Comments on SB 21/HB 72

Before the Senate and House Resources Committees

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Background

• Testifying on my own behalf
  – Not representing a client or being paid
  – Bearing my own expenses

• My background
  – Corporate executive (1984 – 1990)
  – Attorney
    • Thirty five years total (full time oil)
    • Been a partner in regional, national and global law firms
    • During my career, have advised major oil companies, mid-majors, small independents, industrial consumers
  – Write often on Alaska oil & gas issues (among others, column for Alaska Business Monthly)
Five things ...

- Competitive rates
- Durability
- Neutrality
- Simplicity/Predictability
- Alignment

Goal: Grow the pie
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- Art. VIII, Sec. 2
  "[t]he legislature shall provide for the ... development... of all natural resources belonging to the State... for the maximum benefit of its people."

- Not just current, but **all** generations

- From my perspective, an important question is what policy achieves the best return overall, not what produces the largest short term revenue stream

**Sample calculation (before NPV)**:

\[
7.5 \text{ Bbbl} \times \$29 = \$217.5 \text{ Billion} \\
3.6 \text{ Bbbl} \times \$34 = \$122.4 \text{ Billion}
\]

*Tax levels based on DOR/DNR SRES 2.15.2013 Presentation (p.5-6), includes royalty and production tax.*
Competitive Rates

• What are competitive rates
  – Those necessary to attract sustained, long term capital
  – Sufficient to move the decline curve to the right

• DNR Commissioner Sullivan

  "We need $4 billion [a year] minimum, and we’re not even close to that now ..."

February 18, 2013
Competitive Rates

- In order to attract sustained, long term capital, Alaska must be competitive across the full, anticipated, long term price range, not just a portion

- The problem with ACES is that it is uncompetitive at the higher ends of the range

- As currently constructed, SB 21/HB 72 may simply reverse the problem
Durability

• What is durability
  – Investors are able to rely on fiscal terms over full investment cycle
  – Substantial, decline rate changing investments contemplate 15 – 25 year payout

• SB 21/HB 72
  – No durability mechanisms included
    • Not established by contract
    • No economic stabilization clause
  – Somewhat internally unstable
    • 20% GRE (ELF experience)
Durability

Canadian approach: Long-term durability depends on producer involvement

“[BC Premier Christy] Clark said Wednesday she will not be able to discuss any of the proposals that are being considered for the new tax regime until after negotiations are complete.

“We have to make sure that, first of all, we are getting maximum benefit for the people of our province, and at the same time that we aren’t imperiling their business case,” she said.

“Because if we want to be competitive, we need to do that through the course of negotiations with (industry), so that’s what we’re working on right now.”

February 18, 2013
“In its 10-year fiscal plan, the state Office of Management and Budget (OMB) projects that spending the cash reserves might fill this gap until 2023 .... But what happens after 2023?”

“Reasonable assumptions about potential new revenue sources suggest we do not have enough cash in reserves to avoid a severe fiscal crunch soon after 2023, and with that fiscal crisis will come an economic crash. “

• SB21/HB 72 assumption of durability appears to be based on hope, not much more
Neutrality

• What is neutrality
  – Letting market decide what investments are best
  – Government bias impairs benefitting from changing technology and market dynamics

• Oil market is dynamic
  – New technology provides new access
  – New understanding of old information
  – Opportunities that might seem the best today are overtaken by new technology and understanding

• Providing incentives to some areas burdens others
Neutrality

- Alaska has significant potential in realizing improved recovery rates from existing fields
  - BP: "When production started at the Prudhoe Bay field the recovery rate of the 25 billion barrels of oil in place was expected to reach 40 percent. Today, using new technologies that estimate has increased to more than 60 percent."
  - Each 1% improvement in Prudhoe recovery rate equals an additional 250 MMbbls
- Consistent with focus elsewhere
  - Current emphasis in Norway

Estimated Undiscovered Conventional Oil Resources on Alaska North Slope

<table>
<thead>
<tr>
<th>Field</th>
<th>P10</th>
<th>P50</th>
<th>P90</th>
<th>Economically Recoverable @ $30/bbl</th>
<th>Expected Typical Field Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central North Slope</td>
<td>2,000</td>
<td>3,400</td>
<td>3,900</td>
<td>3,000</td>
<td>32 - 64</td>
</tr>
<tr>
<td>Beaufort Sea</td>
<td>400</td>
<td>8,200</td>
<td>23,200</td>
<td>5,800</td>
<td>-</td>
</tr>
<tr>
<td>Chukchi Sea</td>
<td>2,300</td>
<td>15,400</td>
<td>40,100</td>
<td>9,900</td>
<td>32 - 64</td>
</tr>
<tr>
<td>NPRA</td>
<td>400</td>
<td>900</td>
<td>1,700</td>
<td>500</td>
<td>64 - 128</td>
</tr>
<tr>
<td>ANWR</td>
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<td>15,400</td>
<td>15,500</td>
<td>9,900</td>
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</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>38,300</strong></td>
<td><strong>19,400</strong></td>
<td><strong>29,100</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: USGS Reports 2011-185 and 309-4112;
DOE/NNSA, Assessment of undiscovered technically recoverable oil and gas resources of the nation’s outer continental shelf

SB 21/HB 72
- Better than ACES, but still attempts to direct investments
- Favors investment in new fields (bill does significantly expand what is considered new)
- But burdens investments that are designed to increase ultimate recovery in old fields

February 18, 2013
Simplicity/Predictability

• What is simplicity
  – Easy to administer; not subject to significant interpretation/dispute
  – Easy to calculate and compare to other investment alternatives across a range of prices

• SB 21/HB 72
  – Structure much more simple than ACES
  – Meets global expectations for simplicity
  – GRE is a simple way to deal with preferred investments (if that is a valid goal)
Alignment

• What is alignment
  – Aligned with investors in growing the pie (moving the decline curve to the right)

• Alaska’s approach
  – Relies on indirect policy tools
    • Carrot (fiscal tools)/stick (regulatory action)
    • Relies on consultants for understanding of industry
    • Analogous to driving a car from the back seat
  – Not “in the game,” seeing shifts in market dynamics and identifying new opportunities

• SB 21/HB 72
  – Continues the same approach
  – Continues to look at the industry from the outside and use indirect policy tools
Alignment

• Current approach worked in a Prudhoe-dominated world
  – Uncertain it works as well in a dynamic environment dependent on continual investment
• There may be other ways, but the best I have seen in the world is Norway’s co-investment approach
  – Results in an intense and collaborative focus on developing state resources
  – Developed when Norway realized “royalty” model was not resulting in optimum investment

“The company’s main objective is to maximize the economic value of the state’s oil and gas portfolio on the basis of sound business principles. ...

... The company’s ability to create value is closely related to its ability to collaborate with and influence operators and other partners.”
Summary of Conclusions

*Better than ACES … but material concerns remain, more likely to result in short term than long term investments*

- **Competitive rates**
  - SB21/HB72 not competitive at full range of anticipated prices
  - “Mostly competitive” isn’t good enough when evaluating long term investments

- **Durability**
  - No mechanism included to ensure durability
  - State’s financial position creates significant concerns around long term durability

- **Neutrality**
  - Significantly reduced tilt, but some bias nevertheless remains against important investment opportunities

- **Simplicity/Predictability**
  - Substantially improved

- **Alignment**
  - Same approach as past policy, but with an uncertain effect in an increasingly dynamic and competitive world
Recommendations

• **Adopt SB 21/HB 72 with amendments:**
  – Make competitive across all anticipated price ranges, not just the higher end (avoid a tax increase at the lower end)
  – Provide GRE or similar incentives for investments designed to increase ultimate recovery in existing fields (enable them to compete on level playing field)

• **As important, identify fiscal policy concerns in forwarding the bill to Senate and House Finance Committees**
  – Changing tax policy without fiscal policy likely will encourage only short term investments
  – There are long term fixes: ISER “sustainable budget” model

• **Hold hearings on co-investment model**
  – Norway also made the shift from “royalty” to “co-investment” model
  – Compare against other ways of developing “forward looking radar” for Alaska
  – Evaluate potential contribution toward Commissioner Sullivan’s $4 billion goal