

**ALASKA STATE LEGISLATURE  
HOUSE SPECIAL COMMITTEE ON OIL AND GAS**

March 31, 2005

5:05 p.m.

**MEMBERS PRESENT**

Representative Vic Kohring, Chair  
Representative Ralph Samuels  
Representative Berta Gardner  
Representative Norman Rokeberg  
Representative Nancy Dahlstrom  
Representative Lesil McGuire

**MEMBERS ABSENT**

Representative Beth Kerttula

**OTHER LEGISLATORS PRESENT**

Representative Jay Ramras

**COMMITTEE CALENDAR**

HOUSE BILL NO. 224

"An Act relating to the sale or securitization of certain of the state's oil taken as royalty."

- MOVED HB 224 OUT OF COMMITTEE

HOUSE BILL NO. 234

"An Act relating to the due date for the payment of oil and gas royalty and net profit shares and amending the rate of interest payable on royalties or net profit shares."

- SCHEDULED BUT NOT HEARD

**PREVIOUS COMMITTEE ACTION**

BILL: HB 224

SHORT TITLE: SALE/SECURITIZATION OF STATE ROYALTY OIL

SPONSOR(S): REPRESENTATIVE(S) BERKOWITZ

03/18/05	(H)	READ THE FIRST TIME - REFERRALS
03/18/05	(H)	O&G, RES, FIN
03/31/05	(H)	O&G AT 5:00 PM CAPITOL 124

## **WITNESS REGISTER**

REPRESENTATIVE ETHAN BERKOWITZ

Alaska State Legislature  
Juneau, Alaska

POSITION STATEMENT: Presented HB 224 as sponsor.

REPRESENTATIVE MIKE HAWKER

Alaska State Legislature  
Juneau, Alaska

POSITION STATEMENT: Answered questions regarding HB 224 as cosponsor.

MARK MYERS, Director

Division of Oil and Gas  
Alaska Department of Natural Resources

POSITION STATEMENT: Answered questions regarding HB 224.

KURT GIBSON, Petroleum Investments Manager

Division of Oil and Gas  
Alaska Department of Natural Resources

POSITION STATEMENT: Answered questions regarding HB 224.

## **ACTION NARRATIVE**

**CHAIR VIC KOHRING** called the House Special Committee on Oil and Gas meeting to order at [5:05:26 PM](#). Representatives Kohring, Samuels, and Gardner were present at the call to order. Representatives Rokeberg, McGuire, and Dahlstrom arrived as the meeting was in progress.

### HB 224-SALE/SECURITIZATION OF STATE ROYALTY OIL

[5:06:09 PM](#)

CHAIR KOHRING announced that the only order of business would be HOUSE BILL NO. 224, "An Act relating to the sale or securitization of certain of the state's oil taken as royalty."

REPRESENTATIVE ETHAN BERKOWITZ, Alaska State Legislature, presented HB 224 as sponsor. He explained that the bill addresses the idea of the securitization of oil as well as gas, or "anything that the state sells or gets royalties off of." He noted that a few years ago the state chose to securitize money that it received from a tobacco settlement. He clarified that to securitize is to take future payments up front in a lump sum. He continued:

Some would argue there's a discounting that occurs because you haven't actually received the product, but yet there's others who might suggest that [it] could be a premium price because in the instance of oil, the price is so high today. ... It could bring an element of stability to the industry that everyone seeks.

REPRESENTATIVE BERKOWITZ explained that any time there is a sale of an asset, the buyer is essentially buying all of the reserves.

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CHAIR KOHRING asked if this has happened in other states.

REPRESENTATIVE BERKOWITZ replied that he hasn't heard of any other states that have securitized oil. However, he noted, "Alaska's in a unique position where it is our oil."

REPRESENTATIVE MIKE HAWKER, Alaska State Legislature, commented that the bill is a product of discussions among legislators over how the state might approach ways to stabilize oil and gas revenues and potentially lock in higher prices. He noted, "The bill was crafted to be a permissive bill, not a mandatory bill, in that it really is simply putting into statute here an authority for us to investigate this further, fully, and with the appropriate academic resources."

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REPRESENTATIVE ROKEBERG asked, "Is this kind of the GARVEE [Grant Anticipation Revenue Vehicles] bond of oil, ... where we're trying to create a financial instrument that ... generates near term cash with the risk elements of a long term instrument?"

REPRESENTATIVE BERKOWITZ replied:

It could be viewed that way. ... When people initially conceptualize securitization with Alaska's oil, they tend to go to the big picture and imagine we're going to securitize all our royalty. And it doesn't necessarily have to be viewed in that context; you could deal field by field, for example. And I think in some of the more marginal fields, securitization might prove to be an interesting way of bringing

stability for the producers and also getting the state out of the day-to-day management.

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REPRESENTATIVE HAWKER clarified that a GARVEE bond is a grant anticipation revenue vehicle in which [a state] will receive a federal grant in a fixed dollar amount in the future for a certain project. There are two big differences between a GARVEE grant anticipation vehicle and securitization, he said. One difference is that there is no assurance that the GARVEE bond would be met by those grants, while securitization is a commodities transaction more than a revenue anticipation transaction. Another difference is that the amount for a GARVEE bond is fixed, whereas with securitization there potentially is a way to hedge prices and lock in on high oil prices.

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REPRESENTATIVE SAMUELS asked for clarification.

REPRESENTATIVE HAWKER replied that securitization would actually be time limited; the state could securitize the royalties for a certain time frame for a certain reserve. He continued, "Now [industry has] paid you for that up front; if they do not develop it, don't produce it, don't get it downstream themselves, it sits in the ground and reverts to the sovereign at the expiration of the securitization term."

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REPRESENTATIVE ROKEBERG stated, "I'm rather astounded to think that you're considering developing a financial instrument based on nonproduced commodity."

REPRESENTATIVE HAWKER replied, "I would truly expect that the people making the investment would expect to produce. But the point is if they chose not to produce, the resource would still remain and ultimately revert to the sovereign."

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REPRESENTATIVE ROKEBERG noted that the state would benefit but he voiced concern about the investors.

REPRESENTATIVE BERKOWITZ stated, "If I wanted to get a securitized interest in something, I would buy from a producing field."

REPRESENTATIVE ROKEBERG asked if the sponsors had looked at the history of the security called PBT, Prudhoe Bay Trust, which is traded on the New York Stock Exchange against Prudhoe Bay oil.

REPRESENTATIVE HAWKER replied that he had not.

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REPRESENTATIVE ROKEBERG said, "Clearly when you're going to be creating some kind of financial instrument, you make assumptions about discounted rates at present values and managing risk." He asked how the sponsors proposed to manage the risk in [securitization].

REPRESENTATIVE BERKOWITZ responded that Representative Rokeberg was making the issue more complex than necessary. He continued, "If you put something on the market, and if you get a high enough bid for it, then you make the transaction; if you don't get a high enough bid, you don't make the transaction."

REPRESENTATIVE ROKEBERG stated that if [the state] can't guarantee industry the amount of recognized realized return by investor, there won't be any investors. He said, "To do that you're going to have to discount the flow that would be derived from the terms of the state arrangement with whoever the producer is. You're discounting your future cash flow, and you're giving something up that shifts the risk to the investor."

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REPRESENTATIVE BERKOWITZ reminded the committee that the state securitized a tobacco settlement.

REPRESENTATIVE ROKEBERG agreed and pointed out that he was a leading proponent of that action. He commented that the securitization of the tobacco settlement was primarily driven by risk elements and the state was "very fortunate to get some of the highest benefits by being early on." He continued:

Those types of ... instruments are no longer even marketable on Wall Street. But that was a major driving force behind that decision as a matter of

public policy, was to lower the risk to the State of Alaska to that income stream, thereby securitizing it and putting it on the market and shifting the risk to Wall Street, and we did good. I'm not sure the same scenario here comes into play, particularly if you get into a situation with a commodity that may have an upside potential for raising prices, you're going to be giving it away and the investor will be betting that you're wrong.

REPRESENTATIVE HAWKER reiterated that the bill is a permissive bill that would allow the "best minds in the state" to investigate the possibility or securitization, and if it has merit, the state could propose a transaction.

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CHAIR KOHRING closed public testimony.

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MARK MYERS, Director, Division of Oil and Gas, Alaska Department of Natural Resources, commented:

One of the concerns I would have is that ultimately the state has to recognize it's not the producer; it doesn't ultimately control the rate of production. We have a say in it through our plan to development, but on a day-to-day basis the operations belong to the producers of that particular field. So if the state were to sell, it doesn't really have the ability to guarantee x amount of barrels on a given day, and that might be a problem in terms of cash flow for someone who has a limited option in time for a volume of oil.

Also, under our current requirements for royalty in kind sales, and this would be a type of royalty in kind sale, ... in the ground is a little bit different than actually selling at Pump Station One, as we normally do. But we have a requirement to achieve the royalty in value as a benchmark. So it's going to be very hard for us to benchmark when there'd be a net benefit to the state because, again, we're not going to be able to predict prices, [nor] are we really going to know how much of a discount a person's going to have to take in buying the commodity....

Generally these types of deals would have to be significantly discounted, probably, over the expected market value to make sure that your investment was secure. So I do think there's a potential conflict with our physical and economic way standard. Again, if you have a contract and you're trying to deliver as much oil as you can in a period, it may lead the state ... to a position where it's in conflict on the physical and economic way standards in terms of the rates of productions and the off-take rates of both oil and gas.

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KURT GIBSON, Petroleum Investments Manager, Division of Oil and Gas, Alaska Department of Natural Resources, asked if the purpose of the bill was to use the securitization as a form of price hedging, and if so, if there was another way to go about establishing a price hedging mechanism without securitization because, he noted, the two are not necessarily linked.

REPRESENTATIVE HAWKER replied, "The intent of this bill is simply to grant the state the authority to investigate the merits or the demerits of this sort of transaction in all of the permutations that it might be constructed ... [that may provide] any benefit to the State of Alaska."

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REPRESENTATIVE BERKOWITZ commented that price hedging wasn't his original intent for the bill. He turned the committee's attention to AS 38.06.010, which is the purpose section for the Alaska Royalty Oil and Gas Development Advisory Board, which says:

It is the purpose of this chapter to facilitate the wise development of Alaska's oil and gas royalty interests by providing means and procedures for sales, exchanges, or other disposition of those interests in ways calculated to promote private economic growth consistent with applicable environmental standards and public fiscal stability, and in accordance with AS 38.05.183.

REPRESENTATIVE BERKOWITZ commented that there are many ways to point out problems with any kind of different way of looking at disposing of a state asset. However, he said:

if we're going to be consistent with exploring the wise development of Alaska's oil and gas royalty interests, we ought to give the [Alaska Royalty Oil and Gas Development Advisory Board] the widest latitude possible, and let the people that are trained ... in this area make a choice and bring those choices to the legislature. ... I can conceive of a situation where we could dispose of a considerable amount of our royalty interests for a large sum of money, which would provide, for example, a pot ... [where] the revenue off of that pot would be sufficient to help bridge the state's fiscal gap.

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CHAIR KOHRING noted, "I can also foresee the state incurring some major risk because you really don't know what's in the ground unless you have some very competent people to get in there and do some very thorough analyses to see what we really have there."

REPRESENTATIVE BERKOWITZ agreed that there would be risk involved, yet he pointed out that year after year there are more transactions occurring in the oil fields. He continued:

There are lease transactions on a regular basis, so clearly the industry has the means and the ability to make these kinds of transactions, to make these assessments, and the state had some understanding of what goes on with those kind of transactions and ought to have as wide a latitude as possible to dispose of our interests or to protect our interests. ... We can have a better idea of the value of our property if we contemplate what securitization would bring to us.

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REPRESENTATIVE SAMUELS asked Mr. Gibson to clarify the difference between hedging and securitization.

MR. GIBSON explained, "The primary difference is ... when you contemplate securitization, you're exchanging a series of payments for a single lump sum. But the prospect of hedging price risk simply suggests that you agree on a forward price for a commodity and then continue to receive a series of payments at

that price." In response to Representative Samuels, he clarified:

The key distinction, I think, would be the discount rate. ... In both cases you've got a series of payments. When you securitize you exchange the series of payments for a lump sum; in order to determine what the present value of that series of payments is, you have to establish a discount rate. In either case you have to establish a forward price. In one case you're continuing to receive a series of payments but you've agreed upon a price; you're no longer floating with the market. In the case of securitization, not only are you agreeing on a forward price, you're agreeing on how you're going to discount that price and take it in a single lump sum payment today.

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REPRESENTATIVE ROKEBERG asked Mr. Gibson if he had ever seen anything like this done. He remarked that he thought there would be a high discount rate and the state would give up substantial amounts of future income.

MR. GIBSON responded that there would have to be a substantial discount rate to accommodate the price volatility. He noted that he has never seen a sovereign sell its royalty on a securitized arrangement. In response to Representative Rokeberg, he stated that he is not aware of any other commodity that has been securitized, noting that his familiarity is primarily with oil, gas, and deregulated power.

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REPRESENTATIVE BERKOWITZ commented that there is indication that the Republic of Congo and Mexico both have done this.

CHAIR KOHRING asked if the sponsors have asked industry representatives what they think about this bill.

REPRESENTATIVE BERKOWITZ replied that he has had preliminary conversations with different members of industry and has heard mixed responses, ranging from distrust of the state to interest in the idea.

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REPRESENTATIVE ROKEBERG asked the sponsors why they chose securitization over the hedging concept.

REPRESENTATIVE BERKOWITZ explained that he opted for securitization because preliminary numbers indicated that this was an option worth pursuing. He continued:

If someone wants to talk about hedging as another alternative, I'm not adverse to that. I think the state should have at its disposal every possible tool when it comes time to getting the most value from our resource. And there are different ways of assessing whether we get the most value. And I would argue that we have a constitutional requirement to get maximum value, even if it requires us to make some hard choices and go through some difficult protocols, which is what I heard might be some of the concerns with the securitization.

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REPRESENTATIVE ROKEBERG responded that he too believes that [legislators] have a responsibility to generate a secure income stream for the state. He asked if the sponsors would consider adopting "some type of a studying task force or commission or something to look into this as well hedging and these other issues." He commented:

What we have in terms of the bill here is a suggestion that we turn over the responsibility to the [Alaska Royalty Oil and Gas Development Advisory Board] to make a public policy. I'm not sure that's the right thing we should do statutorily, when in fact this decision should be made in the legislature. ... If this concept has any merit, I think it does deserve further study rather than just devolving our rights to another agency.

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REPRESENTATIVE BERKOWITZ commented that the bill is written in a permissive way. He reiterated that because [the legislators] have a constitutional obligation to get maximum value from the state's resources, "it seems almost incumbent upon the commissioner of [the Alaska Department of Natural Resources (DNR)] to pursue an investigation whether securitization does bring maximum benefit to the state from our resources." He

continued, "I think if [DNR personnel] haven't taken a look at securitization, they've been remiss in their responsibility." He commented that the preliminary numbers [of projected income from securitization] are very high.

REPRESENTATIVE HAWKER remarked that he would be happy to arrange more informal discussions [with committee members]; however, he said that he would be uncomfortable presenting the preliminary numbers to the committee as a statement of fact.

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REPRESENTATIVE ROKEBERG commented that he is more interested in hedging strategies than in securitization.

REPRESENTATIVE BERKOWITZ pointed out that one of the advantages of securitization is that it could be applied on a field-by-field basis. He said, "It's another option for investment in the state, and it offers the state another way of providing stability."

[5:42:16 PM](#)

REPRESENTATIVE HAWKER replied to Representative Rokeberg:

I don't believe that these financial strategies are mutually exclusive; it is not one or the other. ... I think we have an absolute obligation ... to pursue all strategies that may benefit the state. And I would personally be very happy to work with you on pursuing a hedging strategy as well as this strategy. I think the more ... investigations we put on the table the farther we can take every one of these issues, [and] the more comfortable we can get the public with the state participating in some very sophisticated capital markets.

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CHAIR KOHRING asked for the opinion of the committee regarding the bill.

REPRESENTATIVE ROKEBERG replied, "I'm not at all comfortable moving this bill right now because I'm not sure what it really does. It may give the royalty board the license to gamble right now; without a little more oversight and direction from the legislature, I'm not at all comfortable moving it on."

CHAIR KOHRING suggested the concept of making any transaction that the commissioner may engage in subject to legislative approval.

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REPRESENTATIVE BERKOWITZ pointed out that any long-term sale of more than a single year's worth of royalty currently requires legislative approval.

CHAIR KOHRING clarified that on page 1, line 9 of HB 224 the word "commissioner" refers to the DNR commissioner.

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REPRESENTATIVE DAHLSTROM moved to report HB 224 out of committee with individual recommendations.

[5:47:53 PM](#)

REPRESENTATIVE ROKEBERG stated, "I won't object to moving the bill but I'm going to be signing 'Do not pass,' for the record."

There being no objection, HB 224 was reported from the House Special Committee on Oil and Gas.

#### **ADJOURNMENT**

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at [5:48:46 PM](#).

