project development phase, which could benefit the state given concerns about its bonding capability. He added that it had also been discussed that the veracity of the claim was uncertain because there were many reasons to think that the impact on the state's credit rating and balance sheet would be the same either way.

Mr. Mayer stated that given the former administration's arguments, enalytica believed some of the substantial scrutiny and skepticism was merited. He referred to significant discussion about whether the TransCanada tariff

cost was competitive to market norms. He relayed that Enalytica had provided some analysis to show that compared to tariff costs in the Lower 48, the TransCanada cost was well within the lower end of the norms. Enalytica had also considered whether the more relevant comparison was the state's own cost of debt, given the limited risk borne by TransCanada. He recalled there had been substantial discussion about the risk/reward balance for the state under the deal with TransCanada. He detailed that TransCanada had taken on very limited risk under the deal. He elaborated that at numerous times during the project construction stage up to 90 days after FID [final investment decision], TransCanada had been given the right to depart the project and be paid of 7.1 percent interest. He explained that the risk of an increase in capital cost was borne by the state through a higher tariff. Most of the core risks that a true equity partner would bare were retained by the state. He relayed that TransCanada only bore one fundamental risk, which pertained to risk that came from the credit outlook of the state. He elaborated that TransCanada had agreed to provide financing at a particular cost of debt and equity, which involved some judgements on the state's financial health and the ability to take full faith in credit of the state to market. He reasoned that even that risk had been limited because TransCanada had the right to leave the project if it decided the project no longer made commercial sense.

Mr. Mayer continued to speak to the points on slide 2. He relayed that there was concern related to the risk/reward distribution of the deal with TransCanada and a feeling that it reflected the negotiating leverage of each of the parties at the time, given the presence of AGIA obligations as a result. TransCanada had taken on very limited risk and appeared much more like a debtor to the project than a true equity holder; however, it possessed much of the control that an equity holder would have. The organization had been given the right to exercise the state's vote on the 25 percent of the GTP and pipeline. While there were certain areas where the state held veto rights, TransCanada could treat the project as its own investment and exercise its vote as it saw fit. He noted that there had been testimony in the past week about occurrences where the state had to view TransCanada as another commercial participant it had to negotiate with.

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Mr. Mayer highlighted the concept of back-in-rights (the final bullet on slide 2). He discussed that the MOU and original deal contained numerous off-ramps. He noted that many legislators had observed that some of the off-ramps appeared to lead straight back to an on-ramp. He elaborated that the state could terminate [the agreement with TransCanada] for numerous reasons at various times, but the MOU included a clause specifying that if the state proceeded with the project or a substantially similar project within 5 years of termination, the state had to offer TransCanada the right to participate. Due to the areas of concern, the state wanted to ensure there was at least one solid off-ramp. He explained that TransCanada had clarified that the back-in-right would be put into an eventual Firm Transportation Services Agreement (FTSA), but not into the Precedent Agreement that would govern the relationship with TransCanada until the end of 2015. He furthered that the end of 2015 was the key point in the contractual relationship with TransCanada where there was one clean off-ramp; it was the one time the state could opt to sever the relationship without incurring an ongoing commitment.

Mr. Tsafos relayed that the consultants planned to walk the committee through their process in approaching the question [related to the partnership with TransCanada]. The consultants had worked to develop a report on their assessment of Governor Walker's proposal and saw their role as conducting due diligence on behalf of the legislature. He relayed that they had worked with Black and Veatch [financial consultant to the state] to understand its model and assumptions. He relayed that enalytica was very comfortable with the Black and Veatch numbers. He noted that enalytica did not try to replicate the numbers given time constraints. He relayed that enalytica had a number of conversations and an in person meeting with the Black and Veatch team to discuss its numbers. Additionally, enalytica had a good conversation with DNR to understand its concerns and how the department viewed the proposal. He noted that he and Mr. Mayer had been present for all of the legislative hearings on the topic.

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Mr. Tsafos communicated that enalytica largely agreed with substantive case that had been made by the administration. He relayed the intent to run through all of the different areas that made sense to enalytica. He noted that the state did not seem to have many compelling alternatives to approving the administration's proposal because of the impact on the December 4 [2015] vote and what it meant for the budget. The presentation would focus on two things: 1) offering context and clarification on some of the statements made by the administration, particularly around the financial merits of the TransCanada buyout; and 2) to share some of enalytica's views on who would take on responsibilities that had been performed by TransCanada.

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Mr. Tsafos highlighted slide 3, "Where We Agree with Administration and Where Not":

Where we agree with administration statements

The State of Alaska (SOA) will pay TransCanada (TC) no matter what

Under failure case, terminating TC relationship now much cheaper than terminating later

Mr. Tsafos elaborated that under a project failure scenario it would be very painful to write a check for hundreds of millions of dollars (possibly \$1 billion) for a failed project and the state would be paying interest throughout that time. He continued to address slide 3:

SOA retains risk, but TC retains most decision making (TC's only risk is deterioration of SOA credit)

SOA credit rating will be hit regardless of whether TC is in the project or not

SOA has several financing options—no need to panic about having higher cash calls

Mr. Tsafos added that it was typical at the current early stage to not have a detailed financial plan. He noted that financing typically occurred at the FEED [Front End Engineering and Design] stage. Sometimes financing was

closed even after FID, provided there had been discussions with the bank and there was comfort with the financing. There was nothing about the absence of a detailed financial plan that was concerning to analytica at the current time. He continued to address slide 3:

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

Mr. Tsafos expounded that the state would no longer have the opportunity to step away from TransCanada in a clean way if it signed an FTSA (due to the back-in-rights provision). He continued to speak to slide 3:

Not having Alaska Gasline Inducement Act (AGIA) makes a big difference in SOA calculations

Mr. Tsafos recalled that for many legislators, it had been important to avoid the possibility of treble damages, litigation, and arguments. In addition to ensuring that the state could leverage the work that had been done under AGIA (for which it had paid a substantial portion). He addressed the last point on which analytica agreed with the administration:

Non-alignment in voting and non-visibility of information undermine original case for TC in AKLING

Mr. Tsafos qualified that analytica was not part of the project negotiations and could not say how quickly TransCanada would respond; however, there had been testimony by the administration that had addressed some of the issues. He discussed that in theory TransCanada was supposed to be the state's agent in the project; however, the original case was undermined if the company was less of an agent and more like a party the state had to negotiate with. He addressed two areas where analytica differed from the administration (slide 3):

Where we differ from or wish to supplement administration statements

The strictly financial case for severing relationship with TC is not as compelling as has been argued

Decision should focus on strategic, not financial considerations: expansion plans and AK LNG vision

Mr. Tsafos elaborated that analytica believed the state should not limit its considerations to the idea that the state had two sources of financing (i.e. TransCanada or the market) and which was cheaper, but it should consider other tangibles and intangibles that TransCanada brought to the relationship and how the state may replace the company once it was gone.

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Senator Dunleavy remarked on Mr. Tsafos' testimony that the financial implications for the state would not be that significant. He explained that the committee had heard for the past week that the state would realize a savings up to \$400 million. He asked Mr. Tsafos if he concurred with the figure.

Mr. Tsafos replied that Mr. Mayer would address the question in several slides.

Mr. Mayer addressed slide 4 titled "Is the Financial Upside Truly Compelling?" The slide addressed the first of two claims in the argument put forward by the administration:

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

Mr. Mayer pointed to the image of a chart presented by the administration on the left of slide 4. The chart included two red bars representing the TransCanada interest rate financing cost and gray bars representing the borrowing rate the state may achieve under a series of credit ratings from AAA to A-(based on data from consultant FirstSouthwest). He planned to address each of the claims in detail.

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Senator Bishop queried the price of gas that had been used to determine the \$400 million in potential savings to the state. He asked if a benchmark of \$100 per barrel or other had been used.

Mr. Mayer replied that there would be a slide that addressed the specific question. He stated that the core variables looked at the cost of debt in different scenarios, rather than the cost of gas. He explained that the discussion was primarily related to financing for the state's infrastructure rather than anything to do with revenues the project would generate, which were the same in both cases.

Mr. Tsafos added that Black and Veatch numbers showed a scenario with and without TransCanada. He noted that all of the market assumptions were the same for both cases. Whatever oil and gas price the analysis assumed in the TransCanada scenario had also been used in the non-TransCanada scenario. He believed Black and Veatch had used a long-term oil price assumption of \$80 per barrel.

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Mr. Mayer considered the state's cost of debt with or without TransCanada (slide 5). A table on the slide presented numbers from a FirstSouthwest analysis. He pointed out that the figures in the interest rate on taxable bonds column were the same as the gray bars on the previous slide for each of the credit ratings shown. He noted that there were some additional details analytica believed were pertinent in thinking through the state's likely cost of debt, particularly if the state opted to raise most of the capital through debt rather than savings and equity and if it was primarily done through debt on the state's balance sheet versus project financing or other options. The FirstSouthwest analysis assumed that the primary driver of credit rating was the proportion of unrestricted general fund (UGF) that would be devoted to debt service. The analysis had found that the state could maintain its AAA credit rating up until the point that 5 percent of the state's UGF revenue was spent in debt service; beyond that threshold the state could begin to see credit downgrades. He elaborated that at a debt service limit of up to 8 percent the state could retain a credit rating of AA+; with a debt service limit of up to 10 percent the state could retain a AA rating; with a 12 percent debt service limit the state could retain a AA-rating; and with a debt service limit of 20 percent it could retain an A credit rating. He discussed how the numbers related to the amount of new debt the state could

issue. He provided a hypothetical scenario where in 2017 the state conducted one enormous bond issuance.

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Mr. Mayer remarked that the FirstSouthwest analysis assumed the DOR forecast on state revenues through the 2020s, which included a return to oil prices of \$110 per barrel by 2020 and revenues returning to around \$4.2 billion [per year]; the forecast projected the figures would remain flat for the 20 years following 2020. He shared that enalytica had reengineered the model and had come up with the same figures. Additionally, it had looked at scenarios with declining revenue out into the future. He explained that in a scenario with declining revenue the maximum debt the state could borrow at an A credit rating would decrease from the \$15 billion to between \$10 billion to \$13 billion. He stated that broadly speaking, the presentations from the administration showed the expected capital commitment for the project at around \$14 billion to \$15 billion for the state. He remarked that the cost was effectually true with or without TransCanada's involvement. He reiterated that if the state paid for the project with one large general obligation bond it could have an A credit rating with an interest rate of 5.34 percent (based on data on slide 5).

Mr. Mayer referred back to the gray bar chart on the left of slide 4. He stated that the comparison was accurate, but the lower bars shown on the chart would be much more relevant if the state opted to pay for the project entirely on its balance sheet. He noted that cost represented by the lower bars was less than the cost of capital through TransCanada, but not substantially lower. For that reason, enalytica agreed that there was financial upside, but it may be less compelling than the full range of possibilities that had been presented.

Co-Chair MacKinnon communicated to the public that the full report and the meeting documents were online.

Mr. Mayer addressed the second of two claims in the argument put forward by the administration (the chart on the right of slide 4):

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

Mr. Mayer turned to slide 6 to elaborate on the claim. He stated that it was important to understand that without rounding up the cost of annual savings presented by the administration were actually \$360 million instead of \$400 million.

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Mr. Mayer continued to look at slide 6, which included two cash flow charts from a Black and Veatch presentation. He pointed out that the right hand side of the cash flows showed an increased benefit of up to \$400 million per year. He explained that the blue line on the left chart represented the project without TransCanada and was substantially lower because it assumed the state would finance the project with 70 percent debt/30 percent equity. He detailed under the 70/30 scenario the state would be responsible for 30 percent of the \$7 billion that TransCanada would have paid; 30 percent of \$7 billion was approximately \$2 billion. Without TransCanada the state would be responsible for an additional \$2 billion in equity outlays and a substantial portion of the \$360 million in annual returns would simply be a function of the \$2 billion the state invested up front. He stated that the net present value (NPV) of the future cash flows depended largely on the discount rate used. Enalytica strongly suggested applying a commercial discount rate when the state looked at any commercial investment. He noted that for the current discussion there were easier ways of doing the analysis without getting into discount rates.

Co-Chair Kelly asked Mr. Mayer to clarify his statements without any qualifiers. Mr. Mayer replied that the \$360 million in annual benefits was a result of investing an extra \$2 billion up front. He stated that when thinking about the overall value, it was not possible to focus on one leg without thinking about the other leg. One way to look at the situation was to try to determine an NPV for the time value of money; it would only be slightly higher than zero at a commercial rate of return. He believed there was a better way, which was to think instead about the rest of the numbers shown on the Black and Veatch graph (slide

6). The baseline was the \$360 million, while the other numbers used a scenario where the entire cost of TransCanada's participation was replaced with 100 percent debt. He explained that with 100 percent debt there would be no additional equity to put in upfront. The chart showed the assumption on the cost of capital for the state in raising funds that would lead to each of the numbers. Under Black and Veatch's numbers if the state could raise all of the required capital at a 4 percent interest rate it would save \$260 million per year (as opposed to the \$360 million); whereas, savings would reduce to \$130 million per year at a 5.5 percent interest rate. He concluded that from a purely financial standpoint the state would be better off without TransCanada. However, he recommended being cautious when thinking about how large the financial benefit would be. Additionally, he recommended thinking more about the numbers on the right hand bars (on the chart shown on the right) than the left hand bars. He noted that it was particularly the case when digging further into some of the assumptions.

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Mr. Mayer referred back to the left chart on slide 4 titled "TC Cost of Capital vs. State Debt Interest Rate." He stated that the red bars represented the TransCanada cost of capital at 6.1 percent up until a year after construction, and 5.8 percent from that point forward. He noted that the shift was a function of the change in the capital structure from 70/30 debt to equity to 75/25 debt to equity. The numbers were lower than the previously presented "headline" numbers of 7.1 percent and 6.75 percent. He explained that the difference was driven by the variance in the 30-year Treasury rate, which could change until pinned down at FID. He explained that in the past year the 30-year Treasury note had dropped by about 95 basis points (almost 1 percent). For example, if the relative cost of capital to the state without TransCanada was 5.3 to 5.5 percent compared to a rate of 5.8 percent, there would only be a half a percentage point spread regardless of the 30-year Treasury rate.

Co-Chair MacKinnon surmised that the administration had provided a "best case" scenario, which analytica believed may be slightly optimistic; however, it was still fair to say that there was upside from a financial perspective. She

asked if her statements were fair. Mr. Mayer believed her statements were very fair.

Co-Chair Kelly asked for verification that if the transaction was viewed purely as financial, the difference between using TransCanada as equity and the rates the state could obtain on its own by financing the entire portion of TransCanada's participation would be fairly small.

Mr. Mayer agreed, but noted that it depended how the term "fairly small" was defined.

Co-Chair MacKinnon stressed that \$30 million or \$130 million was a substantial amount of money, which could fund the Department of Education and Early Development for many years.

Co-Chair Kelly made a remark about hundreds of billions of dollars of sales over years and an amount being somewhat diminished in comparison [note: beginning of statement indecipherable].

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Vice-Chair Micciche surmised that if the decision was based purely economically, buying out TransCanada and shifting to state control over the 25 percent was likely positive. He assumed that factoring in the benefit of eliminating the conflict between the state and TransCanada added to the net positive although in a less financially concrete way.

Mr. Mayer broadly agreed with the statements. He discussed that the prior administration's argument that had been made two years earlier was that TransCanada and the state would be highly aligned, that the state would have an expansion oriented partner, and there was a strong strategic interest regardless of the financials. However, if one believed that in the past two years the state had occasionally been faced with negotiating against TransCanada as a commercial partner rather than being truly aligned, it would substantially change the strategic calculus as to whether there was significant value to the state in making sure it had control of its full voting share.

Mr. Mayer returned to slide 6. He referred to the scenario where the state would pay for the project entirely through general obligation debt as a more cautionary benchmark. The

TransCanada cost of capital would be 6.75 percent as indicated in the MOU without taking into account the rate tracker. He continued that the conversation would not be about \$130 million at a 5.5 rate; it may be necessary to go up a full percentage point to take into account that the rate tracker had not been taken into account in terms of comparing like with like; at that point the savings would be closer to \$90 million. Additionally, it was important to think about that under the previous TransCanada agreements, the state had the equity option to buy back in 40 percent of what had been handed over to TransCanada; if that right was exercised, the numbers could be close to halved. He stated that if the state and TransCanada really wanted to make the relationship work and the state was concerned about financing costs there were also ways to bring the numbers down further by executing the equity option agreement. He noted it was a strategic consideration, but it appeared there were many reasons why things were not working out from the strategic standpoint.

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Mr. Tsafos remarked that the financial aspects would not be included in the remainder of the presentation. He highlighted slide 7 titled "TC Inflection Points Opens up Broader Questions." He remarked that some of the questions were directly related to TransCanada and others were more tangentially related. He explained that the list included questions to ask as the process moved forward.

Mr. Tsafos stated that the entire process of SB 138 built around the idea that the project would not work unless the producers and the state were aligned and there was one area where the producers and the state would not be aligned. He explained that the producers wanted to commercialize their resource; whereas the state had some broader interests in making sure the infrastructure could be utilized to open up the basin for new companies to find oil and gas. He furthered that the area involved a fundamental tension between the producers and the state, which had been the area where TransCanada would have the state's back. The plan had been that TransCanada would sit in the project meetings and would be thinking how to get more gas flowing through the pipe. Throughout the negotiations TransCanada would be on the lookout to ensure the project was not designed in ways that would limit the ability of expansion and increased gas flow. He noted that because enalytica had

not been in the negotiations, they did not know how accurate the theory was. Absent TransCanada, the state would be on its own and would have to take over the responsibility; it would have to protect its own interests in areas where it was inherently misaligned from the producers.

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Senator Bishop asked for verification that AGDC would take on the responsibility. Mr. Tsafos replied that based on testimony, enalytica's understanding was that the share belonging to TransCanada would go to AGDC; however, it was not fully clear to enalytica who the counter parties were in all of the agreements. He imagined that the state would more broadly be looking out for the interests, but in terms of the party, much of the responsibility would fall to AGDC.

Mr. Tsafos continued to discuss slide 7. He discussed that protecting the state's interests would require multiple people all the way from "the general to the foot soldier." He explained that it would be necessary for the state to review every decision to ensure the protection of the state's interests. One of the things that had concerned enalytica was that thus far AGDC did not have a presence on the 135-person project management team, which was making daily decisions. He stated that the issue was concerning because the state needed to make sure to match the big-picture strategic vision with the day-to-day decisions made at the lower levels that would have an impact on how expandable the pipe would be and how much more gas the infrastructure could withstand. He communicated that the state would best protect its interests if there was a clear cohesion between the highest level and everything underneath.

Mr. Tsafos stated that enalytica believed the issue was crucial specifically related to the expansion capability and ensuring that the pipe would be full; there were two ways enalytica thought about the state protecting its interest in that regard. The first focus was on the present day; it was necessary for the state to get the engineering and governance structures correct to ensure that the pipeline was as expandable as possible. He discussed that the HOA allowed any party to expand the infrastructure on its own as long as the action did not adversely impact the

other parties. He observed that while the provision sounded good, the devil was in the details - specifically, he questioned what it meant to not adversely impact the other parties. He questioned how expansions would be governed if one of the producers made another discovery on the North Slope, whether the state would have the unilateral right to take up all of the expansion capacity or not, and how the additional compression cost and fuel use would be allocated. There were currently a significant number of design and governance questions that would determine whether in 2026 an explorer could put gas in the pipe.

Mr. Tsafos discussed that the second focus was on the future. He relayed that when gas was flowing in 2026 the state would need someone to talk to every single company finding oil and gas in the state to determine whether the gas could be put through the pipe. The individuals would need to determine regulatory, commercial, financing, and tariff components in order to get gas through the pipe. In theory TransCanada would have held the responsibility during the operational phase. He was not suggesting the state needed to hire the individuals in the present day, but the concept was one of the implications to consider without TransCanada.

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Senator Dunleavy reasoned that there would always be some misalignment, because the sovereign party wanted a continual flow of gas sold at a high price. This required the addition of more gas over time, which may be at odds with some of the current lease holders. He wondered if the state was on track, or if there were some "red flags" that should be considered. He queried a comparison with similar projects throughout the world. He asked if the project was headed in the right direction.

Mr. Tsafos replied that comparing the project to other parts of the world was difficult, because Alaska was uniquely situated. He addressed maximizing gas through the pipe. He noted that many locations with long-term LNG projects had national oil companies serving the role; they owned the asset and resources and were sometimes contractually or constitutionally entitled to the gas regardless of who produced it. He remarked that some of the questions would be answered throughout the normal business process. He pointed to Malaysia, Bernai, or Indonesia where

the original gas source had been depleted and there was a process through which new suppliers had access. He furthered that Alaska could not necessarily count on the regulatory structure for protection because the project was export oriented and it was not clear the state would have the Federal Energy Regulatory Commission implementing supporting structures, which would differ than other places where countries faced the same challenges. He stressed that the broad structure that Alaska was pursuing made sense in terms of the governance and the serious exploration about the cost and benefits of a 48-inch pipe. However, he emphasized that the devil was in the details. He explained that the state needed to understand how every decision, contract, and piece of equipment would impact its ability to expand the infrastructure in the future (10 to 20 years out). He remarked that TransCanada had been responsible for the work on the state's behalf [which would change with the company's departure from the project]. He noted it would be useful to understand how the state would backfill the capacity [previously filled by TransCanada]. He reiterated that he was not concerned about the big picture, but the devil was in the details.

Senator Dunleavy referred to discussions about TransCanada secondees continuing to provide work on the project. He surmised it would be the expertise the state should have as it continued through the process.

Mr. Mayer replied that it was important to keep in mind that current TransCanada secondees would remain on the project until May 2016. The additional provision of secondees was a continuity solution for the next 6 months, but it was not a long-term solution to the problem. There was a serious need for the state to determine how it would fill the gap in the future.

Senator Dunleavy surmised that the question would be how the state obtained the expertise, whether on an individual basis or by bringing another outfit to fill the role. Mr. Tsafos replied that the state could either hire internal capacity directly or through contracting or the state could find a different partner.

Co-Chair MacKinnon noted that there was a supplemental request, which would allow DOL to seek some of the early negotiations through legal contracting. She believed the work fell under the \$10 million request. She noted she was

not certain the funds were for the specific work referred to by Senator Dunleavy in regards to expansion, but the administration did see the need to bring on additional experts at present.

Senator Dunleavy referenced testimony provided to another legislative committee by enalytica that every now and then the company saw or heard things that left them scratching their heads. He asked for further detail on the comment.

Mr. Mayer recalled that the question had been about the overall progress of the project and whether the original vision of AKLNG had been maintained. He had responded that enalytica had developed an increasingly cooperative working relationship with some of the new administration's departments (DNR and DOR in particular). He elaborated that enalytica had steadily become closer and more comfortable with how the state was progressing, the capacity it was building up, and the approach it was taking into negotiations. He relayed that enalytica had less contact communication with AGDC in terms of how it was building up its capability. He elaborated that enalytica was working to build the relationship to understand AGDC's plans and how it planned to fill some of the gaps. He continued that all of the interaction with the state gas team at the departmental level had given enalytica significant faith in its approach. He stated that every now and then statements had been made at a higher political level that enalytica was unsure how they related to the progress being made in moving forward under the HOA.

Co-Chair MacKinnon asked if a specific example was when Attorney General Craig Richards had discussed confidentiality and had asserted to the Senate Finance Committee that he was able to receive confidential information and that he had not signed a confidential agreement, but could not share the information with the committee. She remarked that she had been scratching her head [over the statements].

Mr. Tsafos believed the best way to explain was to refer to slide 7 [Alice in Wonderland image and quote included on the slide]. He referenced testifying before another legislative committee in April. He addressed that the state had been going down one path and then some statements had been made that made it seem like a different path had been taken. He believed it was particularly relevant in the

context of TransCanada being out of the project. He elaborated that a project in which gas was possibly bought from producers at the wellhead was a very different project. He relayed that the last two slides of the presentation would address the issue. He explained that it was a major adjustment to the structure of the project. Even though there were parts of the structure that seemed to be going ahead in a clear direction there were occasional statements that seemed to suggest a different endpoint or a slight variation to the endpoint. He explained that it was not necessarily good or bad if the project reached a point where two parties withdrew and suddenly the state was buying gas at the wellhead and had a much bigger share of the infrastructure, but it would no longer be the same project. He believed it was important to think about the end points and how they affect decisions at present. He noted that the comment referred to by Senator Dunleavy and Co-Chair MacKinnon was not specifically attributed to confidentiality.

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Co-Chair MacKinnon wondered how the structure worked within confidentiality for transparency and an effective business environment.

Vice-Chair Micciche stated that considering the royalty in kind (RIK) principles associated with the project, there was no value in production taxes and royalty. He observed that as a 25 percent owner, the value was likely in specified AKLNG volumes. He saw a potential financial conflict for the state. He wondered how careful the state had to be to ensure the expansion commercial case did not directly compete with the value of foundational RIK export volumes.

Co-Chair Kelly asked Vice-Chair Micciche to rephrase the question.

Mr. Mayer restated the question and responded. He addressed that the state had two sets of interests: 1) making a commercial assessment of the project that was similar to the assessment made by the producers in terms of wanting the greatest possible rate of return on the investment; 2) expanding and opening the basin. The question was related to how to compare the two objectives to ensure that the

state was not sacrificing one objective by pursuing the other.

Vice-Chair Micciche agreed with Mr. Mayer's rephrasing of the question.

Co-Chair Kelly asked for further clarification on the question.

Mr. Mayer explained that the question was about how to make sure the state did not sacrifice commerciality of the project as a result of its concerns about expansion capability in the future.

Co-Chair MacKinnon remarked that the question was about a tradeoff of benefits.

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Vice-Chair Micciche rephrased his question. He stated that in the rush to increase production, he wanted to know the most careful points for the state to consider to ensure that expansion did not directly compete against maximum value to the state in the AKLNG project.

Mr. Mayer replied that the decision around a 42-inch pipe versus a 48-inch pipe was a useful way of thinking about the project. He detailed that there were many solid reasons why the state's project partners had made an initial assessment that the 42-inch pipe was the way to go based on where the steel could come from and how many loads of steel were required. He noted that the items had led to the decision, especially in the context of the realization that there was an additional Point Thomson of spare capacity after 16 years of production that would need to be brought online at some point. Additionally, there was some fairly substantial Point Thomson expansion capacity within the 42-inch pipe. He elaborated that the administration's idea to look further at the 48-inch option acknowledged that there was a tradeoff between capital expenditures upfront versus future operating expenditures related to achieving an expansion. He continued that if the ultimate goal was to secure an extra billion cubic feet per day of expansion, it could be done under both pipe options; however, the 48-inch pipe would use much less fuel because it required fewer compressor stations. There was a clear cost-benefit tradeoff to be made about the value placed on the expansion

option. He furthered that it needed to be a deeply commercial and economically rational decision, but it may be one in which the payoffs were different for the state and the producers. How the items were weighted depended enormously on one's assessment of the future resource base on the North Slope (not only looking at resources, but what was potentially commercial, and what probabilities were assigned to the items).

Mr. Mayer stated that ultimately all of the items needed to be taken into account in deciding what value the state would place on the expansion capacity and to look at the breakeven point in the value of fuel. He elaborated that if more fuel was used to drive more compressors it would be necessary to determine the price of gas that would make everything equal. He noted that the state would be in a much better position to make the decision when the full work the project was proposing to do on the 48-inch option came back. He believed it was very reasonable for the state to have different objectives from the producers on the issue. He remarked that if the state had different objectives, the objectives could be met potentially through a larger pipe or through the state's negotiation on expansion terms. In either of the cases the decision needed to be driven by economics and the value of the different cases.

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Vice-Chair Micciche voiced his concern about ensuring that the project had the skillset to make sure that expansion principles did not put the state in a position of working against itself.

Co-Chair MacKinnon remarked that the Senate Finance Committee greatly appreciated that Governor Bill Walker had removed the issue of a reserves tax from the special session agenda. She believed it appeared that the administration was moving forward to enter into gas sales agreements at present. She remarked that unfortunately no one from the administration was available during the current meeting. She wondered what analysis should be done from a financial perspective and on what time line. She referred to analytica's response to Vice-Chair Micciche's question that more information was better so that the analysis was economically driven. She wondered what analysis should have been done in order for the state to be

asking for gas sales agreements from its partners. She used a marathon analogy related to pacing oneself throughout the race and sprinting at the end to cross the finish line.

Mr. Tsafos replied that he would address slides 8 and 9 and could then follow up on any remaining questions. He addressed the following question on slide 8: "What's in a Sales and Purchase Agreement (SPA)?" He relayed that most LNG SPAs were about 100 pages with. Enalytica had printed off an SPA as an example, which had been fully executed for about 2 million tons of LNG. He noted that if a buyer was purchasing gas at the North Slope they would not have to worry about the tanker sizes.

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Co-Chair MacKinnon asked if it was an accurate that the state should not care about the issue addressed by Mr. Tsafos. She wondered if not knowing the tanker cost would impact the decision unless someone else was picking up 100 percent of the cost. She surmised that if someone else picked up the tanker cost, they could build luxury liners to haul LNG that the state would have no influence over and would have to pay a tariff for. She thought the state should care about the entire process and cost of the entire transport of its product to a potential buyer.

Mr. Tsafos agreed that the state should care about the entire process. He noted that the agreements were complicated. The state would outline specifics related to approaching ports to receive the gas, who paid for tugs, and other. He stated that when a transaction happened at the port, significant information would be outlined related to the specifics of the transaction point. He stressed that the state absolutely had to think about the economics and related aspects, but there would be some technical things it could skip.

Mr. Mayer furthered that it was important to distinguish between what needed to be specified in the contract versus the commercial case and everything that needed to be taken into consideration when entering into the negotiation and agreeing to the terms.

Co-Chair MacKinnon asked if it was fair to say that enalytica's presentation included contracts within contracts or separate rounds of negotiation with different

levels of detail for the final agreement. She asked for verification that the state may not need all of the details to make an economic decision for Alaska on gas sales and marketing.

Mr. Mayer replied in the affirmative. He noted that there were two key challenges associated with issue under discussion. The first related to the volume of the agreement and all of the things that needed specification, which was a set of challenges of itself. He expounded that the issue related to the quality of the legal team and how long it took to nail all of the items down. The second related to understanding commercial terms and determining the state's best interest. He furthered that one of the large challenges associated with executing the agreement was understanding the value of the gas, the cost of bringing the gas to market, and what price made sense. He noted that Mr. Tsafos would elaborate on the topic momentarily.

Co-Chair MacKinnon referred to slide 7 and asked the presenters to go through TransCanada's inflection point. She asked for a further explanation of the items analytica had proposed for the committee's consideration.

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Co-Chair MacKinnon looked at slide 7, and asked for an explanation of each bullet. Mr. Mayer addressed the bullets on slide 7. He addressed that analytica's first concern in terms of how the state could best protect its interests in the project was ensuring the state was participating at every stage of the project (related to both big picture and daily decisions). He referred to the 135-person project management team that currently had no secondees from AGDC. When it came to matters of expansion, some of the concern related to the governance level, which translated to minute details such as the sizing of particular infrastructure components. He stressed the importance of ensuring the state was well represented on the project management team by people with a combination of clear lines of communication and accountability and who possess technical and commercial insight and understanding. He addressed that

AKLNG could back-fill TransCanada's exit, but analytica wanted to ensure that the state had its own capacity to backfill some of the positions.

Mr. Mayer addressed the question of how the state would ensure expansions. The slide included a bullet stating that the AGDC plan to pursue expansions was unclear. He detailed that the question had been asked during testimony and the answer given at the time was that the situation would be similar to Trans-Alaska Pipeline System (TAPS) with a project company like the Alyeska Services Company. He reminded the committee of the original ideas behind the HOA. He stated it was a project within a project. He furthered that under the HOA any of the parties could initiate and pursue an expansion provided it did not negatively impact the other parties. The parties were not in a position where everyone needed to approve an expansion; the state had the right to pursue an expansion as long as it did not negatively impact the other partners. He noted that in addition to the right, the state also needed to have the capability for expansion including the technical and commercial agreements and understanding that would make it possible.

Mr. Mayer addressed the cost of TransCanada's involvement compared to fully replacing the company with 100 percent debt. Analytica did not yet believe there had been sufficient focus on the overall capital structure the state would use to finance its share. He spoke to the idea of financial leverage. He explained that financial leverage would reduce the amount of money needed upfront, but it would increase the risk and volatility of the state's investment. He furthered that the concept could be compared to either buying a mortgage entirely with cash or a bank account, using 20 percent equity, or using 100 percent financing. He relayed that a small portion of equity took very small movements in the price of real estate to provide either a very high return or a very low return. He stated that the same principles applied in world of using leverage to finance the AKLNG investment. He discussed that the administration had spoken about its concerns that in pursuing the RIK structure, the state was potentially exposed to negative net-back. He elaborated on the idea that under very low LNG price scenarios the state could potentially not have enough revenue from selling LNG to cover all of its fixed costs of transportation. He agreed that it was true in an environment with substantial

leverage involved in financing the share; however, it was no longer a concern if the state had the equity on hand and the desire to finance its participation with the equity. At that point the concern would be about the rate of return the investment would achieve. He stated that in the very worst case scenario the state would not be under water. The same was true with LNG; if the state had built the entire facility with its own equity, prices could drop and it may not make the money it had hoped; however, there would never be a point where the state would have to pay over money to sell the LNG.

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Mr. Mayer continued to detail slide 7. He stated that as long as the entire structure was built heavily on debt, the risk became greater that there would be times when the state made an abundance of money and times when it went into the negative. Enalytica believed it was time that people began thinking about the dynamics in terms of the state's required capital commitment and about the appropriate amount of equity versus debt in trying to reduce the volatility of cash flows and risk to the state.

Co-Chair MacKinnon communicated that she and Senator Dunleavy had recently attended a meeting in Palmer where Rigdon Boykin [South Carolina-based attorney serving as the state's lead negotiator on the AKLNG project] had proposed that the project and its partners could all come together to finance the project. She wondered if that was typical. She believed that some of the partners were surprised by the assertion.

Mr. Tsafos replied that there were two ways to think about the financing of LNG projects. One was to think about the financing happening at the project level where everyone was in it together. Alternatively, the financing could happen differently for each of the partners. He provided a recent project in Israel as an example. He detailed that project was very simple; developers wanted to develop gas to sell to the Israeli market. One of the partners had financed the project entirely through equity; whereas the other partner raised project specific debt. He explained that the partners under the example had different financing approaches for the same project. He noted that the same dynamic existed for LNG projects in general. He detailed that there would be times with the project took on project-

level debt, and other cases when the project partners borrowed against their original claim to the project. He addressed the concept of the project within the project (the idea of each participant holding a share of the gas and the infrastructure) seemed to be leading towards a structure where each partner would have its own financing. He elaborated that the partners could all finance their portion with their own equity, which would not be dependent on another party. To get to a level where the project itself took debt, some changes to the project structure would be required. Currently, AKLNG essentially housed four projects that were all sharing the same infrastructure, but for everyone to financing the project together there would need to be some changes to the structure.

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Mr. Mayer completed detailing slide 7. The last points on the slide pertained to the state's vision for AKLNG. He read a quote from the Lewis Carroll novel "Alice's Adventures in Wonderland":

"Would you tell me, please, which way I ought to go from here?" "That depends a good deal on where you want to get to," said the Cat.

Mr. Mayer believed that a clearly articulated strategic endpoint was currently missing from making the large decisions. He elaborated that if the strategic endpoint was firmly rooted in the HOA that had been established in 2014, it made it clear to think about what was in the state's interest. He furthered that the scenario was all about equal shares of all of the partners and getting as close as possible to perfect alignment between the partners. He stated that under the scenario TransCanada had looked like an anomaly in many ways. On the other hand, the strategic picture began to change under a scenario that included withdrawal agreements, the idea that the state may be buying gas at the wellhead through a tolling or gas sale and purchase agreements that did not originally come from a partner with an infrastructure ownership. He continued that under the second scenario there may be many cases in which it would be desirable for an additional investor (e.g. an independent midstream company) wanted to undertake the financial commitment and risk to move gas through the pipeline (if the state did not want to be on the hook to move the gas through the infrastructure). He concluded that

having a clear, strategic perspective on where the project was going made it much easier to make some of the decisions.

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Senator Bishop stressed that there was a substantial amount of information for individual lawmakers to comprehend associated with the project. He listed various areas of the project that lawmakers needed to understand including finance, legal instruments, gas sales agreements, marketing agreements, and project management agreements. He pointed to the project management team that was made up of best players in addition to AGDC's team that he hoped was also made up of the best players. He remarked that there was an overwhelming amount of information to absorb to make the best decision for the state. He asked if the presenters agreed.

Mr. Tsafos replied that the project was immensely complicated. He referred to a project management team (headed by Steve Butts) chart listing the regulatory bodies (50 to 60) that were required to sign off on decisions. He stated that AKLNG was one of the most complicated projects in history. He stressed that one of the pros and cons was that there were extremely capable partners. He explained that the state would always have to look out for its interests and defending those interests would require substantial money, capabilities, and expertise. He stressed the importance of continuing to examine whether the state was looking at all of the items at the highest and best possible level. Additionally, the state needed to consider whether there was coordination and alignment between each of the pieces so the state could field the best team during negotiations with some of the world's most experienced companies.

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Senator Bishop remarked that Mr. Butts had one team with the best player on gas. He stressed that the team only dealt with the world of gas. Meanwhile, he was working to get his head wrapped around every aspect of the project at a high level in order to make the best decision for the state. He communicated that it was challenging.

Co-Chair MacKinnon directed attention back to slide 7. She pointed to the final point on the slide: "How much do withdrawal agreements raise risks for SOA."

Mr. Mayer replied that they would address slides 8 and 9.

Mr. Tsafos turned to slide 8. He noted that slides 8 and 9 had been included in response to a request by Co-Chair MacKinnon. Slide 8 included a "textbook" sales and purchase agreement, which listed all of the items that should go into a fully executed sales and purchase agreement. He remarked that the items were not all necessarily needed at the present moment. He discussed how long it would take to talk through the items based on standard industry practice. He shared that he had personally worked with a number of companies that had done due diligence on buying or selling gas through a pipeline or LNG. For example, a company may seek advice about buying gas in the Lower 48. He relayed that it would probably take a couple of months to work through the numbers and scenarios to provide a good image on what the investment may look like. After providing the data there would be a number of other layers of due diligence. He explained that due diligence usually happened before commercial negotiations occurred. In his experience, it often took 1.5 to 2 years to conduct the due diligence on a project. He explained that intermediate agreements may be signed - in the same way that AKLNG signed the HOA or MOU. He noted that the legislature had signed an MOU in December 2013, a Precedent Agreement in June 2013, and it had been preparing to sign an FTSA at the current time. He stressed that it had taken two years from the execution of the first agreement.

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Mr. Tsafos discussed slide 9 titled "Withdrawal-Sales Carries Major Risks for SOA." He prefaced the slide as their "Halloween special" as there were some items on the slide that could be quite significant and impactful. He shared a quote by Mr. Mayer "There's two kind of agreements that you may be able to sign before December 4th: one is a very high level agreement that probably isn't very binding; and the second is an agreement that probably isn't in the best interest of the state." He explained that in order for the state to close all of the possible commercial gaps in one month, it may need to make some very serious concessions.

Mr. Tsafos addressed a question posed by Co-Chair Kelly from the prior day related to how much the project would cost. He pointed slide 9 titled "Withdrawal/Sales Carries Major Risks for SOA" and addressed the first line:

Economics: Buying 75 percent of AK LNG gas could cost \$1.4–\$7.4 bn/yr (1995-2014 Henry Hub prices)

Mr. Tsafos elaborated that under the scenario the state would buy the producers' (ExxonMobil, ConocoPhillips, and BP) gas at the wellhead. He furthered that under the scenario the producers were no longer interested in the project and opted to sell the gas to the state. Additionally, the scenario depicted the state purchasing the gas from 1995 to 2014 at the price of Henry Hub (a hub in Louisiana that set the price for North American gas). He expounded that the gas would have cost the state anywhere from \$1.4 billion to \$7.4 billion per year (with an average of about \$3 billion per year, the total for 20 years would be \$60 billion). He explained that if the state bought gas for the next 20 years at the historical prices and it invested another \$60 billion to build the infrastructure on its own, it would be -\$120 billion by the time the project became operational in 2025 or 2026. He qualified that the scenario was a simplistic example that did not include discount rates and a multitude of other items; however, it did illustrate that the project was a major commitment. He reasoned that when the state thought about entering into the commitment, it would want to ensure it understood exactly what it was getting into.

Mr. Tsafos continued to address slide 9 that included a list of items the state would need to sort out before executing something resembling a binding agreement. He addressed the second line, which was related to liability:

Liability: Right to purchase could mean obligation to buy; major contingent liability; options costly

Mr. Tsafos elaborated that if the state agreed to purchase the gas it would be a major contingent liability. He stated that if the state did not have the liability and a Sales and Purchase Agreement, it would have an option. He explained an option was the right, but not the obligation, which would cost more than the right and the obligation. He addressed pricing on the third line:

Pricing: Does SOA have a thorough and detailed understand of pricing/volume risk?

Mr. Tsafos expounded that even from his perspective as a natural gas analyst it was not possible to predict what a good price for the state would be. He emphasized that how much the project would cost, the timeline, and the market appetite for the project were all unknown. He stressed that at the current point it was very difficult to come up with a price that the state could have some certainty around. He addressed the concept of asymmetry on the fourth line:

Asymmetry: If producers are willing to commit to a set price, does SOA really want to buy?

Mr. Tsafos furthered that the only reason the producers would exercise the option was if they thought it would be better than building AKLNG. The only way the state would have title to the gas was if the producers thought the project would not make them money. He reasoned that it was not a very good position for the state to be in. He moved to the fifth line:

Title: If gas has an "option" attached to it, legal title become less clear

Mr. Tsafos provided a hypothetical example related to trying to sell the gas in Japan. The gas could be entitled by a party in Prudhoe Bay, but the state may have an option to the gas. He questioned under what conditions the option would be triggered. He addressed activation and questioned if a deadline would be imposed. For example, the gas could be lost by December 31, 2018 if something had not been done. He continued that if he was in commercial negotiations and was trying to get the other side to commit, the other side understood there was a big risk because they may commit, but if other things did not happen by the date, the gas would be lost. He reasoned that it became very murky commercially.

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Mr. Tsafos addressed gas transfer on the sixth line (slide 9):

Transfer: Where is gas transferred? In what condition (e.g. what happens to CO2)?

Mr. Tsafos queried what would happen to the CO2. He noted that Mr. Butts had stated there was 12 percent CO2. He questioned whether the state would buy the CO2. He wondered if the state would have to agree with the Prudhoe Bay operator to sell the CO2 back. He asked how the CO2 of the gas would be priced. Additionally, he asked if the state buy the gas clean from CO2, in which case it would not be a wellhead sale. He stressed that there were many things to think about. He pointed to "fiscals" on the eighth line:

Fiscals: What kind of fiscal certainty would producers want to offer binding agreement?

Mr. Tsafos elaborated that the state's 25 percent [share] was part of royalty and part of tax as gas. He asked if the other side would agree to sell to the state based on current or some other fiscal arrangements (the state would want to know how much tax it would pay). The last two statements on slide 9 took a step back. He pointed to the ninth line:

Focus: Overly focused on failure; lower commitment; opt out rather than work issues

Mr. Tsafos elaborated on the topic of focus. He stated that there were only 24 hours in a day and the question was about how the hours were spent. He reasoned that if the entire day was spent trying to determine what to do if the project failed, time was not being spent trying to determine how to make the project succeed. He provided a puzzle analogy. The scenario included four people who were tasked with figuring out a puzzle and the winner was told they would receive a free cruise. In the scenario one party realized it could just take another party's place by offering its spot on the cruise. He explained that one party could chose to sell the gas and have someone else figure the "puzzle" out. He stated that at that point the issues were not really being solved when half a person's thoughts went to figuring out how to get on the cruise without solving the puzzle. He explained that it created misalignment when all of the parties were not working together to resolve the issues.

Mr. Tsafos agreed that Governor Walker had a point. The major risk for the project was getting to a gate that some people wanted to go through and others did not. Enalytica argued that it was not clear that dealing with the issue at present instead of in the future would make the risk easier to handle. He continued that there were two options if a project reached a stage gate where one party did not want to proceed: either to work the issues to determine a solution or to determine what it would take to buy the party out. He stated that the scenario occurred in LNG projects. He stressed that later on in the project a party would have much more information on which to wisely base a decision on. For instance, if the issue arose at the pre-FEED to FEED stage, the state would probably know if the cost would be closer to \$45 billion or \$65 billion. For example, there may have been discussions with the market and the Lazard report on financing would be completed. He emphasized that there would be much more information available on which to make a decision; whereas, trying to sort the issue out at present would raise a host of risk the state would have to think through and comprehend before it could make a decision that it would not really regret later on.

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Co-Chair Kelly communicated his concern related to the gas sales and withdrawal agreements. He asked if the gas sales agreements had to be complete by the December 4, 2015 deadline. He asked if Mr. Tsafos believed the agreements could be done later on.

Mr. Tsafos replied that what was required and what the administration wanted were two different things. He noted that in order to safeguard the state's interest the agreements could also be done later. He clarified that he was not making a statement on how the administration viewed the need to have the agreement prior to December 4. He noted that only the administration could answer how it viewed the issue. He reiterated that the state could still safeguard the interest even if it did not have a deal by December 4.

Co-Chair Kelly surmised that the administration was insisting on the completion of the sales agreement by December 4, 2015. Mr. Tsafos believed the administration would like to see the agreements completed prior to

December 4, but he did not know how important it was to them. He added that the agreements could still be negotiated towards the end of pre-FEED.

Co-Chair Kelly referred to the presenters' testimony that it could take two years to develop a sales agreement for a project like AKLNG. He asked for verification that a sales agreement had to be negotiated with each of the partners involved in the project.

Mr. Tsafos agreed, but qualified that he was not certain what the level of understanding was at present and how far apart the two sides were. He referred to due diligence companies did in negotiating agreements. He noted that he did not believe ExxonMobil needed to do a political risk analysis of Alaska.

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Co-Chair Kelly interjected his understanding that many of the assumptions would be done at the same time. Mr. Tsafos agreed. Co-Chair Kelly asked for verification that three sales agreements would need to be completed. Mr. Tsafos replied "that's our understanding."

Co-Chair Kelly assumed each agreement would not take a full two years, but he surmised that they would take significant time. He had heard that the administration had not begun the agreements. He asked for the accuracy of the statement.

Mr. Tsafos replied that he could not speak exactly to the status of the agreements. However, he believed recent letters from each of the producers appeared to be something that would be seen at the start of a negotiation. He relayed that he did not know how much back and forth there had been between the producers and the administration.

Co-Chair Kelly had heard "they're nowhere in the neighborhood." He commented on the complexity of sales agreements and believed the administration seemed to be insisting on establishing the agreements by December 4. He asked if there was a risk that the administration would vote against moving forward if the sales agreements were not complete by that time. Mr. Tsafos deferred the question to the administration.

Co-Chair Kelly wondered if the situation was a possibility. Mr. Mayer replied that they had all heard the same testimony from the administration. He believed it was safe to say that a definitive answer had not been provided. He stated that it was clear that a vote on the work plan and budget was set to occur on December 4 and thus far there had been no testimony on whether a yes vote would occur regardless of the negotiation.

Co-Chair Kelly questioned whether the state should be "freaked out." He noted he did not need a response.

Co-Chair MacKinnon remarked that AGDC had asserted that Mr. Joe Dubler [vice president and chief financial officer, AGDC] would cast the vote on its behalf on December 4. She wondered if it was a fair assumption. Mr. Tsafos replied that the state's seat on the AKLNG Management Committee was held by AGDC; its employee Mr. Dubler sat on the committee and was responsible for voting. He recalled Mr. Dubler's testimony that his vote was directed by the board of AGDC.

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Co-Chair MacKinnon shared that the legislature was awaiting a blueprint on how the administration viewed the structure of the project moving forward. She asked if it was fair to say that if ExxonMobil, BP, or ConocoPhillips were willing to sell the state's gas that the legislature should be highly interested in why the producers believed selling the gas would be a good thing to do at the current point in the project. Mr. Tsafos agreed.

Senator Bishop believed Mr. Tsafos had stated that if the producers were willing to sell that the state probably should not buy at this time. Mr. Tsafos agreed.

Senator Bishop asked for verification that Mr. Tsafos had sold gas before. Mr. Tsafos answered that he had helped companies conduct due diligence to sell gas. He had not personally bought or sold gas.

Senator Bishop remarked that the presenters had provided clarity on how long it took to conduct due diligence on a purchase sales agreement. He queried the number of individuals needed to execute and conduct thorough due diligence. Mr. Tsafos replied that the question was difficult to answer precisely. He stated that the work

would not all be full-time; there could be four or five people doing the economics and commercial aspects. Additionally, lawyers were needed. He relayed that it was not a "one man" job, but it was not a 20 or 30 people job either. There were items that would probably not be done under the current situation such as conducting political risk analyses because the items were known. He believed it could take 5 to 10 people.

Senator Bishop wondered if that response was based on per participant. Mr. Mayer replied that the numbers put forward by Mr. Tsafos assumed a high level of preexisting understanding of all of the commercial parameters of the transaction. Particularly, about what the cost to bring the gas to market actually was. He noted that the information was not currently known.

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Co-Chair MacKinnon thanked the presenters. She referred to a question she had asked at a press conference the day before related to the governor's assertion that SB 138 had some fundamental flaws. She addressed a response she had received from Mr. Darwin Peterson dated October 31, 2015 (copy on file):

Dear Senator MacKinnon,

In response to the question you posed to me in Senate Finance during the hearing on October 30th, I offer the following response:

When the Governor stated that SB 138 was fundamentally flawed, he was speaking primarily about the issue of project certainty. He has spoken many times about the need for adequate provisions to ensure a partner who withdraws from the project will still commit the gas they control...

Co-Chair MacKinnon noted that the letter continued on to say that the governor's administrative team was complying with the constraints that SB 138 had provided in statute. She appreciated the quick response. She noted that the Senate Finance Committee was still in search of further information on the state's end goal and what it was trying to accomplish outside of the transaction to purchase TransCanada and approve the work plan.

Co-Chair MacKinnon made a correction for the record. She explained that she had received comments the previous day that she thought were from Mr. Butt regarding "bumps in the road" at a Palmer hearing. She relayed that the comments had actually been made by Dave Van Tuyl with BP.

[12:24:06 PM](#)

AT EASE

[12:25:46 PM](#)

RECONVENED

Co-Chair Kelly MOVED to ADOPT the committee substitute for SB 3001 Work Draft 29-GS3812\P (Martin, 10/31/15).

Co-Chair MacKinnon OBJECTED for discussion.

LAURA PIERRE, STAFF, SENATOR ANNA MACKINNON, explained the sectional analysis (copy on file):

Sec. 1

Legislative Intent

(a) that the supplemental appropriations for the Departments of Law, Natural Resources, and Revenue be accounted for separately

(b) that the administration carry out the TransCanada interest acquisition in an expedited manner

Ms. Pierre elaborated that the goal was to have the transfer made prior to December 4, 2015. She continued to read the sectional analysis:

Sec. 2

Supplemental appropriation request for the Department of Law for \$10,100,000 for outside legal counsel contracts and internal agency costs

Sec. 3

Supplemental appropriation request for the Department of Natural Resources for \$2,126,000 for marketing, contractual services, and personal services

Sec. 4

Supplemental appropriation request for the Department of Revenue for \$1,381,000 for personal services and travel and contractual services

Ms. Pierre detailed that the amounts were the same as the amount presented by Pat Pitney, Director, Office of Management and Budget, Office of the Governor. She read the remainder of the sectional analysis:

Sec. 5

Fund Capitalization

(a) \$68,455,000 is appropriated from the General Fund to the Alaska Liquefied Natural Gas (AK LNG) Project Fund to acquire the interest currently held by TransCanada Alaska Development Inc.

(b) \$75,600,000 is appropriated from the General Fund to the Alaska Liquefied Natural Gas Project Fund for the state's share of Preliminary Front-End Engineering and Design (Pre-FEED) work for the AK LNG Project

(c) Statutory designated program receipts received for reimbursement for costs of field work from the AK LNG Project Fund are appropriated to the AK LNG Project Fund

(d) Statutory designated program receipts received for reimbursement for costs of field work from the In-State Natural Gas Pipeline Fund are appropriated to the In-State Natural Gas Pipeline Fund

Sec. 6

Lapse of Appropriations

The appropriations made in Section 5 do not lapse

Sec. 7

Retroactivity

If sections 2-5 take effect after November 15, 2015,
sections 2-5 are retroactive to November 15, 2015

Sec. 8 Contingency

The appropriation made in section 5 (b) for Pre-FEED
work, is contingent on adoption of a work plan and
budget for the AK LNG Project by December 31, 2015

Sec. 9 Immediate effective date

Co-Chair MacKinnon WITHDREW her OBJECTION. There being NO
further OBJECTION, Work Draft 29-GS3812\P was ADOPTED.

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

#

ADJOURNMENT

12:30:39 PM

The meeting was adjourned at 12:30 p.m.