

2/09/12
JUDGE
GLEASON' S
DECISION: AN
ALTERNATIVE
PERSPECTIVE
BY BRADFORD
KEITHLEY

<TARGET><BILL></BILL><SUBJECT>2-09-12 JUDGE GLEASON'S
DECISION AN ALTERNATIVE PERSPECTIVE BY BRADFORD
KEITHLEY</SUBJECT><COMM>SRES27</COMM></TARGET>



Bradford (Brad) G. Keithley | Partner

Brad Keithley is a partner and co-head of the Oil & Gas practice at Perkins Coie. He is based in the firm's Anchorage and Washington, D.C. offices. Prior to joining Perkins Coie, Brad was a partner for 18 years with the global law firm of Jones Day, based primarily in the firm's Dallas and Houston offices, and before that was senior vice president and general counsel of Arkla, Inc., at the time the third largest gas company in the United States (and now part of CenterPoint Energy Inc.). Brad started his career as an attorney advisor in the Office of the General Counsel to the Secretary of the Air Force, after which he joined and became a partner with Hall, Estill, Hardwick, Gable, Collingsworth & Nelson, in Tulsa, Oklahoma.

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EDUCATION

- ▣ University of Virginia
School of Law, J.D., 1976
Notes Editor, *Journal of International Law*
- ▣ University of Tulsa, B.S., 1973

BAR ADMISSIONS

- ▣ Virginia
- ▣ District of Columbia
- ▣ Oklahoma
- ▣ Alaska

COURT ADMISSIONS

- ▣ U.S. Supreme Court
- ▣ U.S. Court of Appeals for the District of Columbia Circuit

Throughout his career, Brad's practice has been concentrated in the areas of oil & gas regulation, commercial transactions and litigation. His clients have included major oil & gas companies, oil & gas pipelines, large and medium independents, as well as major consumers of natural gas. During the last ten years, Brad's practice has focused primarily on matters related to Alaska oil & gas, international and U.S. LNG issues, matters related to oil & gas exploration, and development and production on U.S. federal lands and waters. Brad is a past co-chair of the Institute of Energy Law's Annual Oil & Gas Law Conference and was a founding co-chair of the Institute's Annual Law of LNG Conference.

PROFESSIONAL RECOGNITION

- ▣ Ranked by *Chambers USA*, as "America's Leading Business Lawyers," 2004 - 2008, 2010
- ▣ Ranked by *Chambers USA*, as "America's Leading Environment & Natural Resources Lawyers," 2011

PROFESSIONAL LEADERSHIP

- ▣ Center for American and International Law, Institute for Energy Law, Advisory Committee, 2000 - Present; Oil & Gas Committee, 2002 - Present
- ▣ Center for American and International Law, Institute for Energy Law, Annual Conference on the Law of LNG, Co-Chair, 2004 - 2005
- ▣ Center for American and International Law, Institute for Energy Law, Oil & Gas Committee, Chair, 2003
- ▣ Center for American and International Law, Institute for Energy Law, Annual Oil &

Gas Law Conference, Co-Chair, 2001 - 2002

- ▣ Rocky Mountain Mineral Law Foundation
- ▣ Energy Bar Association

COMMUNITY INVOLVEMENT

- ▣ University of Virginia School of Law Annual Giving Campaign, National Chair, 2010 - present
- ▣ Regional University System of Oklahoma, Ad Hoc Committee on System Development, 2005 - 2007

RELATED EMPLOYMENT

- ▣ Jones Day, Dallas and Houston, TX, Partner, 1990 - 2008
- ▣ Arkla, Inc., Little Rock, AR and Shreveport, LA, Senior Vice President & General Counsel, 1987 - 1990; Vice President & General Counsel, 1984 - 1987
- ▣ Hall, Hardwick, Gable, Collingsworth & Nelson, Tulsa, OK, Partner, 1981 - 1984; Associate, 1978 - 1981
- ▣ Secretary of the Air Force, Office of the General Counsel, Attorney/Advisor, 1976 - 1978

PAST EVENTS

12.01.2011 - **Issues Relating to Developing Federal Lands**
12.02.2011 **and Waters in Alaska**
Speaking Engagement
Law Seminars International
William A. Egan Civic & Convention Center / Anchorage, AK

12.06.2010 - **The Sixth Annual Comprehensive**
12.07.2010 **Conference on Energy in Alaska**
Speaking Engagement
Dena'ina Civic & Convention Center / Anchorage, AK

12.07.2009 **Meeting the Challenge of Extracting and**
Getting Alaska's Natural Resources to Market
Speaking Engagement
William A. Egan Civic & Convention Center / Anchorage, AK

Judge Gleason's Decision: An Alternate Perspective

*Bradford G. Keithley
Partner & Co-Head, Oil & Gas Practice
Perkins Coie LLP*

August 9, 2012

Disclaimers

- The opinions expressed here are entirely my own; not speaking on behalf of any client
- Not involved in the case, but monitored the case and have studied the decision closely because of its potential impact on Alaska
- Not here to challenge or dispute the logic or conclusion of the opinion

Agenda

- Background
- What the decision says
- What the decision doesn't say
- The implications for the future

Background of the Case

- State court dispute over the valuation of TAPS for property tax purposes
- Parties: Alyeska v. the North Slope Borough, Fairbanks North Star Borough and Valdez (and the Alaska Dep't of Revenue)
- Life of TAPS is relevant to TAPS economic value and accumulated depreciation
- Decision subject to appeal to the Alaska Supreme Court

What the Decision Says

- Judge Gleason found that the value of TAPS for property tax purposes was \$8.94 B (2007), \$9.64 (2008), \$9.24 (2009)
- In the course of determining those values, concluded that “the life of TAPS based on its proven reserves and incorporating its minimum capacity throughput limitations as of ... 2007, 2008 and 2009 is at least until 2065.”
- Based on her conclusion that TAPS can continue to accommodate flows as low as 70,000 bbl/d

What the Decision Doesn't Say

- The decision doesn't say anything about current or reasonably foreseeable production levels
 - The decision simply says that the production tail will continue longer
- The decision also doesn't say anything about the effect of declining production on the state's economic well being
 - The decision doesn't speak to state revenue

The Implications

- Joe Balash has it right ...
 - “Deputy Natural Resources Commissioner Joe Balash said *a 300,000-barrel a day throughput scenario ... would be a ‘disaster,’* because at that level, the state budget would be in a ‘dire deficit.’”
 - Becky Borher (AP), Fairbanks Daily News-Miner, Jan. 8, 2012 (17 paragraphs into the story).
- To paraphrase James Carville from the 1992 Presidential campaign
 - In Alaska, “It’s the production rate ...”
 - ... not the reserve life

Current ANS Production Forecast

Figure 4-11. Alaska North Slope Production, FY 2011 and Forecasted FY 2012-2021⁽¹⁾ (million barrels per day)

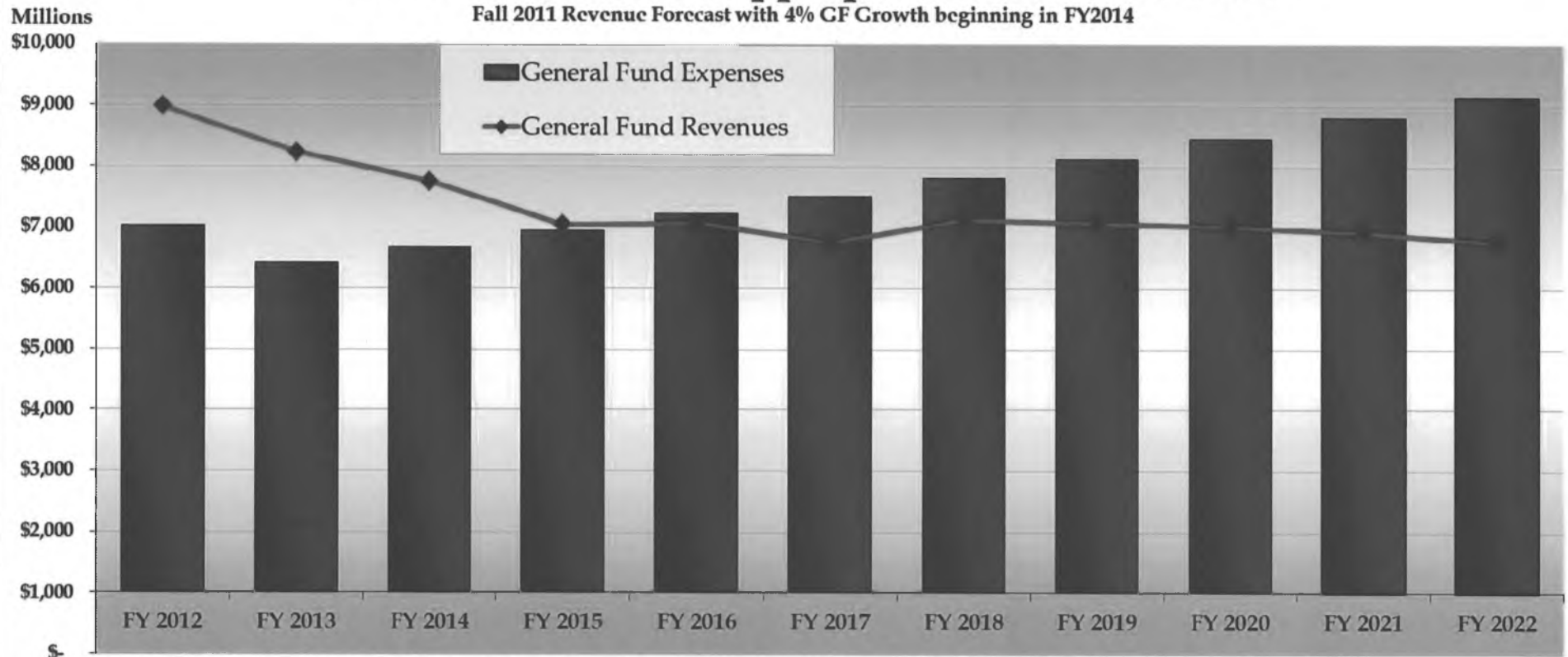
Fiscal Year	Currently Producing	Percent Change from Prior Yr.	Under Development	Under Evaluation	Total ANS	Percent Change from Prior Yr.
2011	0.603	(6.3%)	0.000	0.000	0.603	(6.3%)
2012	0.548	(9.1%)	0.026	0.001	0.574	(4.7%)
2013	0.485	(11.6%)	0.069	0.001	0.555	(3.3%)
2014	0.451	(6.9%)	0.099	0.010	0.561	1.0%
2015	0.406	(10.0%)	0.115	0.017	0.538	(4.1%)
2016	0.369	(9.1%)	0.151	0.029	0.550	2.1%
2017	0.336	(9.1%)	0.179	0.034	0.549	(0.1%)
2018	0.307	(8.5%)	0.171	0.066	0.544	(0.9%)
2019	0.282	(8.1%)	0.166	0.066	0.515	(5.4%)
2020	0.262	(7.4%)	0.164	0.061	0.486	(5.6%)
2021	0.241	(7.7%)	0.161	0.056	0.458	(5.8%)

⁽¹⁾ Some of the oil forecasted in the Under Development and Under Evaluation categories are from new projects in fields currently producing.

Scenario 3: Governor's FY2013 Budget with 4% Annual GF Expenditure Growth beginning in FY2014

GF Revenue versus Appropriations FY12 to FY22

Fall 2011 Revenue Forecast with 4% GF Growth beginning in FY2014



Annual appropriations exclude deposits to Public Education Fund and other special purpose appropriations such as to the Constitutional Budget Reserve or Statutory Budget Reserve.

Source: Office of Management and Budget FY2013 10-Year Plan (p. 13)

Scenario 3: Governor's FY2013 Budget with 4% Annual GF Expenditure Growth beginning in FY2014

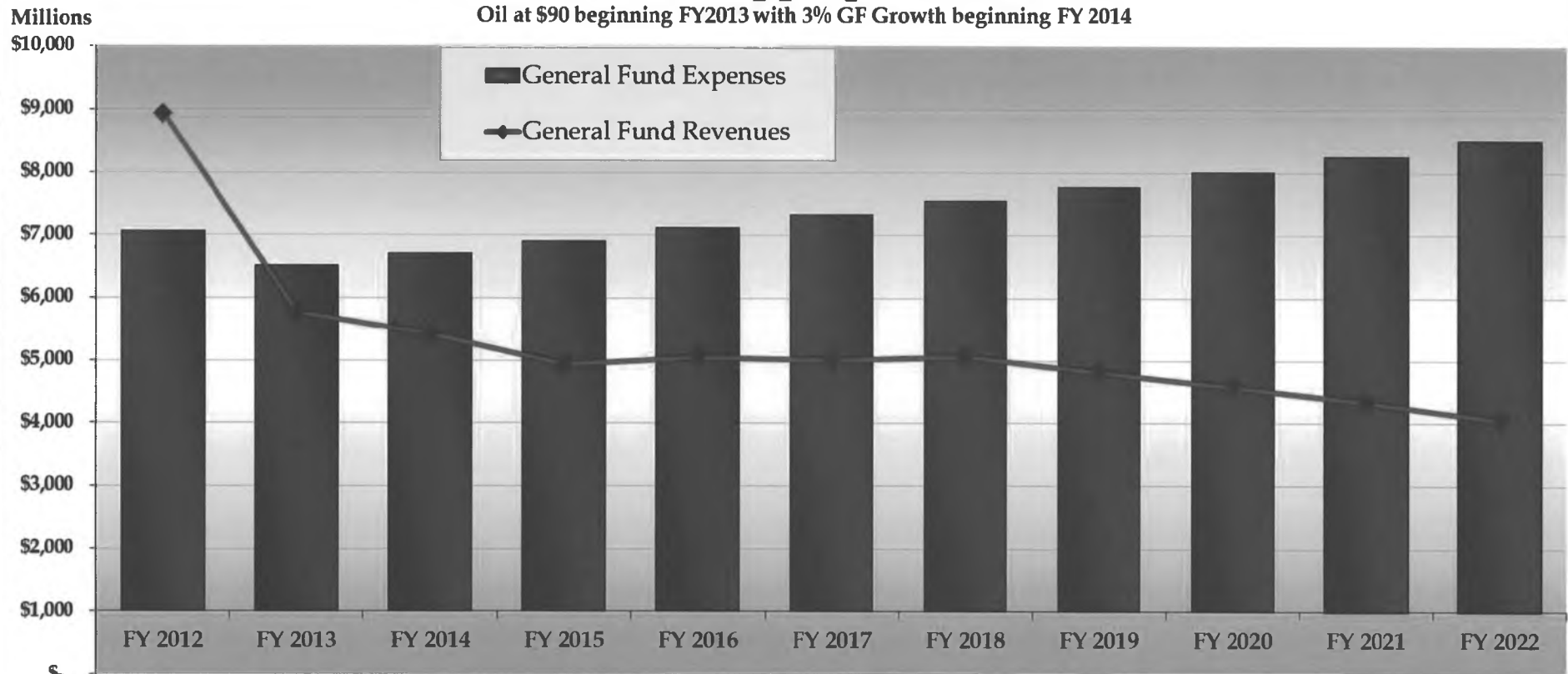
Oil Price & Production	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Fall 2011 forecast ANS West Coast (\$/bbl.)	\$108.98	\$109.47	\$109.08	\$108.75	\$107.79	\$106.05	\$108.76	\$111.54	\$114.39	\$117.31	\$120.31
Fall 2011 forecast ANS production (mmbbl./day)	0.574	0.555	0.561	0.538	0.550	0.549	0.544	0.515	0.486	0.458	0.432
Revenue vs. Spending (\$millions)											
General Fund Revenues ^{1/}	\$8,981.8	\$8,217.7	\$7,742.8	\$7,043.4	\$7,065.5	\$6,738.9	\$7,125.0	\$7,070.4	\$7,012.1	\$6,917.5	\$6,757.0
General Fund Expenses	\$7,041.8	\$6,430.2	\$6,687.4	\$6,954.9	\$7,233.1	\$7,522.4	\$7,823.3	\$8,136.3	\$8,461.7	\$8,800.2	\$9,152.2
Budget Surplus/Shortfall	\$1,940.0	\$1,787.5	\$1,055.4	\$88.5	\$167.6	\$783.5	\$698.3	\$1,065.9	\$1,449.6	\$1,882.7	\$2,395.2
Reserve Balances (\$millions)											
CBRF Main Account Balance End of Year	\$5,408.7	\$5,615.9	\$5,830.2	\$6,051.9	\$6,281.3	\$6,518.6	\$6,764.1	\$7,018.0	\$7,280.8	\$7,552.6	\$6,703.9
CBRF Subaccount Balance End of Year	\$4,972.2	\$5,323.6	\$5,700.0	\$6,102.9	\$6,534.4	\$6,996.3	\$7,490.9	\$8,020.4	\$8,587.4	\$9,194.5	\$9,844.4
CBRF Total	\$10,380.9	\$10,939.5	\$11,530.2	\$12,154.8	\$12,815.6	\$13,514.9	\$14,254.9	\$15,038.4	\$15,868.2	\$16,747.0	\$16,548.3
Statutory Budget Reserve Balance	\$4,402.1	\$6,189.5	\$7,245.0	\$7,333.5	\$7,165.9	\$6,382.4	\$5,684.1	\$4,618.2	\$3,168.6	\$1,285.9	\$0.0
TOTAL RESERVES	\$14,783.0	\$17,129.1	\$18,775.2	\$19,488.3	\$19,981.6	\$19,897.3	\$19,939.0	\$19,656.6	\$19,036.7	\$18,033.0	\$16,548.3

Source: Office of Management and Budget FY2013 10-Year
Plan (p. 14)

Scenario 2: Revenue@\\$90 oil FY2013 Governor's Budget plus 3% Annual Growth beginning FY2014

GF Revenue versus Appropriations FY12 to FY22

Oil at \$90 beginning FY2013 with 3% GF Growth beginning FY 2014



Annual appropriations exclude deposits to Public Education Fund and other special purpose appropriations such as to the Constitutional Budget Reserve or Statutory Budget Reserve.

Source: Office of Management and Budget FY2013 10-Year Plan (p. 11)

Scenario 2: Revenue@ \$90 oil FY2013 Governor's Budget plus 3% Annual Growth beginning FY2014

Oil Price & Production	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Fall 2011 forecast ANS West Coast (\$/bbl)	\$108.98	\$90.00	\$90.00	\$90.00	\$90.00	\$90.00	\$90.00	\$90.00	\$90.00	\$90.00	\$90.00
Fall 2011 forecast ANS production (mmbbl./day)	0.574	0.555	0.561	0.538	0.550	0.549	0.544	0.515	0.486	0.458	0.432
Revenue vs. Spending (\$millions)											
General Fund Revenues ^{1/}	\$8,981.8	\$5,775.3	\$5,414.2	\$4,926.1	\$5,049.8	\$5,001.6	\$5,056.2	\$4,807.1	\$4,574.3	\$4,331.3	\$4,041.2
General Fund Expenses	\$7,041.8	\$6,430.2	\$6,623.1	\$6,821.8	\$7,026.5	\$7,237.2	\$7,454.4	\$7,678.0	\$7,908.3	\$8,145.6	\$8,390.0
Budget Surplus/Shortfall	\$1,940.0	\$654.9	\$1,208.9	\$1,895.7	\$1,976.6	\$2,235.7	\$2,398.2	\$2,870.9	\$3,334.1	\$3,814.3	\$4,348.7
Reserve Balances (\$millions)											
CBRF Main Account Balance End of Year	\$5,408.7	\$5,615.9	\$5,830.2	\$6,051.9	\$4,922.3	\$2,835.4	\$510.9	\$0.0	\$0.0	\$0.0	\$0.0
CBRF Subaccount Balance End of Year	\$4,972.2	\$5,323.6	\$5,700.0	\$6,102.9	\$6,534.4	\$6,996.3	\$7,490.9	\$5,801.2	\$2,771.7	\$0.0	\$0.0
CBRF Total	\$10,380.9	\$10,939.5	\$11,530.2	\$12,154.8	\$11,456.7	\$9,831.7	\$8,001.8	\$5,599.7	\$2,771.7	\$0.0	\$0.0
Statutory Budget Reserve Balance	\$4,402.1	\$3,747.2	\$2,538.2	\$642.5	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
TOTAL RESERVES	\$14,783.0	\$14,686.7	\$14,068.4	\$12,797.4	\$11,456.7	\$9,831.7	\$8,001.8	\$5,599.7	\$2,771.7	\$0.0	\$0.0

Source: Office of Management and Budget FY2013 10-Year Plan (p. 12)



Shell sees oil lows of \$70 in 2012 volatility Oil giant reports 54% jump in 2011 profits despite tough final quarter

BY EMILY GOSDEN, THE TELEGRAPH FEBRUARY 2, 2012

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STORY

PHOTOS (1)



Shell's chief executive, Peter Voser, outlined an aggressive long-term growth strategy, focused on 'upstream' exploration and production. He said the strategy would help Shell ride out volatility and increase cash flow by up to 50pc over the next four years. It would spend

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MORE ON THIS STORY

- Global oil prices mixed on U.S. demand, Iran
- Current oil price
- Herald topic: Royal Dutch Shell
- Be a Source for the Calgary Herald,

... maybe even
Scenario 2 is
too optimistic

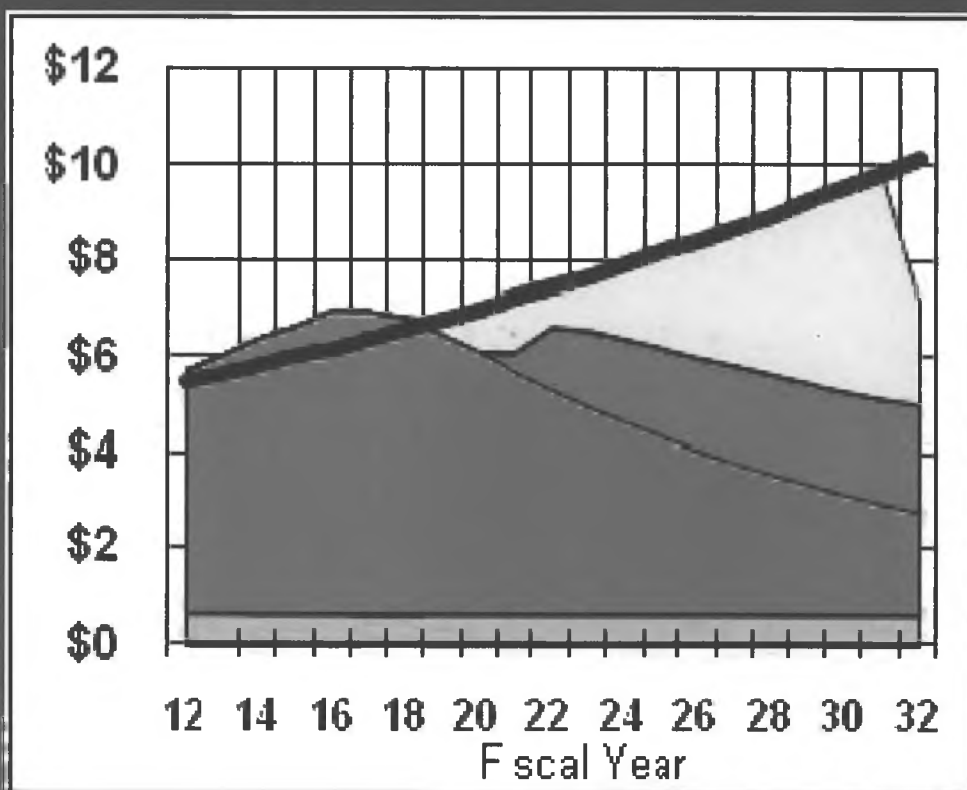
Another perspective ...

- The Administration's 10-year forecast only goes out to 2022
- Last year, Scott Goldsmith of UAA's Institute of Social and Economic Research (ISER) extended last year's forecast on out another ten years ...

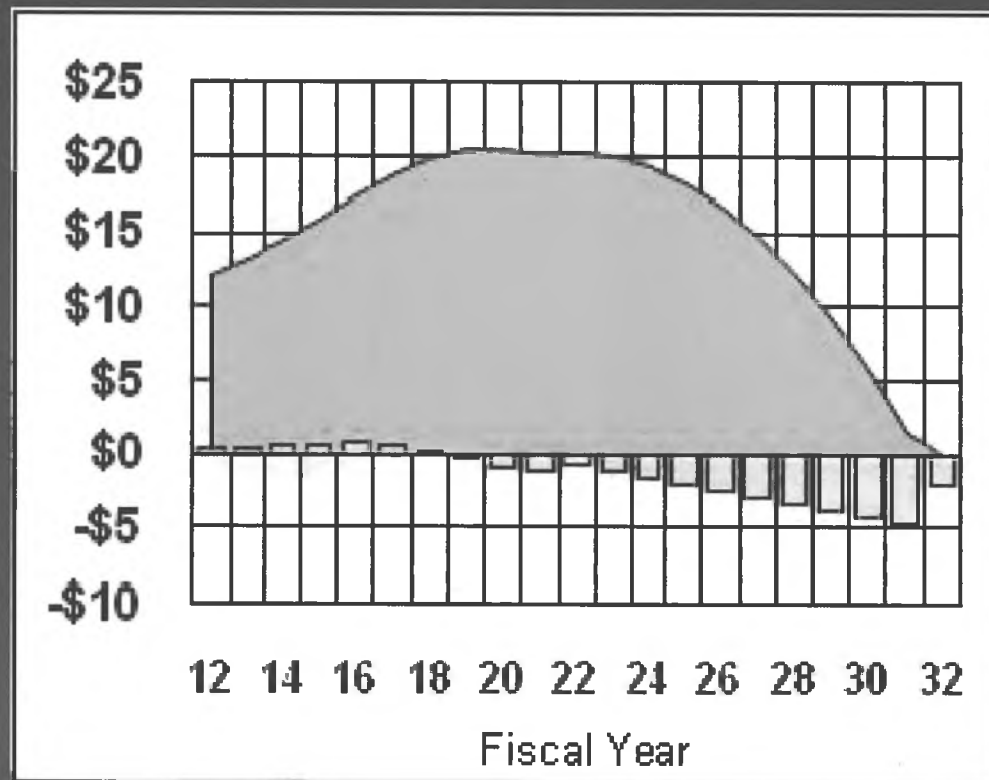
OMB FISCAL PLAN—EXTENDED

(2012 Billion \$, includes gas monetization)

GF Projection



Financial Reserve

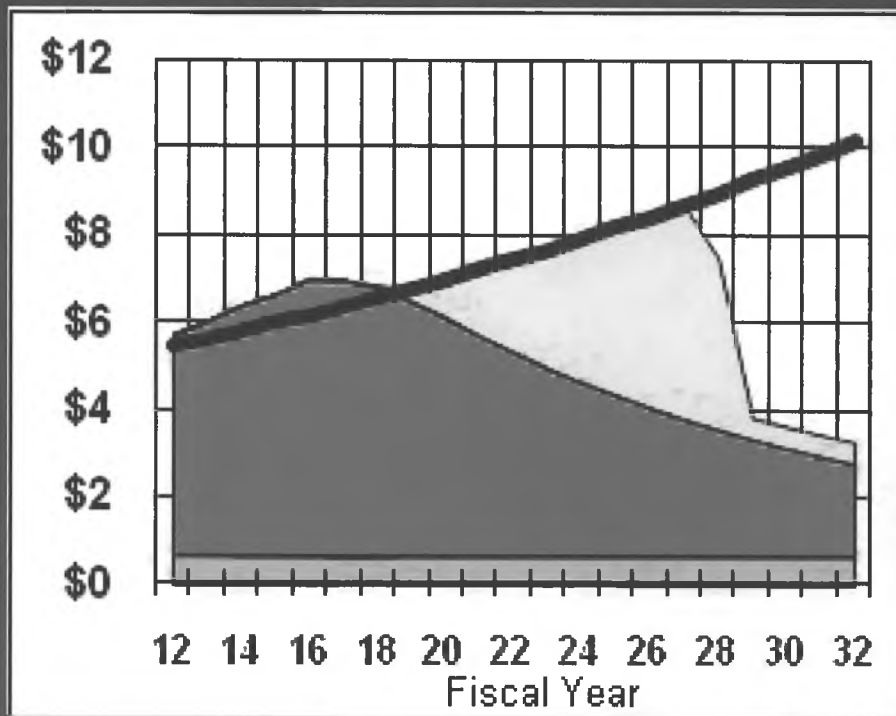


Source: *Revising the State Fiscal Plan to Account for Petroleum Wealth, Web Note No. 9, Institute of Social and Economic Research University of Alaska Anchorage by Scott Goldsmith (p. 5, 2011)*

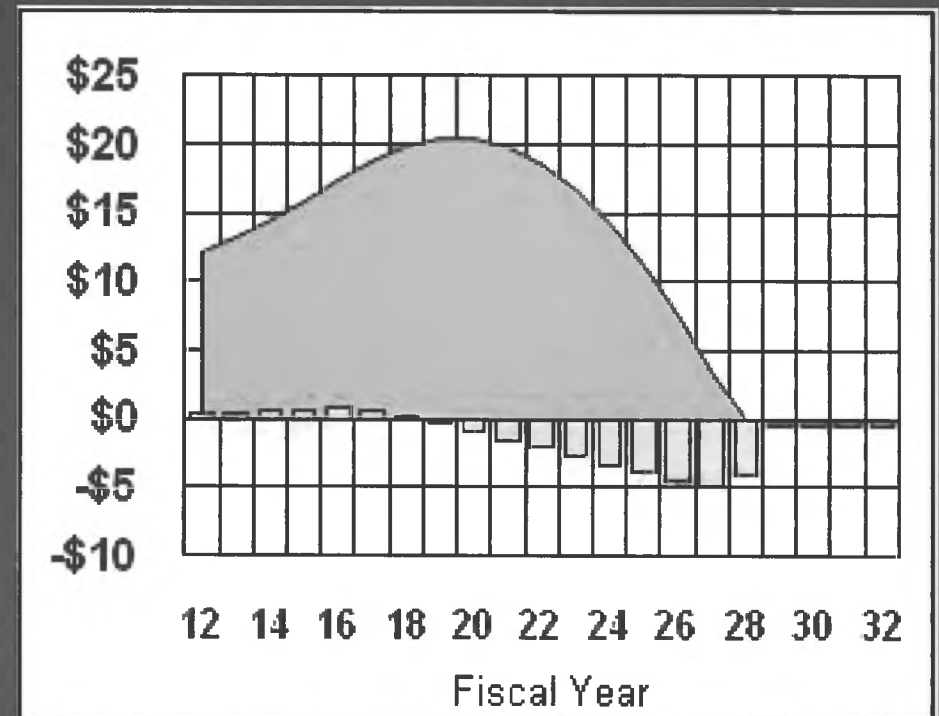
OMB FISCAL PLAN—EXTENDED

(2012 Billion \$, no gas)

GF Projection



Financial Reserve

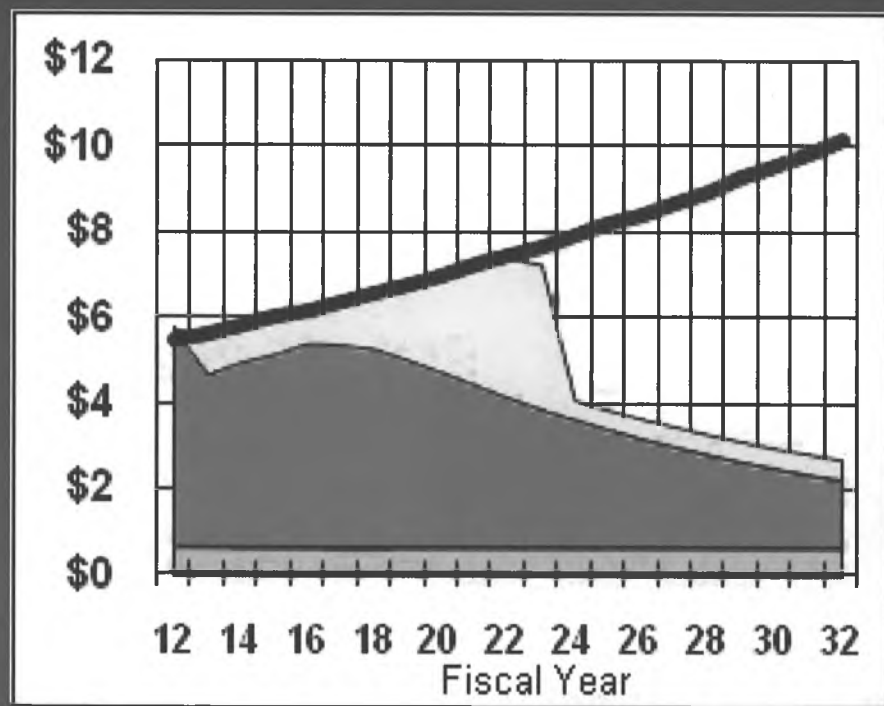


Source: *Revising the State Fiscal Plan to Account for Petroleum Wealth, Web Note No. 9, Institute of Social and Economic Research University of Alaska Anchorage by Scott Goldsmith (p. 5, 2011)*

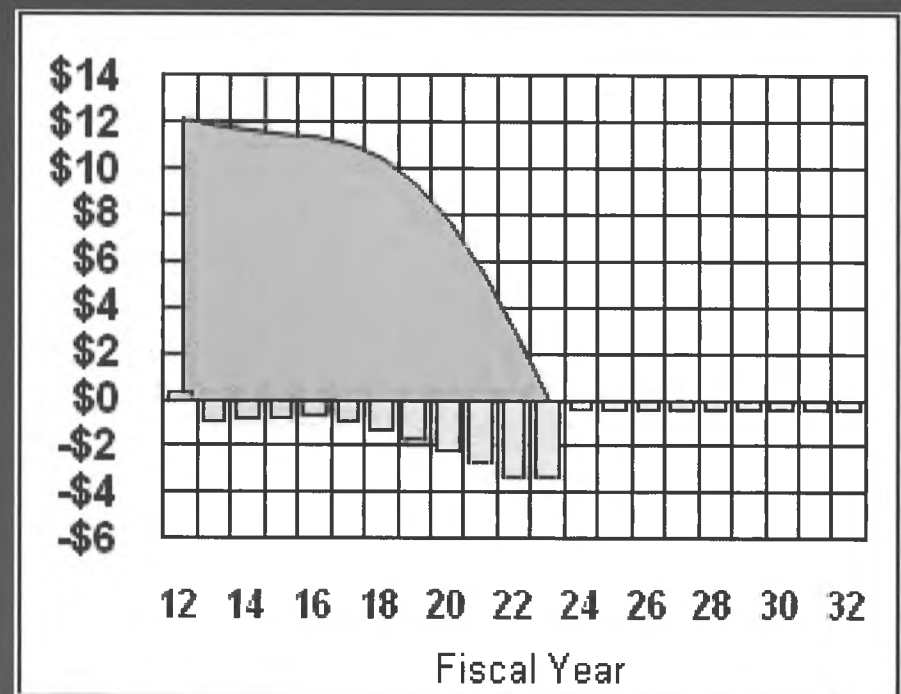
OMB FISCAL PLAN—EXTENDED

(2012 Billion \$, no gas/75% of oil price)

GF Projection



Financial Reserve



Source: *Revising the State Fiscal Plan to Account for Petroleum Wealth*,
Web Note No. 9, Institute of Social and Economic Research
University of Alaska Anchorage by Scott Goldsmith (p. 5, 2011)

Other Consequences of the Decision

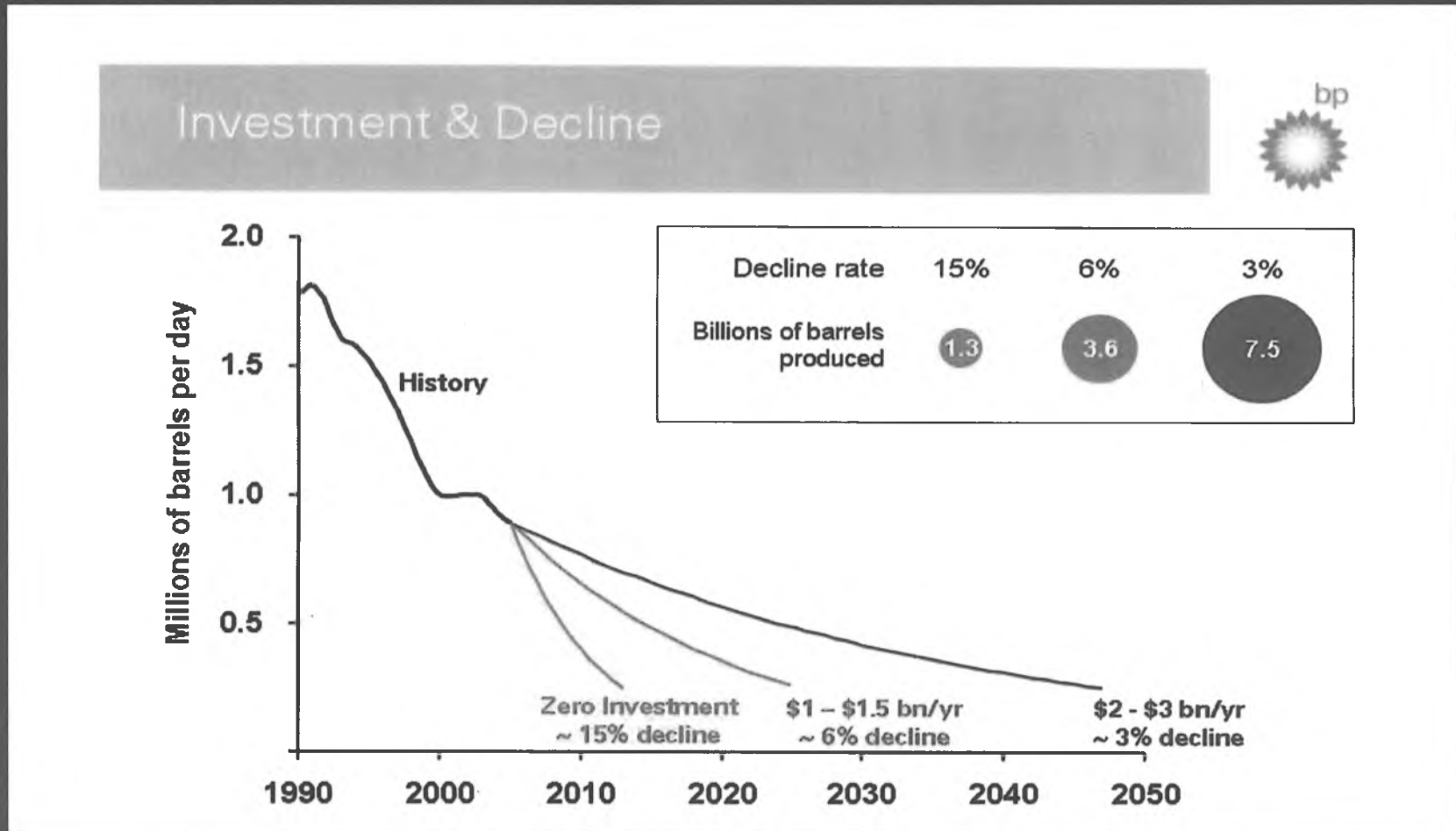
- Increases TAPS rates
 - Roughly 25% of current TAPS rates are to recover ad valorem taxes; increased taxes, increased rates
- Decision disproportionately benefits NSB, Fairbanks and Valdez; hurts State
 - Increased TAPS rates reduce royalty and production taxes
- Significant additional tax hike on industry
 - Reinforces perception of unpredictable and litigious Alaska business environment

Conclusion

- Judge Gleason's Decision ...
 - ... says nothing about which decline curve Alaska is on
 - ... at most, the decision merely says that the tail end of the decline curve may be extended longer than some have previously forecast
- In short, the person that turns the lights off on Alaska's economy can stay a few more years, but the remainder will have left long before

Back Up Slides

Alaska's Three Alternative Futures

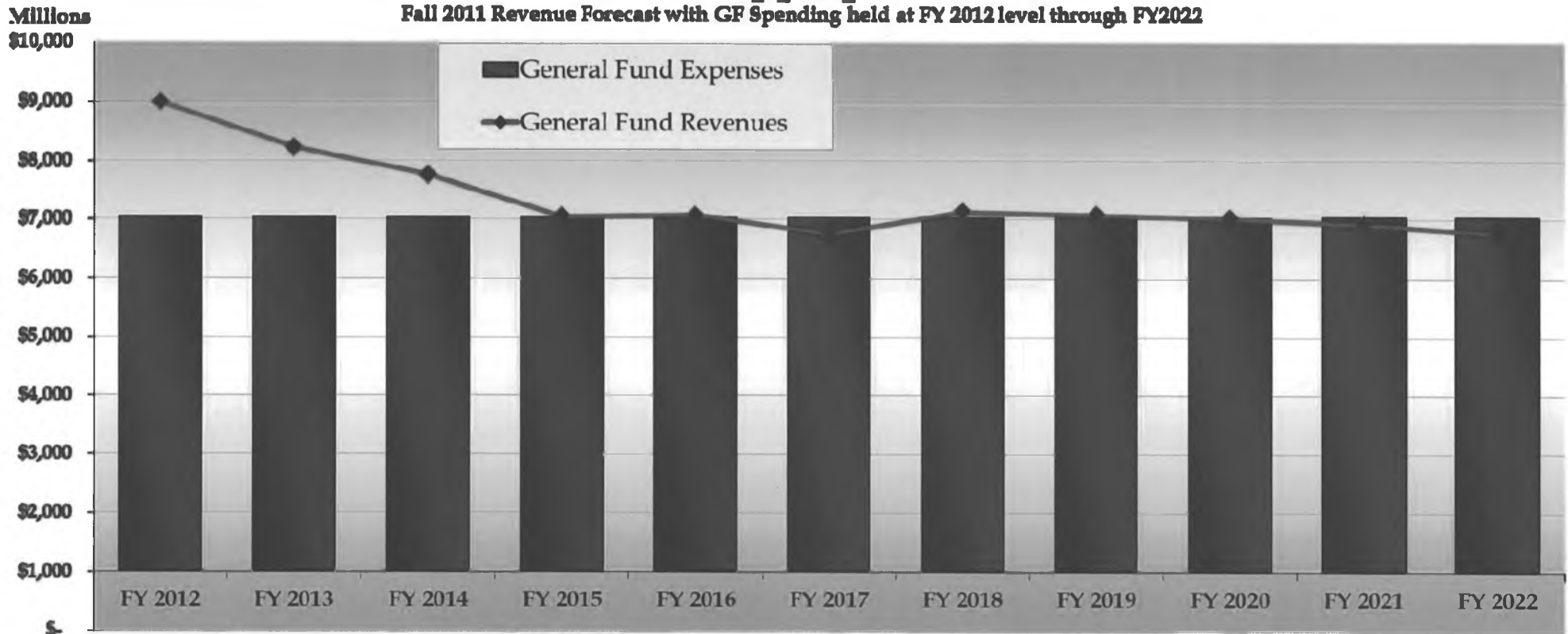


Source: BP Presentation on Proposed PPT
(Alaska State Legislature House & Senate Resources
Committees 2006)

Scenario 1: General Fund Spending held at FY2012 level (\$7.0 billion) through FY2022

GF Revenue versus Appropriations FY12 to FY22

Fall 2011 Revenue Forecast with GF Spending held at FY 2012 level through FY2022



Annual appropriations exclude deposits to Public Education Fund and other special purpose appropriations such as to the Constitutional Budget Reserve or Statutory Budget Reserve.

Source: Office of Management and Budget FY2013
10-Year Plan (p. 9)

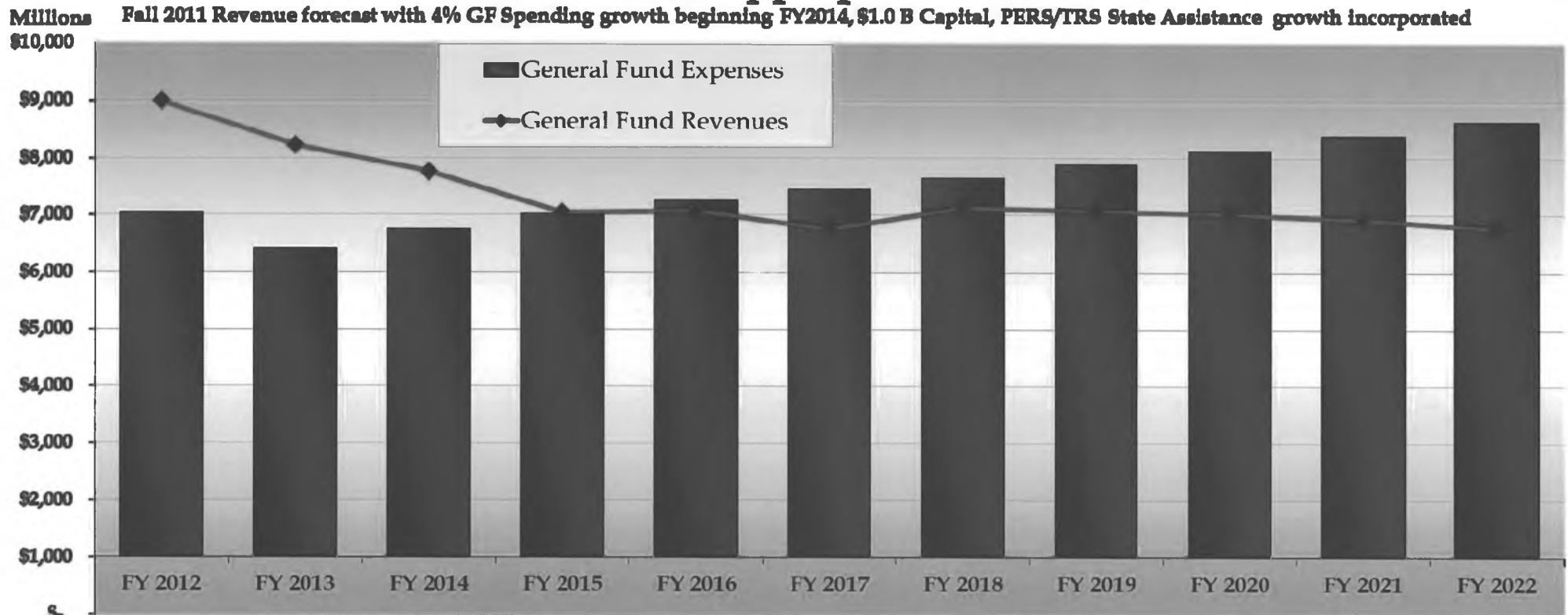
Scenario 1: General Fund Spending held at FY2012 level (\$7.0 billion) through FY2022

Oil Price & Production	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Fall 2011 forecast ANS West Coast (\$/bbl.)	\$108.98	\$109.47	\$109.08	\$108.75	\$107.79	\$106.05	\$108.76	\$111.54	\$114.39	\$117.31	\$120.31
Fall 2011 forecast ANS production (mmbbl./day)	0.574	0.555	0.561	0.538	0.550	0.549	0.544	0.515	0.486	0.458	0.432
Revenue vs. Spending (\$millions)											
General Fund Revenues ^{1/}	\$8,981.8	\$8,217.7	\$7,742.8	\$7,043.4	\$7,065.5	\$6,738.9	\$7,125.0	\$7,070.4	\$7,012.1	\$6,917.5	\$6,757.0
General Fund Expenses	\$7,041.8	\$7,041.8	\$7,041.8	\$7,041.8	\$7,041.8	\$7,041.8	\$7,041.8	\$7,041.8	\$7,041.8	\$7,041.8	\$7,041.8
Budget Surplus/Shortfall	\$1,940.0	\$1,175.9	\$701.0	\$1.6	\$23.7	\$302.9	\$83.2	\$28.6	\$29.7	\$124.3	\$284.8
Reserve Balances (\$millions)											
CBRF Main Account Balance End of Year	\$5,408.7	\$5,615.9	\$5,830.2	\$6,051.9	\$6,281.3	\$6,518.6	\$6,764.1	\$7,018.0	\$7,280.8	\$7,552.6	\$7,833.8
CBRF Subaccount Balance End of Year	\$4,972.2	\$5,323.6	\$5,700.0	\$6,102.9	\$6,534.4	\$6,996.3	\$7,490.9	\$8,020.4	\$8,587.4	\$9,194.5	\$9,844.4
CBRF Total	\$10,380.9	\$10,939.5	\$11,530.2	\$12,154.8	\$12,815.6	\$13,514.9	\$14,254.9	\$15,038.4	\$15,868.2	\$16,747.0	\$17,678.2
Statutory Budget Reserve Balance	\$4,402.1	\$5,577.9	\$6,279.0	\$6,280.6	\$6,304.3	\$6,001.5	\$6,084.7	\$6,113.2	\$6,083.5	\$5,959.2	\$5,674.4
TOTAL RESERVES	\$14,783.0	\$16,517.5	\$17,809.2	\$18,435.5	\$19,120.0	\$19,516.3	\$20,339.6	\$21,151.7	\$21,951.7	\$22,706.3	\$23,352.6

Source: Office of Management and Budget FY2013
10-Year Plan (p. 10)

Scenario 4: FY2013 Governor's Budget with 4% Annual Agency Growth, Capital at \$1.0 B, PERS/TRS

GF Revenue versus Appropriations FY12 to FY22



Annual appropriations exclude deposits to Public Education Fund and other special purpose appropriations such as to the Constitutional Budget Reserve or Statutory Budget Reserve.

Source: Office of Management and Budget FY2013 10-Year Plan (p. 15)

Scenario 4: FY2013 Governor's Budget with 4% Annual Agency Growth, Capital at \$1.0 B, PERS/TRS

Oil Price & Production	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Fall 2011 forecast ANS West Coast (\$/bbl.)	\$108.98	\$109.47	\$109.08	\$108.75	\$107.79	\$106.05	\$108.76	\$111.54	\$114.39	\$117.31	\$120.31
Fall 2011 forecast ANS production (mmbbl./day)	0.574	0.555	0.561	0.538	0.550	0.549	0.544	0.515	0.486	0.458	0.432
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General Fund Revenues ^{1/}	\$8,981.8	\$8,217.7	\$7,742.8	\$7,043.4	\$7,065.5	\$6,738.9	\$7,125.0	\$7,070.4	\$7,012.1	\$6,917.5	\$6,757.0
General Fund Expenses	\$7,041.8	\$6,430.2	\$6,763.6	\$7,029.2	\$7,271.3	\$7,463.1	\$7,663.3	\$7,890.1	\$8,129.3	\$8,378.4	\$8,639.7
Budget Surplus/Shortfall	\$1,940.0	\$1,787.5	\$979.2	\$14.2	\$205.8	\$724.2	\$538.3	\$819.7	\$1,117.2	\$1,460.9	\$1,882.7
Reserve Balances (\$millions)											
CBRF Main Account Balance End of Year	\$5,408.7	\$5,615.9	\$5,830.2	\$6,051.9	\$6,281.3	\$6,518.6	\$6,764.1	\$7,018.0	\$7,280.8	\$7,552.6	\$7,833.8
CBRF Subaccount Balance End of Year	\$4,972.2	\$5,323.6	\$5,700.0	\$6,102.9	\$6,534.4	\$6,996.3	\$7,490.9	\$8,020.4	\$8,587.4	\$9,194.5	\$9,844.4
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Statutory Budget Reserve Balance	\$4,402.1	\$6,189.5	\$7,168.8	\$7,183.0	\$6,977.3	\$6,253.0	\$5,714.7	\$4,895.0	\$3,777.8	\$2,316.9	\$434.2
TOTAL RESERVES	\$14,783.0	\$17,129.1	\$18,699.0	\$19,337.9	\$19,792.9	\$19,767.9	\$19,969.6	\$19,933.4	\$19,646.0	\$19,064.0	\$18,112.4

Source: Office of Management and Budget FY2013 10-Year
Plan (p. 16)