The Honorable Bill Walker
Governor of Alaska
PO Box 110001
Juneau, Alaska 99811-0001

November 3, 2015

A PROPOSAL TO REDUCE THE GASLINE RISK

Dear Governor Walker;

It is unreasonable to think that the State will get a return on an investment in the gasline project for 8 – 12 years. While waiting the State should do everything in its power to support the project, including taking its gas in kind and providing fiscal certainty on taxes.

However, there should be a discussion between your Administration and the Legislature about the risks the State will face after it buys out TransCanada. By owning 25% of the project the State will be required to pay 25% of the front end, pre-construction costs prior to a decision by the Producers whether or not to build the project. What happens to those funds if the Producers decide ***not*** to build the project? This paper proposes two alternative ways to avoid that risk.

The front end pre-construction costs that the State must pay (even if the project is not built) are considerable It has been estimated that Front End Engineering and Design will cost approximately $2 billion, of which the State's share would be $500 million.

But the State's share could be more - detailed engineering and design is normally 7-8% of a project's capital cost. Assuming that the capital cost is $55 billion, the State would owe over a billion by this measure. How much State money would actually be at risk is hard to know at this point because a spending schedule is not available.

The project risks are considerable. Alaskans will not have a more realistic estimate of the cost of construction ($45 – 65 billion) until FEED is completed. At present we have no permits, no construction schedule, no agreement on the size of the pipe (42" v. 48"), no ramp up schedule for LNG production (the market can only take so much LNG at the start of such a project without depressing demand, thereby reducing the price) and no real ability to estimate what the price of LNG will be 8 – 12 years from now.

However, the Administration is proceeding on the assumptions that after buying out TransCanada the State will own, and pay for, its 25% share of the project and that the Producers will build the project 8 – 12 years from now. The first assumption is dangerous because the second assumption is unknowable..

For example, FEED is next big project decision the Producers need to make. If they decide to proceed to FEED the State would be required to pay its 25% share ranging from $500 million to over a a billion dollars. If the Producers then decide for whatever reason not to build the gasline, a decision over which the State has no control, the State would lose its investment.

The State's record of losing its pre-construction investments on gasline projects demonstrates the risk of assuming that a project will be built 8 - 12 years in advance of first gas. For example:

1. The 1978 Legislature awarded a 27-year contract to Texas based Alaska Petrochemical Company selling them nearly all of our Royalty Oil. Three years later the company known as AlPetCo closed its doors, walked away owing the state nearly $60 million.

2. Governor Hickel used private money to fund Yukon Pacific, but the line was not built and its investors lost money.

3. The State made $500 million available to TransCanada to build the line under Governor Palin's Alaska Gasline Inducement Act (AGIA) and is now spending another $150 million to buy out of the agreement.

4. Had AGIA succeeded in constructing a gasline to the Lower 48, it would have lost the State money because of the advent of the new, shale gas technology.

5. The Port Authority failed to build a gasline to Valdez and lost the pre-construction money invested by Fairbanks, Valdez, and the North Slope Borough in the process.

Each of these projects was advanced in good faith by Alaskans who had the best interests of the State at heart. The problem is that whether a project that has an 8 – 12 year lead time will actually ever be built is unknowable.

There are two ways to advance the project but prevent the State from losing pre-construction risk money if it is not built:

First Alternative:

1. The State would maintain the same level of project participation and oversight that it is now doing, except that the State would not advance pre-construction risk money;

2. In cooperation with the Producers the Administration would determine what the pre-construction costs are and make that information available to the Legislature and the public;

3. The Producers have been clear that they require fiscal certainty on taxes and a State commitment to takes its gas in kind before spending $billions on FEED. In exchange for the State agreeing now to fiscal certainty on taxes and taking its gas in kind it is equitable for the State to require that the Producers, not the State, to advance the FEED and pre-construction risk money to develop the project;

4. If the Producers elect to construct the project the State would then pay its 25% share of the pre-construction costs as part of its financing of its 25% share of the construction costs; and

5. If there is no project the State would not pay the pre-construction costs.

Second Alternative:

1. The State would provide fiscal certainty on taxes and commit its gas to the project as Royalty in Kind, but the State would not be an owner of the gasline or the liquefaction plant. This is the same arrangement we currently have with TAPS.

2. The State would be responsible for selling its gas. It would pay a transportation tariff to the gasline owners.

3. In advance of reaching such a decision the State would make an economic analysis of the financial impacts of ownership (including the risk of loss of pre-construction dollars and construction cost overruns) versus non-ownership. The analysis would also compare what would have been the economic consequences had the State owned a share of TAPS versus the funds the State has made without owning such a share. This information would be made available to the Legislature and the public and discussed.

In conclusion it is equitable to have the Producers take the risk of losing the pre-construction costs in exchange for fiscal certainty and the State taking its gas in kind because the Producers control the decision of whether or not to construct the gasline. Moreover, these are risks the Producers take on projects all over the world. Conversely, as the record above shows, the State has already lost significant amounts of money in taking these pre-construction risks.

Finally, prudence dictates that the State avoid significant financial risk at a time when it needs to conserve State funds because of low oil prices and falling production.

Yours truly,

______/s/______________
FRANK H. MURKOWSKI
Former Governor of Alaska
Former Alaska Senator

_____/s/_____
JIM CLARK
Former Chief of Staff
To Governor Frank H. Murkowski

_____/s/______
HARRY NOAH
Former Commissioner of DNR
Former Bullet Line Manager

______/s/_______
JOHN REEVES
Fairbanks Businessman

_____/s/_______
PERRY GREEN
Green Furriers