# AK LNG

## PROS AND CONS OF A STATE-LED PROJECT

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Nikos Tsafos, President › nikos.tsafos@enalytica.com

http://enalytica.com

# Assessing different structures for AK LNG

**Different project structures**

Option 1. AK LNG becomes a state-owned, tolling project.

Option 2. Same as Option 1, but the state tries to lower cost of supply.

Option 3. AK LNG becomes a state-owned, merchant project.

What are the pros and cons of each structure?

What are the core principles that should guide the state's efforts?

What questions might the Legislature be asking?

# 1. AK LNG BECOMES A STATE-OWNED, TOLLING PROJECT

**Project structure**

State owns the hardware: the gas treatment plant, the pipeline, and the liquefaction.

State signs long-term agreements with companies to use its facilities.

The companies then pay the state a tariff for use of those facilities.

State could be a shipper too for royalty gas and/or tax as gas (if it chooses to take gas in kind).

State uses these long-term commitments to attract investors and/or finance.

**Assessment**

Main benefit is that this structure relieves the producers from their CAPEX burdens.

It also removes some complexity and risk (e.g. negotiating PILT, maybe even stabilization).

But this structure does not, in itself, lower the cost of supply (all depends on taxes).

Project risk also rises as execution burden shifts from producers to state.

# 2. Same as 1, but state tries to lower cost of supply

**Project structure**

State owns the hardware: the gas treatment plant, the pipeline, and the liquefaction.

State signs long-term agreements with companies to use its facilities.

The companies then pay the state a tariff for use of those facilities.

State could be a shipper too for royalty gas and/or tax as gas (if it chooses to take gas in kind).

State uses these long-term commitments to attract investors and/or finance.

State willing to accept a lower rate of return for tariff-setting purposes.

State lowers property taxes.

**Assessment**

Same as Option 1.

These changes can make a big impact on the cost of supply.

But, the state is effectively trying to make the project competitive on its own.

How are other parties (e.g. the producers) contributing to making project more competitive?

# 3. AK LNG BECOMES A STATE-OWNED, MERCHANT PROJECT

**Project structure**

State owns the hardware: the gas treatment plant, the pipeline, and the liquefaction.

State buys the gas at the wellhead, and sells it further downstream (e.g. FOB at Nikiski).

Gas sold either from arms-length negotiations or from leaseholders' "duty to produce."

**Assessment**

If the transaction makes commercial sense, state isn't really needed.

(e.g. If the state buys gas at Henry Hub and sells for HH+$7, producers can do deal directly.)

If the transaction takes on commodity exposure, risks and possible returns risk exponentially.

(e.g. If the state buys gas at Henry Hub but sells LNG at oil-linked price.)

If producers are willing to sell the gas, you probably shouldn't buy the gas.

(i.e. producers will only sell if it's a better deal than engaging market directly.)

Are the risks of a "duty to produce" approach fully understood?

# Core principles

**State-led project needs credibility boost**

Any transition to a state-led project raises serious questions about execution and governance.

State needs to upgrade its capabilities—and will have to bear the cost of this.

**Don’t expect to outsource risk**

It’s hard to see why third parties will join this project and accept a sub-par return.

State cannot expect to take on full control while outsourcing risks to others.

**State cannot avoid partner veto**

State cannot hope to find investors who will not ask for veto rights over FID (at least).

(i.e. No investor will surrender the right to veto a boondoggle.)

**Don’t overdo financial engineering**

Return is a project-level, not a sponsor-level, concept—it should match project risk.

Leverage increases risk, which increases the expected return on equity.

**Focus on risk-return**

What returns are acceptable for AK LNG? And how much risk is the state willing to take?

# Critical questions

Why state ownership?

What's the organizational plan?

What's the project structure?

What's the plan for securing/confirming tax-exemption?

What's the financing plan?

Who are the target investors?

What's the risk-sharing strategy?

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