The Heads of Agreement and Memorandum of Understanding: *Risks and Benefits*

A Presentation to the Senate Finance Committee

February 25, 2014

Department of Natural Resources

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Commissioner

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Guidance Documents & SB 138

Heads of Agreement (HOA)

- Describes roadmap to advance project through phased process.
- Describes understanding and consensus on key terms.

Memorandum of Understanding (MOU)

- Describes agreement to transition from AGIA License to a more traditional commercial relationship.
- Describes key commercial terms for that relationship.

HOA and MOU Describe **how** SB 138 would be used.

Senate Bill 138

- ***Participation*** *in the AKLNG Project.*
- ***Percentage*** *of State Gas Share and Participation in the AKLNG Project.*
- ***Process*** *for development of Project Enabling Contracts and* ***Legislative oversight*** *and* ***approval*** *of future contracts.*

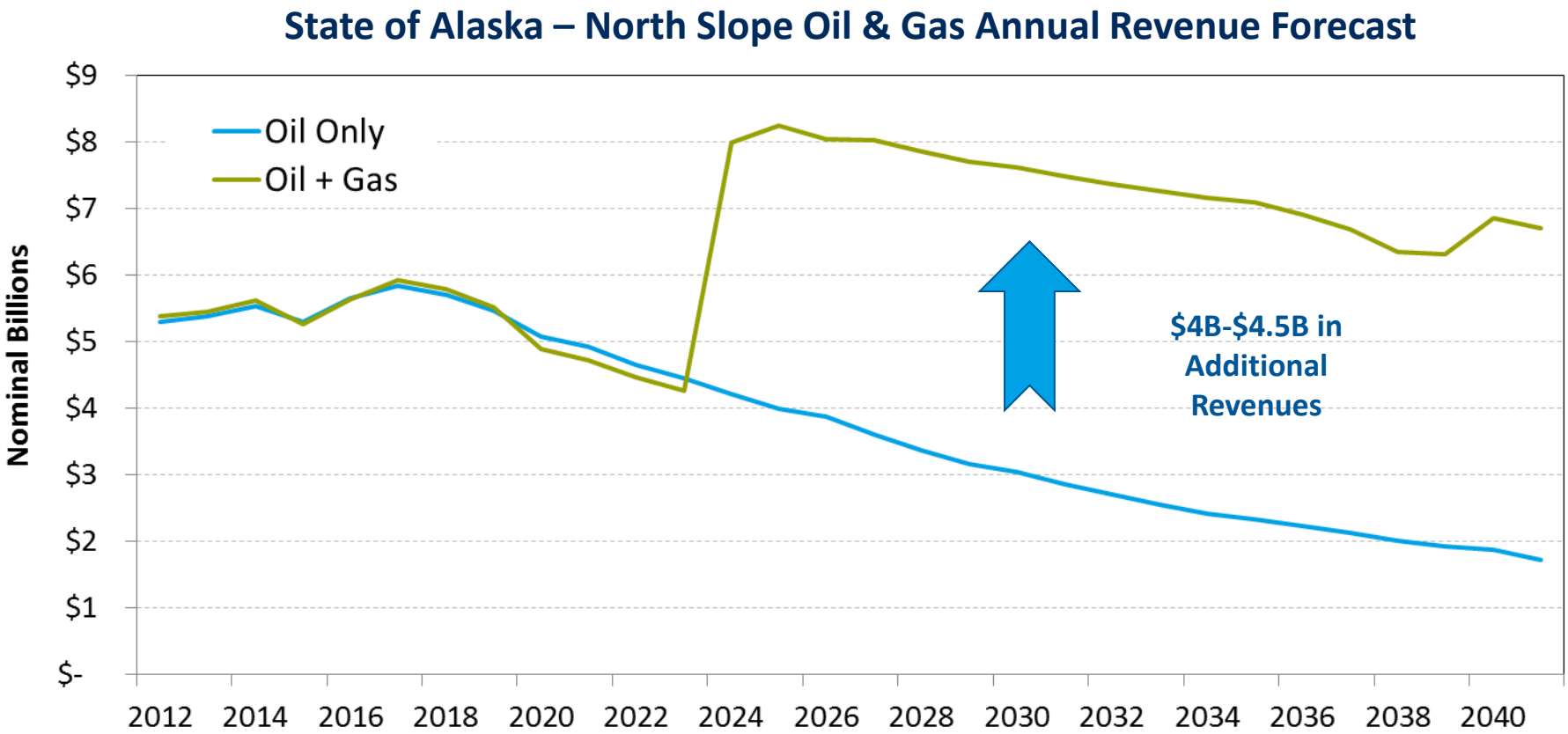
Legislature decides whether to advance or not.

Introduction

- **Should the State participate in the AK LNG project?**
  - What are some of the benefits?
  - What are some of the risks?
  - Can the risks be mitigated?

- **Should the State partner with TransCanada?**
  - Does partnering with TransCanada advance State interests?
  - What are the risks and benefits of partnering with TransCanada?

LONG-TERM NORTH SLOPE OIL & GAS REVENUES ARE DRIVEN BY AKLNG PROJECT SUCCESS



ROYALTY STUDY HIGHLIGHTS & RECOMMENDATIONS

STUDY FINDINGS

- GLOBAL LNG MARKET IS GROWING & COMPETITIVE
- GOVERNMENT TAKE & COST STRUCTURE FOR AKLNG PROJECT ARE HIGH
- AKLNG IS EXPECTED TO BE A LARGE, COMPLEX, HIGH COST PROJECT
- PROJECT STRUCTURE IS LIKELY TO BE PRODUCER-OWNED INTEGRATED
- VARIOUS RISKS INHERENT IN PROJECT & STATE PARTICIPATION

RECOMMENDATIONS

- IMPROVE COMMERCIAL ATTRACTIVENESS OF PROJECT
- RETAIN VALUE TO STATE
- CREATE ALIGNMENT BETWEEN STATE AND PRODUCERS
- RECOGNIZE & MANAGE RISKS ACTIVELY

→ STATE EQUITY PARTICIPATION

The HOA:
A Step Toward Mitigating Risks

The Heads of Agreement begins the process of mitigating risks identified in the royalty study by committing the Parties to a phased approach to the project.

Key State concerns are recognized and Parties commit to developing agreements during Pre-FEED and FEED.

- Marketing Risk
- Expansion Principles
- Regulatory Framework and 3rd Parties

January 14, 2014

HEADS OF AGREEMENT

By and Among

THE ADMINISTRATION OF THE STATE OF ALASKA

ALASKA GASLINE DEVELOPMENT CORPORATION

TRANSCANADA ALASKA DEVELOPMENT INC.

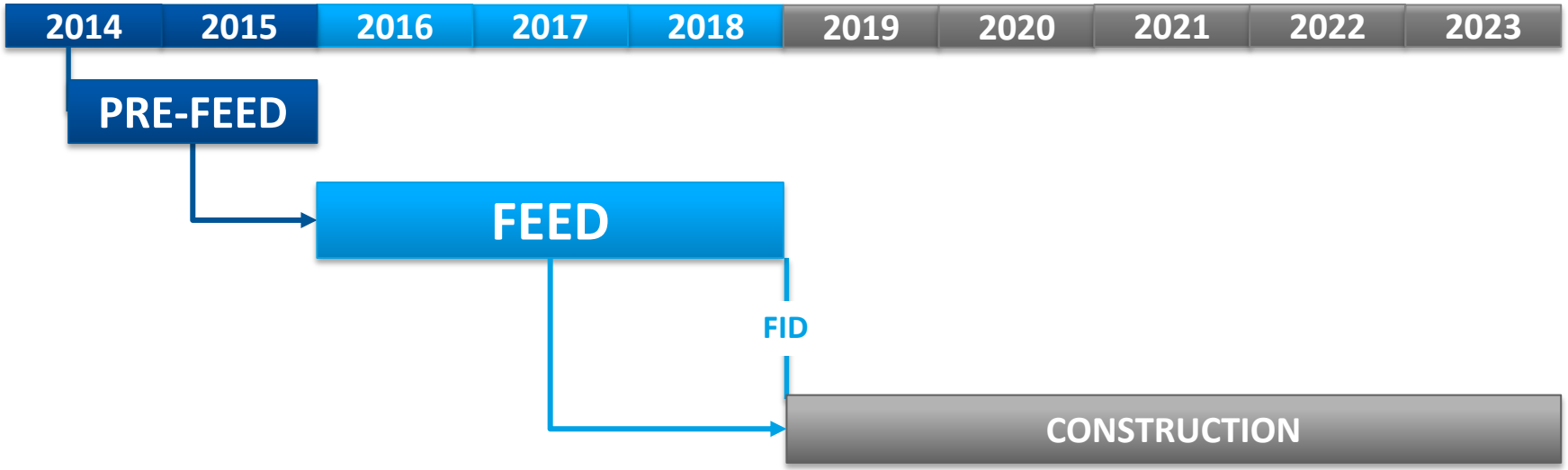
EXXONMOBIL ALASKA PRODUCTION INC.

CONOCOPHILLIPS ALASKA, INC.

BP EXPLORATION (ALASKA) INC.

FOR THE ALASKA LNG PROJECT

PUTTING THE HOA WITHIN THE CONTEXT OF AKLNG TIMELINE



STATE INVESTMENT

$43 - $108 million or ~1% of Total Investment	$180 - $450 million or ~2%-3% of Total Investment	$7 - $13 billion or ~95%-97% of Total Investment

HOA lays out principles to advance the project to pre-FEED and enter into commercial agreements

HOA: AKLNG Infrastructure Components

In order to understand the context of the proposal, we need to return to the Heads of Agreement (HOA) and State participation in the project as outlined in Articles 5 and 6 of the HOA.

The HOA describes how the Parties intend to cooperate in the joint pursuit of the Alaska LNG project – which is comprised of the PBU and PTU transmission lines, gas treatment plant (GTP), Pipeline, and LNG Plant.

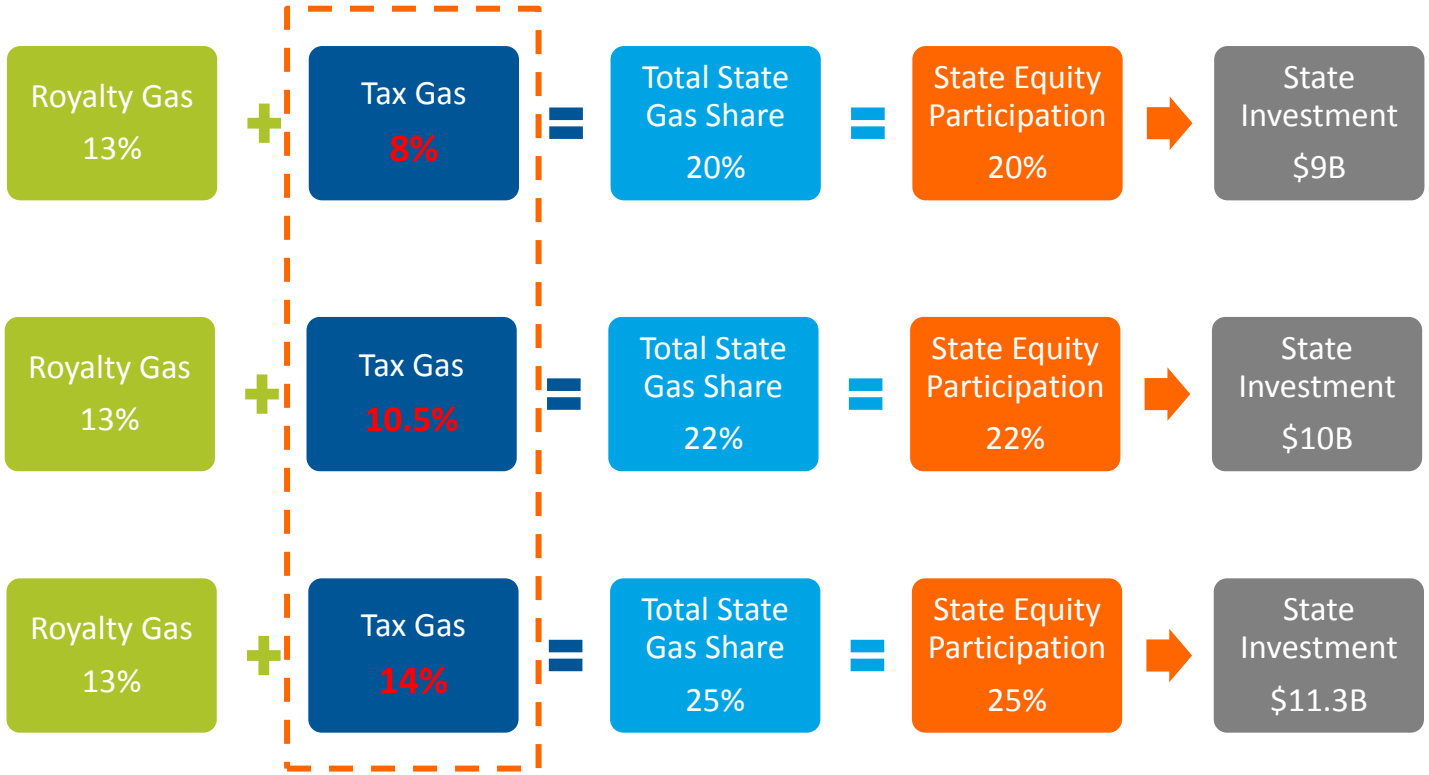
GTP
& Transmission Lines

PIPELINE

LNG Plant

GROSS TAX RATE SETS THE TOTAL STATE GAS SHARE & EQUITY PARTICIPATION

VALUE TO SOA

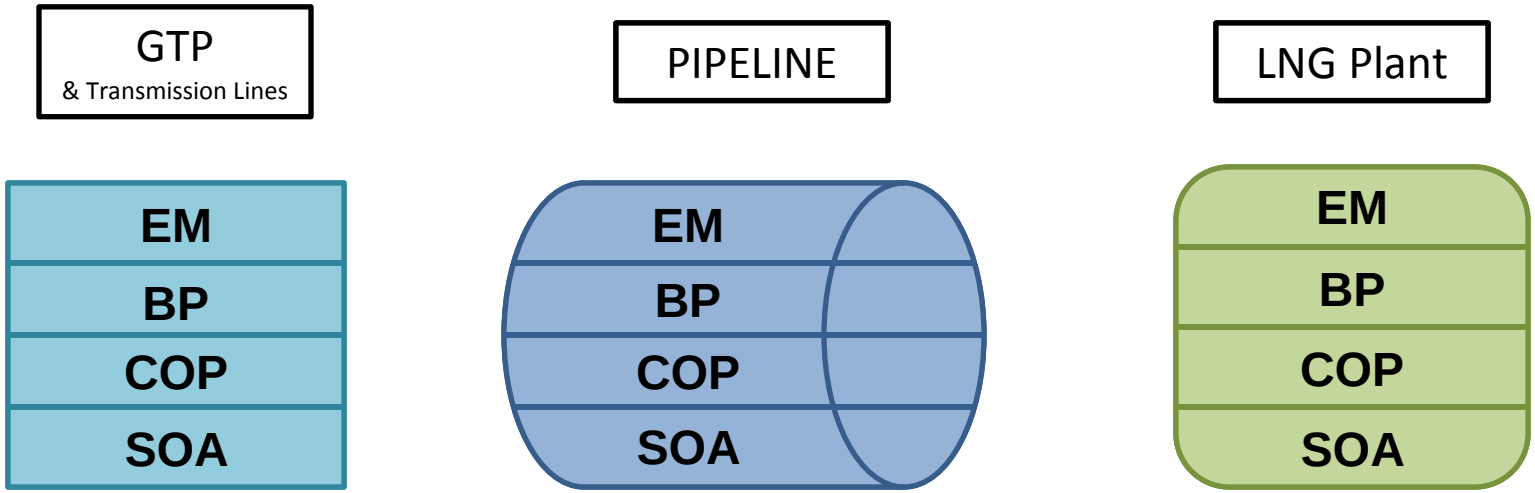


The Heads of Agreement describes this concept.

HOA: Equity Interest in Infrastructure

The overall structure of the HOA contemplates an alignment of the State's tax and royalty interests in the gas with an equity interest in each component of the infrastructure.

Each of the Parties will be responsible for their own financing and set the terms for access to their share of the project.



HOA SCORE CARD RELATIVE TO CRITERIA

Royalty Study Recommendations	How HOA Addresses Recommendation	
Alignment Through Equity	Equity Participation Along Supply Chain; Royalty and tax as share of gas	
Improve Commercial Attractiveness	Increases Producer IRR Reduces government take through reducing Feds share	
Preserve Value to the State	State is NPV and Cash Flow Neutral relative to Status quo	
Manage Risks		
Price Exposure	Equity Participation in midstream dampens exposure to prices	
Capital Costs	TC participation lowers State's cash calls prior to commercial operation	
RIK Marketing	HOA reflects intent of Producers to negotiate to market State's share of gas	
Structure of Participation	Project within a project, Stage gated commitments, Access & pro-expansion principles, Access to information	

Key Takeaways: Heads of Agreement

- LNG is a significant opportunity for Alaska and Alaskans.
- Phased process with commensurate steps.
- Off-ramps for all Parties.
- Maintains AGDC momentum on Alaska Stand-Alone Pipeline (ASAP).
- Creates opportunities to mitigate State risks identified in royalty study.
- Major risk is **cost** of State participation.

The Memorandum of Understanding

The MOU with TransCanada provides a roadmap for a transition from the AGIA license to a more traditional commercial relationship with TransCanada.

The MOU describes how the State will:

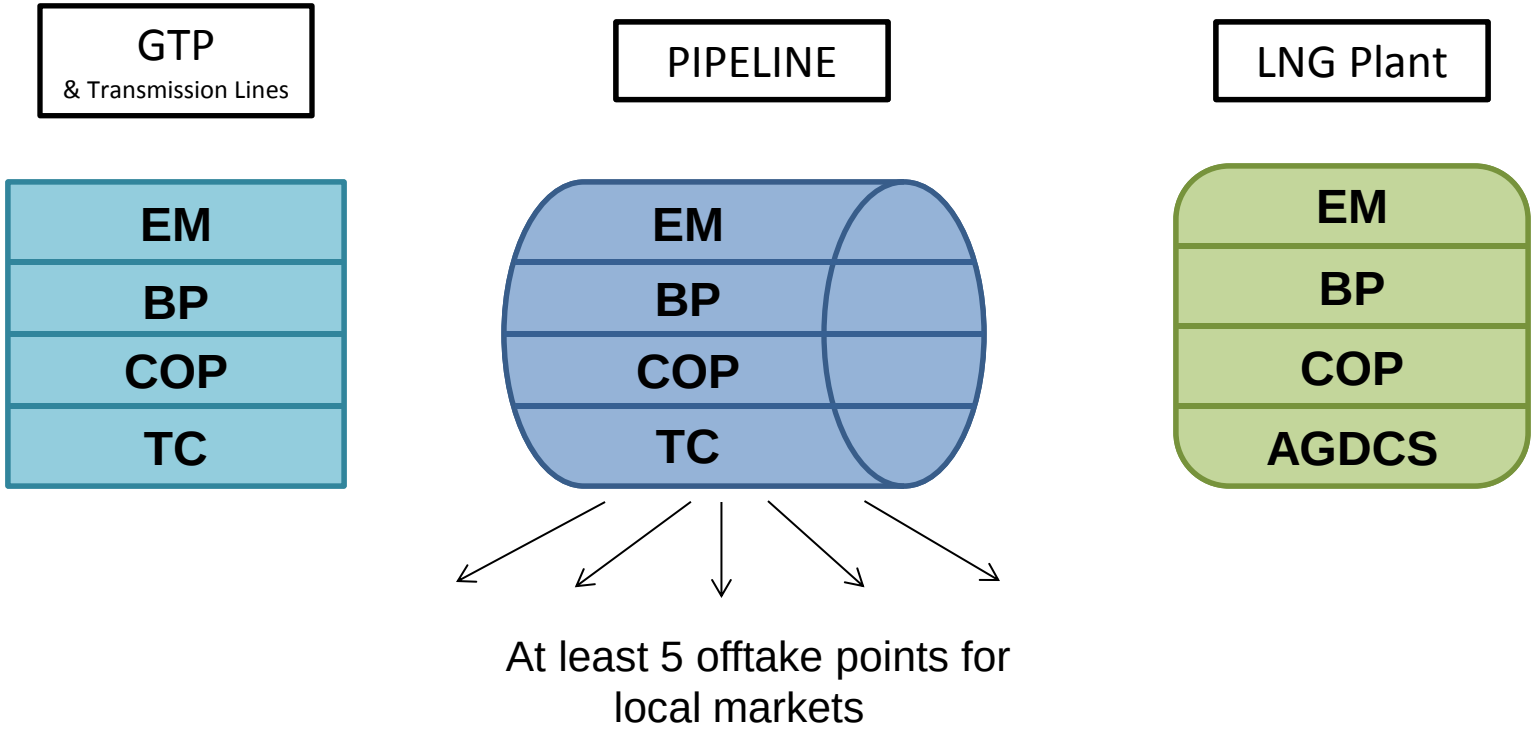
1. Abandon the AGIA license.
2. Partner with TransCanada in the midstream (Transmission lines, GTP and Pipeline) of the AKLNG project.
3. Provide for active interest in expansions.

Key Terms of MOU:

1. Favorable Debt to Equity Ratio
   - 75/25 ratio for rate-making purposes reduces the State's tariff.
   - Lower tariffs improve the State's overall cash flows.
2. Cash Contributions by TransCanada
   - TransCanada as project developer reduces the State's exposure to cash calls and obligations until the pipeline is in service.
3. Improved Value to the Treasury
   - When you consider the opportunity cost of utilizing the State's capital (which earns 6% in the treasury), our NPV is improved overall.
4. Expansions
   - TransCanada committed to 70/30 capital structure for expansions.
5. Gas to Alaskans
   - At least 5 offtake points
   - Distance sensitive rates with three zones for delivery

MOU: Transporting Alaska's Gas:

The MOU details TransCanada's terms of service for transporting Alaska's State Gas Share via the GTP and Pipeline. It is further contemplated that a subsidiary corporation of AGDC will be established to carry the State's interest in the LNG plant.



TransCanada will create an affiliate, TransCanada Alaska Development Inc. ("TADI"), for the AKLNG project

Exhibit B of the MOU:

Contains a term sheet for the State to exercise an equity option up to 40%* of the partnership established by TransCanada for the relevant portion of the midstream.

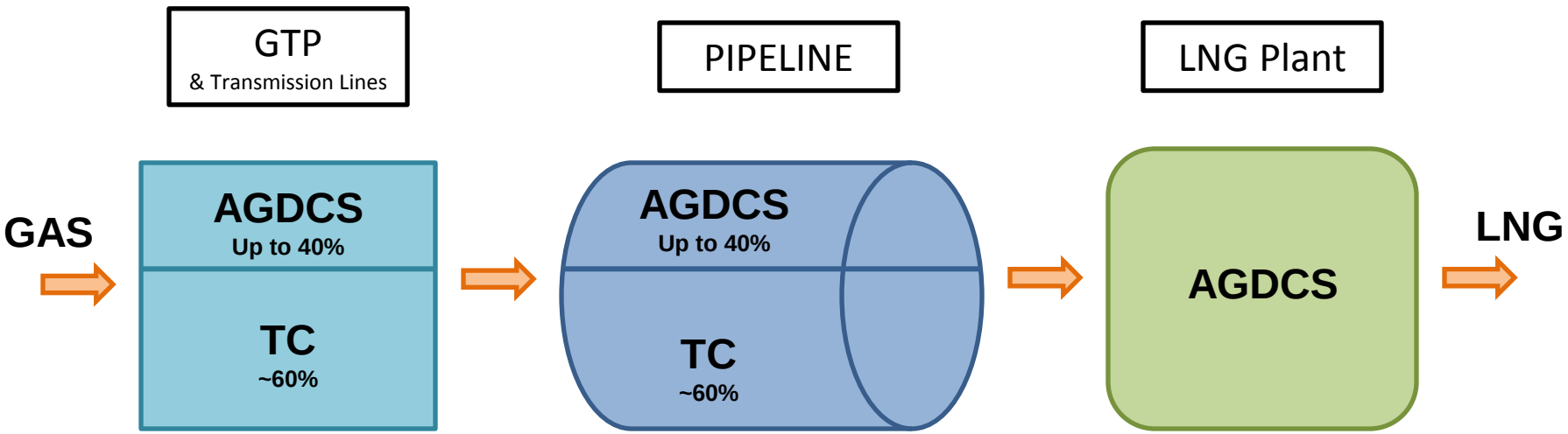
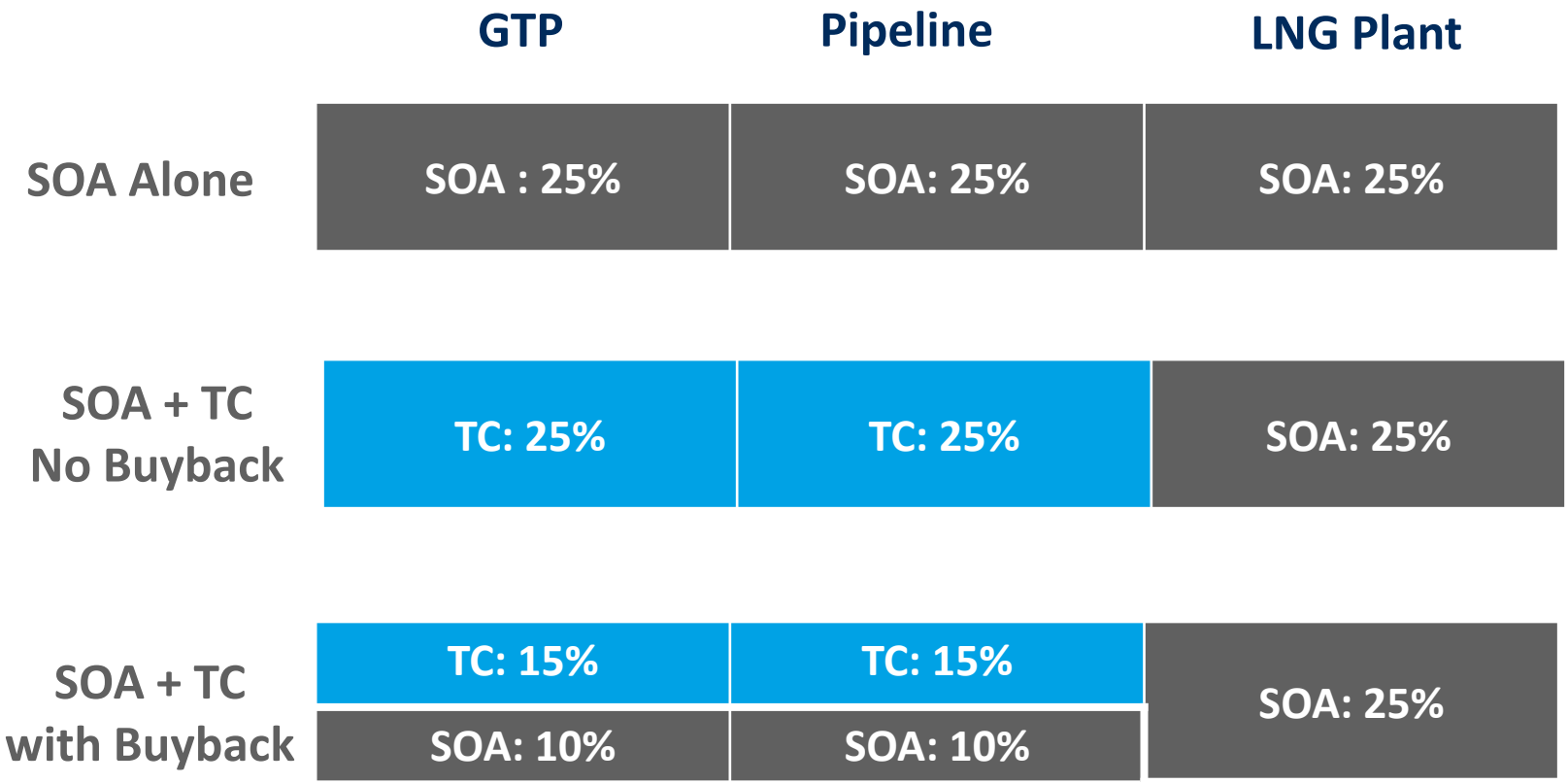


*Exhibit B specifies TransCanada's interest in the midstream components will not be less than 14% of the total (Exhibit B, Page 1).

MOU: Describes how the State will share the responsibility for its share of the project with TransCanada

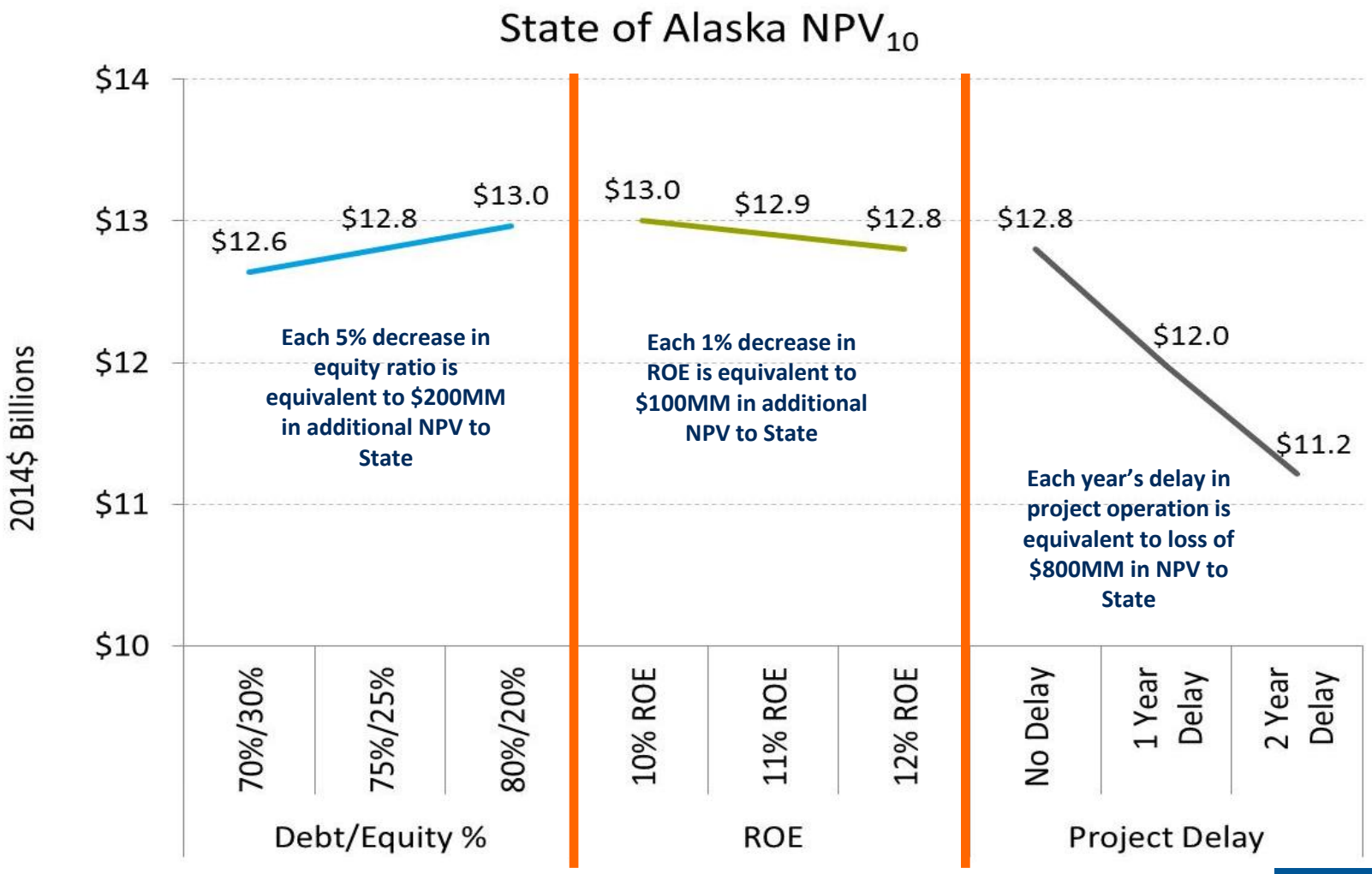


* Assumes 25% State equity participation

Source: Graphics provided by Black & Veatch

RETAINING MOMENTUM ON PROJECT COULD BE MORE VALUABLE THAN SECURING BETTER COMMERCIAL TERMS

TC AS PARTNER



Comparing the Commercial Terms

FERC Certificate Orders

Examples of Approved Capital Structure and Return on Equity ("ROE") for Major New/Expansion Projects (Initial Rates)

Pipeline	Project Description[1]	Capital Structure (Debt/Equity)	ROE
***Bison Pipeline LLC*, 131 FERC ¶ 61,013 (2010)**	Proposal to construct a new 302-mile, 30-inch diameter system from near Gillette, WY to interconnect with Northern Border	50/50	14.00%
***ETC Tiger Pipeline*, LLC, 131 FERC ¶ 61,010 (2010)**	Proposal to construct a new 175-mile, 42-inch diameter system from near Carthage, TX to near Delhi, LA	50/50	14.00%
***Fayetteville Express Pipeline LLC*, 129 FERC ¶ 61,235 (2009)**	Proposal to construct a new 64.3 miles of 42-inch diameter pipeline from Conway County, AR to Panola County, MS	50/50	14.00%
***Florida Gas Transmission Company, LLC*, 129 FERC ¶ 61,150 (2009)**	Proposal to construct 483.2 miles of pipeline expansion facilities and the addition of 213,600 additional compressor HP	60/40	13.00%
***Ruby Pipeline L.L.C*, 128 FERC ¶ 61,224 (2009)**	Proposal to construct new pipeline from the Opal Hub in Lincoln County, Wyoming to an interconnection with PG&E's system at the Oregon/California border (Malin, Oregon)	60/40	14.00%
***Mid-Atlantic Express, L.L.C.*, 126 FERC ¶ 61,019 (2009)**	Proposal to construct new pipeline from the proposed Sparrows Point LNG terminal (Baltimore, MD) to an interconnection with three existing interstate pipelines in Eagle, PA	70/30	14.00%

[1] All of the information contained in this chart was derived from the orders cited in the "Pipeline" column.

IMPLICATIONS OF OPTIONS AND POTENTIAL OFF RAMPS

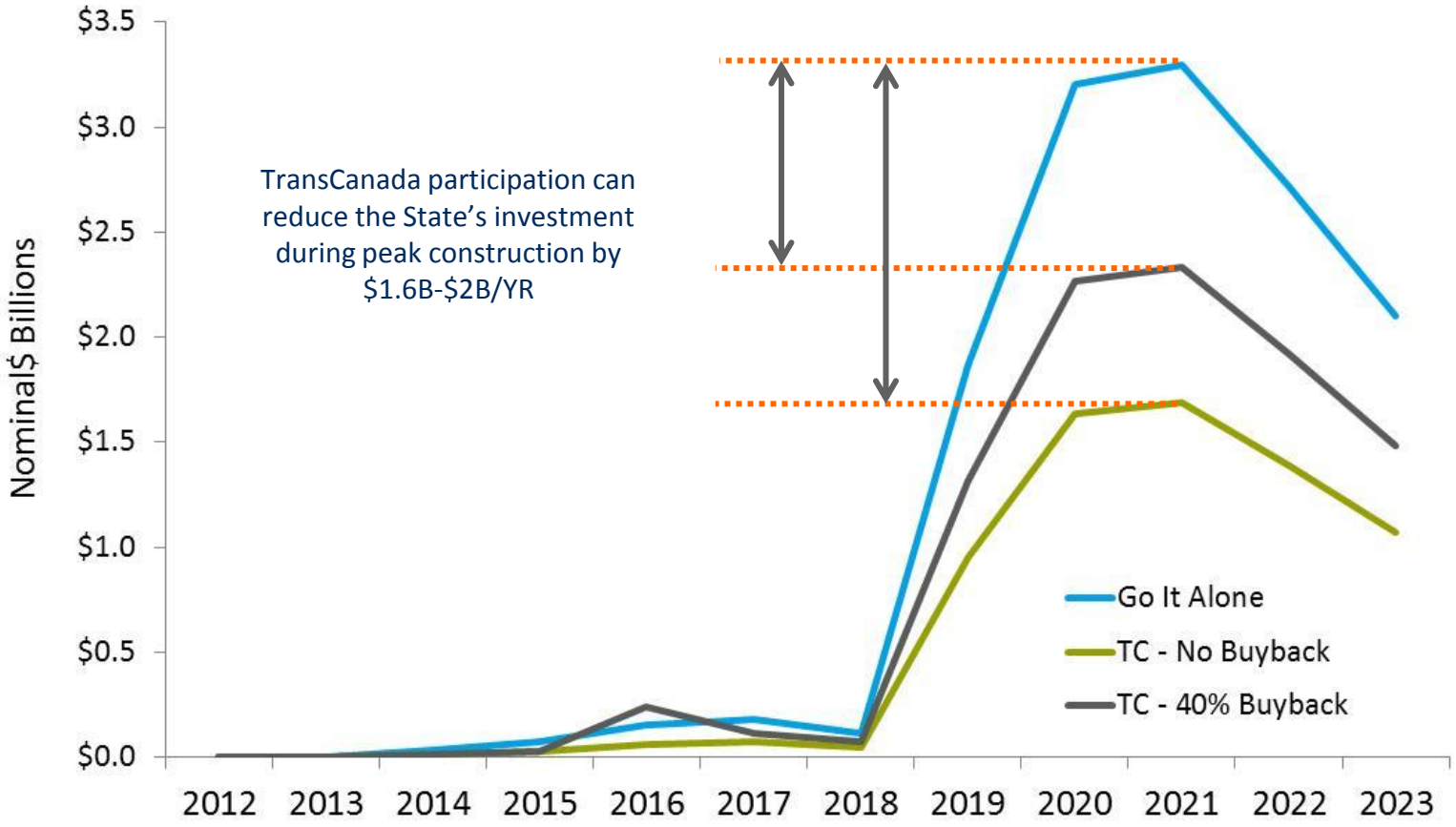
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
TIMELINE:						FID				
PROJECT STAGE:	PRE-FEED		FEED			CONSTRUCTION				

STATE INVESTMENT

SOA GO IT ALONE:	$108M	$450M	$13.2B
TC NO BUYBACK:	$43M	$180M	$6.7B
	Pay TC Dev. Costs of ~$70M (Incl. AFUDC of $5M)	Pay TC Dev. Costs of ~$390M (Incl. AFUDC of $50M)	
TC WITH 40% BUYBACK:	$43M	$360M	$9.3B
	Pay TC Dev. Costs of ~$70M (Incl. AFUDC of $5M)	Pay TC Dev. Costs of ~$230M (Incl. AFUDC of $30M)	

* Assumes 25% State equity participation

The "MOU" Memorandum of Understanding with TransCanada; Partnering to Share Risk



The MOU enables the State to partner with TC to advance key State interests like expansion policy and third party access during Pre-FEED and FEED while sharing risks in the construction phase of the project.

Source: Graphics provided by Black & Veatch

CAN THE STATE GO IT ALONE? - STATE'S DEBT CAPACITY

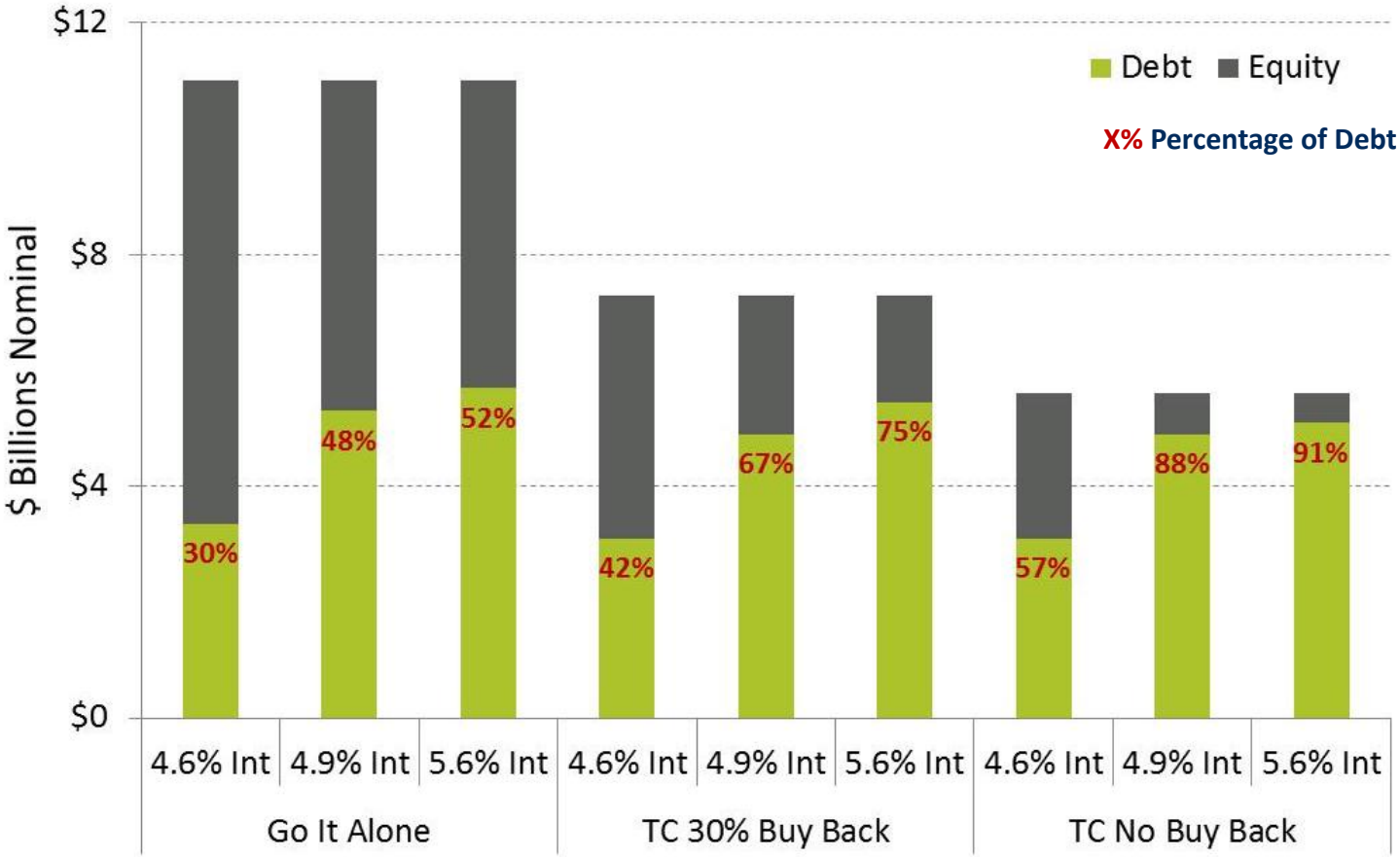
- **Financing the State's share of the AKLNG Project on the State's balance sheet – key issues:**
  - At what cost of debt?
  - Debt servicing as what % of general fund unrestricted revenue?

Scenario 1 (lower interest)	• SOA Debt at 4.6% • Debt Service limited to 3% of GFUR
Scenario 2	• SOA Debt at 4.9% • Debt Service limited to 5% of GFUR
Scenario 3 (higher interest)	• SOA Debt at 5.6% • Debt Service limited to 6% of GFUR

*** High-level, indicative assumptions based on input from Department of Revenue**

THE AMOUNT OF CHEAP DEBT AVAILABLE TO THE STATE COULD BE LIMITED

Indicative Levels of Debt for State to Finance 20% Equity Stake in AKLNG Project



*** Analysis based on high-level, indicative assumptions based on input from Department of Revenue. Financing arrangements for the AKLNG project will become clearer further into the development process.**

Key Takeaways: MOU

- Delays in momentum will generally outweigh gains in commercial terms.
- Partnering with TransCanada:
  - Advances key State interests (expansion & access) during Pre-FEED and FEED.
  - Supports larger State Gas Share by sharing risk in construction.
- Provides transition out of AGIA with passage of enabling legislation.
- Off-ramps exist with TransCanada in MOU.

Summary

- **State participation in the AK LNG project:**
  - Maximizes the value of the State's resources.
  - Improves competitiveness of AK LNG project.
  - Puts State in a position to mitigate risks.
- **Partnering with TransCanada:**
  - Advances key State interests (expansion & access) during Pre-FEED and FEED.
  - Supports larger State Gas Share by sharing risk in construction.
- **Phased process allows all Parties to mitigate risks.**

Source: Letter dated October 1, 2012 to Governor Parnell (Exhibit I-B of HOA)

THANK YOU

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Resources

http://dor.alaska.gov/AKGasDocs.aspx

www.dnr.alaska.gov/AKgas.htm