

ALASKA PERMANENT FUND CORPORATION
Regular Meeting of the Board of Trustees
June 19, 2006

Location of Meeting
Anchorage Marriott Downtown
820 West 7th Avenue
Anchorage Room
Anchorage, AK 99501

SUMMARY MINUTES
Monday, June 19, 2006

Trustees Present: Trustee Brady, Chair
Trustee Frank, Vice Chair
Trustee Wohlforth
Trustee Hudson

Trustees Absent: Trustee Corbus
Trustee Marquez

Staff Present: Michael Burns
Rick Shafer
Joyce Andrews

Invited Participants Present: Bob Bartholomew, consultant to the Fund
Robert Linden, PACE Global Energy Services
Bo Poats, PACE Global Energy Services
Keny Zeng, PACE Global Energy Services
Richard Straebel, PACE Global Energy Services
Tom Hirsch, PACE Global Energy Services (via telephone)

CALL TO ORDER

CHAIR BRADY called the meeting to order at 10:30 a.m.

ROLL CALL

All members, with the exception of Trustee Corbus and Trustee Marquez, were present at the time of roll call.

APPROVAL OF AGENDA

TRUSTEE WOHLFORTH moved to approve the agenda. TRUSTEE HUDSON seconded.

There being no objection, the motion passed unanimously.

SCHEDULED APPEARANCES AND PUBLIC PARTICIPATION

(Recording Secretary Note: The following shown in the following presentation quotation marks are excerpts from a transcript of the February 25, 1999 tape played by Ms. Obermeyer at the June 16, 2006 Alaska Permanent Fund Board of Trustees meeting.)

THERESA NANGLE OBERMEYER stated she had played a tape at the March 7, 2006 meeting and its contents were not recorded in the minutes. She played the tape for the Board of Trustees. In the tape, which was recorded at the American Association of Energy Economics Alaska Chapter (International Association of Energy Economics), Arco Alaska, February 25, 1999, she asked Trustee Wohlforth, who served then as current chair of the Alaska Permanent Fund Board of Trustees, the following: “What is your response as the current Chair of the Permanent Fund Board, and as an American, and as a long time licensed attorney in this state, do you believe that our country is based on a system of checks and balances, and do you believe that the Permanent Fund Board members should be confirmed by the Legislature so that we don’t have to sit here and always be told numbers? Can’t, aren’t we all, these people you have already said, Eric, are some of the brightest people around, shouldn’t they be able as individuals to deal with whatever is going on and analyze things as thinking Americans? The question is, do you believe that your job should have to be confirmed by the Legislature?” Trustee Wohlforth replied ”Dr. Obermeyer, I entirely agree that the Board should be appointed by the Governor, confirmed by the Legislature, and serve for 10 year terms, not be subject to firing at will as they currently are. So I completely agree with your position and I think it is unfortunate that we have a system where each Administration throws all the old Trustees out and the new Trustees sit there with the notion, ’My God, I am responsible for \$25 billion bucks and the people of the State suffer for six or eight months while they achieve a learning curve so I agree with you 100 Percent.’”

MS. OBERMEYER mentioned that on February 25, 1999 Trustee Wohlforth told an entire room full of economists that the Alaska Permanent Fund Board should be conformed by the legislature and have 10 year terms. Trustee Wohlforth has been on the Board for 11 years. She stated she is not against anyone and she sees the Trustees as having a lot of decency. She stated that it is difficult when she gets through the mail that she is supposed to lose her teaching certificate because she has been acquitted in a 7-day jury trial. She did not think that Chair Brady could imagine the life she has had to lead since her election to the Anchorage School Board in 1990. She stated that we live in a police state. She stated that in her life she simply wants to help. She makes friends wherever she goes. She stated she understands and knows why everything has happened.

MS. OBERMEYER mentioned that HB316 went through the Legislature this session and the Alaska Bar Association, for the first time in the history of the state, got only a one-year renewal through June 7, 2007. Her husband has been attempting to become licensed to practice law in the state of Alaska for 22.5 years. Before the Alaska Bar Association automatically got a four-year renewal at

the beginning of the legislative session. She stated the bill was introduced with only a three-year renewal. The bill was not discussed during the legislative session. She noted also that Bob Evans was paid \$70,000 as the Bar Association consultant and he did not attend any of the meetings. The House Judiciary Committee met before legislative adjournment decided on a one-year renewal. The Senate Judiciary Committee did as well.

MS. OBERMEYER next mentioned Eric Croft and what a young person must be thinking growing up in Alaska and what they see as an example. She stated she knows a good example and Eric Croft does not. She stated he is highly educated and is an engineer and an attorney who has been in the State house for many years. Since 1998 he has been in charge of the Alaska Bar Exam Review called BAR/BRI for eight years. She asked that someone figure out what is going on that he thinks he can be governor. She recalled when Eric Croft first became head of the BAR/BRI and she contacted Mr. Croft's father and said it was bad for him. All the wonderfully bright law school graduates go to the BAR/BRI every evening and he is sitting there helping them, knowing that probably only half of them will be licensed.

Lastly, MS. OBERMEYER stated that on May 24, 2006 she gave the Trustees information on the fact that it is time that young people in Alaska have some better education. She and her husband have been working on the Physicians Supply Task Force, which is scheduled to give a report to the Governor at the end of June. She stated there needs to be a medical school in Alaska. She stated that Alaska is one of only five states in the US that does not have a medical school, which are Wyoming, Washington, Alaska, Montana, and Idaho or WWAMI. Alaska is also the only state in the US that does not have law school. She stated that Puerto Rico has four law schools. She felt young people should understand good examples. She thought that any one of the Trustees could simply write a check and start a law school. She asked where are Trustee Marquez and Trustee Corbus, noting that Bill Corbus is one of the wealthiest men in southeastern; he owns Juneau Light & Power. She stated he is wealthy yet all he is doing is investing in the stock market to enrich his private bank account.

CHAIR BRADY stated that he is charged with following the mandates in the statutes for the Board. He stated that many of the points raised by Dr. Obermeyer have been discussed at length with many of the citizens of the State of Alaska, but the pertinent issues before the Board are those on the agenda for this meeting. DR. OBERMEYER asked what do Alaskans get. She felt the dividend was embarrassing. She mentioned that the nation is not built on handouts, she does not want one, but she would be pleased to Chair the Permanent Fund Board. She felt it was appropriate to talk about the Fund Board because this is the year of a gubernatorial election. She wished the Trustees a happy summer and good fishing.

PACE GLOBAL ENERGY

For more information on this presentation, please refer to the document entitled "PACE Global Energy Services, Alaska Permanent Fund Corporation, Board of Trustees, Gas Pipeline Investment " dated June 19, 2006 and kept on file at the APFC offices.

MR. BURNS stated the investigation that is the subject of this meeting has two phases. In the broadest terms there is the pro-active phase and there is then the reactive phase. The subject matter at the last meeting and today's meeting is pro-active, an educational component to understand the dynamics, economics, challenges, and opportunities of an investment in a gas pipeline. The process is coming to the point that there will have been a good educational review and until there is a deal to which the Fund can react and the consultants can advise, there will be a hiatus.

CHAIR BRADY asked whether all Trustees are comfortable with the agenda for this meeting, what is to be accomplished and why. He commented that he felt somewhat smothered with the amount of input, but he wanted to be sure the other Trustees were comfortable with the Board's role.

BOB BARTHOLOMEW stated the process of evaluating a potential investment in a gas pipeline began in January/February 2006. The Board and Executive Director recommended hiring a professional consultant advisor with gas pipeline experience to assist the Fund. That led to a selection process in early May, which culminated in PACE Global Energy Services being hired. May 25 was the first official Board meeting for Trustee education where two presentations were given on general investment and investment specific to infrastructures relating to energy and pipelines. The Governor and Administration have been involved in a gas pipeline project for nearly two years and have been receiving feedback in recent months from their consultants, the public, and legislators. The Administration is spending this week in retreat evaluating the input they have been receiving, looking at fiscal interest findings, and looking at the contract that was issued, and looking to see if anything needs adjustment or updating based on the input. The Legislature has adjourned from session, so they have no active issues in front of them related to the gas pipeline. There is some anticipation that in the summer or fall they might come back into session to work on these issues. The Legislative Budget and Audit (LB&A) Committee has been taking the lead on hiring the consultants and advisors to guide the Legislature and has been holding hearings throughout this period. Those hearings have produced reading material and Mr. Bartholomew has produced a compendium of all of the documents that have been created as part of this process that will be given to the Trustees.

MR. BARTHOLOMEW clarified that the objective for today is to make sure the Trustees are left with information and a basis of the characteristics, key concepts, and key issues that the Trustees should evaluate in making a decision regarding investment in a gas pipeline. He explained that without specifics on an Alaska gas pipeline, the material would be more general in nature.

MR. BURNS reiterated that the Administration and Legislature, the public policy makers of the state, have a decision-making process that is broader than that of the Fund. They have an economic internal rate of return that involves job creation, betterment of the state, and development of the state resources. The Fund's decision is based strictly on the internal rate of return on this investment. It is from this perspective that the matter is viewed and how the decision will be made.

MR. BARTHOLOMEW introduced Bo Poats, project director. MR. POATS agreed that the perspective of this decision is that of an investment to the Fund. He briefly reviewed the information that would be presented on the infrastructure project investment world and, in particular, the Alaska pipeline project. From the May presentation, PACE took away a clear charge to focus on specific issues, the interest, and the process and issues with which the Fund will need to familiarize itself in order to be an effectively informed investor. He encouraged that this be an interactive session and one that positions the Fund for an effective engagement with the State at the appropriate time.

TRUSTEE WOHLFORTH asked if the public comment period is open until July 25, 2006. MR. BARTHOLOMEW believed the Governor had taken the action to extend the public comment period to July 23, 2006. TRUSTEE WOHLFORTH asked when the LLC agreement might be available, which is vital to any financing discussion. MR. BARTHOLOMEW stated he has discussed this with the Department of Revenue (DOR) and they are working with the producers on that, but there are no timeframes.

MR. POATS stated that discussion would be within the context of pending tax legislation, pending legislation on the formation of the Alaska Natural Gas Pipeline Corporation (ANGPC) and the formation of the project company LLC.

MR. POATS introduced and provided background on Richard Straebel, project manager, Keny Zeng, primary financial expert on the Board education process, and Robert Linden, director of strategic gas services. He indicated the information presented today would be first with respect to the State's and the Fund's potential objectives and concerns; second the Fund's potential timing and form of participation; third, PACE's view of an investment decision tree framework, that is, the logical steps toward the achievement of an investment or a no-go decision; and fourth, a review of the risk exposures and funding levels implied by the proposed structure. It is appropriate to evaluate this opportunity in a risk-adjusted return. There will be a discussion of the forms of participation, as well as the timing and role of the Fund vis-à-vis the other investors, which will be important in terms of framing that analysis. Some preliminary structures will be reviewed to look at risk exposures and how they relate to the timing and form of investment. Finally, there will be a discussion of the level of action in the legislative arena that perhaps needs to settle and crystallize before the analysis goes much further.

MR. POATS began with a discussion of the producers' perspective regarding a gas pipeline. MR. LINDEN remarked that from the newspaper accounts, one is likely familiar with the trials and tribulations of producers in trying to deal with how to maximize the value of their North Slope investment over the years. It has always been obvious there is gas in Alaska and that there is a tremendous gas market in the Lower 48. With a 10-year lead-time and the volatility of prices over the last 25-30 years, all of the producers have been cautious about building a line from one place to another. Complicating that is activity globally and the efforts of many major producers to develop a comparable global distribution system for liquefied natural gas (LNG). Many billions of dollars are being invested in setting up the LNG infrastructure, it is a 10-year process, and most of that gas is destined for the US. With high gas prices, drilling rig rates are rising in the US and Canada. There is evidence of a supply response there. LNG volumes are starting to build and there is an element of caution.

In terms of the North Slope, the producers are looking at the deal as a package involving oil and gas. For the past 10 years, the decision was re-injecting the gas and maximizing oil production as the way to maximize the value of the asset on a risk-adjusted basis. High gas prices have changed that equation somewhat, but there is an element of caution. The issues are how much oil revenue will be generated and the other dynamics regarding the alternative uses of gas and the potential for oil. With the "gas crisis" in the Lower 48, loan guarantees that were passed last year have made a difference and it will be easier to attract passive finance. That does not address producers' equity concerns, but it makes their lenders more valuable. The discussion on the production taxes have been aimed at maximizing oil production in the north and also to initiate the source of a new stream of taxes and royalties in the form of natural gas production. MR. LINDEN remarked that 35 trillion cubic feet of natural gas is a lot and there is likely more. It represents a form of future funding for the government in general, and the Permanent Fund in particular, although that is not part of the Board's decision.

MR. LINDEN stated the producers are watching the market and thinking of their alternatives. As the LNG boom has occurred over the last six or seven years, the idea of stranded gas assets located adjacent to a navigable waterway has been the first goal; that situation does not prevail on the North Slope on a year-round basis. Part of the concern is being drawn into a process that takes on a life of its own; producers are trying to keep some distance and control their destinies. He stated he has worked with all of these producers and has experience negotiating contracts with them and they are not easy.

TRUSTEE FRANK stated his questions have been lingering since the discussions of this issue began and they have to do with whether there is an obligation on the State to participate to make the deal go or is it an opportunity to participate. Both assertions are made in the PACE presentation; page 4 states "large capital requirements concentrate risk and necessitate state participation" and page 5 states "the state should share in the wealth by owning a share of the gas pipeline." He

felt it was worthwhile for the Trustees to be clear if there is an obligation to make the project go, in which case it may be in the State's best interest to participate, and then to decide whether it is best for the State to do it or the Fund to do it. There is also the assertion that it is an opportunity that was missed with the oil pipeline and that should not be missed with a gas pipeline.

TRUSTEE FRANK also had a question regarding the issue of State ownership at 20% and combining the royalty and severance taxes into 20% and taking them in kind versus in value. He understood that taking it in kind helps reduce the risk for the producers and, on the other hand, he is told that others could take a share of the pipeline and the State's ownership may not be integral. If other financing was not available and other investors were not willing to take the risk, then an important decision exists whether the potential revenues that come into the Fund are an equity kicker that might induce the Fund to go beyond looking at the internal rate of return (IRR). If in fact the Fund is the "missing link" that can make the project go, the Trustees should look at whether it would be prudent to make the investment in order that the project can move forward.

CHAIR BRADY stated that his perspective is that, if an investment is proposed but the specifics and initial steps are not taken, there is a gap in knowledge and information. It occurred to him that the Fund is "playing ball" against the "home team," but does not know how to do so. He believed the Fund is competitive and will do the right thing for residents of the State of Alaska, but he then questioned whether the Fund would be asked to be a backstop to the State before the federal guarantees. He questioned if the Fund would be asked to help the State in their portion and indemnify the entire project. He posed the question of the Fund being a financier, but had the opportunity to option that into a put to equity. In that scenario, lending the money covers the first exposure on the downside. He noted, however, that the Fund is a non-taxable entity and there is a disadvantage in terms of the benefits to those who have to pay taxes, such as depreciation. He questioned whether the Fund could trade depreciation for a tax-paying entity for something that would benefit the Fund, such as a higher percentage of the deal. The question is whether the Fund should look at the deal differently since it cannot take advantage of depreciation or can that be traded for some other benefit. He complimented Mr. Burns and Mr. Bartholomew for starting the educational process, but was concerned that the initial steps in the deal have not been accomplished. Assuming that the deal will happen, then it can be examined. It is his opinion that something will be put on the table without much time to prepare unless the current educational process is undertaken.

TRUSTEE WOHLFORTH stated his understanding was enhanced by reading the summary of the discussion in Legislative Finance between Gregg Erickson's experts and the State's experts. He felt the best information is that being produced by Mr. Erickson.

TRUSTEE HUDSON hoped PACE would identify the risks to the Fund. The benefits will be emphasized, but the Fund's responsibility is to identify the risks. He felt that a clear articulation of the risks and explaining how the Board can make a determination would be beneficial.

MR. LINDEN responded to Trustee Frank's question about the apparent contradiction and ambivalence in PACE's presentation. He stated there is a concept in physical science called activation energy that requires a certain amount of energy in order to create much energy afterward. What is occurring between the State and the producers at this time is to build up activation energy that is sufficient to get commitments that will bring forth the benefits being speculated about. The things up front are more acutely known and measurable than the benefits in the out years. The initial consideration is what is required for the deal to happen and then, once it happens, what can be taken.

TRUSTEE WOHLFORTH did not think that was responsive to Trustee Frank's question. MR. STRAEBEL responded that, in terms of whether this is an obligation or an opportunity, the way the fiscal contract is drafted it is an obligation for the State to take a 20% interest in the project. If the State did not take that 20% equity in the project, then the sponsors would have had to fund that 20%, which would reduce their return on the project. The State making this investment improves the producers' position. TRUSTEE FRANK asked if it is the ownership in the line or the obligation to ship and pay the tariff that actually helps the producers. Anyone would like a guaranteed return on the pipeline; the obligation to ship the gas is the important consideration. He felt that if this fact is not on the table, part of the Fund's educational process is missing. If the Fund is just talking about ownership in the line with no obligation to ship and the State retains the obligation to ship, that is an entirely different situation. A guaranteed rate of return with the producers backing the deal sounds good. There are also considerations such as cost overruns. To the extent the tariff is defined and there is a guaranteed commitment to ship regardless of the tariff, things are okay; if some cost overruns are not included in the tariff, there is risk. The Fund needs to be educated about these considerations.

MR. POATS stated that the obligation, as presented by the advisors to the producers, is that the State is obligated to participate for the current proposal, which includes the shipping obligation and the commitment to a ratable share of capacity. He stated PACE would present the questions that need to be posed to the State in a discussion for clarification. These questions should be asked in a well-structured meeting with DOR. The form of the obligation is more open and to date has been conjectural in terms of equity investment, size of debt, etc. He felt it was important to hear from both the Fund and the State what would be the form of participation. What should interest the Fund in terms of its potential participation is not yet clear. The Fund's participation will be driven, to a large extent, by the State's potential view of the Fund's role, which runs from nil to potentially very important. The State must be asked what is implied in terms of commitment and

what form the commitment will take. A well-structured set of issues, questions, and working understandings, backed by documentation if necessary, would be very valuable to frame the meeting with the State.

MR. POATS remarked on in-kind returns that the producers are looking for to shed risk across the board. They are not only looking just for the investment, but also for the subscription to 20% of the capacity and management of the gas. They are seeking the dissolution of concentration in their hands. That is an important part of the deal as currently proposed, as well as from the standpoint of the State's ability and perspective on its capability to manage that. It could be said that the Minerals Management Service does this all the time and they are capable, but the components in this deal could be more challenging and could require a well-conceived approach. It's important for the State and then secondarily for the Fund, if it is contemplating being a partial equity within the State agreement, to clarify what are the perceived risks, how it will be managed, and what will be the process. He stated that risk parameters can be put on each consideration, but they will be assumption-driven. One assumption would be the risk of holding capacity, what is the function of the value of that capacity, how well subscribed it is, and what details are proposed in the contract agreement for the procedures for nominating for incremental capacity and disposing of it. To understand these risks it is necessary to have a good understanding of the gas pipeline marketing and trading business. These are good starting points with respect to tax depreciation. There must be serious consideration of whether that will require special legislation, whether it will be addressed in the LLC contract, and if the producers will offer a way to monetize that. This is a valuable piece of the investment that would be lost, if not.

TRUSTEE FRANK stated that, if the Fund owns the pipeline and there is a tariff that is supported by agreements to ship and the shippers fail to ship, he assumed the Fund could avail itself through the court system to enforce the contract. He asked if that creates a situation where the Fund is suing the State to get its return on investment. He felt this was worthy of analysis. MR. BURNS thought the lenders might sue the shippers ahead of the owners. TRUSTEE FRANK stated that is not what happens in his experience; owners are responsible for protecting their legal interests and if the owner goes bankrupt, the bank might step in. If the Fund is due the money and the State does not pay, it would either have to sue the State or choose not to do so. CHAIR BRADY stated this is hard to ascertain because the Fund does not know what it will be asked to be in terms of the structure, if it will be a debtor/creditor or an equity partner. TRUSTEE FRANK felt that analyzing this could help lead to the approach that is best for the Fund. MR. POATS stated the structure discussed in the documents is shipper pay structure, which is fairly standard. That structure has a clear elucidation of what would be the damages in the event of non-performance. He expected that to be appended to the LLC and the ANGCP. The key is ensuring that the documentation in the ANGCP is consistent with normal commercial arrangements in the industry. The lenders will insist on this, if the investors do not handle it.

MR. LINDEN felt the first consideration is rate design. As long as the monthly payment is made, the Fund should be indifferent as to whether the pipeline is empty or full. TRUSTEE FRANK clarified his point that the State of Alaska has a public corporation called the Alaska Permanent Fund Corporation and so the Fund could be suing itself. TRUSTEE WOHLFORTH stated that would be out of the Fund's control and the Legislators' control; the lenders would dictate if that happens. TRUSTEE FRANK acknowledged this point, but noted that the unique circumstance would be that the State is the shipper and the Fund is the pipeline owner and one is obligated to pay the other under contract and his question is what happens if the State does not perform.

Regarding utilization of depreciation, MR. STRAEBEL remarked that it is normal to allocate depreciation to the partner who can get the most benefit. For instance, if one partner is in a high tax bracket and can recoup \$.40 on the dollar for utilizing that depreciation, the depreciation will be allocated to that partner and the other partner may get a higher percentage of gas flow. The question in this situation is when the pipeline files their rates with FERC will FERC already anticipate, knowing that the State and Fund do not pay taxes, and adjust the rate so that there is no benefit to be allocated. TRUSTEE WOHLFORTH asked if this is likely. MR. STRAEBEL felt the FERC would anticipate that certain partners would not pay taxes and lower the rate accordingly, assuming the project is structured on those terms. TRUSTEE FRANK asked if the contract is silent on this and if it will be dealt with in the LLC. MR. ZENG responded that this is not yet decided. Whether the FERC allows this depends largely on the ownership structure, financing structure, and whether there are state bonds that are tax-free. MR. BURNS noted that the consultant has been asked to not do analysis on "moving parts." TRUSTEE FRANK understood that FERC uses an after-tax rate of return that anticipates depreciation. MR. POATS indicated this is correct, but noted there are many ways to refine the internal treatment relative to what is presented to the FERC. For instance, once a cost of service is presented to the FERC, there may be ways to optimize incurred costs and get a tax benefit out of the structure. MR. POATS stated that it could change over a time. CHAIR BRADY stated that as an investor he is thinking of the benefits of being a financier of the asset rather than owning the asset. The liabilities of the Fund are relatively short-term, but this deal is a long-term commitment. Absent some of the tax benefits and with FERC possibly changing the deal and the partners doing mergers and acquisitions in the future, the Fund is in the position of being in a changing environment. It seemed to him that with the mentality of the populace, the best way to accomplish the deal is to be the financier as opposed to an equity participant.

MR. POATS stated there are trade-offs between being a financier and being a term equity participant. The latter carries the exposure to risk for a long time. If this asset were marginal or challenging, the exposure would continue. It may be preferable to review a bridge financier role for the Fund to get the project done as cheaply as possible with the maximum return the Fund can derive and then

perhaps be in a position to liquidate. There may be a structure where the State or producers are willing to take the Fund's interest back over time. It will be important to delineate the roles the State contemplates for itself and for the Fund and how the Fund needs to look at its risk/reward across alternative investment types and what the State is willing to do to make the Fund comfortable. CHAIR BRADY stated he would like to see a double-digit rate of return on the FERC portion of the gas and do mezzanine financing with that put or call and avoid the liability that in some generations from now the pipeline will have to be parted and sold. MR. POATS felt the key issues are the cost of the Fund's money for that investment versus alternative sources, and what are alternative investments outside of Alaska or this project that could be similarly engaged so that the Fund's mandate is met. CHAIR BRADY noted that the Fund's obligations are relatively short-term, which he preferred over speculating over a longer-term. The Board's job is to maximize the benefit of the \$34 billion Fund to its residents as a prudent investor. A long-term investment such as this, without the benefit of tax advantages, is "putting a lot of eggs in one basket" without the knowledge of what will be done at the end of the day. He felt the Fund must review this as an investment on behalf of the Fund with whatever durations are possible and with an exit strategy.

MR. STRAEBEL agreed there are a number of investment structures to be examined, one of which he did not consider. He felt the long-term success of the pipeline would depend to a large extent on explorer gas. He thought perhaps the Fund could retain an option to sell its take in the pipeline to an explorer in the future.

TRUSTEE FRANK understood that owning the pipe is very different than owning the right to capacity and the obligation to ship, so it seems that the explorer would rather have the right to ship. This is something about which the Board should know. He understood that the State argument for State ownership is to get the State to participate in sharing some of the low return portion of the overall project, i.e. the pipeline, so that the return to the producers is higher on the total project by concentrating their ownership in the upstream aspects. He felt this was worthy of further analysis because it seems that the producers could sell off ownership in the pipe in any number of ways. The argument that the State must participate based on this argument seems good superficially, but he was not sure it is the most salient argument. CHAIR BRADY added that the direction the Fund is taking, with the consultant's help, is to find creative ways for the Fund to get the best deal or not do it. He did not want to see the Fund being a deal-breaker. He did not understand how much the State needs the Fund in order to make the deal happen. MR. POATS stated the point of the Fund taking proactive steps at this point in the process is to ensure the Fund's questions and positions are laid on the table so it is not presented with a fate accompli. Part of the process is to ensure that the Fund is proactively educated and is educating the State through its discussion. He acknowledged that the State has put a great deal of effort toward education, but it is important to hear the issues in the context of specific financing

and capital structures and other “rules” of the investment. CHAIR BRADY noted that two of the Trustees are State employees and, due to confidentiality issues, are not able to discuss these issues. MR. POATS added that the State is motivated through economic returns and through its access to capital, largely debt, to be a low cost provider. If that assumption does not hold and a lower cost provider can be found that brings all the dimensions to the table that are sought by the producers, the State should be looking to that lower cost provider to share its interest. An important discussion with the State is what is its understanding of how the producers arrive at their apparent conclusion of the State’s obligatory participation.

TRUSTEE WOHLFORTH noted that the finance report states “From the State’s perspective, the participation of the Permanent Fund Corporation as a lender would help Pipeco meet cash calls and project costs, particularly in the case of cost overruns, without diminishing its equity stake in the project.” MR. POATS stated that is perhaps the key role contemplated by the advisors to the producers in terms of the role of the Fund. That statement gives rise to concerns, such as what is the Fund’s protection against overruns, why is the Fund the capital supplier of last resort, what rate of return does the Fund receive for that service, and what is the liquidity of that investment. He also suggested there is a structure that would potentially make that a very reasonable participation; this includes coverage of the Fund’s commitment, adequate return, and commitment by the producers to share with or lead in terms of taking the risk of overrun.

TRUSTEE FRANK stated the Fund has been told FERC sets a rate that may or may not be the actual rate paid. He asked whether, if the Fund provided additional equity, would it be limited to FERC’s determination whether those costs are incorporated into the tariff and could there be an agreement outside the tariff to indemnify the Fund so there is a return on any cost overruns. He noted that any pipeline owner would argue that cost overruns should be incorporated into the tariff. However, the Fund has been told the risk with a cost overrun for an owner is that FERC does not give the tariff to support the additional capital so the return on capital is lower than anticipated. TRUSTEE WOHLFORTH stated there is also a risk in terms of the high amount required to finance.

CHAIR BRADY suggested taking a break and then allowing 45 minutes for the consultants to present information without interruption.

WORKING LUNCH 12:07 p.m. to 12:27 p.m.
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MR. POATS discussed the State’s objectives/principles of the investment, differentiating higher level economic principles from financial objectives. He felt it was important to be mindful of the objectives in discussions with the State. For example, if expandability is a principle, how will it be achieved and how will it be structured in the LLC agreement. The objectives are intended to limit the State’s liability for construction overruns and other costs that create the risk in the project

and, at the same time, there is an interest on the part of the producers for the State to take on the majority of that exposure. The view is that the State's participation, in concert with the producers, will present the strongest front to the financial markets. This appears logical in terms of the structure that is proposed. There is a question whether utilization of DOE guarantees can be utilized in a project financing structure. The initial views are that this is utilizable as opposed to member financing where the advisors to the State and producers raised significant concerns over whether or not DOE would allow their guarantee to be applied on an individual member basis as opposed to a rolled-up project basis. There is an objective to seek an 80/20 structure, which may be problematic in an LLC; the State would be the primary entity providing the requisite backstop to cost overruns and risks associated with the project. The State has a number of objectives but there are also limitations on the availability of its capital and its potential exposures. These are the focus of the Fund's involvement with the State and how to resolve conflicts in terms of its interests.

MR. STRAEBEL stated that both the DOE guarantee and debt/equity ratio of 80/20 give rise to the question whether, since SB2003 allowed the State to sell bonds, the DOE could guarantee work in concert with those bonds, which would offer extremely low cost financing, and whether the State could conceivably sell more bonds than their pro rata share.

MR. POATS stated Appendix F of the fiscal interest finding (FIF) goes into detail about the necessity and value of insurance for those bond issuances and that typically only 25% of projects get that kind of insurance.

MR. POATS reviewed objectives and principles of the Fund, which are consistent with the overriding principle to work as a prudent investor in a manner consistent with its mandate and to consider the in-state investment relative to other investment opportunities and ensuring the Fund is comfortable that this opportunity represents an equal or preferable opportunity to others of its type. In terms of the financial objective, a long-term investment real rate of return of at least 5% is desirable within a diversified portfolio. The Fund must review the in-state investment relative to its risk levels and to ensure it is comparable to alternate investment opportunities. The latter is difficult to frame until there is greater clarity what risk/reward gradient is offered. The overriding principles pose the question of whether there are sufficient common interests or where potential difficulty might be encountered in resolving interests. There will be a challenge in terms of meeting the Fund's interest in the context of the interests of the State and the producers.

MR. POATS reviewed convergent and divergent interests. It is not necessarily the case that maximization of the investment value meets the Fund's concerns if it comes at the expense of lower return on the pipe component only, for example. There must be close examination of the scenarios and potential form and timing of investments to determine whether or not there are some convergence or

divergence of priorities. In terms of maximizing values, the producers look at the overall project, the State looks at the pipeline and royalties, including economic internal rates of return (EIRR), and the pipeline only being the Fund's interest, consistent with its charter. In terms of minimization of risk, the producers are looking for the state to carry backstop, the State needs some limit to that backstop, and the Fund desires limits as well and a return consistent with what risk it is taking in the form of its investment. In terms of maximizing control, the producers will mandate majority control, the State will accept a limited role, and the Fund views this as more of a passive investor, but is an actively interested investor in the context of its potential role with the State in the formation process. With respect to the overall value of the project, there is some convergence of interest between the State and the producer and some alignment, subject to the threshold ownership interest in the pipe being satisfied. There are a number of ways to satisfy the Fund in terms of maximizing wellhead value. Finally, while the producers do not want an overly transparent process, it will open up with the State's participation; the Fund's desired transparency depends on the funding structure. MR. STRAEBEL noted that in a perfect world all of the parties would have convergent interests, but the Fund must look at its interests in isolation.

MR. POATS next reviewed the issue of conflicts and potential steps toward resolution. This process would be fleshed out in a second-stage discussion with the State. In terms of the issue of State support required to accommodate the project risk, which is subject to reasonable limits, the producers need the State as a backstop in relation to overruns and risk and the State needs some limit to that. Potential resolutions are to get the producers to accept at least an allocated risk and, where they are suited, to take on that risk contractually and move it to other parties. The process of shedding some of the risk to producers must be discussed. Another potential solution is for the Fund's capital base to be viewed as a potential supplement to the State, subject to the prudent investor rule, which would imply adequate exposure limits, adequate returns, and some backstop to the Fund's exposure.

CHAIR BRADY asked for an example of allocating risk to producers where they are best suited to take it. MR. POATS replied that there could be a requirement that an Engineering Procurement Construction (EPC) contract be in place that has industry standard terms for allocating cost overrun exposure to the EPC contractor. CHAIR BRADY remarked that there has been a strong suggestion that there will be overruns and that the partners are responsible on a pro rata basis. MR. POATS stated the nature of the project financing is to shift the risk to the party that is best positioned to absorb that risk. In this case, the State is a passive participant in that contract negotiation and the producers are engaged on point with various EPC contractors. Through their EPC contract framework they can push hard for limits or they can go softer. TOM HIRSCH stated another way to shift the risk to the producers would be to be clear in the shipper contract that, to the extent there are cost overruns, the shippers agree to pay the higher rate that would be derived from the higher cost of the pipeline.

TRUSTEE FRANK asked whether the State would be able to negotiate a deal where the producers pick up the cost overruns. He noted that the presentation from PACE states “producers need State backstop.” He asked if the State needs to backstop its 20% share or are the producers looking to the State to backstop cost overruns in totality. MR. POATS explained that the working assumption is that this is pro rata. MR. ZENG stated it is possible to shift the entire risk to the State because the principle is to shift the risk to the cheapest source. The question is the cost for the State to provide that guarantee. TRUSTEE FRANK remarked that one of the rationales put forward for the producers owning the line rather than a pipeline owning company is that they are in the best position to control the cost of construction. If this is the case, the State should not hold any more than its pro rata share. An argument could be made that the State should hold less than its pro rata share because it is not in a position to control construction costs. He asked whether that would be outlined in the LLC. TRUSTEE WOHLFORTH expected that this should be in the LLC agreement. MR. BURNS noted that the 80% is comprised of the other minority owner, but the producer minority owners have more in common than the other owners.

MR. POATS continued with his presentation, noting that the other conflict area is maximization of return to the overall project versus return to the pipeline company. The potential resolution would be to ensure that adequate reserves are funded to support the pipeline investment. That raises the question of the source of those reserves, how they are priced, and whether the LLC contract is detailed enough to provide a working indication of the reserve plan. In the LLC contract it must be clear that there is sufficient protection provided to the pipeline investor only, what is the recourse to the pipeline segment share, and is there adequate support for the pipeline economics an adequate risk sharing between producers and the State. If the Fund is involved, the State will be asked about the adequacy of that LLC agreement and elaboration on the conditions of exposure as a function of pre- and post commercial operation.

The third area of conflict is control; producers want to maintain control. The State would expect a limited role and an active role in terms of negotiation. The resolution would be to delineate necessary rights in the partnership agreement, indentures, and other inter-company agreements.

MR. POATS reviewed the potential form of the Fund’s involvement and the timing of participation. The forms could be equity, debt, security/guarantees, or credit reserves. Equity investment could be a straight pro rated equity investment, a preferred rate with accelerated returns with different features in terms of liquidity event, and there could be a redeemable form of equity that cold be structured in terms of a liquidation or rollover and a buy-back obligation. In the early stage of the investment, in particular, there is relatively higher risk, but there may be a deemed structure that the Fund may be required to decide whether to take or leave.

Debt could be in the form of a term loan with potential conversion rights to equity. This offers much flexibility and the issues will be pricing, duration, and protections to the Fund should it be a mezzanine or contingent loan provider. Depending on the protections in the loan arrangement and the extent of the exposure, it should be lower risk, but there would also be lower return. If the price is too high, the State and producers will be pushed to look for other lenders. It will be difficult to compete with the State, particularly in terms of its cost of money. The issue will be at what point the Fund's capital should kick in and, if so, what is an appropriate pricing for that capital and should the State allow the Fund to lead in terms of the first portion of debt and take a fall-back role or vice versa. It is attractive to lead with the Fund's capital and then revert to the State because doing the reverse implies that the Fund is stepping in as an alternate backstop. The flexibility and cost of money available to the State will always be preferable to the limited amount available to the Fund.

In terms of securities and guarantees, SB2003 states the parties are free to engage in the forms these investments would take, including creating subsidiaries in which the capital commitments would be defined and executed. There is the ANGCP, called Pipeco, which is the State entity, and the agreements on the capital structure would be done a level above that in a separate entity.

TRUSTEE FRANK noted that this brings up the huge policy issue of whether it is more appropriate for the State or Fund to hold the equity. The State initially said they would prefer it be them, but they asked the Fund to begin examining the possibility. This begs the question what is the Legislature's role in making the decision which entity would hold the equity. If the State creates a new corporation, the Legislature would be required to do that. Any appropriations for investment into a pipeline would require State legislative action. There will be legislative approval of the concept of the formation of the Pipeco Corporation. He felt legislative action would be required and healthy in terms of making the policy decision of who should own the equity. MR. POATS believed this is contemplated by SB2003; whatever capital structure is proposed would require legislative approval. CHAIR BRADY was concerned to think of the State and Fund being at odds with each other. TRUSTEE WOHLFORTH noted that another dynamic that plays into this is whether or not this is an investment that is externalized; that is, if the State gives credit support to an externalized or publicly purchased equity or debt investment or if it is not externalized. The State has done very well when it has created entities that have borrowed money on public markets for its public purposes versus direct appropriations. That is a public policy issue that he assumed the Legislature and/or Administration would explore.

MR. POATS stated this is one reason PACE likes the concept of a bond issuance versus a series of appropriations. There is the issue of the guarantees underlying that bond and its pricing. One approach is pooling capital resources and reviewing the most effective use of those resources. A question would be if the Fund is

better positioned as a provider of a term or construction loan, with the State behind it, or vice versa with the Fund posting a guarantee to backstop the State's underlying security and with the Fund being satisfied that the limit of its guarantee and coverage it is provided are adequate vis-à-vis the level of return expected. That form of security or guarantee could take several different forms. From a cost capital perspective, having that additional capacity would help to lower the overall financing costs with benefits being distributed back to the producers. Then the issue is ensuring that the producers step in negotiations with the State for their fair share of risk exposure. This is an example where the Fund, working through the State, can influence the final structure of the capital. Eventually the Fund will want a capital structure model. MR. STRAEBEL added that the Fund must assess its potential investment within the framework of its statutory mandate and investment criteria.

TRUSTEE FRANK stated that, on the one hand, there is the State and its General Fund and on the other is the Permanent Fund with its principal. The Fund makes investment decisions that include the principal and the earnings reserve. In the middle is the over \$4 billion earnings reserve. The Legislature cannot spend the Fund's principal, but it can spend the earnings reserve. Those funds should be clearly set out in the structure.

TRUSTEE HUDSON asked how difficult it would be for the Fund to compete with other State financing alternatives in terms of debt. MR. ZENG explained that the State would have other sources than the Fund to finance debt; the simplest is revenue bonds or general obligation bonds. The interest rates on those bonds will be low and they will be tax-exempt. TRUSTEE FRANK stated he had assumed that any bonds issued by the State for this project would not be tax-exempt. MR. STRAEBEL stated SB2003 defines them as tax-exempt bonds. TRUSTEE WOHLFORTH stated that this would be determined under federal law, not state law. MR. BURNS explained that the State has said it would be public purpose, but the IRS must make the determination. TRUSTEE FRANK asked why the entire project would not be financed in this fashion. TRUSTEE WOHLFORTH clarified that this is a private purpose financing, not a public purpose financing, and he suspected the bonds would be taxable. For this reason, the argument that the Fund debt may be more expensive than State bonds is flawed. He stated that it would be problematic because it is an inter-agency borrowing; he would prefer to see the debt externalized in public markets.

MR. POATS commented that, with the assumption that the State's bonds would be taxable, there is a more interesting cost competition potential for the Fund. TRUSTEE FRANK was concerned with the previous comment that because the State might have the lowest cost source of capital, it could be looked to as a source of overrun financing. He would be more comfortable if the discussion was not that the State be the source of project overrun financing. He suggested that, if this statement is going to be made, it should be quickly followed with the assumption that the producers would have an appropriate guarantee for their

share. The people of Alaska do not want the State to be lined up to pay for uncompensated cost overruns. MR. POATS felt that is a process of negotiating the capital structure of the LLC. Were it to be agreed that, subject to limits, the State's appropriation is the most efficient option, there would be a producer guarantee to that given their credit rating. TRUSTEE FRANK suggested that for the sake of simplicity it might be better to not take one stance or the other.

MR. SHAFER assumed that in order to retain its 20% ownership interest the State would have to put up its share of cost overruns. MR. BURNS indicated the State does not want to lose its 20%. TRUSTEE FRANK thought the discussion was extended to the State being the source for project overrun financing, beyond the pro rata share. MR. ZENG replied that the basic assumption is a pro rata share. The producers and State will determine the shares. The obligation between the partners is still debatable.

MR. POATS next reviewed the timing and extent of funding being sought. Some of the activities in terms of a timeline beginning with government approvals and ending with gas delivery. Among those activities, several are key: government framework within the next year, activating the open season process at the end of year two, and procurement in year four. The open season process is very important because the anchoring of the investment is on the working assumption there are sufficient subscribers and value in the capacity to support the financing. That proposition should be tested in advance of significant outlays of funds. MR. POATS noted that the information provided by PACE includes a breakdown of contemplated equity outlays over the potential timeline, based on 20% participation with leverage of equity from the State entity and ANGCP. In the first four to five years, critical investment decisions must be anchored around the agreements, the open season process, and with a procurement decision before significant dollars of over \$1 billion per year are sanctioned in the form of the construction contract. The investment must be carefully evaluated in light of the key milestones and in light of the structure and protections offered in terms of the capital investment made by the Fund at any point in time. This would allow for review of a construction loan to isolate its potential overrun, risk exposures, and coverage with respect to guarantees in a post-construction mode versus a development loan that covers the whole period. This review would be based on the working assumption that sponsors behind this project are more than equally committed in terms of maintaining costs and performing in a diligent manner to achieve successful construction and conclusion of the project.

MR. POATS stated that while there is more risk in the early phases of the project and more potential to overrun, the level of investment is manageable and, with appropriate structures, the Fund could put limits on its exposure. In addition, the Fund can look at the various periods of investment and seek to become comfortable with the level of its reserves and/or credit support committed to different time periods. Through conversion features or other time limiting features the Fund could put itself in a position to provide more mezzanine coverage and

support and have as much return and with as much control and protection as it feels appropriate for the investment.

MR. POATS reviewed several key milestones and areas of risk, namely the full permitting and project sanctioning occurring at the end of year four and the first gas movement in year nine. In terms of framing the Fund's investment against cumulative cash requirements, it will be important to look at the timeline and the period of financing and the flexibility the Fund might want to pursue in terms of its time limits or option rights across that time horizon.

For example, the Fund could have a proportional structure across the time horizon. Any kind of investment could be structured more as a lump sum that is contingent upon achieving certain milestones. It would be possible in a discussion with the State to put an optimal time risk horizon on the investment and, if the State is flexible in its assessment of funding capacity, the Fund's role could be optimized vis-à-vis its risk. MR. STRAEBEL noted that each subsequent area circled on the timeline represents a private development stage at which risk drops significantly.

MR. POATS reviewed a diagram of the potential ownership structure, anchored on the ANGPC, or Pipeco, within which the State will structure its investment. He noted that the GP/LP structure could be shown in this diagram as well and there could be subsidiary structures as well. The State entity, per the drafted law, would be able to invest in each geographic and/or functional subsidiary component that would have a match from the producer side, consistent with the overall terms of the LLC and with the terms of the ANGCP. Analogous to the Fund's side structuring of its capital, the producer consortium might have its own side deals.

TRUSTEE FRANK asked about the underlying logic of there being separate operating organizations. MR. POATS explained the logic is both from a functional and management perspective in terms of the business and it also allows for potential modification of the participants in each of the subsidiary enterprises. The LLC will need to be closely examined in terms of whether it is acceptable from the State's perspective with regard to what entities and terms can flow into the subsidiary entities. The intent is to recognize there are different geographic and functional components of the system that would be conducive to separate terms for investment and possibly for management and there are incentives built into each entity between the major investors. MR. BURNS added that several of the subsidiaries would have potential separate agreements that would not be an obligation of the other partners. TRUSTEE FRANK asked if the same ownership percentages are being contemplated in the subsidiaries. MR. BURNS understood that is planned. TRUSTEE FRANK asked if the LLC would delineate the rights to sell interest in those subsidiaries. MR. STRAEBEL assumed that would be in the LLC. TRUSTEE WOHLFORTH thought it was complicated to have five operating companies.

MR. POATS next reviewed the decision-tree framework. MR. ZENG stated the State would be a major force in determining whether the Fund will participate in the deal or not. The Fund's investment decision will be mostly driven by the fiduciary duties outlined in various legislation, investment policies, and resolutions. The investment return and risk will have to match other investments, whether in-state or out of state. For the Fund this is a pure investment objective. The Fund does not carry special interest; it will be critical for the Fund to use commercial structure and financial instruments to enhance the rate of return and reduce downside risks. MR. ZENG stated the key question is whether the State has enough funding sources to support the project. The question of whether the Fund's participation is a deal-breaker is difficult to answer. It is possible that the State does not need the Fund's participation in order to push the project ahead. The question is if the State has enough cash reserves or can borrow cheaply enough. There are intangible benefits that the Fund could provide to the project. If the State has enough funding sources to support the project and the Fund's participation provides some other intangible benefit, there is the question still of whether the Fund compares favorably against other funding alternatives.

TRUSTEE FRANK noted that if the Fund invests in this project as it does other assets, the returns flow back to the APFC and are deposited by law into the earnings reserve where they are accessible by the Legislature. This brings out the policy issue that if the State invests in the pipeline, the return on its investment would be returned directly to the General Fund; whereas, if the Fund invests its funds, the return goes into the earnings reserve. Theoretically, however, the return could be accessed by the Legislature by law if pipeline revenues were distinguished from all other revenues that now go to the earning reserve. The Legislature might wish to consider this up front and it is salient from a policy perspective. He assumed that most legislators want the benefits of State ownership to flow to the General Fund in order to meet general government obligations. MR. BURNS stated that, assuming the Fund invests laterally in the ANGCP, the revenue would flow from the pipeline tariffs to that corporation and those revenues go to the General Fund and they would have to appropriate the return to the Fund. TRUSTEE WOHLFORTH stated the Fund has a constitutional requirement to invest in income-producing investments. TRUSTEE HUDSON noted that if the money is taken out of the corpus the return has to come back to the Fund. TRUSTEE FRANK stated that the constitution says that all of the earnings of the Fund go into the General Fund unless otherwise provided by law. Other law has provided that they go into the earnings reserve of the Fund. The Legislature could change that law so that the Fund earnings on this pipeline investment stay in the General Fund and all others go back to the APFC or they could let them all come back to the APFC. The Legislature has to deal with it one way or another. If they want the funds to go to the General Fund, they should not ask for the Fund to invest. TRUSTEE WOHLFORTH stated the Fund has been the most sacrosanct and untouchable of funds and he would expect future Legislatures to adhere to that point of view. In addition, the Fund is not at the table negotiating the terms of the LLC because the State has initially said it does

not think the Fund's participation will be needed. These two points color his reaction to the entire prospect.

MR. ZENG stated it has been PACE's assumption that the participation by the Fund would be voluntary and that any investment is bound by the Fund's fiduciary duties and would require a return from its investment. The State may not like that. It may require the legislative process to move funds from the Fund and, at that point, the Board is released from its fiduciary obligations.

MR. ZENG reviewed several State equity funding alternatives. The first preference on the part of the State is a 100% equity contribution, if that can be achieved. The opportunity cost on this option is the return on the Constitutional Budget Reserve Fund at 4%. The State would desire some flexibility to have the funds available at any time. The second option is general obligation or revenue bonds, subject to whether or not those bonds are tax-exempt and if it does not exceed the State's borrowing capacity. The borrowing cost for this option is 5%. These bond funds have low flexibility and require debt service reserves. There may be a role for the Fund to provide those reserve funds. Once there is a steady stream of revenues from the project it is possible to refinance capital with revenue bonds. The last funding source is the APFC. This would have a mandated return of 8% and a required return on equity of 12%. The Fund has the flexibility to invest in many forms and in multiple stages of the project. The bottom line is that the Fund's investment policy must be met.

TRUSTEE HUDSON asked what is the current balance in the Constitutional Budget Reserve (CBRE). MR. ZENG replied that it is currently \$2.2 billion. MR. BARTHOLOMEW noted that \$300 million was put aside into a subsidiary of the CBRE potentially to be available for up front costs, to be determined by the Legislature.

MR. ZENG reviewed a potential investment decision tree framework involving the State the APFC and potential investment structures. It is ultimately the State responsibility to decide whether the APFC can provide any strategic benefit in terms of sharing risks and lowering cost of capital. If the State feels the Fund's participation is strategically important, then the Fund still has the decision whether or not to invest. If the Fund decides to invest, PACE would propose a GP/LP structure. The benefit of a GP/LP structure is that it would allow dissection of the risk and operating responsibilities between the general and limited partners so the Fund can be a passive investor. TRUSTEE WOHLFORTH asked how the second row in this decision tree is different from the first in terms of the investment structure. MR. ZENG replied that there are two roles, but the boxes are essentially the same. If the State, for any reason does not consider the Fund to be strategically important, there will be a case-by-case investment decision. If the Fund can be involved in any stage, it would be evaluated against all other investment options. At every stage the Fund would perform due diligence. TRUSTEE WOHLFORTH felt this was a distinction without a difference. MR.

POATS noted that the first row in the decision tree framework is that the State has determined the Fund's participation is strategically necessary, whereas the second row is that the State has determined that the Fund's participation is not needed, but could be welcomed, if it is competitive. TRUSTEE WOHLFORTH felt the categories of investment shown in the second row could apply to the first as well. MR. POATS agreed, explaining that the second row is potentially a piecemeal process that involves negotiating what is the optimal structure of investment and it is implied that the level of investment is likely lower. MR. ZENG added that in the first case, the Fund would have to think about a variety of issues up front compared to the second case where the Fund would be involved in a more nimble decision process.

TRUSTEE FRANK remarked on the four investment options shown in the second row of the framework and noted that if the State were a common equity state the FERC rate of return would be easy to understand, but he wondered about the risk/reward with a credit guarantee. He asked if there are insurance companies or something from which the Fund would be buying guarantees. He was also concerned with early stage preferred equity, noting that the highest risk is cost overruns in the early stages. He asked for more information on these, if they are to be considered. MR. ZENG stated that these are big issues that would be explored during the structural stage. He noted that even a FERC guarantee is limited. It is possible for the Fund to limit its exposure and still get a reasonable rate of return. MR. POATS added with respect to a credit guarantee that the Fund would look at how much is being offered as a guarantee, where it falls in the cascade, and in terms of the pricing of the guarantee the Fund would look at the project as would an internal rating agency to develop a base rating of how the guarantee should be priced. If the structure is not competitive, no advantage is offered. One form of potential investment could be taking some of the reserve and putting it up to back payment obligations for a defined period of time. The issue would be the exposure and the potential need to draw, and if there were the need to draw on it, what would be the payment terms and the capacity of the State and the producers to make the Fund whole. It is important to structure the alternative vehicles in response to what the State and its advisors are suggesting would be incremental potential added value. TRUSTEE FRANK said he would like to know more about what are typical rates on those types of credit guarantees. MR. POATS stated the simplest place to start is in an LLC. TRUSTEE FRANK explained that the word "guarantee" carries a connotation. He thought what was actually being discussed is financing an additional debt requirement, which is not as problematic. He asked that the language be clear and that terms be defined in ways that people can understand and that are not alarming. TRUSTEE WOHLFORTH understood this was like a bank guarantee of debt. MR. BURNS thought the issue is additional capital contributions. It is one thing for the producers to say they will cover their share of cost overruns; the State cannot guarantee continued funding of a private undertaking. TRUSTEE FRANK noted that there is no use of the word "pro rata" in this discussion, which should be clear. MR. SHAFER stated this is simply a way to participate, potentially from the beginning. TRUSTEE WOHLFORTH

noted that it is external participation, and it is not a bad way to participate. MR. SHAFER thought there is also the question of whether there is an implied guarantee. MR. POATS suggested using the terminology “pro rata first stage incremental support” in order to be clearer.

MR. ZENG stated that there are three phases of investment and there is the flexibility for the Fund to invest in any of those three. The Fund can exit at any stage.

MR. POATS reviewed remaining issues and analysis needs. The things that warrant further analysis include confirmation of the State’s objectives and interests through a discussion with the State. Second, confirm the range of instruments being contemplated and timing assumptions and potential splits among the equity/debt instruments across state entities. Third, use the State’s assumptions to simulate project performance under alternative capital structures, including evaluation of variables and how those break out between cost and timing exposures. A common framework is important for the State to share its working assumptions and for the Fund to ascertain if they are adequately capturing risk in terms of the Fund’s vantage point. Fourth, monitor State revenue adequacy and project performance. Fifth, clarify legislative and contractual parameters that frame the decision sequence process. Sixth, develop investment scenario analysis of alternative structures and fine-tune them with respect to timing and flexibility features. Finally, develop a “menu” of potential structures that might be contemplated for the Fund to further investigate.

MR. POATS reviewed the history of the authorizing legislation and the pending legislation respecting a gas pipeline. MR. STRAEBEL noted that the project has largely been enabled by legislation and will likely require legislative support going forward. The State Constitution encourages the State to help develop its infrastructure and resources to benefit the public. The Alaska Natural Gas Pipeline Act passed in 2003 by Congress enabled an \$18 million guarantee up to 80% of the cost of the project. TRUSTEE FRANK suggested that this information include the fact that the earnings of the APFC go into the General Fund unless otherwise provided by law and law does provide that the earnings of the APFC go into the APFC earnings reserve. TRUSTEE WOHLFORTH noted that the quote shown in the presentation as from the Alaska Constitution is out of the statute not the Constitution.

MR. POATS presented an illustrative financial model overview. He explained that this overview used a high level financial model to test the investment requirement/result sensitivities to various scenarios and input assumptions. Certain assumptions about the project development and cash flow schedule, financing structure, form of participation, and regulated tariff and cash flow after operation were the high level working assumptions used. The key metrics that will be generated are investment shortfalls and the impact on rate of return. Financial outputs and performance outputs would be generated at a later point.

Key variables include price levels, project cost overruns and delays, and uncertainties related to cash flows. PACE wants to begin framing assessments of risk within a quantitative framework using either the State's assumptions or the Fund's developed modifications thereto.

MR. ZENG first reviewed a scenario of cost-of-service tariff buildup. The tariff will typically be composed of operating cost, depreciation that will be amortized over 30 to 40 years, FERC allowed return on debt, FERC allowed return on equity, property taxes, and income taxes. The example scenario shows operation over a 5-year period. TRUSTEE FRANK recalled that property taxes would be dealt with separately. MR. STRAEBEL stated this is a hypothetical example using numbers found in the documents. He noted that a 30- to 35-year model is typical for this type of project, whereas this scenario shows only five years. MR. ZENG noted that the filing is based on projections and the actual costs are likely to deviate from the filed costs.

TRUSTEE FRANK asked whether, if financing is a shorter duration than the tariff term, the FERC envisions changes in the tariff based on changes in interest rates and changes in interest costs. MR. HIRSCH replied that there is no requirement that the pipeline come back to FERC to change its rate at any given point in time. If the debt is repaid, even though it changes the capital structure of the company for rate purposes, it does not automatically change the FERC rate. If the pipeline were to come in for a rate change, then the pipeline capital structure would, at that point, be 100% equity and that would affect the overall rate of return because the FERC would be making the ruling on the allowed return on equity and would not be considering the cost of debt. TRUSTEE FRANK asked what has happened over the last 20 years as the cost of debt has come down consistently. Obviously, pipeline companies have been refinancing and taking advantage of market rates being low. He asked if FERC has allowed them to simply make more money. MR. LINDEN replied that pipeline returns are up. TRUSTEE FRANK assumed FERC makes sure the rates are commercially reasonable. MR. HIRSCH stated that when the FERC sets the rate it ensures that the rate of debt is commercially reasonable. There have not been many rate change filings filed by pipelines until the last several years. He noted that there are many other costs so, even though the cost of debt may be lower, other costs may have risen.

TRUSTEE FRANK noted that when a project is financed, the repayment is debt that includes principal and interest. He asked how that is handled from a cash flow perspective. MR. HIRSCH stated the depreciation is a repayment of the principal.

MR. ZENG next reviewed a graphic depiction of the funding sources and investment amounts for a project with a total capital cost of \$21 billion. Once 80% debt is removed and the equity is split among the partners, the APFC would have 10% of effective interest or \$420 million cash required to join the ANGCP.

Any investment return would be calculated from the proportional investment. TRUSTEE FRANK noted that the positive revenues from this project do not begin flowing for a long time, so the discount rate used to calculate the rate of return has greater importance. MR. ZENG explained that this analysis does not cover any discount rate because it is a cost-based calculation. TRUSTEE FRANK asked if an internal rate of return (IRR) has been calculated not using a discount rate. MR. ZENG explained that the IRR is a mathematical function and represents a break-even point. MR. STRAEBEL explained that the investment return calculation shows the IRR in three scenarios: investment at the beginning of the project, investment from project sanction, and investment from project operation. Investing later and getting immediate return on that investment would yield a higher rate of return. MR. ZENG added that the FERC bases its rate on a permanent capital structure, so if equity is put in ahead of the project operation, the cost for the investment is very high and the IRR will be significantly decreased. TRUSTEE FRANK asked if the mezzanine debt rates are regulated. MR. ZENG replied that mezzanine debt would not be FERC regulated. TRUSTEE FRANK understood that FERC would allow construction cost interest to be included in total cost. He believed that construction interest would be substantial. MR. STRAEBEL agreed that construction cost interest could be substantial. TRUSTEE FRANK thought this amount could be very high, perhaps several billion dollars. MR. STRAEBEL thought it could be 25% or 30% of total project costs. TRUSTEE WOHLFORTH asked if that amount was or was not included in the \$21 billion total project cost figure. TRUSTEE FRANK replied that it is not included and there is also no contingency. MR. STRAEBEL stated that construction cost interest is a cost normally included in calculating rate of return. MR. ZENG stated that should be included because it is allowed by the FERC. Typically a project is refinanced and the original mezzanine debt is replaced with permanent equity. MR. STRAEBEL stated that an IRR of 8.4%, considering the development and construction risk at the start, is not advisable, but 14% at the date of commercial operation is a good return.

TRUSTEE FRANK noted that the investment return calculation takes the cash flows that begin in year 11 and there is an assumption that there is no return on the investment until cash seems to flow, which does not seem logical. FERC will let it be recouped, so it seems unrealistic to show it in the analysis indicating an 8.4% return. The market and FERC will allow for return on the construction period. MR. STRAEBEL stated the return rates shown in the analysis are not the actual returns that should be expected, rather they depict the time value of money; if the Fund invests earlier and does not have some future benefit, a lower rate of return is achieved. TRUSTEE WOHLFORTH suggested that these charts should clearly state that. TRUSTEE FRANK felt the information presented by PACE should present the potential rates of return more realistically so that it is more easily understood. MR. BURNS thought the tariff is based on when the gas starts to flow. TRUSTEE FRANK stated that an investor is compensated for the investment in the project from the time it is invested. MR. STRAEBEL agreed

with Trustee Frank that the producers that will invest in this pipeline from day one will expect and most likely receive something greater than an 8.4% IRR.

MR. HIRSCH explained that the FERC allows funds used during construction. The FERC has a formula that includes the short-term interest rate on the money invested or used over time for construction as part of the pipeline rate base; that accumulated interest is included in the initial rate calculation as capital cost and it is then amortized over the life of the pipeline. There may be other costs incurred by the producers, such as studying the project and doing preliminary work, that are not construction costs. Those types of costs may perhaps be included in the initial rate calculation.

TRUSTEE FRANK thought the way this information is presented in PACE's presentation could lead to misimpressions. MR. POATS suggested that this could be corrected by adding to the note. The working assumption is that the investor is a taker of these returns when, in fact, a construction loan and an investor in the construction phase would clearly negotiate a position for more than an 8.4% return and it would be justifiably allowed, whereas an investor at year 10 that has not gone through that risk would not expect to make 14%. In essence, the negotiation process in terms of structuring price and capital will force these numbers to be leveled in terms of the timing and form of the investment.

MR. ZENG noted that even the 14% IRR is not fully guaranteed; the revenue could be different than the example shows because it uses a 100% capacity factor. It is also possible that the rate could be higher.

MR. ZENG reviewed the sensitivity of the rate of return to certain assumptions. The base case is what is presented in Appendix J of the information provided by one of the State's financial advisors. This scenario assumes that early stage investors are not being compensated for taking on initial risks. The front-end carrying costs will have impact on the rates of return. Most of the construction cost overrun will be allowed in the FERC rules. It is likely that the eventual capital costs will be different than the capital cost structure allowed by the FERC. There is a variance between the true capital costs and what is allowed by the FERC and there is a delay between when the rate is refilled and the FERC approves the rate; there is always a risk in terms of what the FERC will or will not approve. Capacity factor is most important factor in terms of its effect on the IRR. Lower capacity factor and low revenues will decrease the investment rates of return dramatically. Resource risk figure assumes a case where the project will not be able to fill the pipeline and uses a 50% capacity factor up to 27 years. Because that event is so far in the future, the impact on return is small. Insurance can be purchased to cover Force Majeure, which is a business interruption risk. The analysis assumes a 60-day loss of revenue and the event is one in 10 years.

TRUSTEE FRANK asked that PACE consider reworking this part of their presentation in light of previous conversations. He also felt it would be interesting

to examine late stage investment, or selling the Fund's investment to determine if a higher multiple might be achievable because an investor is willing to pay more for a higher rate of return.

TRUSTEE WOHLFORTH stated he did not understand the Project Return and Exposure under the Alternative Scenarios chart. MR. STRAEBEL explained that if the Fund were to come in at the commercial operation stage with a \$420 million investment, the return would be 14%. With a base case of 14%, the cost overrun would drop the return to 9.5%; the cost overrun is defined as a two-year delay and 20% extra cost. TRUSTEE FRANK noted that this implies an uncompensated cost overrun, not a FERC allowed cost overrun. MR. STRAEBEL agreed that this is a key point.

MR. ZENG stated that there is an assumption that will be recovered as well. Anything additional to the FERC guaranteed rate would have to be financed by equity so that is the impact of the cost overrun. There is a deviation between what is allowed in the FERC capital structure and what is in the actual capital structure.

TRUSTEE FRANK commented that to the extent that FERC allows overruns to be incorporated would the FERC determine that the overrun took longer than it should have and not allow the extra financing to compensate for that delay. He thought perhaps the FERC would not allow construction interest on the delay period, but asked is it common for the FERC to not allow the inclusion of the time value on money for construction delays. MR. LINDEN replied that this is determined on a case-by-case basis. In a circumstance like this where the shippers and pipeline owners are largely the same, it is unlikely that the shipper, which is the usual source of the protest before FERC, would make their case to the FERC. He added that he would ask what are the relative levels of risk for each of these various outcomes and what mitigation steps can be taken. MR. BURNS understood from the chart that, even if more equity had to be put in and it had to be in for two years longer, the IRR is affected. TRUSTEE FRANK believed that if there is a two-year delay and the cost of that capital is rolled into the FERC rate, the rate of return would not be reduced. It is only if the FERC does not allow the extra cost to be included in the cost model would the rate come down. MR. ZENG stated that the model uses the IRR over the life of the project. The true impact is the deviation between what was filed with the FERC and the actual cost. He believed the majority of cases indicate that costs could be recovered. TRUSTEE FRANK stated if there were not compensation for the cost overrun and the delay, then the IRR might come down from 14% to 9.5%, as the chart shows, but if it is compensated that would not be the case. He suggested that PACE recalculate the IRRs it is showing based on further analysis. MR. STRAEBEL posed the question if the producers would be motivated to pursue with diligence a rate increase or is there a perverse incentive to not recover the cost overrun in the tariff so that the shipping costs are lower. TRUSTEE FRANK stated that Alaskans have been living under the impression for the last 20 years that producers want to spend as much as possible on the pipeline so they get a higher rate of return.

CHAIR BRADY commented that Bob Malone explained the Alaska Pipeline to him by stating that labor costs and the price of materials could not be controlled, which caused cost overruns, but that was not gross negligence, poor engineering, poor design, or poor application. He understood that there would have to be gross negligence in the design and construction of the project or the costs are included in the FERC. TRUSTEE FRANK thought a good case would be made before FERC that the costs and delays were unavoidable. CHAIR BRADY felt there was motivation and natural instinct to do the project prudently, but there are unknowns such as adequate labor, labor costs, and unresolved legal issues.

MR. BURNS referred to page 13 of the presentation, Timing of Funding Options, and noted that \$2 billion is spread over the entire time period of the project.

TRUSTEE FRANK recalled that construction overrun risk would be put with the party that could most easily accept it. He questioned who would and could take the kind of risk that is envisioned with this project. He doubted that engineering and construction companies would provide hard dollar estimates for a project of this nature and in this dollar range, given the risk of possible bankruptcy because of unknowns. MR. STRAEBEL replied that contractors do agree to contract provisions for liquidated damages for schedule, performance, and cost for billion dollar projects. This is done routinely in the power generation sector and it is even being discussed for new nuclear plants. He personally did not have experience with pipeline contractors in this regard. TRUSTEE FRANK suggested that, based on his limited experience, in order for there to be a hard dollar figure, there must be good construction drawings, which requires high expenditures. He questioned if construction cost overruns could be eliminated, to the degree that has been asserted, through hard dollar contracts. TRUSTEE WOHLFORTH agreed entirely with Trustee Frank and particularly when there are scenarios of delay. MR. STRAEBEL noted that it might also be the case that producers have so much experience in this area that if they had the option to get an EPC contract with liquidated damages, they would prefer not to pay the premium required for the wrap because it is likely 12% to 15%. They may be willing to take the risk because they have worked with the contractors in the past and they are preferred customers. TRUSTEE FRANK acknowledged this point, but felt the assertion that has been made, although not by PACE, that hard dollar contracts will ensure cost overruns are controlled is unreasonable. CHAIR BRADY noted that it is not only likely that there will be overruns, it is predictable; the question is to what degree. TRUSTEE WOHLFORTH felt it would be interesting to see the range of magnitude of cost overruns that the producers develop. MR. STRAEBEL thought that when the Fund is approached by the State they will have to make the pro forma available and the project can then be evaluated. TRUSTEE WOHLFORTH thought it is the producers that would not let loose of the figure, not necessarily the State. TRUSTEE FRANK assumed that hundreds of millions of dollars would be spent to plan and design this pipeline in order to produce a best estimate.

CHAIR BRADY suggested that the presentation be concluded.

MR. HIRSCH stated that the FERC allows the recovery of all prudently incurred costs, including cost overruns and costs related to project delay. There must be gross negligence or mismanagement for those costs to not be allowed. There is a question when they would be allowed. The rate will likely be based on the actual costs being incurred when the initial rate filing is made. A rate change could be pursued thereafter based on a cost overrun. MR. HIRSCH remarked on the shipper cost factor. The FERC sets tariff rates. If the shipper and producer cannot agree on a rate, the shipper can fall back on the FERC rate. This is important because if the shippers have a different rate formula in their contract, they are only bound to the FERC rate.

TRUSTEE FRANK asked if the FERC rates are generally lower. MR. HIRSCH replied that sometimes they are a fixed rate and could be lower or they could be based on formulas and sometimes that rate is above and sometimes below the FERC accepted rate. TRUSTEE FRANK asked how the rate could be above the FERC rate. MR. HIRSCH stated it could be a negotiated rate that is approved by the FERC that the producer can charge the shipper. TRUSTEE FRANK explained he was viewing this from FERC's consumer protection role. He did not understand why FERC would allow a rate greater than their approved rate. MR. BURNS explained that FERC allows a higher return. TRUSTEE FRANK did not understand why FERC would allow a rate to be negotiated that is higher than what they established, which is presumably one that is lower. Given the FERC's charge to protect the consumer, he wondered what would be the scenario wherein the FERC would allow a rate higher than what they deemed appropriate. MR. HIRSCH stated the policy the FERC is applying, which is fairly new, is that so long as the shipper can always fall back to the FERC rate, that is a protection afforded to the shipper. If the shipper wants to negotiate a contract that results in a rate above the FERC rate and the contractor comes to the FERC and asks the contract to be approved, they will likely approve it. TRUSTEE FRANK confirmed through Mr. Hirsch that in this case the FERC is not protecting the consumer, but rather is protecting the shipper that might have a different perspective than the pipeline owner. MR. BURNS asked if a shipper would agree to a greater rate in order to guarantee capacity. MR. HIRSCH replied that sometimes the rate is more important than the level of the rate vis-à-vis the FERC rate. It is possible that the shippers will fall back on the FERC set rate in the contract between the pipeline and the shippers.

MR. LINDEN stated the FERC is looking for demonstration of meaningful competition, so the shipper has options and also some kind of transparency. If the shipper prefers to bet with the market and not with the FERC allowed rate, they will ask for a demonstration. It is unlikely that the Alaska Natural Gas Pipeline will be deemed a highly competitive market for getting gas from the North Slope to Chicago, Illinois.

TRUSTEE FRANK understood that the current oil pipeline has been described as many pipelines within one pipeline because every company has its own tariff. MR. HIRSCH did not believe that would be the case with this gas pipeline. TRUSTEE FRANK asked if just one tariff would be anticipated for the gas pipeline. MR. HIRSCH replied in the affirmative. The rate schedule would define service for each class of service. There is a set of terms and conditions related to credit-worthiness that the shipper must demonstrate, as well as scheduling of delivery, etc. TRUSTEE FRANK thought that the LLC would outline whether the State has a 20% share of a common tariff and a joint operating expense of which it gets a pro rata share, or there is perhaps the potential that the partners could wind up with separate rates and separate operating allocations. MR. LINDEN explained that the tariff would involve many numbers over various services, zones, etc. TRUSTEE FRANK explained this is important because the Fund should know the potential for changes to the perception that things will be great. MR. HIRSCH stated there would be a schedule of rates within the tariff. It remains to be seen whether there will be different rates for gas delivered in state or for gas delivered to Canada. He presumed there would probably be some accommodation for gas delivered in the state, so the rate would be lower. TRUSTEE FRANK stated FERC made a ruling that there would be a mile-by-mile rate structure, but there is the question of who offers the gas that gets the lower tariff. MR. LINDEN remarked that underlying the tariff is the cost allocation. MR. HIRSCH stated there are issues in terms of the quantity of gas that will be delivered in the state and the quantity of gas delivered to the Canadian border. MR. LINDEN stated it is nice to have some say in the regulatory process because some agreements could negatively affect the investment. TRUSTEE FRANK asked if the suggestion is that FERC would analyze this only if there were interveners. MR. HIRSCH stated there are two practicalities: one is FERC is going to do what has to be done to make this project go, and the second if there is no FERC test the scrutiny is less than if there is a FERC test.

MR. POATS lastly reviewed prospective next steps. These include: crystallizing legislative and contract parameters, gaining an understanding from the State what is its own analysis of the Fund's potential participation and their funding capacity, reviewing the APFC's funding capacity and timing scenarios under alternative types of investment, confirming and evaluating the decision process to better structure an engagement with the State, and developing an agenda for the discussion with the State through questions, clarifications and additional analysis. As needed, issue briefs will be developed to look more in-depth into issues. Lastly, the analysis and approach will be refined to reflect the emerging legal and market risk parameters. As follow up to this meeting, PACE can refine and clarify the information it has presented and produce a revised version of the presentation or work on an internal draft of key issues that might be sent in advance to get a response before any future meeting. It is important that the State be informed of the issues that are a concern to the Fund and what they should be prepared to address at the first meeting between the Fund and the State.

TRUSTEE WOHLFORTH felt the Fund had gone as far as it could, given the existing state of play. Until the State LLP agreement is in hand, he felt not much more could be done.

CHAIR BRADY felt the Fund is proceeding in the right direction, whether it is only slightly or very far ahead in the process.

OTHER MATTERS

None

TRUSTEE COMMENTS

TRUSTEE HUDSON felt each of these meetings makes the Fund more aware of the complexities of this issue. He suggested the next meeting be based on more substantive information.

CHAIR BRADY felt the next step is to determine where the other two Trustees are on this issue and when they can start participating in discussions of the Fund's agenda. MR. BURNS felt it was still an open question whether or not those Trustees will ultimately participate. He believed the Department of Law found it appropriate for them to participate in the educational portion of this process, but schedules have conflicted with the Fund's meetings. CHAIR BRADY felt that there is also a decision whether there is a conflict of interest, given that these individuals are employees of the State of Alaska.

FUTURE AGENDA ITEMS

None

ADJOURNMENT

The meeting was adjourned at 3:15 p.m.

APPROVAL OF MINUTES

/s/ Carl Brady, Chair, Board of Trustees

/s/ August 23, 2006