

# Some things to look for and ask about in the AGIA License Determination

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Legislative Budget and Audit Committee

Alaska State Legislature

June 2008 Special Session

# My Assignment:

- Part I. Talk about “What to look out for - Questions to ask - Help legislators examine the issues.”
  - Commissioner Galvin: “This is just the beginning – need to understand as well as vote.”
- Part II. Ways to think about a vote

# Part I. Major Reasons Given to Vote for TransCanada License

- (1) Enforceable commitments
- (2) Makes a “dazzling” amount of money for everyone – so producers will sign on and project will advance
- (3) “Guarantees” State’s must-haves for an “enhanced open-access pipeline”
- (4) Best way of getting LNG export
- (5) Best way of meeting in-state gas needs

# Another Reason to Support a TransCanada License

- Probably won't harm the prospects for a line and may strengthen them

# Item #1. What are the Enforceable Commitments in the License?

- Licensee agrees to 20 “must-haves” listed in AS 43.80.140 (AGIA)
- 7 Procedurals related to obtaining license
- 3 Pre-sanction commitments (ex-tariff)
- 5 Tariff commitments
- 5 Local commitments

# 7 License Procedurals

1. File an application on time
2. Provide thorough description
8. Describe GTP (including some rate commitments)
9. Propose reimbursement plan
16. Waive right to appeal license decision
19. Detailed description of applicant
20. Demonstrate readiness to implement project

# 3 Pre-Sanction Milestones

## 3. (FERC) & 4. (RCA) Milestones

- Open Season within 36 months
- Use FERC pre-filing procedure
- Apply for CPCN by date certain

## 5. Assess market every two years (also in tariffs)

# Is there an enforceable commitment for a pipeline?

Is there an enforceable commitment for a licensee to build a pipeline? Is there an enforceable commitment for a licensee to sanction a pipeline?

“We are not obligated to build a pipeline. That is not what AGIA requires.” – TC Vice-President, Tony Palmer, February 6, 2008, Presentation to House Open Caucus.



# What is the “Enforceable Commitment” for an Open Season?

- “Must-have” is
- “...conclude by a date certain, that is not later than 36 months after the date the license is issued, a binding open season...” (AS 43.90.130 (3))
- TransCanada certifies they will “comply with AGIA”
- If license granted this summer – open season by Summer 2011?

# Is there an “Enforceable Commitment” for an earlier Open Season?

- TransCanada commits... ***subject to the License being issued by April 2008***, to conclude an initial binding Open Season within 18 months after issuance of the AGIA license. (TC Application page 10)
- TransCanada commits ... to conclude a binding Open Season by September 30, 2009 (TC Application page 2.2-85)
- TransCanada would conduct the Open Season...within 18 months following the date the License is issued (TC Application page 2.2-53)

# Reminder: What does an Open Season accomplish?

- A Open Season is where shippers make Firm Transportation commitments – if there is a line built they will ship or pay.
- It is these commitments-to-pay that underwrite the financing of the line.
- Typically it is these commitments that demonstrate the need for the pipeline to the FERC.
- Question: Will a pipeline be built without FT?

# What is the “Enforceable Commitment” for a Certificate of Public Convenience and Necessity (CPCN)?

- “Must-have” is
- “...apply for a FERC CPCN ... by a date certain” (AS 43.90.130 (3))
- TransCanada commits...subject to the License being issued by April 2008, to apply for FERC CPCN by December 2011. (TC Application page 10)
- TransCanada commits ... to apply for a FERC CPCN by December 30, 2011 (TC Application page 2.2-85)

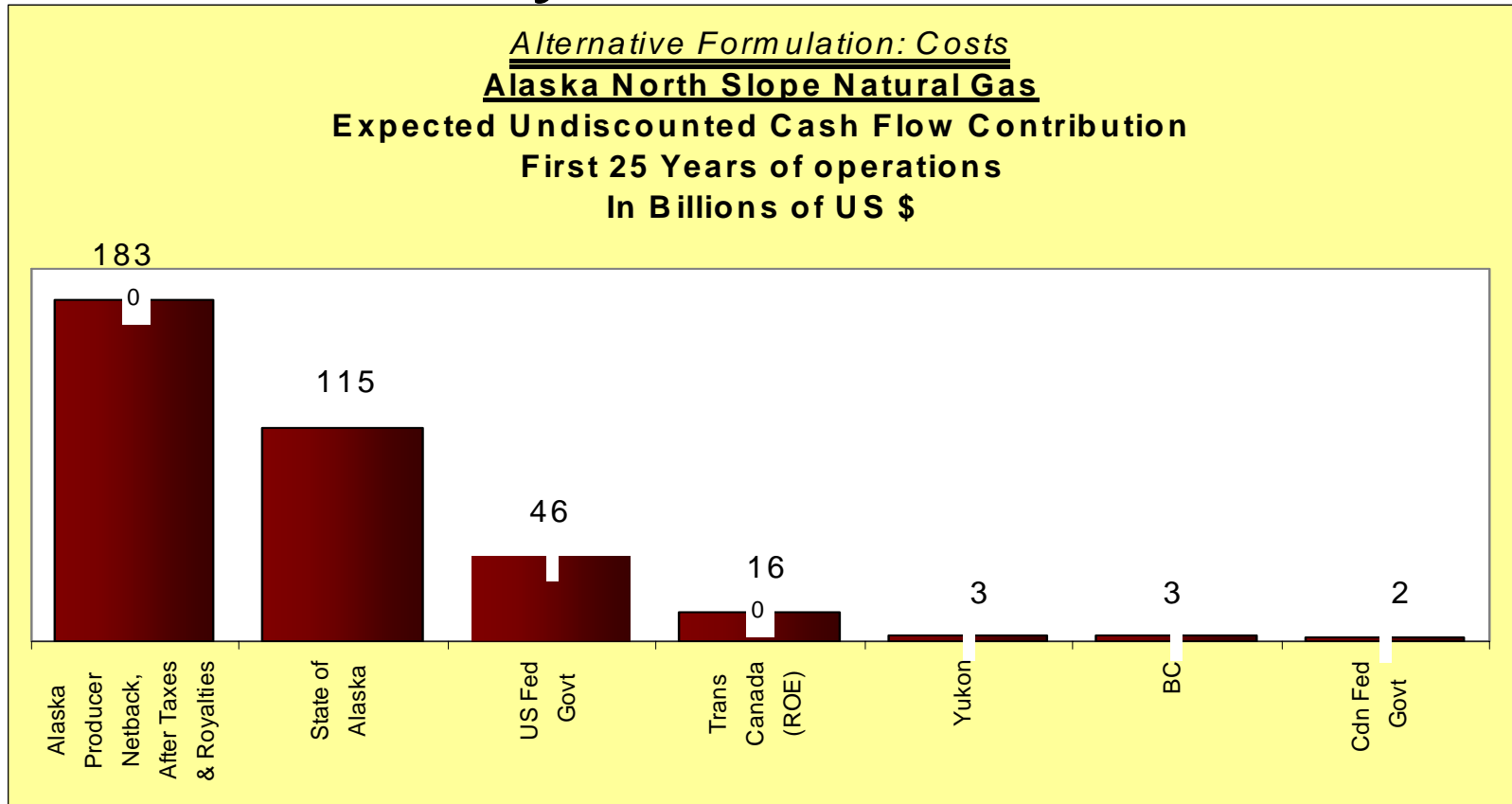
# What does getting a CPCN accomplish without FT?

- If the FERC sees a project with FT commitments on the horizon will they favor a project without FT commitments?
- When do pipeline companies start placing orders? When they have FT or the Certificate?

# Item #2 What kind of money does everyone make?

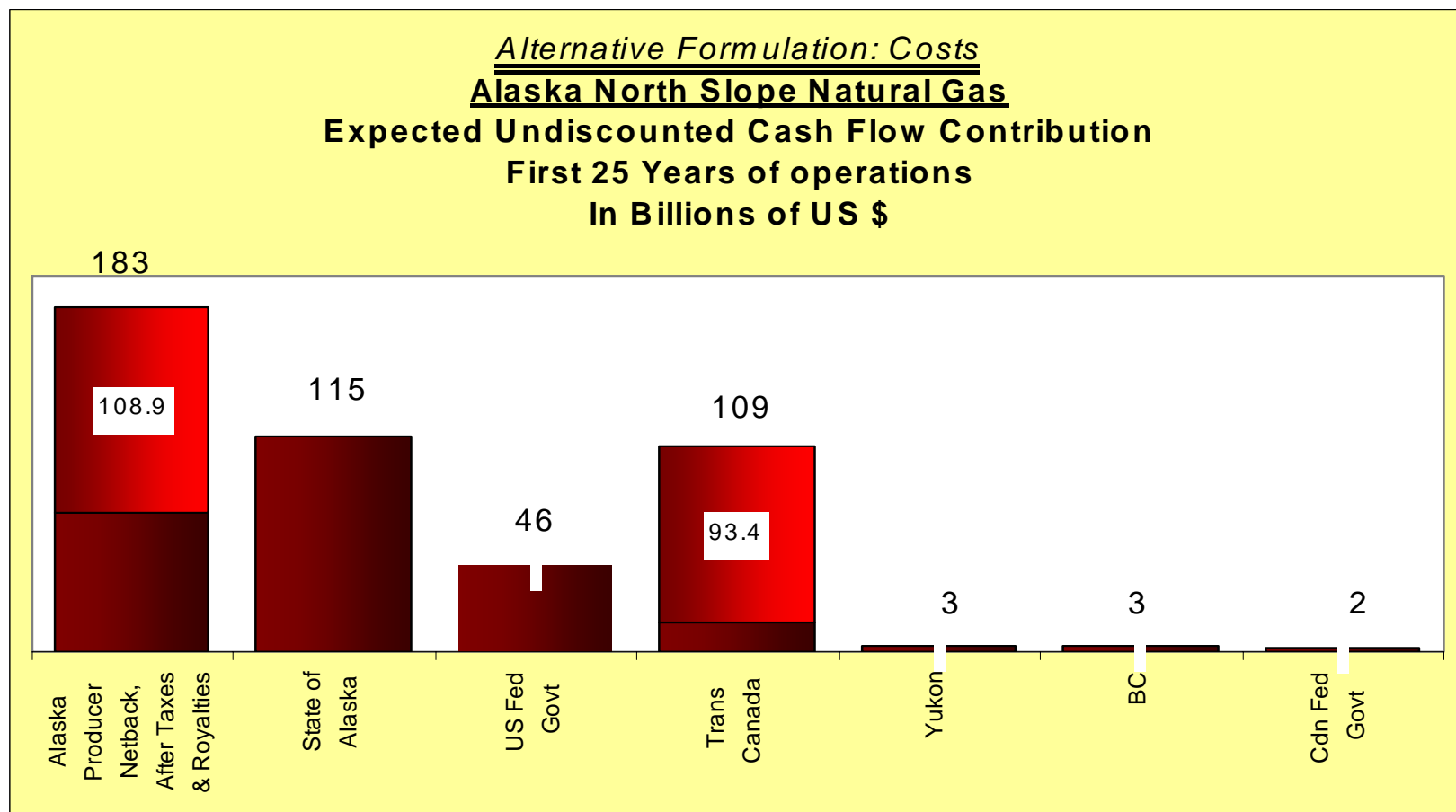
- (will return to the enforceable commitments for the other “must-haves” later – as they all assume a working project.)
- “Everyone” is Three Parties:
- Shippers: Producers (or their customers) that own the gas and are taking the commodity price risk - they pay production & income taxes and royalties directly to State.
- State Collects Taxes and Royalties. (US federal and Canadian authorities also collect some taxes.)
- TC is Carrier, can make a regulated rate of return shipping contracted gas. (Income and property taxes passed on in tariff to shippers.)
  - US Federal Taxes, Canadian Federal Taxes, Canadian Provincial Taxes

# Who makes what money in TC January 2008 Version ?



Source: TC Application, January 15, 2008, Corrections Attch D page 2.10-6

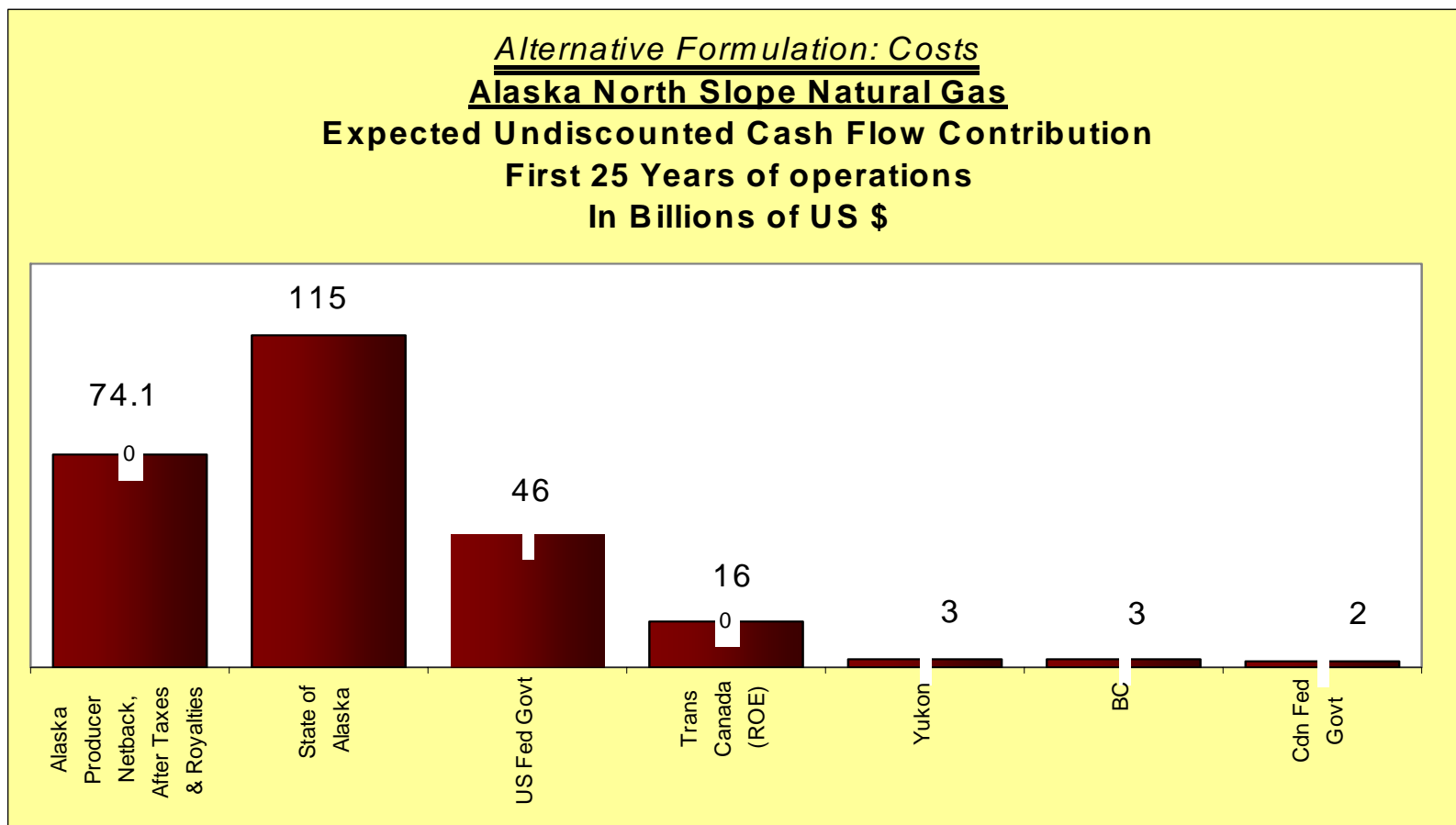
# Does parallel treatment of costs yield a clearer picture of who makes money?



Source: TC Application, January 15, 2008, Corrections Atch D page 2.10-6

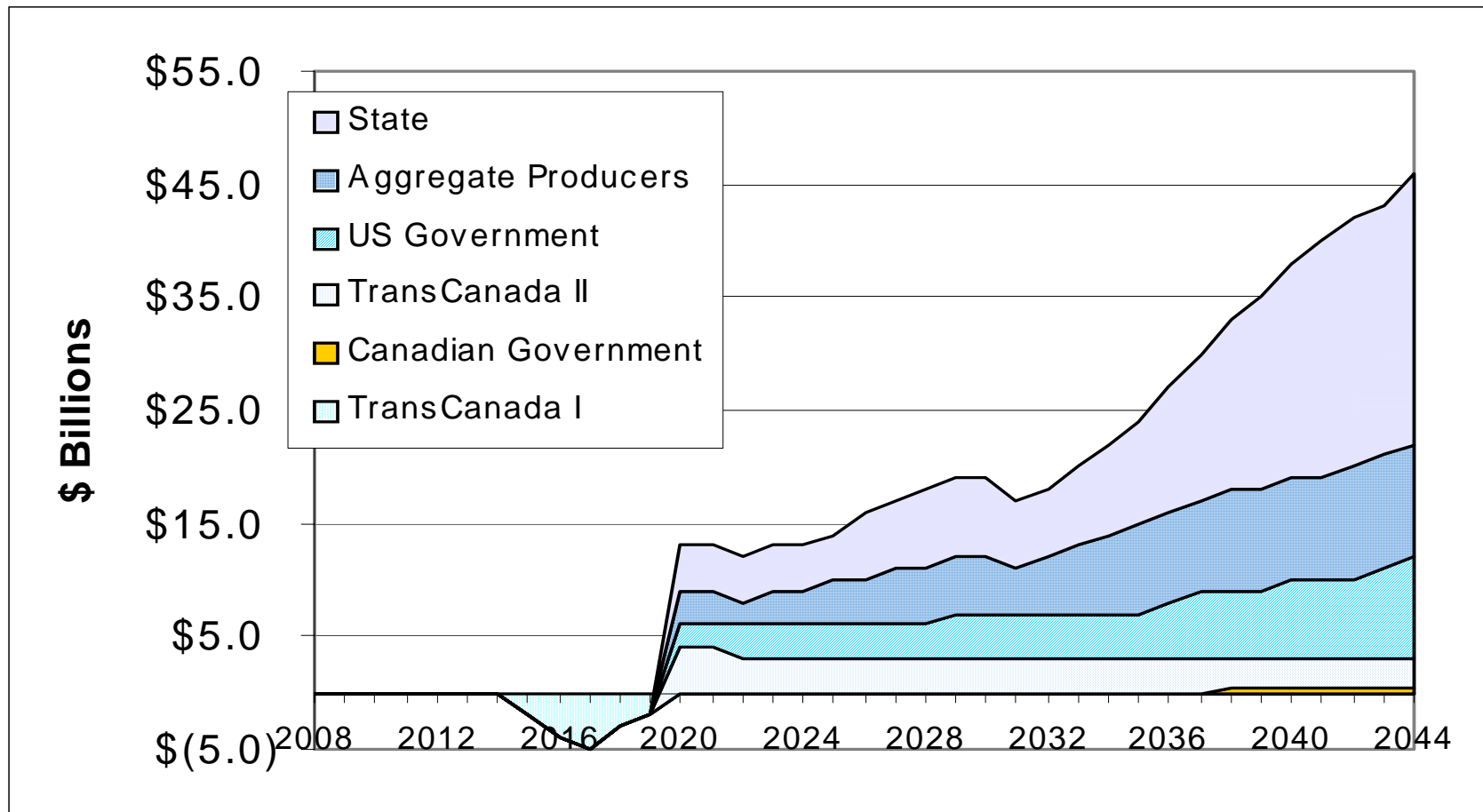


# Does parallel treatment of costs yield a clearer picture of who makes money?



Source: TC Application, January 15, 2008, Corrections Atch D page 2.10-6

# Who makes money in Black & Veatch May 2008 Version?



Reproduction of Figure 5-2 Bcf/d Proposal Base Case Expected Cash Flows (AGIA NPV Analysis Report, Black & Veatch, May 2008, page 122)

# Who makes money in Black & Veatch May 2008 Version?

Expected Cash Flows extrapolated from figure 5-2

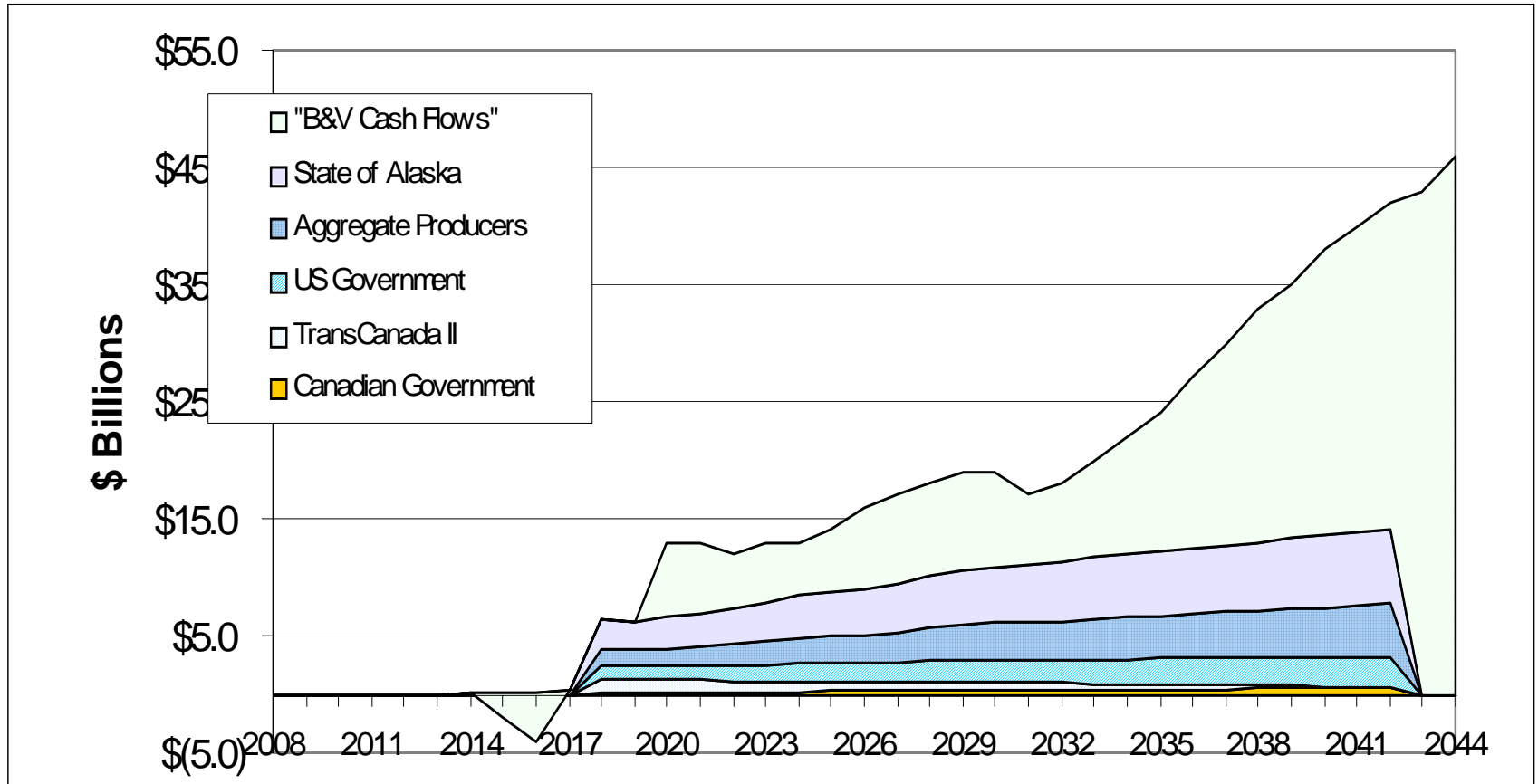
	Total Dollars		Discounted Dollars
	Estimate of Black & Veatch Analysis	Discount Rate	Black & Veatch Analysis
In Billions of Dollars			
Canadian Govts	\$ 3.5	5.0%	\$ 0.7
US Federal Govt.	114.0	5.0%	30.5
State of Alaska	257.0	5.0%	66.1
Trans Canada	57.5	8.8%	4.5
Producers	154.0	10.0%	13.5
Producers	154.0	15.0%	5.2
Total Dollars	\$ 586.0		

(AGIA NPV Analysis Report, Black & Veatch, May 2008, pages 123, 193 173, 160, 175 for NPVs)

# How do the Black and Veatch May 2008 Analysis and TransCanada Jan 2008 Analysis of 4.5 bcf/d, 25 year project compare?

	Total Dollars (undiscounted)			Percent Change between Analyses	Discount Rate	Discounted Dollars		Percent Change between Analyses
	Trans Canada Application	Estimate of Black & Veatch Analysis				Trans Canada Application	Black & Veatch Analysis	
In Billions of Dollars								
Canadian Govts	\$ 8.2	\$ 3.5	-57%	5.0%	\$ 2.4	\$ 0.7	-72%	
US Federal Govt.	46.4	114.0	146%	5.0%	14.7	30.5	107%	
State of Alaska	114.6	257.0	124%	5.0%	36.1	66.1	83%	
Trans Canada	16.4	57.5	251%	8.8%	3.6	4.5	25%	
Producers	74.1	154.0	108%	10.0%	8.1	13.5	67%	
Producers				15.0%	3.4	5.2	53%	
Total Dollars	<u>\$ 259.7</u>	<u>\$ 586.0</u>						

# How do the Black and Veatch May 2008 Analysis and TransCanada Jan 2008 Analysis of 4.5 bcf/d day 25 year project compare graphically?



TransCanada "Economic Viability Analysis", TransCanada, January 15, 2008  
 Correction to AGIA Application, Appendix R

# What prices were used in Black & Veatch work ?

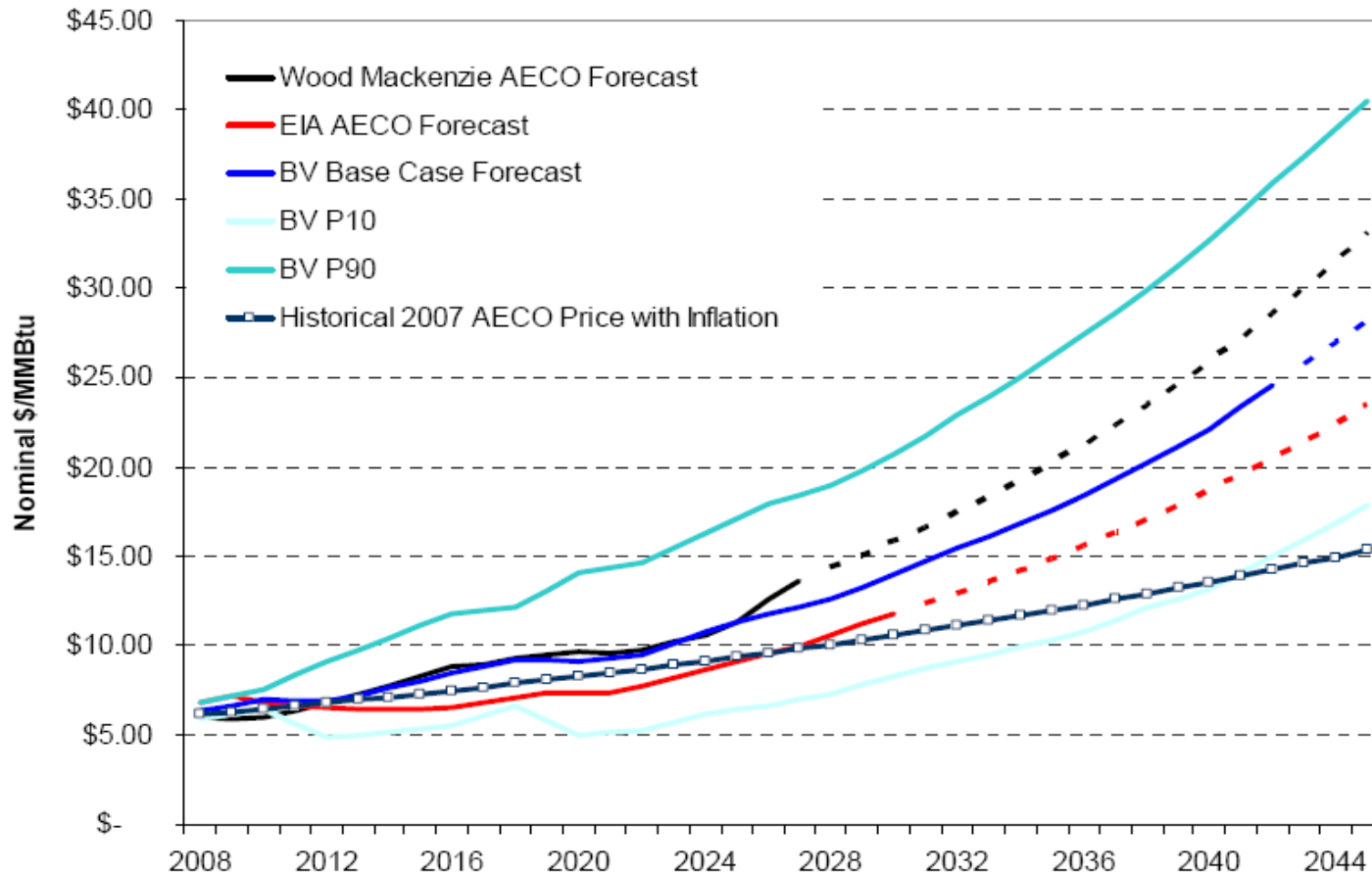
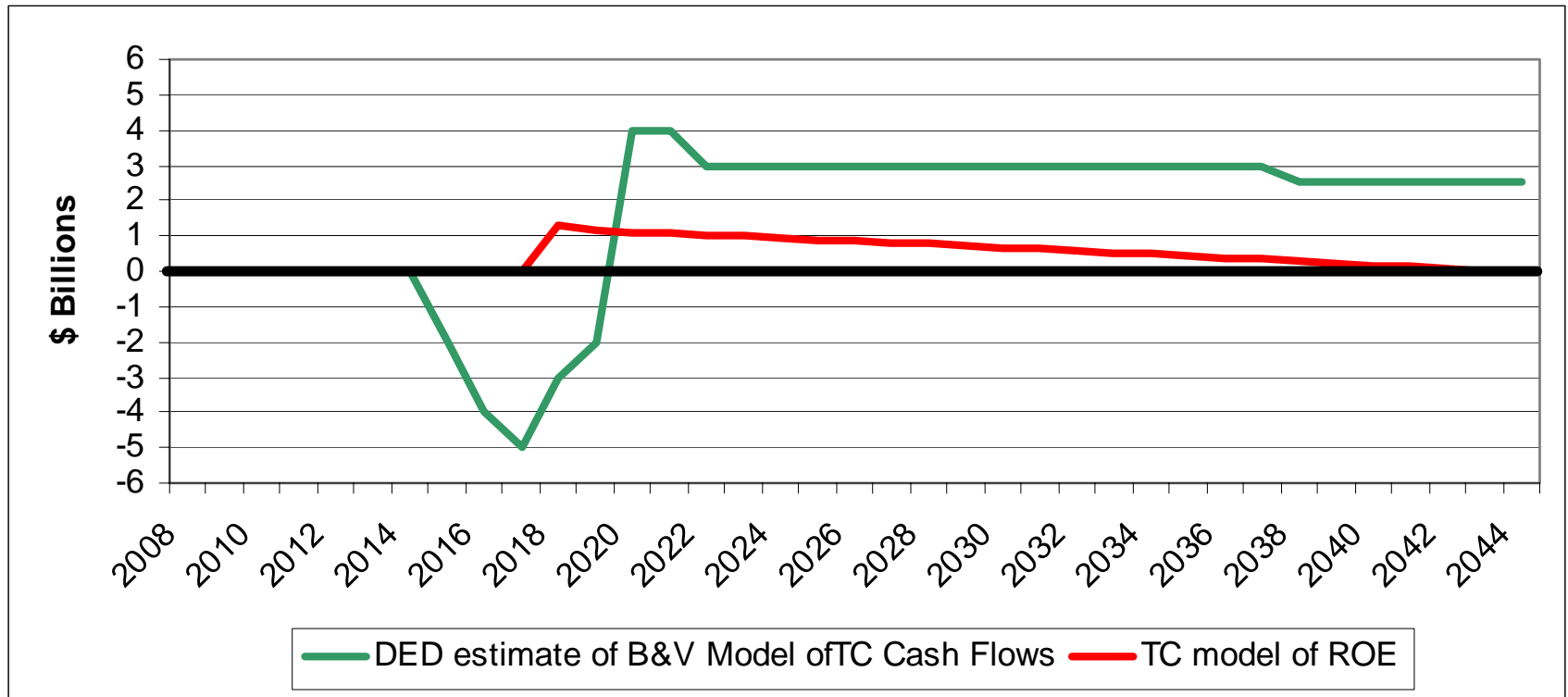


Figure 4-35 Aeco Price Forecasts (Nominal \$) (AGIA NPV Analysis Report, Black & Veatch, May 2008, page 105)

# How do the forecast prices Black and Veatch used compare with those TC used?

	2042 AECO nominal Price per mmbtu
Wood MacKenzie AECO Forecast	\$ 27.00
EIA AECO Forecast	21.00
<b>BV Base Case Forecast</b>	<b>25.00</b>
BV p 10	15.00
BV p 90	37.00
Historical AECO w/inflation	14.50
TC 2005 EIA inflated	\$ 13.30

# What is the difference between TC and B&V estimate of TC Dollars? (B&V includes outlay and return of investment?)





# Is State harmed or helped by delay in project?

(Data from longer delays not published)

Table 5-3: NPV<sub>5</sub> for the State<sup>71</sup>

	Base Case (NPV <sub>5</sub> )	1 Year Delay (NPV <sub>5</sub> )	Difference (NPV <sub>5</sub> )
Royalties	\$21,149	\$21,273	\$124
ACES Tax	\$35,664	\$37,482	\$1,818
Property Tax	\$2,709	\$2,656	(\$53)
State Corporate Income Tax	\$4,579	\$4,446	(\$132)
<b>State of Alaska Totals</b>	<b>\$64,099</b>	<b>\$65,857</b>	<b>\$1,758</b>

AGIA NPV Analysis Report, Black & Veatch, May 2008, page 157

# Are producers harmed or helped by delay in project?

(Data from longer delays not published)

Table 5-2: NPV<sub>15</sub> for all Producers

	Base Case (NPV <sub>15</sub> )	1 Year Delay (NPV <sub>15</sub> )	Difference (NPV <sub>15</sub> )
<b>Producer Total Revenue</b>	\$16,915	\$15,222	\$1,692
<i>Less Cash Expenses:</i>			
Capex	\$1,415	\$1,146	\$270
O&M	\$506	\$433	\$73
Royalties	\$2,256	\$2,027	\$229
ACES Tax	\$3,392	\$3,234	\$158
Property Tax	\$358	\$313	\$45
State Corporate Income Tax	\$565	\$488	\$77
Federal income Tax	\$3,238	\$2,884	\$353
<b>Producer Net Cash Flow</b>	\$5,185	\$4,697	\$488

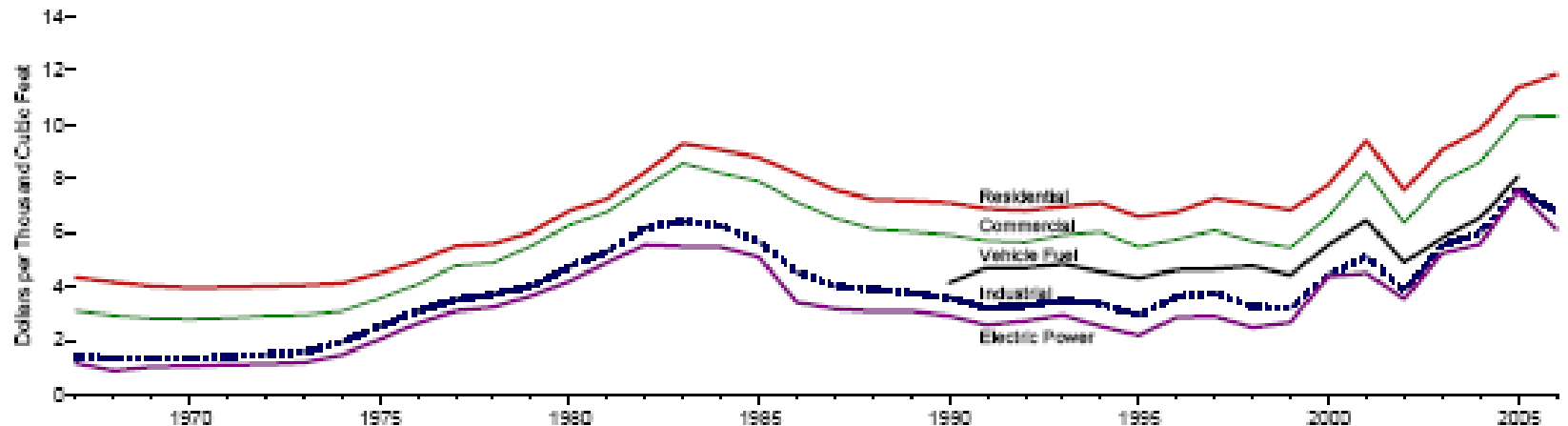
AGIA NPV Analysis Report, Black & Veatch, May 2008, page 157

# Is State harmed or helped by delay in project?

- State investment buys progress
  - Delay Costs the State – deferred revenue
    - Intrinsic value ~ deferred revenue from gas commercialization
    - Extrinsic value ~ weakened bargaining position
- Left over from a lower price assumption?
- (Is AGIA Worth \$500 Million? Alaska Gasline Determination May 30, 2008)

# How robust is the assumption of rising real prices over life of project?

Real<sup>a</sup> Prices, 1967-2006



<sup>1</sup> See "Nominal Dollars" in Glossary.

<sup>2</sup> Based on 97.8 percent of volume delivered.

<sup>3</sup> Based on 78.5 percent of volume delivered.

<sup>4</sup> Based on 21.9 percent of volume delivered.

<sup>5</sup> Based on 93.8 percent of volume delivered.

<sup>6</sup> In chained (2000) dollars, calculated by using gross domestic product implicit price deflators. See Table D1.

Source: Table 6.3.

# Why are the producers concerned about fiscal certainty?

- What are the producers concerned about?  
Low prices when the state will have revenue issues of its own?
- Or high prices with lots and lots of Upstream rents?
- Both? Neither?

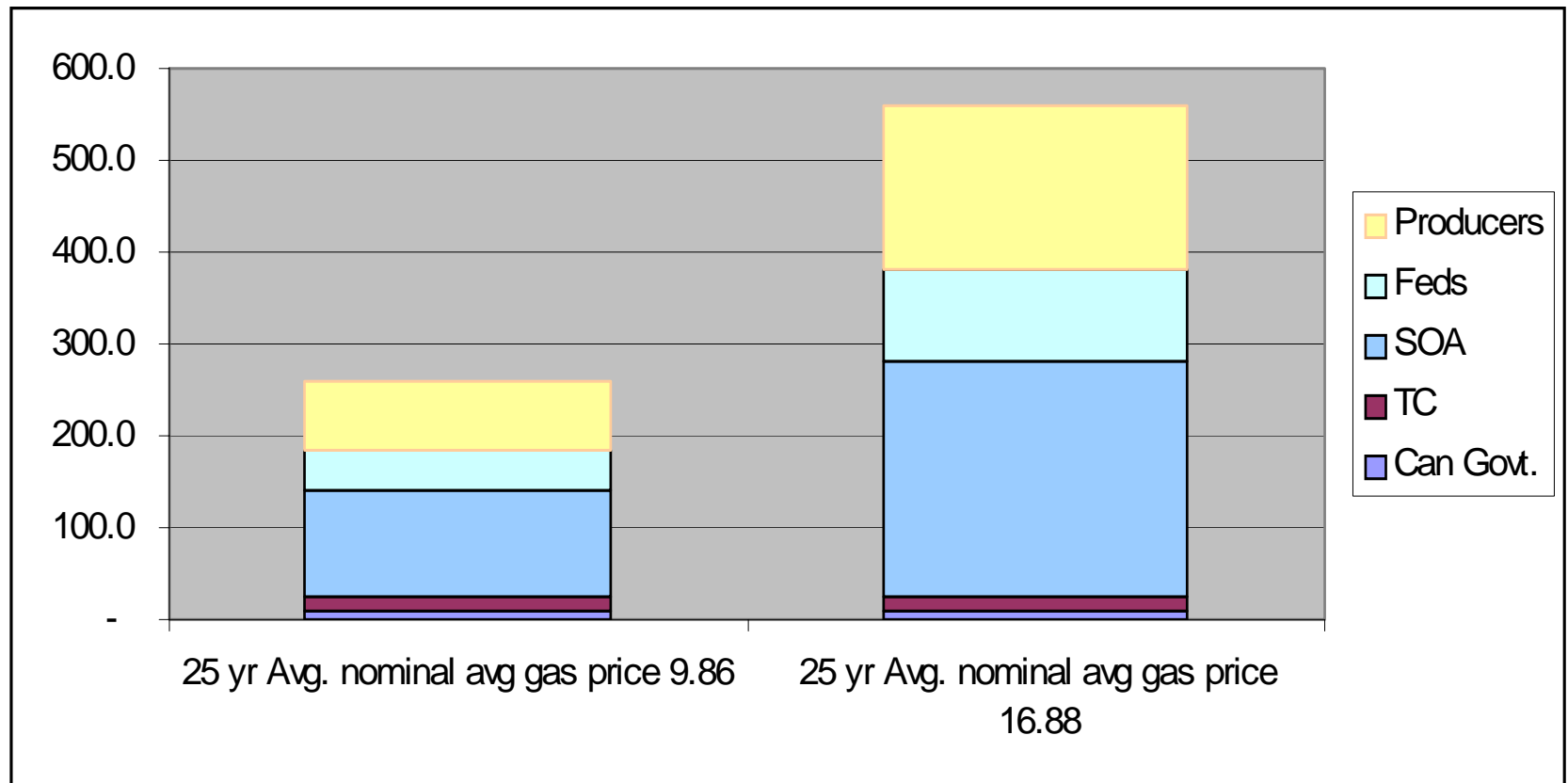
# Words Matter

- Avoid:
- a “subsidy”
- “\$10 billion dollars in concessions”
- OK:
- “Quid pro quo, Something for Something”
- “State investment buys progress”
- “State investment buys provisions”
- (Is AGIA Worth \$500 Million? Alaska Gasline Determination May 30, 2008)

# If Everyone Makes Money – Is there Room To Move?

- State used quid pro quo and found someone to build pipeline.
- Now it needs to find someone to sign FT commitments to finance pipeline. Is current quid pro quo sufficient?
- At high prices what is the relative weight of midstream and upstream dollars?

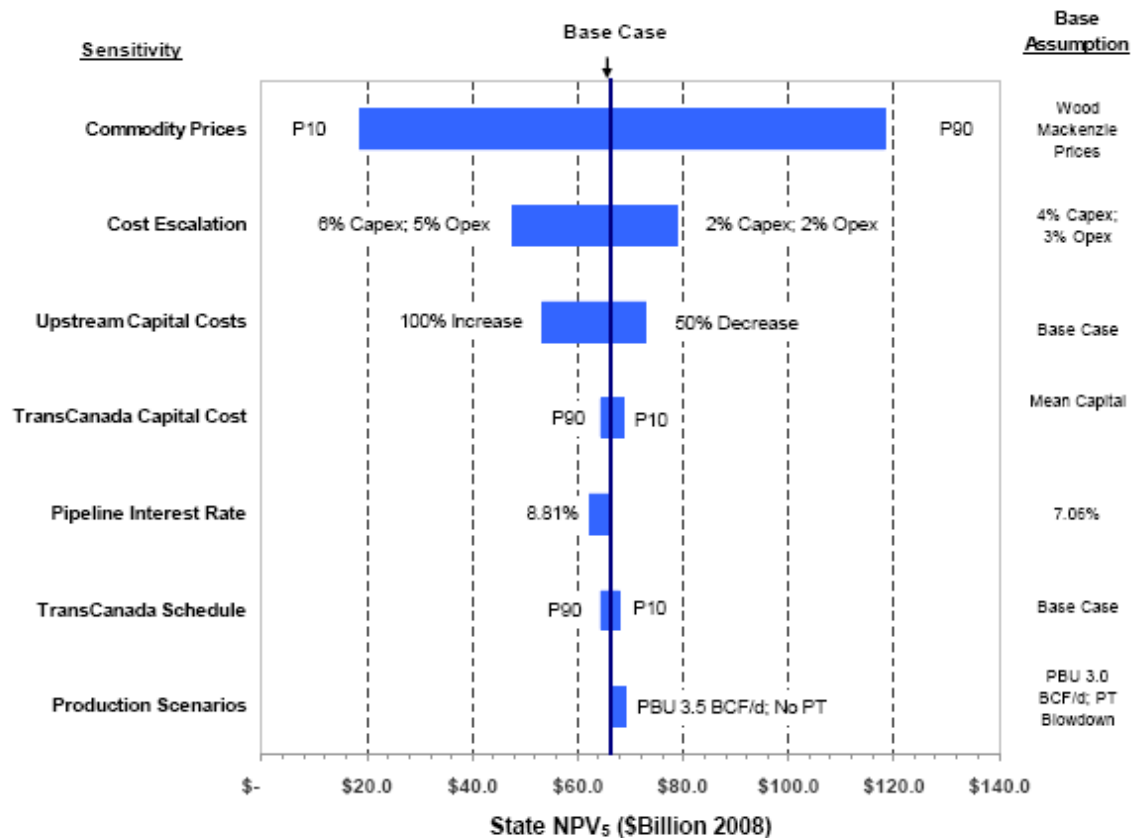
# How important is the allocation of upstream value driven by price to the state? TC answer (does not incorporate progressivity):





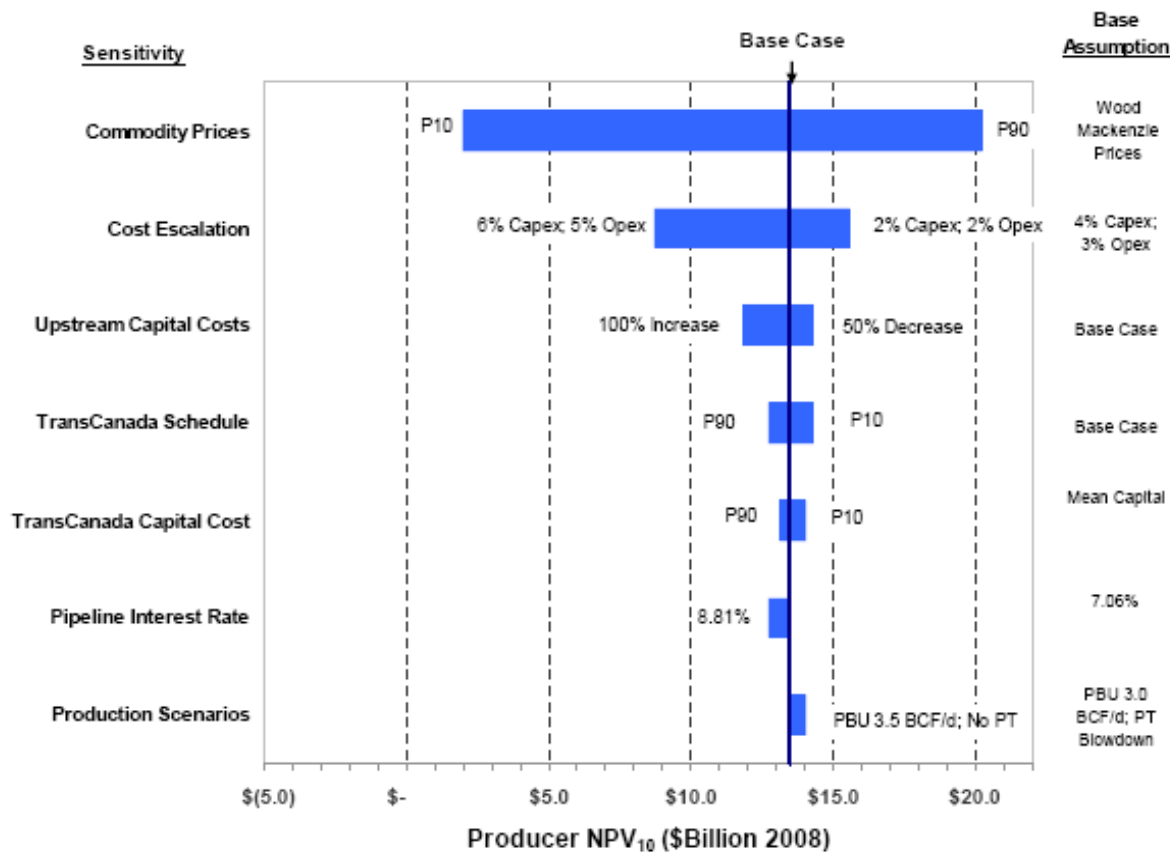
# How important is the allocation of upstream value driven by price to the state? B&V answer:

Figure 5-4: State NPV<sub>5</sub> Sensitivities for the 4.5 Bcf/d Proposal Base Case (Tornado Diagram)



# How important is the allocation of upstream value driven by price to the state? B&V answer:

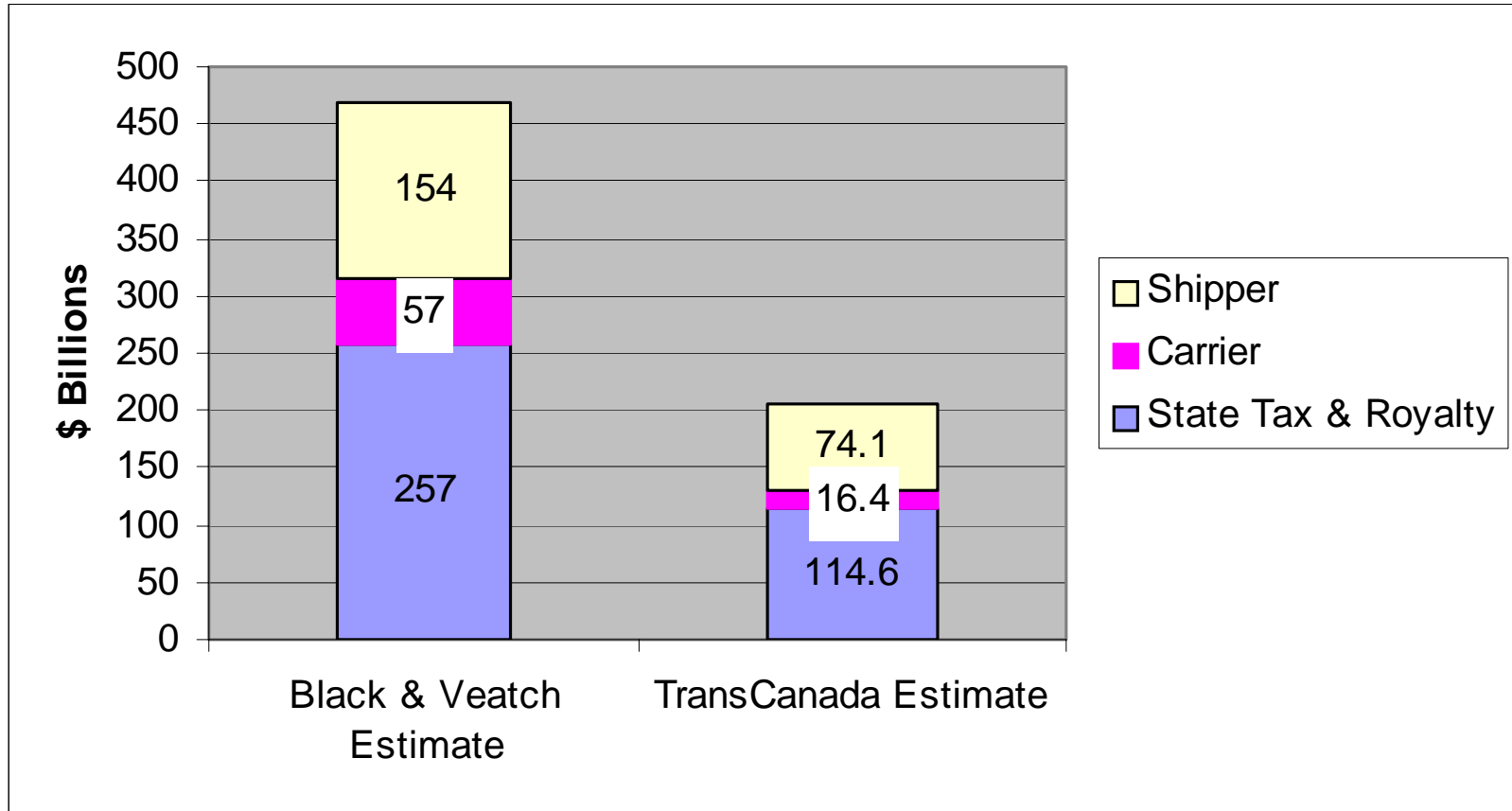
Figure 5-5: Producer NPV<sub>10</sub> Sensitivities for the 4.5 Bcf/d Proposal Base Case (Tornado Diagram)



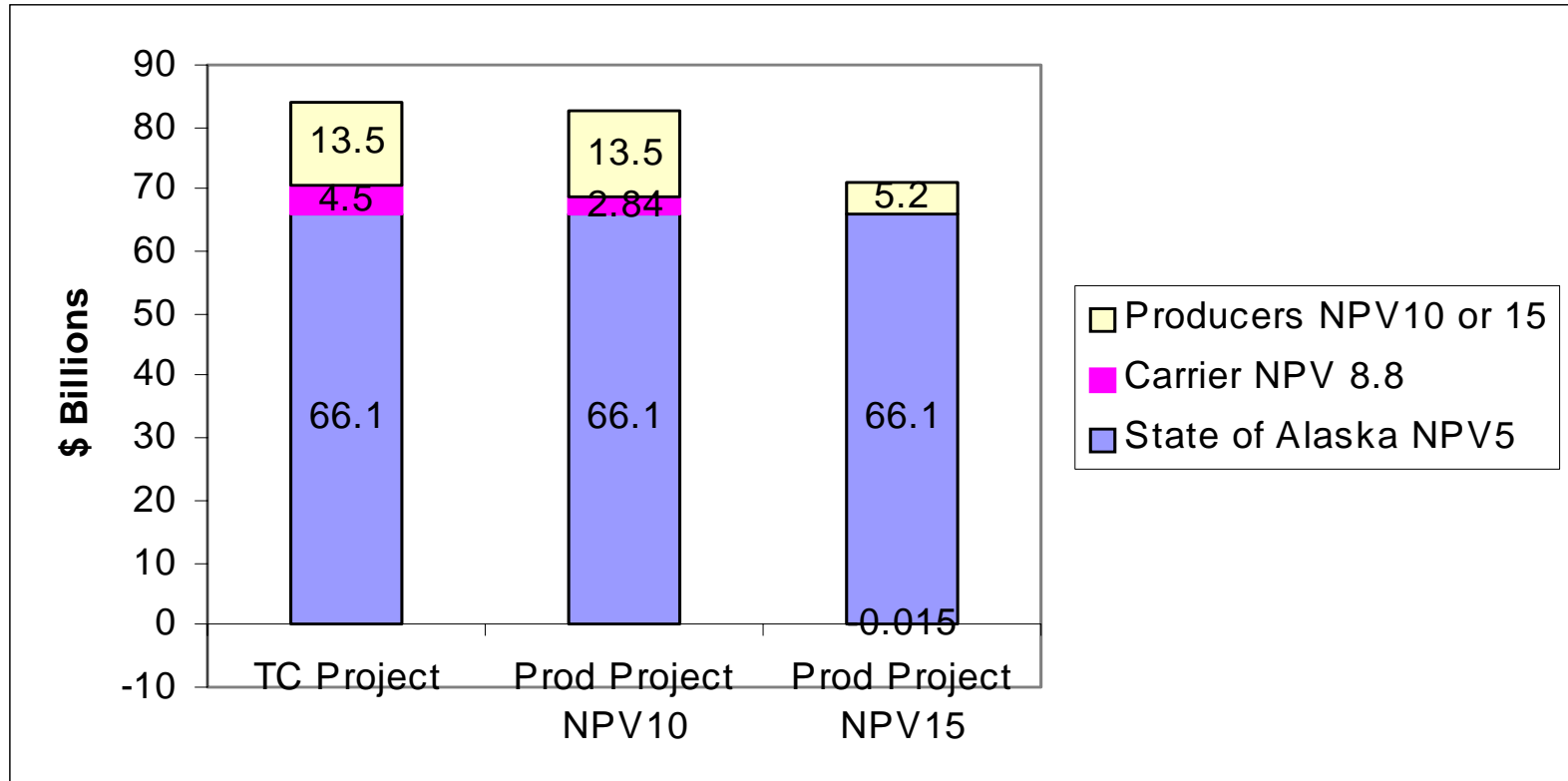
# Everyone Makes Money Questions: Would the producers make more as producer/carriers?

- Are the producers making so much money (114 billion or 256 billion) that they would sign on to this project no matter what?
- Assume producers agreed to all the AGIA “Enhanced Equal Access” provisions and built and owned pipeline instead of TC  
What happens?

# Simplistic estimate of effect of moving shipper cash flows from TC to producers (ignores income tax)



# Everyone makes money questions



Note: NPV8.8 TC cash flows of \$4.5 billion shrink to \$2.8 when restated as NPV10 Producer Cash flows, and become negative \$ 15 million when restated as NPV15 Producer Cash flows. (Income taxes ignored)

# Everyone Makes Money

- Take Away Questions: If State, Shippers and TC all make money from the TC project, do combined shipper/producers make more from a producer project?
- How much of state money flows from state incremental effects of must-haves and how much from “unenanced” project?
- Which leads to Item #3 - “enhanced open access line”

# Item # 3. How does the state achieve an “enhanced open access line?”

- Pipeline will be open access pipeline under federal law.
- Goal of “must-haves” is to turn it into an “enhanced open access pipeline”
- Does obtaining commitments from Trans Canada about the positions they will take in front of regulators or the negotiated outcomes they will accept guarantee an “enhanced open access pipeline?”

# What are the Enforceable Commitments for an “enhanced open access line”?

- FERC or NEB not bound by AGIA – and they will know that TC has contracted to take the position they are advocating.
- FERC and NEB have jurisdiction over negotiated rates.



# How will Third Parties be affected by TransCanada's commitments?

- Imagine yourself as an explorer facing “an unknown and uncertain regulatory process - that doesn't exist anywhere else, don't know how long it will take, don't know whether it will succeed” — DOR Commissioner Galvin May 28, 2008, Alaska Gasline Determination Public Forum)
- Is navigating the new rules at FERC any clearer with TransCanada commitments?

# What has FERC's usual practice been in these cases?

- Have any of the unique requirements added by the US Congress in ANGPA have ever been part of FERC traditional practices?

# 5 Tariff Commitments

- 6. Expand in reasonable engineering increments and on reasonable commercial terms.
- 7. Rolled in Rates (up to 15% of original tariff)
- 10. Minimum 70% debt (TC license @75%)
- 11. Cost overrun mechanism
- 18. \$500 million state spending not in rate base

# How will Third Parties be affected by TransCanada's commitments on rolled in rates?

- True “Open Access” will be when – “Explorers have confidence that pipeline will be expanded...new gas will pay a fair transportation rate (rolled in rates) (In State Energy Alaska Energy Authority May 30, 2008, Alaska Gasline Determination Public Forum)
- “Explorers won't explore without confidence...” (DNR Dept. Commissioner Marty Rutherford May 30, 2008, Alaska Gasline Determination Public Forum)
- Does TransCanada's commitment make the difference in confidence above and beyond federal presumptions? Does TransCanada's commitment increase make the difference to overcome likely objections from existing shippers?
- Are rolled in rates money out of TransCanada's pocket or just rearranging dollars between shippers?

# Are there better ways of achieving “Rolled In Rates” or other “Must-Haves”?

- FERC already has presumption favoring rolled in rates for an Alaska Project (Any pipeline – not just this project).
- Who is going to object to rolled in rates? In general – the existing shippers long term contracts for volumes.
- Is having that conversation with those shippers more likely to achieve the “must have”?

# What happens in tariff negotiations?

- Limit on Equity % – TransCanada pays, shippers gain.

# What happens in tariff negotiations?

- Cost over run risk mechanisms – TransCanada takes on some risk. Wide variety of mechanisms with different winners and losers under different circumstances?

# What happens in Tariff negotiations?

- According to the Administration \$500 million “credit to rate base pays for itself in increased future revenues.”
- Were the rest of the “must-haves” free?
- If the state paid for entire line and had only operating cost as tariff would “credit to rate base pay for itself in increased future revenues? Where is the breakeven point?



# Does state already have a tool to protect upstream tax revenues from on tariff issues?

- Under new AS 43.55.150 if (a) “the shipper is... affiliated with the transportation carrier or with a person that owns an interest in the transportation facility...
- (b) gross value at the point of production is calculated using the actual costs of transportation or the reasonable costs of transportation ... whichever is lower. The department shall determine the reasonable costs of transportation using fair market value...or other reasonable methods.”

# Items 4 & 5 – Does this license create unique opportunities for Local Gas and LNG export ?

- Wrap together the local “must have” enforceable commitments and the “best path to LNG export” and “best path to “local energy use.”
- How will this license lead to in-state gas in ways that other project won't?
- How will this license lead to an LNG project in ways that other project won't?

# The syllogism

- All these benefits will flow from a pipeline project.
- This license is the best/only way to start a pipeline project.
- Hence all these benefits flow from this License.

# 5 Local Commitments

- 12 - 5 in state take off points
- 13 – Firm transportation with distance sensitive rates even without FT commitments
- 14. Local headquarters
- 15. Local hiring and contracting
- 17. PLA

# Are local hire benefits unique to this project? What if anything should be read into this membership?

## Commissioners AGIA Training Steering Committee

### Members and Staff

#### Industry Members

Edgar Cowling, Conoco Phillips

Dave Rees, BP

Dave Matthews, HC Price

Tony Delia, Arctic Slope Regional Corporation

Bonnie Jo Savland, Alyeska Pipeline

# Unique to TC Project?

- If state got all 20 “must-haves” for \$500 million, how much value do these local commitments probably don’t account for?
- Are Local Gas use projects and LNG export both more promising as incremental add to any project?
- Is the ANGDA principle for “lowest cost gas to Alaskans”: “Ride as far as you can in the big pipe” tied to this project?

# What is the enforceable commitment for In-State Rates without FT?

- “TransCanada would offer firm transportation service ...provided that In-State Shippers must execute long-term firm transportation contracts with the Alaska Section for Service.”
- “In the event there is insufficient capacity for the delivery of in-State gas, TransCanada is prepared to expand the Alaska Section to accommodate such deliveries, provided that such expansions are in engineering increments under commercially reasonable terms and conditions.”
- TC AGIA Application, November 30, 2007, (page 2.2-70)

# How does TC make its money?

- Transporting gas?
- Return on investment in equipment?
- If it takes less equipment and gas is transported fewer mcf/miles when gas is delivered to Alaska rather than AECO are the State and TC aligned on in-state projects?



# AGIA Mechanism

- AGIA provided inducements for
  - a carrier to hold an open season and obtain a license [as a prelude to constructing a line]
  - shippers to agree to underwrite a line in that open season

# AGIA Mechanism

- The Carrier Inducements proved sufficient
  - Was the \$500 million a fair trade for value?
    - Did someone give up \$500 or was new value created?
  - Was TC allowed to play with “shipper chips”?
    - Will a “win/win” work against the shipper inducements or make the producer conversation more difficult?
  - What were TCs alternatives?

# AGIA Mechanism

- Will the shipper inducements be sufficient?
  - Does making them a one time offer enhance the inducements value?
  - What are the shippers' alternatives?

# Part II: The Vote - Beginning or end of Competition?

- Awarding a license encourages another competitor -
- Unless the state treats the awarding of the license as the end of the competition and the crowning of the winner, and
  - (1) doesn't work on producer/state issues that affect both parties on any project; or
  - (2) goes on to favor the licensee over other potential projects like LNG export, producer line or incremental GTL plants just because of license.

# Beginning or End of Competition?

- “We are not here to stop them [the producer line].” – DOR Commissioner Galvin, 5.28.08 at Alaska Gasline Determination Public Forum
- “State has considerable interest in steering producer gas to T/C project” – DOR Commissioner Galvin, 5.28.08 at Alaska Gasline Determination Public Forum

# Asking Questions of Other Projects

- It is easier to ask detailed questions about detailed projects.
- Enforceable commitment #2 was a detailed description of project.
- What are other projects learning if they start to invest and work toward an open season?

# How can another ‘competitor’ “with no credit and no customers” strengthen the prospect for a line?

- The more information gathered the better (State is paying for roughly 80% of work).
- Producers may use non-conforming offers at a T/C open season to forward the conversation.
- If each party brings strengths, a merged project may result. Producers may add value with GTP, T/C may add value in Canada.
- FERC experts believed FERC may act to bring projects with commercial conflicts to resolution. (may be sub optimal for both Carriers but in national (and state?) interest.

# Questions as to what happens next?

- What is the right set of carrots and sticks for State to employ to bring the shippers in to finance the project?



# Questions as to what happens next?

- Anchor shippers/producers want fiscal stability, State wants enhanced access provisions.
- When do we have the Upstream conversation? If the producers want to wait until their open season, how does state advance the conversation without bidding against itself? Do we ask TransCanada to be the in the middle?