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The Global Reach Of The Energy Industry

The Editor interviews Rick L. Burdick, Managing Partner for International Operations at Akin Gump.

Editor: As managing partner for Akin Gump's international operations that include energy, where have you conducted cutting-edge and leading cross-border transactions during your 30 years of practice?

Burdick: Most of my transactions in that category involved our firm's experience in Russia. At the beginning of our practice in Russia in the early '90s, we did a capital markets offering for Lukoil that was the first capital markets offering for a Russian company after the dissolution of the Soviet Union. It took the form of a convertible bond offering that had a very innovative structure, requiring us to have a law implemented by President Yeltsin. That offering was done without the benefit of financial statements, so it is probably the only the prospectus that has ever been issued where the first risk factor states "this company does not have any financial statements." In order to get the offer successfully underwritten, we brought in Arco to purchase a substantial portion of the securities in tandem with an upstream deal with Lukoil. In addition, the firm was involved, although I was not, in the first NYSE listing for a Russian company.

Editor: Please describe the involvement of the legal team that you led that completed the largest privatization in Russia's history by a U.S. oil company in Russia?

Burdick: We represented Lukoil in the ConocoPhillips privatization transaction, part of a larger transaction that we, together with Lukoil, collaboratively

developed as a new concept. The transaction involved ConocoPhillips's buying a significant stake in Lukoil and having an active role in its governance. ConocoPhillips and Lukoil also entered into an upstream joint venture

in the Timan-Pechora region of Russia that involved the development of an oil field and the construction of an export terminal. The transaction rested on ConocoPhillips's being able to take a significant stake in Lukoil so that they would be able to account for the transaction on an equity basis, meaning its stake in Lukoil would have to be in the range of 5 to 10 percent. However, at the time, the market for Lukoil stock on the London Stock Exchange was somewhat illiquid. It seemed impractical that ConocoPhillips acquire a big enough stake, fast enough without taking a huge price risk. So the solution that we developed was that the Russian government, which owned a 7.9 percent stake in Lukoil, was approached to sell their interest to ConocoPhillips. At the same time, this required us to comply with Russian privatization laws, which mandated that a bidding process be set up to ensure that the Russian government receive the highest return on its investment. We worked with the government to design a privatization process that complied with the law, and ConocoPhillips ended up being the successful bidder in that transaction. With the initial 7.9 percent ownership ConocoPhillips had comfort that it could continue buying Lukoil shares, building their stake over time to the goal of 19.9 percent (or roughly 20 percent) ownership, allowing for equity accounting. We also had to develop a



Rick L. Burdick

package of governance rights that would get ConocoPhillips the desired accounting treatment.

Editor: Another noteworthy transaction is FirstEnergy's acquisition of Allegheny Energy in which you played a leadership role. Describe the approvals required for this transaction. Why was this acquisition of key importance?

Burdick: FirstEnergy is a utility headquartered in Akron, Ohio. Allegheny represented an opportunity for the company to acquire a similar utility with a similar business model that had a service area that was adjacent to FirstEnergy's existing service area and that was approximately two-thirds its size, making its footprint much larger. FirstEnergy's strategy has been to consider acquisitions that are adjacent to its service territory. So the Allegheny transaction fit very well with FirstEnergy's strategic objectives. Since we were dealing in a regulated industry, we had to get approval from the FERC as well as state regulatory approval in five or six jurisdictions where both parties had footprints. The laws and the approval processes as well as the politics of the approval process are different in each of those states. We worked closely with the general counsel of FirstEnergy (who by background was a state regulatory lawyer), who led the effort while our team developed the structure and the corporate process to meet the state regulatory approval processes.

I first received a call from FirstEnergy on January 7, and the date of the merger agreement was February 10 of that year. During that time frame, Washington had the two biggest snowfalls of its history. The logistics of keeping everybody at Akin Gump working during that period of

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time were extremely challenging. It was a very quick deal that required the deployment of a very large team. The regulatory issues were very sensitive in terms of the way we positioned the transaction. Unlike many utility deals that fail due to lack of success in getting state and federal regulatory approvals, this deal got done, closing in around a year's time.

Editor: Shale gas is playing an important role in U.S. energy development. Do you see other areas of the world, such as China, starting to tap into this source of energy? Why has this technology not been developed in other parts of the world?

Burdick: Shale gas has obviously revolutionized the U.S. industry. Internationally, it has promise in China, Argentina, Mexico, etc. While these areas have promise, I think it is going to take some time to develop for a couple of reasons: first, those who have this know-how are resident in the U.S. Many of them do not have a lot of international experience or experience in other international basins where unconventional resources could be developed; second, if you look at China specifically, a lot of the shale opportunity is in very mountainous terrain, making drilling conditions more difficult or more expensive – as I understand it, many of the formations are also deeper than they are in the U.S.; third, in order to develop those resources, a service industry must be developed to provide drilling and fracking services. In addition, the infrastructure to transport the production from where it is found to where it gets consumed is necessary.

Another impediment to growth of fracking elsewhere is that the state owns the mineral rights in most other countries. In some ways, licensing these rights would be easier because you would negotiate with one party. While there are some prospective areas in Europe, the politics of fracking produce environmental concerns. There are different challenges in all areas of the world, which means it will be some time before the U.S. know-how is deployed to other regions.

The know-how of taking those drilling and fracking techniques and applying them to the various formations has just developed recently, although the “technology” for the development of unconventional resources has existed for 30 years. Each play is different. So what has

worked in Barnett, where this technique was first applied, does not necessarily work in the Eagle Ford, or the Haynesville, or the Utica. In each play, engineers have to learn what works in that play as to how they do the fracking, how they do the drilling and how they do the completion. It is an experimental process before you get to the point where it becomes more or less perfected for a play.

Another interesting point is that those who have led this revolution have been initially small entrepreneurial companies that have now become companies with significant market capitalizations, such as XTO, Chesapeake and Southwestern. My own theory is this type of risk-taking and know-how requires a nimble entrepreneurial culture.

Editor: There have been many innovations in technology for the extraction industries. Which innovations will have the most far-reaching impact on these industries?

Burdick: Unconventional development know-how, horizontal drilling and fracking have to be at the top of the list, as well as the engineering associated with deep water exploration and production. Deep water exploration is like going to the moon. A drill ship may be drilling in ten thousand feet of water in an effort to drill a hole twenty thousand feet into the earth, encountering resistance from wave action and wind. Sub-sea completions are done by robots. The wells are produced through flexible pipe to a spar buoy, which in turn delivers the contents onto a floating production and storage facility. All that engineering is extremely impressive!

Editor: How can the oil and gas companies solidify their presence in third-world countries? How do they protect themselves from expropriation?

Burdick: The statistic is something like 70 percent of the undeveloped oil and gas is in the hands of government-controlled enterprise. For a large oil company, the only way to replace reserves is to enter that market in some way. There are a number of different approaches. Some companies go it alone, that is, they plan to obtain a license from a foreign government, develop the field themselves and sell the production. They need to assess carefully what their risk of expropriation

might be. Other approaches would include a local private partner, providing a local presence, giving the partner and its country something of a stake in completing the project, the theory being that the right local partner will help insulate you from expropriation and regulatory risk to some degree.

If I were a government designing a model, I would try to use the development of my own natural resources as a way to build my own oil company. I would use a partnership with an international company to build the development and financial skills needed to become a global oil company. This approach provides sustained economic development for the host country. For instance, Statoil was at first exclusively focused in Norway and has become a global oil company as a result of the development of the North Sea. Such a model represents a mitigation of the expropriation risk because the government oil company owns all or part of it.

You either have to decide you are going to go it alone and assess the risk on your own, or if you are going into a riskier place, the local partner or a partnership with the state-owned company makes sense.

Editor: Do you agree with some commentators that the U.S. can become energy independent by 2020?

Burdick: I think that will happen, but at that time what does energy independence mean? Gas is sold into a domestic market unless turned into LNG. We have a plentiful supply of gas that is sustainable for a very long period of time. In terms of gas, we already are independent and have been for some time because we have never imported significant amounts of LNG into the U.S. In terms of oil, we can become independent in that the production here in the U.S. is more than we need to satisfy our own needs. But, at the same point in time, we are never going to be independent of the global market for oil because oil is a global commodity. Demand in India, China and elsewhere is going to impact the price of oil in the U.S. unless the government were to decide to insulate U.S. citizens from the global market with a system of price controls. As a representative of the industry, I obviously would not favor that policy, preferring that the U.S. lean towards a free market for energy in the U.S.