

**ALASKA STATE LEGISLATURE
JOINT MEETING
SENATE RESOURCES STANDING COMMITTEE
SENATE FINANCE COMMITTEE**

February 13, 2012

9:02 a.m.

MEMBERS PRESENT

SENATE RESOURCES

Senator Joe Paskvan, Co-Chair
Senator Thomas Wagoner, Co-Chair
Senator Bill Wielechowski, Vice Chair
Senator Bert Stedman
Senator Hollis French
Senator Gary Stevens

SENATE FINANCE

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Donald Olson
Senator Dennis Egan
Senator Joe Thomas
Senator Johnny Ellis

MEMBERS ABSENT

SENATE RESOURCES

Senator Lesil McGuire

SENATE FINANCE

Senator Lesil McGuire

COMMITTEE CALENDAR

PRESENTATION: ARCTIC AND ALASKA OIL ECONOMICS

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

PEDRO VAN MEURS, Ph.D., President
Van Meurs Corporation
Nassau, Bahamas

POSITION STATEMENT: Presented information on Arctic and Alaska Oil Economics.

ACTION NARRATIVE

[9:02:44 AM](#)

CO-CHAIR BERT STEDMAN called the joint meeting of the Senate Resources Standing Committee and the Senate Finance Standing Committee to order at 9:02 a.m. Present at the call to order were Senators Egan, Ellis, Thomas, Stevens, Olson, Co-Chair Wagoner, Co-Chair Paskvan, Co-Chair Hoffman, and Co-Chair Stedman.

Presentation: Arctic and Alaska Oil Economics

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CO-CHAIR STEDMAN announced that the presentation would be on Arctic & Alaska Oil Economics.

SENATOR FRENCH and joined the committee.

PEDRO VAN MEURS, Ph.D., President, Van Meurs Corporation, presented information on Arctic and Alaska Oil Economics. He explained that some of his credentials included being a consultant in the Canadian oil industry, forming his own consulting company in 1974, and advising world governments about petroleum taxation and fiscal terms.

He shared that in 1997 he worked with Governor Knowles on LNG exports to Asia and the Alaska Stranded Gas Act, and in 2003, he worked for Governor Murkowski on the natural gas line contract and PPT.

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MR. VAN MEURS related that in December of 2011, he was invited by Representative Mike Hawker to present a seminar on current conditions in the oil industry in Alaska. He maintained that he has a good understanding of oil and gas issues in the state.

CO-CHAIR STEDMAN explained that Representative Hawker is the Chair of the Joint Legislative Budget & Audit Committee. Mr. Van Meurs presented to the entire legislature in Anchorage.

MR. VAN MEURS described the plan for the presentation which would include four sessions that deal with policy options for Alaska oil and gas. He shared Governor Parnell's objective, which is to achieve a Trans Alaska Pipeline System (TAPS) throughput of 1 million barrels per day. He said he personally believes that goal is achievable in the next ten to fifteen years or so.

He stressed that HB 110 doesn't even come close to getting Alaska to that goal. He suggested that more elaborate legislation would be required. He explained that major policy and fiscal changes would be needed to encourage significant additional levels of investment of about \$7.5 billion per year.

SENATOR STEVENS asked if Mr. Van Meurs would be discussing the goal of 1 million barrels per day in more detail.

MR. VAN MEURS replied that he hoped to illustrate, step by step, how that goal might be reached.

SENATOR STEVENS inquired if it was a good goal to try to achieve for Alaska.

MR. VAN MEURS believed that it was for Alaskan's to determine if bringing new resources on stream to create new jobs and more business was a good goal.

CO-CHAIR WAGONER summarized that it would take \$7.5 billion per year of investment above the current level to reach the goal. He asked what it would take to get a constant level of 600,000 barrels per day.

MR. VAN MEURS explained that in order to produce heavy oil and other expensive resources, there would need to be about \$30 per barrel of investment. For every \$100,000 per day, \$3 million must be invested because ongoing production would still be declining. To stabilize at 600,000 barrels per day, an additional 200,000 barrels per day would have to be produced.

CO-CHAIR WAGONER related that the legislature has been told by both major producers on the North Slope that they are not going to produce heavy oil or viscous oil for eight to ten years. Because of permafrost and other conditions, the producers feel that they are not ready to extract that oil. He cautioned not to include heavy oil in the tabulations.

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MR. VAN MEURS understood why those producers would not be ready under current fiscal terms. He did not see any insurmountable conditions in the North Slope where, with the correct fiscal terms, producers would not invest in heavy oil.

MR. VAN MEURS related that major policy and fiscal changes could also induce significant exports of Liquid Natural Gas (LNG) prior to 2025.

He continued to explain the presentation topics: new policy framework required, international competitive environment, proposed terms for existing and new light oil, and proposed terms for heavy oil, shale oil, and natural gas.

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MR. VAN MEURS reported on the new framework that would be required in order to increase investment in Alaska. He noted that much of the material he was presenting was from a large international study entitled, "World Rating of Oil and Gas Terms." Four of the six volumes of the 2011-2012 study rating the fiscal terms of more than 140 countries have been completed. Those include North American wells and shale plays, deep water, the Arctic, and shallow water.

Co-CHAIR STEDMAN requested more background on the world rating system.

MR. VAN MEURS explained that his firm occasionally does a complete overview of all the fiscal systems in the world in order to determine their attractiveness for investors. It is a study of the fiscal rates of 140 countries. He emphasized that the study requires comparisons of similarly situated fiscal systems. The purpose of the study is to provide governments and investors with an idea of how attractive particular fiscal systems are to investors.

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MR. VAN MEURS related that he will propose new fiscal terms for Alaska oil and gas in order to demonstrate how a new fiscal system can be created and to indicate the order of magnitude of the amounts and rates that would need to be adopted.

He explained that he will use the concept of "government take" frequently during the discussion. He showed a simple demonstration of how government take is determined. If gross revenues are \$100 bbl, costs are \$20 bbl, divisible income \$80

bbl, and royalty is 10 percent, then the formula for government take would be $\$10/\$80 \times 100\% = 12.5\%$. He summarized, "You take payments to government and divide it by the pre-tax profit." It is a percentage of net. He added that government take is presented on an undiscounted and real basis using an escalation and inflation rate of 2 percent.

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MR. VAN MEURS stated that he did not believe HB 110 would lead to increases in oil production. He predicted if better terms were offered for new petroleum, it could lead to investment in new light oil; however, that alone wouldn't change the trend in declining oil production. In order to increase production, other resources such as heavy oil, shale oil, and gas should be tapped. Those resources will not be produced unless fiscal terms are changed or defined.

MR. VAN MEURS related that significant political changes must occur in Alaska in order to attract new investment. The most important factor is that the competitors in Alaska have changed, so the style of doing business must change. Alaska has to define competitive fiscal terms for investors and offer fiscal stability for large new projects.

He stated that Alaska is the only jurisdiction in the world without defined fiscal terms for major oil and gas resources, such as heavy oil, shale oil, and natural gas. He maintained that this is a major obstacle for new investment.

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SENATOR FRENCH inquired how the statement regarding the state's not having terms "squares" with Alaska having an extensive taxation/credit system on the books. He suggested that saying the state has no terms is an overstatement.

MR. VAN MEURS replied that the state has no viable terms for gas. The terms under ACES are designed for light oil and PPT wasn't designed for heavy oil. He clarified that there are no terms designed for heavy oil like there are in Alberta or North Dakota.

CO-CHAIR STEDMAN recalled the first go round for PPT where there was discussion of a 20 percent capital credit targeting heavy oil in a net system.

MR. VAN MEURS agreed that when PPT was designed there were considerable discussions about stimulating heavy oil. The main

reason for shifting from ELF to a profit system was to create a system that could be adjusted to include heavy oil. However, the rates were set and reset on the basis of light oil economics, not heavy oil.

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MR. VAN MEURS stated that it will be very difficult to introduce changes in the current, somewhat unfavorable, political climate in Alaska. He said that Alaska has structural problems when developing policy. Policy evolves differently in small nations versus large nations. There is also a somewhat unfavorable dependency relationship on the three major oil companies which creates resentment.

He related that jurisdictions with small populations, with less than million people, are often "project driven". They tend to wait for someone to propose a project before deciding on detailed terms that are often complex because many local interests need to be dealt with. He gave examples of small communities.

[9:31:37 AM](#)

He continued to say that large populations have generic petroleum codes and tax laws which deal with all petroleum resources. Terms are identical for all investors and may be adjusted for each bid round. Often petroleum fiscal terms are relatively simple. He gave examples of large populations.

MR. VAN MEURS turned to the competitive framework for Alaska over the last fifteen years. In 1997 oil prices were low, European and Asian gas prices were low, LNG trade was very limited, the focus was entirely on conventional oil and gas, and conventional oil production was declining in North America. Oil companies looked at Latin American, African, and Asian countries for new exploration. The method of doing business was by negotiation of production sharing contracts with tough terms.

CO-CHAIR STEDMAN asked for more information about Alaska's competitors, especially why Latin America, Africa, and Asia were named.

MR. VAN MEURS explained that in 1997, U.S. oil production was declining and in order to find new low cost conventional oil, investors had to go to new areas. The tendency was to go to new countries to find low cost oil and gas. Alaska was competing with these low cost countries. Negotiation of production sharing

contracts was the style of business. Russia was still closed because it didn't have a viable legal system developed yet.

[9:37:02 AM](#)

MR. VAN MEURS turned to the competitive framework for Alaska in 2012. It is an economic environment with high oil prices, high European and Asian gas prices, and a booming LNG trade. There is a focus on unconventional oil and gas, and oil production in the U.S. and Canada is increasing.

He related that Alaska is behind in adjusting to this new world. The three major oil companies are now looking at selling LNG to Asia. Alaska is now competing with other states, such as North Dakota, Texas, Arkansas, and Ohio. Canadian oil sands are getting a lot of investment and Russia has come on board. The main LNG competitor of Alaska is now Australia.

He explained that all of Alaska's competitors have well-defined fiscal systems and they don't need to negotiate anymore. The terms are fixed and attractive. In Australia all you need to do is find a buyer. Alaska is largely competing with Organization for Economic Cooperation and Development (OECD) countries that have defined and attractive fiscal terms.

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CO-CHAIR STEDMAN requested a definition of conventional and unconventional oil.

MR. VAN MEURS replied that conventional oil and gas are resources "as we know it" today. Exploration wells are drilled to find oil and gas fields and reservoirs, and if they are attractive enough, production begins.

He related that the location of unconventional oil and gas is already known. Shale oil has already been located from drilling projects. Heavy oil and oil sands don't need to be discovered, but need new technology to develop. Unconventional resources are not located in a reservoir, but in the original source rock. With high oil prices, new technology is developing very rapidly in order to access unconventional oil and gas.

CO-CHAIR STEDMAN asked why Alaska should pay attention to national oil company impact in the world.

MR. VAN MEURS stated that the most amazing development over the last 15 years has not been the development of national oil companies, but a new type of company called "state supported or

state capital company" like Petrogas, which is officially private, but works with government support. That type of competitor might be interested in developing Alaska.

[9:47:35 AM](#)

SENATOR THOMAS asked if Mr. Van Meurs would cover how Alaska stacks up against Australia.

MR. VAN MEURS said he would address that issue in the afternoon.

SENATOR FRENCH noted that fiscal stability is a theme running through the presentation. He questioned the fiscal stability in Texas, Russia, and Alberta.

MR. VAN MEURS replied that those entities have fixed and attractive fiscal terms. He agreed with Senator French that none of Alaska's competitors offer fiscal stability. In many jurisdictions investors are willing to invest without fiscal stability because they believe the governments of those jurisdictions will act reasonably. Russia may be the exception.

[9:50:44 AM](#)

CO-CHAIR PASKVAN asked if North Dakota's fiscal terms fit into MR. Van Meurs' definition of fixed, attractive fiscal terms.

MR. VAN MEURS replied that for shale gas in North Dakota the fiscal terms are about 60 percent government take, which is quite attractive when compared to conventional oil terms in Alaska. In most states there are three classes of land; federal, state, and private. On the state and federal lands, the royalties are fixed; on the private lands the royalties must be negotiated. Once the lease is concluded, the terms are fixed.

CO-CHAIR STEDMAN thought those conditions referred to shale oil.

MR. VAN MEURS agreed.

CO-CHAIR PASKVAN asked if the fixed fiscal terms were based on a defined royalty and a defined production tax based on a percentage of gross revenues.

MR. VAN MEURS explained that most states have four fiscal components: royalty, corporate and state income tax, production tax, and property tax. The terms are known for all of those components.

CO-CHAIR WAGONER noted that one of Alaska's problems is sticking with one tax system. He asked how many systems are figured on net tax system rather than a gross tax system.

MR. VAN MEURS pointed out that the huge difference between royalties in Canada and royalties in the United States is that in Canada the royalties are based on formulas, with some on net profits, and in Alaska they are based on a fixed number. In Australia some taxes are similar to PPT. Brazil has profit sharing somewhat similar to Alaska. Some competitors have financial terms based on gross and some are based on profits similar to Alaska.

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MR. VAN MEURS reported that the project by project approach in Alaska is a lengthy process, which is unfortunate because gas is an aggressive market. He shared two examples where the lengthy process resulted in loss of a major project. Under Governor Knowles the development of the Stranded Gas Development Act resulted in Asian buyers going elsewhere. Under Governor Murkowski's gas line project, the process was dragged out and didn't go forward.

He stressed that gas markets change rapidly and buyers are practical, so Alaska must be aggressive if it wants a gas project. Currently, Alaska's process is too long for it to be an aggressive player.

SENATOR FRENCH pointed out that the public and the legislature didn't hear about Murkowski's gas line until 2006, not 2003 as in depicted in slide 18. He said he was not sure that project was a missed opportunity, in light of current gas prices.

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MR. VAN MEURS agreed. He clarified that the negotiating process started in 2003 and lasted until 2006 when it was brought to the legislature. He noted the process was too slow. If the gas line had been approved in 2004, it would have cost \$14 billion. Alaska would not have made much money. If gas prices go back up, it is a major lost opportunity.

MR. VAN MEURS suggested that Alaska needs to start competing with its competitors by defining terms for all of its resources: existing light oil, new light oil, heavy oil, ultra heavy oil, shale oil, new natural gas, and associated natural gas.

He added that Alaska also needs an "open for business" brochure that sets out all terms for investing in oil and gas in Alaska. He maintained that deal by deal negotiations are far too slow.

He questioned what happens if nobody responds to those terms. Alaska would still have valuable information about the market and about investors.

[10:01:08 AM](#)

MR. VAN MEURS related that no implementation measures need to be taken for existing or new production for light oil unless the project involves major new investments, such as the development of Point Thomson. Simply publishing the new terms would be adequate. With respect to heavy oil, shale oil, natural gas, and gas-to-liquids, it is unlikely that investors will commit to large multi-billion dollar programs unless there is a degree of fiscal stability in a contractual framework. He stressed the importance of Alaska's moving to fiscal stability.

He turned to the topic of contractual relationships. If investors feel that fiscal stability is required for their investments, the state should be authorized to sign contracts without further legislative approval. The process would be similar to the approval of oil sands plant in Alberta.

He suggested that the fiscal stability period could range from 10 to 25 years, depending on the nature of the contract. In exchange for being offered fiscal stability, the investor would have to commit to a substantive work program. It is understood that the matter of whether or not Alaska can offer fiscal stability, is an issue to be decided by the Alaska Supreme Court.

SENATOR FRENCH stated that the constitution is black and white about this issue. It says the state's tax authority can never be surrendered, suspended, or contracted away. He thought it was politically unrealistic to expect that it would ever happen.

[10:06:44 AM](#)

MR. VAN MEURS brought up other great difficulties in achieving Alaska production increases. The main difficulty is that the three major oil companies are in a "harvesting mode", which means their main objective is drawing cash out of Alaska to invest elsewhere. Companies don't see major large projects available in Alaska, but do see them in other countries. He pointed out if companies had an interest in investing in Alaska, they would be investing \$50 bbl instead of \$10-15 bbl.

CO-CHAIR STEDMAN asked when the harvest mode started.

MR. VAN MEURS reported on three phases of investment in a new petroleum basin: the investment mode, the sustained presence mode (reinvesting most of their cash), and harvesting mode (reinvesting a small amount of their income). He stated that the oil industry has been in harvest mode for a long time. The whole reason PPT was introduced in 2006 was to try to make Alaska more attractive and reverse some of the harvesting mode.

[10:11:04 AM](#)

CO-CHAIR PASKVAN inquired if the corporate philosophy regarding the harvesting mode is influenced by not finding more large reservoirs.

MR. VAN MEURS answered that there are still possibilities in Alaska for investment, even for new light oil. He opined that there still could be about 1 billion barrels of new high cost light oil production available through discoveries as a result of new exploration, small discovered fields, and infill drilling of existing fields. Major companies are already infill drilling.

SENATOR WIELECHOWSKI joined the committee.

CO-CHAIR PASKVAN asked if Alaska is in transition from only three major companies to more independents and other world majors.

MR. VAN MEURS replied yes. He said it is normal for mature petroleum production to attract smaller companies. Norway and Britain are examples of that. He predicted that large investment by the major oil companies could still be valuable.

[10:15:23 AM](#)

CO-CHAIR HOFFMAN referred to Point Thomson's heavy oil. The industry says that they are not ready for heavy oil. He questioned how Alaska could be more aggressive in encouraging the industry to invest in producing heavy oil.

MR. VAN MEURS offered to present a detailed strategy for addressing that issue.

SENATOR THOMAS inquired if Mr. Van Meurs would also discuss commitments to a substantive work program and lease terms.

MR. VAN MEURS said he would not be addressing the issue of substantive work programs because that is a broad policy change, not a targeted change. The broad concept is to offer fiscal stability in order to attract work commitments. In most nations work commitments are large and structured in phases.

[10:18:48 AM](#)

CO-CHAIR PASKVAN inquired why the focus is on investment instead of production. He used the example of Alaska's investing of \$4 billion in the North Slope under PPT and ACES, yet there is still a declining throughput. He asked if, for fiscal stability, the focus should be on production instead of amount of investment.

MR. VAN MEURS replied that the work program in various nations is defined in different ways: amount of work, production, or investment.

[10:20:40 AM](#)

There being no further business to come before the committee, Co-Chair Paskvan adjourned the joint meeting of the Senate Resources Standing Committee and Senate Finance Standing Committee at 10:20 a.m.