Evaluation of SB 138 & Associated Proposed North Slope Natural Gas Commercialization Proposals

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Introduction: Market Challenges

- Competition
  - Twice the amount of supply as there is demand in Asia in 2030
- Pricing
  - Prices appear to be falling
    - Buyers realize sellers were making windfalls at prices linked to high oil prices and increased competition among sellers
  - Compete based on cost
- Size Burden
  - Need to capture large incremental share of market in short amount of time
  - Higher breakeven price than much of the competition

Overview of Proposal

- Estimated Cost $45-$65 billion
  - ¼ Gas Treatment Plant (GTP)
  - ¼ Pipeline to Nikiski
  - ½ LNG Facilities & Terminal
- Timing
  - 2014-2015: Pre-FEED (Front-end engineering and design) ($400 million)
  - 2016-2018: FEED ($1.8 billion)
  - 2019: FID (Final investment decision [sanction point])
  - **<u>IF</u>** Sanctioned 2019-2023: Construction
  - 2024: First gas
- Taxation: Producers pay their taxes and royalties as in-kind gas (about 25%)
- Ownership
  - Gas treatment plant (GTP) and pipeline:
    - 25% by TransCanada/State has option to buy into 40% of this
  - LNG Facilities
    - 25% by State through AGDC

In-Value vs. In-Kind Gas

- Helps out the economics of the project considerably
- If the state takes its royalties and taxes **in value**, they pay for 100% of the capital cost, incur 100% of the capital risk, but only get 75% of the revenues
- When the state takes its taxes and royalties as **in-kind** gas, the state assumes the capital commitment for its capacity either through ownership or taking on a firm transportation commitment with a third-party

Marketing the In-Kind Gas

- By taking gas in-value the state benefits from some of the best marketers in the world
- Consider linking in-kind provision with agreement by producers to market state's gas with their gas at the same price they get
    - Otherwise, risk that state may be marketing at prices considerably lower than producers, which could result in losing money

Ownership and Partnership

- Need for ownership due to no regulation on tariffs and expansion, and for lower tariffs
- State does not necessarily need partner for expertise assistance
  - Producer expertise
  - AGDC expertise
  - TransCanada's expertise in gas treatment unclear
  - To the extent there is not a need for expertise, if the state needs a cash partner, it does not necessarily need a pipeline company partner, but a general investment partner

State Does Not Necessarily Need Partner for Cash or Lower Tariffs: 2011 Citigroup AGDC Financing Plan

- Possibility of 100% debt financing
- Possibility of tax-exempt bonds through Alaska Railroad
- Would require potentially no or little equity (cash) before gas starts flowing
- To the extent the state does not need a cash partner, its good credit rating and potential for tax-exempt debt could result in a lower cost of capital

Ownership: Risk of Failure to Sanction

- Sponsors could spend over $2 billion to get to FID and have a project not materialize, of which SOA would be responsible for 25%, regardless of whether it exercised ownership option with TransCanada
- Are producers better equipped to handle that risk?
  - Diversification – some of their other prospects will get sanctioned
  - Finite capital competing not only for gas, but for oil
  - Where other countries do share this risk, the takes are higher
- Will this money make a material difference to the viability of the project?
  - The more interested the producers are in the project, the less they need state money. The less interested they are, the more the state should avoid this risk.
- Balance:

How near tipping point	Probability of Project
Size of the prize	How material is $600 mm

- Could pursue arrangement with producers to buy in to project once it is sanctioned (or at least after pre-FEED) and re-pay feasibility costs with interest

Role of Alaska Gasline Inducement Act (AGIA) in Proposal: Overview of AGIA (2007)

- Monetary inducements in exchange for certain performance questions
- Reimburse share of costs to get to open season and obtain a FERC certificate
- Many provisions in AGIA were antithetical to producers' interests
- Poison pill placed in the statute: treble damages clause

Role of AGIA in Proposal

- Public comments by administration:
  - Aggressive time frame to get gas to market
  - Desire to avoid potential lengthy and costly legal fight over ending AGIA license
  - Proposal designed to end AGIA license amicably
- Appears plan was crafted (at least in part) around giving TransCanada a material role to avoid potential AGIA liabilities
- Could there be better terms if state was not so constrained by AGIA?

Areas Where State Could Possibly Have Better Terms If It Had No Partner / Different Partner

- No Partner: Possibility of full ownership of 25% share of GTP/Pipe with 100% debt financing and possible tax-exempt debt

- Different Partner: Lower cost of capital: higher gas revenues/lower cost gas to consumers

- It would not be difficult to get out of AGIA

Fiscal Stability

- Producers have continually expressed necessity
- Some fiscal stability may be necessary
- SB 138 not stable
- Scope out producers intentions as to what constitutes adequate stability

Property Tax

- Property tax is based on value: the higher the cost the higher the tax
- Lots of litigation on valuation
- No question that there are social impacts from development that need to be addressed and paid for
  - Not clear that impacts are directly related to value
- Looking at cents per unit tax plus impact payment or other approach with municipal advisory board