ALASKA'S OIL ENTERPRISE MODEL IN A GLOBAL CONTEXT

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Bradford G. Keithley
Perkins Coie LLP
Anchorage and Washington, D.C.

Agenda

- Overview of enterprise models currently used for the development of state owned oil resources
- Alaska's current model
- A potential alternative
- An approach for considering the alternatives

Oil Enterprise Models

- Current primary alternatives
  - Lease
  - License
  - Production sharing agreements (PSA)
  - Service contracts (SC)
  - National Oil Company (NOC)
- Different models serve different objectives
- There are many variations on these basic themes; no two countries are exactly alike

Oil Enterprise Models: Lease

- Primary US approach, focused on low risk/low investment from lessor perspective
  - Federal and state lands
  - Evolved from practice on US private lands
- Format
  - Mineral owner (lessor) enters into a contract (lease) which grants to the producer (lessee) within a defined area the right to explore for, produce and develop the resource
  - Term continues for as long as production is maintained
- Usual economic terms
  - Up front bonus/continuing rent payable prior to development and percentage share of revenues to lessor (royalty) once production commences
  - **Risk and cost of investment – including for the lessor's share of the production – is borne entirely by the lessee**
    - Lessor shares in revenues from the first dollar; no provision for initial recovery of costs by lessee
    - In return, pace of investment largely left to lessee

Oil Enterprise Models: License

- A model used by countries focused on upfront development commitments rather than cash bonus (e.g., Norway)
  - Basic format similar to a lease, but with significantly different economic terms
- Format
  - Host government enters into contract (license) which grants to the producer, usually a consortium (licensee), the right to explore for, produce and develop the resource within a defined area (the license area)
  - License area usually is significantly larger than a US lease and license usually granted for a term of years (e.g., 25 once production begins), subject to early termination for failure to meet obligations
- Usual economic terms
  - Producer is required to make a significant initial development commitment (i.e., investment) with specified pace obligations
  - Risk and cost of investment borne entirely by the lessee, **but no upfront bonus and often no royalty obligation** (state take comes through state participation and production taxes)
  - Sometimes contains an "economic stabilization" clause (ensures producer retains same economic result, even if terms of state take later change)

Oil Enterprise Models: PSA

- Another model focused on upfront development commitments, with different rights for the country (e.g., Indonesia)
  - Again, basic format similar to a lease, but with significantly different economic terms
- Format
  - Host government enters into contract (PSA) which grants to the producer within a defined area (usually significantly larger than a US lease) the right to explore for, produce and develop the resource
  - Government reserves right to share in production, often exercised through a NOC
- Usual economic terms
  - Usually, producer is required to make a significant initial investment/development commitment with specified pace obligations
  - Initial cost of investment (and risk of failure) borne entirely by the IOC
    - ***But* if production, producer recovers capital and operational expenditures up front (cost oil**)
    - After cost oil, production (profit oil) is split between the government and the company (e.g., 80% host gov't/20% IOC), with potential for contractually agreed adjustments
  - **Usually contains "economic stabilization" clause**

Oil Enterprise Models: SC

- Sometimes used where resource is well defined, but special development expertise is required
  - Iraq, Saudi
- Format
  - Host government enters into service contract (SC) with producer which provides that producer will operate and submit recommendations for development of an identified field
  - Almost always combined with an NOC component
- Usual economic terms
  - The NOC retains ownership and the risk and obligation of investment
  - The producer is reimbursed for its costs, and is provided with a (relatively small) share of the upside for achieving cost efficiencies or increased production beyond agreed baselines
  - The NOC controls pace
  - Because of the limited upside, not a preferred alternative for producers and accepted only where unique circumstances exist

Oil Enterprise Models: NOC

- State establishes and owns a National Oil Company to develop oil resource
  - Can be wholly or partially state owned
  - Thirteen largest energy companies are NOC's; collectively, NOC's control more than 75% of global crude oil production.
- Format
  - Within the state, NOC is granted a portion of the resource; develops as a partner with producers (who participate under a license, PSA or other agreement and often act as the operator)
  - NOC can be wholly or partially state owned; successful NOC's are increasingly investing outside national borders in order to increase overall returns
- Typical economic terms
  - NOC owns and is responsible for its proportionate share of investment and expenses, retains upside with respect to its proportionate share
    - Sometimes, PSA or other agreement will provide that NOC has a carried interest or back in right (e.g., upon recovery of NOC's share of the costs)
    - Because it is an investor, NOC is in a much stronger position to influence – and direct – pace of development

Alaska's Current Model: ACES

- Although classified as a lease system, ACES has significantly changed the approach being used by Alaska
  - Normal lease system largely defines level of government take by lease
  - Some state taxation is contemplated, but anticipated to be in line with general state tax policy (no other producing state under a lease system taxes at rates approaching ACES)
- With ACES, Alaska essentially has unilaterally converted to a PSC "profit oil" model, but without investor protections or negotiation
  - No "cost oil" provisions with respect to royalty share
  - No "economic stabilization" clause
  - Obligations and rights not contractually defined
- Producer response has been substantially to reduce investment in new exploration and development
  - Producers have reduced pace of activity in response to substantially increased (and uncompensated) risk and burden

A Potential Alternative

- Given the current production decline curve, Alaska cannot afford an extended reduction in investment
  - In the absence of private investment, what can Alaska do about it
- NOC's have worked well in some circumstances; the potential alternative is to consider doing the same here
  - Investment brings with it the opportunity to influence pace and direction
- The Co-Investment (NOC) model
  - A potential response to the significantly reduced level and pace of investment in the development of North Slope oil ("Alaska is not running out of oil; it is running out of investment")
  - Alaska creates an organization (similar to Norway's Petoro) to make upstream investments and take an upstream equity stake

Other NOC Models

- Not all NOC's successful
  - PdVSA (Venezuela)
  - NIOC (Iran)
  - NNPC (Nigeria)
  - PEMEX (Mexico)
- Key characteristics for success
  - Co-investment with IOC's (international oil companies), not supplant them
  - Independence from government
    - No additional burdens
    - Assisted by including some public ownership
  - Focus on oil & gas

The Approach

- Given past success, fixing Alaska's lease model and restoring IOC investment is first option
- *But*, evaluating the "Co-investment option" as part of the going forward mix is important
  - Provides the State with an option to influence and, if necessary, direct the level and pace of investment
  - Also provides the State with an additional perspective on Alaska investments – helps bridge the gap between producers and State
  - State would not need to become an operator, simply an investor (Petoro SDFI model)
- Evaluation should be included as part of Sen. McGuire's proposed "competitiveness review"

Alaska Competitiveness Review

- Currently, Sec. 4 of "Draft CS SB 85 Version E 3-24-11"
- Establishes an Oil & Gas Competitiveness Review Board
  - Legislative, Executive and public members
  - Ongoing review Alaska enterprise model and make annual recommendations to the Legislature regarding changes "that would be conducive to increased and ongoing long-term investment in and development of the state's oil and gas resources"
- Provides forward looking radar to maintain ongoing investment in Alaska