ALASKA'S OIL ENTERPRISE MODEL: A POTENTIAL ALTERNATIVE

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

Commonwealth North Energy Action Coalition

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)

Oil Enterprise Models: Lease

- Primarily a US/Canadian approach
  - 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
  - Bonus, rent prior to development and percentage share of revenues to lessor (royalty) once production commences
  - Risk and cost of investment borne entirely by the lessee
    - In return, pace of investment largely left to lessee

Oil Enterprise Models: PSA

- General model for Investor Owned Company (IOC) participation outside US/Canada
  - Basic format similar to a lease, but with significantly different economic terms
- Format
  - Host government enters into contract (PSA) which grants to the producer (IOC) within a defined area (usually significantly larger than a US lease) the right to explore for, produce and develop the resource
  - Often combined with an NOC component
- Usual economic terms
  - Usually, IOC 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, IOC 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 IOC which provides that it will operate and submit recommendations for development of an identified field
  - Combined with an NOC component
- Usual economic terms
  - The NOC retains ownership and the risk and obligation of investment
  - The IOC 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 IOC's 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 IOC's (who participate under a PSA and often act as the operator)
  - Can be wholly or partially state owned; successful NOC's are increasingly investing outside national borders
- Usual 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 Joint Operating Agreement will provide that NOC has a carried interest or back in right (IOC's recover from NOC's share of production in the event of successful production)
  - 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 contract
  - 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 like Alaska)
- With ACES, Alaska essentially has converted to a PSC "profit oil" model, but without investor protections or negotiation
  - No "cost oil" provisions
  - No "economic stabilization" clause
  - Obligations and rights not contractually defined
- Producer response has been to reduce investment in new exploration and development substantially
  - Producers have reduced pace of activity in response to substantially increased (and uncompensated) risk and burden

A Potential Alternative

- The "Statoil" 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"
- 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 "Statoil Model"

- Statoil is the Norwegian NOC
  - Founded by the Government of Norway in1972
    - "… the authorities considered it strategically important to ensure Norwegian sovereignty over its … resources. The state oil company was given a special status by providing it with large holdings in new discoveries."
  - Partially privatized and made public in 2001; currently 67% government owned
- Independent of Government
  - Makes shareholder reports and dividends to Government, but operates independently (makes its own investment and dividend policies)
  - Partial public ownership reinforces independence
- Successful
  - Statoil is the13th largest overall, and the largest *offshore*, oil and gas company in the world
  - More importantly, has led the exploration and development of portions of Norway's oil and gas resources that otherwise were not attracting investment

Other NOC Models

- Not all NOC's successful
  - PdVSA (Venezuela)
  - NIOC (Iran)
  - NNPC (Nigeria)
  - PEMEX (Mexico)
- Key characteristics for success
  - Independence from government
    - No additional burdens
    - Assisted by including some public ownership
  - Focus on oil & gas

An Approach

- Given past success, fixing Alaska's lease model and restoring IOC investment is first option
- *But*, evaluating the "Statoil option" as part of the going forward mix may be useful
  - 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 necessarily need to become an operator, simply an investor
- Evaluation could be included as part of Sen. McGuire's proposed "competitiveness review"