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MEMORANDUM

VIA E-MAIL

To: Rep. Ralph Samuels
Ms. Cheryl Sutton

From: William A. Mogel
Shuchi Batra

Date: January 23, 2008

Subject: "Contingencies" in TransCanada's AGIA License Application

I. INTRODUCTION

It has been reported that TransCanada's AGIA License Application is contingent upon several conditions.[1] If this report is correct, the Application would not be deemed in compliance with the requirements of AGIA or the RFA.

[1] *Inside FERC* (Jan. 14, 2008) reported:

> TransCanada wants to condition its proposal on recovering federal loan guarantees to pay for any cost overruns. The application also calls for any the federal government to act as a "bridge shipper" in case insufficient volumes are contracted during an open season for the project. (p. 11)

But see Memorandum dated January 8, 2008 to Marty Rutherford from Greenberg Traurig, which states:

> The bridge shipper and loan guarantee concepts are not requirements. Instead they are creative ideas which TransCanada has offered for the State's consideration to help facilitate the development of the project.

This Memorandum examines the “federal loan” and “bridge shipper issues, as well as less publicized aspects of the License Application, which also can be viewed as contingencies.

In addition, it is recommended that a gas pipeline rate expert be retained to analyze whether the proposed rate structure complies with AGIA and/or creates contingencies by including excessive or legally unacceptable costs in rates.[2]

II. AGIA AND THE RFA

Section 43.90.140 (a) of AGIA imposes the obligation on the Commissioners to:

> [R]eview each application to determine whether it is consistent with the terms of the request for applications [RFA] and meets the requirements of AS.90.130.

In implementation of AGIA, the RFA, in Section 1.14 (“Rejection of Applications”), provides:

> An application shall be rejected if it requires additional actions by the legislature or by the Commissioners beyond those actions identified by AGIA, contains conditions not authorized by AGIA or the RFA, includes a reservation of the right to accept or reject the License award….

[2] At page 13, TransCanada states that “[r]ates will be set to recover 100 percent of capital costs, including … [AFUDC] and *contingencies*.” (emphasis added) *See also* TransCanada’s proposed use of recourse rates. (p. 2-2.65). A rate expert could clarify the inconsistency in TransCanada’s proposal for an initial rate base for the Alaska portion of $11.7 billion (p. 2.2-65) and its later representation that the initial rate base would be $14.2 billion. (p 2.2-68)

III. FEDERAL LOAN AND BRIDGE SHIPPER CONTINGENCIES

A. Federal Loan

Prominent in its License Application, TransCanada states, as one of its objectives, that it:

> will work with the State to jointly seek authorization to use the Federal loan guarantee … to fund any construction cost overruns. (p. 16)[3]

According to TransCanada, the loan guarantee would be used to keep rates or tolls at a level that would "provide Shippers with the certainty that their netbacks will never fall below a specified level." (p. 16)[4]

With regard to the Federal loan guarantee, the Application explicitly states (p. 2.2-71) that it is dependent on "an acceptable agreement … reached with the U.S. Government."

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[3] See *infra* at IV.B. of other actions that TransCanada seeks the State of Alaska to undertake. The Alaska Pipeline Act, 15 U.S.C. § 720 *et al* provides for an $18 billion loan guarantee for a "qualified project." Section 720n(a)(3) states:

> The authority of the Secretary to issue Federal guarantee instruments under this section for a qualified infrastructure project shall expire on the date that is 2 years after the date on which the final certificate of public convenience and necessity (including any Canadian certificates of public convenience and necessity) is issued for the project.

[4] Contrary to TransCanada's assertion, the $18 billion loan guarantee provisions of the Alaska Pipeline Act would not be available to TransCanada "until [its proposal] is chosen by [FERC] as the qualified project." 15 U.S.C. § 720n(b)(4). Only *after* that condition is fulfilled, may DOE, in the exercise of its discretion:

> issue Federal guarantee instruments with respect to loan and other debt obligations for a qualified infrastructure project. (15 U.S.C. § 720n(1)).

B. Bridge Shipper

As to the "bridge shipper contingency," the Application states:

> TransCanada, in partnership with the State, would seek to establish a mechanism through which the U.S. Government would assume *some* or *all* of the initial risk of the Project by acting as a "bridge shipper." (p. 16)

Obviously, the bridge shipper concept is contingent upon:

1) the State's "partnership,"[5] and
2) the willingness of the Federal government to enter into an undefined mechanism to bear an unquantified risk that would continue for an indefinite period, i.e., until "the full initial capacity of the pipeline is under contract." (p. 16)

[5] Section 1.14 of the RFA, *supra*, provides that an application *shall be rejected* if it requires additional actions by … the Commission." (emphasis added)

IV. OTHER CONDITIONS OR CONTINGENCIES

A. Credit Support

At page 2.1-4 of the Application, TransCanada states:

> If the credit support for the Project is not sufficient to finance construction of the Project … TransCanada will *not* proceed with the Execution Phase. (emphasis added)

Presumably, the credit support would include two major financial conditions: early access to the $18 billion Federal loan guarantee; and the inclusion of the Federal government as a "bridge shipper."

B. Additional Actions Required From the State

TransCanada states that it would "rely" on the State of Alaska "to ensure a favorable economic environment for potential Shippers." (p. 2.2-52) It goes on to say that the State should reach "agreement on a commercially reasonable and predictable upstream fiscal regime" with the ANS Producers. (p. 2.2-52). In this regard, the application states:

> TransCanada expects the State to fully utilize all of the authorities at its disposal as a sovereign government, taxing authority, natural resource lessor and royalty owner to encourage, induce and persuade the ANS Producers and explorers for new gas to commit gas reserves to the Project. TransCanada also expects the State to thoroughly evaluate and seriously consider the financial and commercial

feasibility of dedicating significant State resources to underwriting an alternative financing mechanism for the Project.[6] (p. 2.2-57 – 2.2-58)

In addition to asking the State to change the "fiscal regime," TransCanada requests that the State of Alaska and TransCanada jointly develop a plan which would include specific steps the U.S. Government could take to support the Project. The key components include:

- discussions with U.S. Department of Energy and U.S. Department of Treasury to seek their support for TransCanada's proposal to use the U.S. Loan Guarantee for Capital Cost Overrun;
- discussions on the toll surcharge concept with FERC and the NEB to obtain their feedback on process for recovering Capital Cost Overrun, and
- exploration of the alternative credit concept, i.e. backstop Shipper contract, with U.S. Government to seek its support for the Project in advance of the Open Season, or in the event of a failed initial Open Season. (p. 2.2-53)

<u>C. Decision to Proceed</u>

The Application at pp. 5-6 states that the project's "go/no-go" ("Decision to Proceed") will be based upon *inter alia* the following factors:

1) Receipt of official U.S. and Canadian regulatory approvals;
2) Receipt of binding bids for all major materials and equipment;
3) Financing in place; and

[6] TransCanada also has proposed that it and the State implement "a comprehensive shareholder outreach and education campaign." (p. 2.2-52; s*ee also* 2.2-58)

4) Project cost estimates that are in accordance with Shipper precedent agreements or other financial guarantors.

If these factors are not met, in TransCanada's sole judgment, it will not continue on to the "Project Development Phase." (p. 5)

D. TransCanada's Contingent Compliance with AGIA

The Application expressly states that TransCanada's AGIA participation is "contingent" on it not being subject to two provisions of AGIA which require that an applicant, upon the request, transfer engineering designs and the like to the State:

The Application provides:

> "TransCanada's AGIA participation is contingent upon the following condition: all assets that TransCanada Corporation and its affiliates have developed and secured prior to the date the License is awarded, with or without further improvements subsequent to the License date of award, will not be subject to the requirement under AS 43.90.240 (e) or AS 43.90.440 and will remain the property of TransCanada Corporation or its affiliates." (p. 2.11-2)[7]

[7] AS 43.90.240(e) and AS 43.90.440(a) refer to: "all engineering designs, contracts, permits, and other data related to the project."

E. Conditions Precedent to Proceed to Construction

The application at pages 2.2-60 – 2.2-61 sets forth seven "conditions precedent" that would have to be met prior to commencing construction.[8] If not met, TransCanada states that it has the option to exercise its "Termination Rights":

> In the event the…conditions precedent…are not met within six months after certificate issuance…TransCanada will have the option as to whether to proceed with the project.

F. Regulatory Approval

The Application, in a section entitled "Commitments", makes clear if "any component" of its proposal does not obtain regulatory approval, TransCanada's commitment is limited to "advocate[ing] support of obtaining it." (p. 1-3)

G. Favorable Toll

TransCanada seeks a "favorable toll" to fully recover costs based on volumes of 3.5 Bcf/d. These tolls are set forth in the Application. (p. 17)

H. Rates

For the Alaska Section, TransCanada is proposing to use a recourse rate that *assumes* 25 year transportation agreements[9] Thus, if TransCanada is unsuccessful in negotiating 25 year

[8] Two of the seven conditions are "receipt of financial commitments … on terms that are acceptable to TransCanada" and that "all Shippers … have a executed PA [Precedent Agreements]." (pp. 2.2-60 to 2.2-61).

[9] The recourse rate will:

service agreements, it must fall back to its negotiated rates for "30 or 35 years," which may not be commercially acceptable.[10] (p. 2.2-54)

I. Foothills' Need to Obtain Rights to Land

TransCanada's Application states that the Canadian Section is subject to Foothills successfully obtaining rights to land outside of the Yukon. TransCanada writes:

> [A]lthough Foothills has easement rights for the entire APP route through Yukon, it will need to obtain rights to land in British Columbia and Alberta. (p. 12)

Although this condition should not be insurmountable for TransCanada, it is a condition that could affect: 1) timing of the certificates; 2) extending the development phase; and 3) increasing rates or tolls.

J. Alberta Hub Volumes

In passing, the Application notes:

> [S]ubject to achieving sufficient volumes to the Alberta Hub *to allow the Project to be constructed…* (p.14 (emphasis added))[11]

> initially provide for the full recovery of capital costs on a straight-line basis over a 25-year period assuming initial Transportation Services Agreement are for 25 years (if the … Agreements are for a different term, then the recourse rate will be adjusted accordingly). (p. 2.2-65)

[10] TransCanada also will offer negotiated rates based upon 30- and 35-year contract terms.

[11] One TransCanada proposal to reduce rates could be accomplished by moving the Alberta Hub from Boundary Lake to Fort Nelson. (p. 17)

Later in its Application, TransCanada represents that for the project to be "economically feasible," a "minimum 3.5 bcf/d of firm capacity commitment" is required. (p. 2.2-54).[12]

K. Catch-all Contingency

The License Application concludes (p. 16):

> There will be many obstacles that arise that will require TransCanada, *the State* and other project participants to explore alternative pathways to a successful project. (emphasis added)

Such language could mean that TransCanada contemplates seeking, on an ongoing basis, additional concessions from the State of Alaska—something which is not contemplated by AGIA or the RFA.

V. CONCLUSION

The sum of the foregoing leads to the conclusion that TransCanada's menu of proposals is inconsistent with AGIA and the RFA. The fundamental condition that TransCanada is seeking the State's intervention—establishing a "predictable upstream fiscal regime"—is not different from the relief long sought by the three major producers.

[12] Even with a throughput of 3.5 bcf/d, tolls would be based on a throughput of 4.5 bcf/d. Such would mean that higher rates would be charged because costs would have to be recovered from lesser volumes. (p. 2.2-54).