

ALASKA LEGISLATURE COMMITTEE FILES 2007-2008 SRES 12716

# Failure to forecast cost increases

I am concerned about the fact that the earlier PPT law weakened the level of interest for late payments in 43.55.020(g). The current bill maintains this.

So this is an added incentive to over declare costs.

# 10% floor on large fields

The PPT is designed as a consolidated tax. Only in this way, does the tax promote the re-investment in Alaska.

The 10% floor on large fields turn the PPT into a tax that is essentially ring-fenced for the large fields. This is an administrative nightmare as is evidenced by the amendment of 43.55.165 (h) and it also removes the benefits of promoting re-investment in Alaska by the large corporations.

This makes no sense. I would strongly recommend not to apply this provision.

# tax credits over two years

This is a silly an unnecessary provision.

The policy is to encourage new oil and gas developments on the North Slope. There is no change in overall government revenues over time, if credits are allowed over two years rather than one. However, it is a much stronger incentive to give the credits in the year the investments are incurred.

I would strongly recommend not to apply this provision.

# “corrosion” issue

This is great politics, but difficult administration. Essentially, the PPT tax collectors would be placed in a constant battle to determine these costs.

The corrosion issue was already fixed in the PPT law by making the first \$ 0.30 per BOE capital costs non-deductible. This was in lieu of the corrosion costs. This is easy to administer. If this overall figure seems too low, than this figure can be changed. Also an amount for non-deductible operating costs can be added.

# Extra incentives for exploration

Beyond the 20% capital investment credit, there is in my view no need for further incentives in exploration.

# “Joint Administration”

The Bill provides for more exchange of information between DNR and DOR. This is good.

However, the bill seems to implement some type of joint administration by DNR and DOR of the PPT. This is unnecessary and very confusing and will lead to bottlenecks.

**ALASKA STATE LEGISLATURE  
LEGISLATIVE BUDGET AND AUDIT COMMITTEE**

October 18, 2007

10:37 a.m.

**MEMBERS PRESENT**

Representative Ralph Samuels, Chair  
Senator Lyman Hoffman, Vice Chair  
Representative Mike Chenault  
Representative Mike Kelly  
Representative Mike Doogan  
Senator Lyda Green  
Senator Bert Stedman  
Senator Johnny Ellis  
Senator Gene Therriault  
Representative Reggie Joule  
Senator Charlie Huggins

**MEMBERS ABSENT**

Representative Mike Hawker  
Representative Kevin Meyer

**OTHER LEGISLATORS PRESENT**

Senator Con Bunde  
Senator Fred Dyson  
Senator Kim Elton  
Senator Hollis French  
Senator Bill Wielechowski  
Senator Gary Wilken  
Representative Bob Buch  
Representative Harry Crawford  
Representative Nancy Dahlstrom  
Representative Andrea Doll  
Representative Bryce Edgmon  
Representative Anna Fairclough  
Representative Les Gara  
Representative Berta Gardner  
Representative Carl Gatto  
Representative David Guttenburg  
Representative Lindsey Holmes  
Representative Craig Johnson  
Representative Keller  
Representative Beth Kerttula  
Representative Mary Nelson

Representative Mark Neuman  
Representative Kurt Olson  
Representative Jay Ramras  
Representative Bob Roses  
Representative Paul Seaton  
Representative Bill Thomas

#### **COMMITTEE CALENDAR**

PRESENTATIONS BY DR. PEDRO VAN MEURS AND DANIEL JOHNSTON -- HOW PPT IN ITS CURRENT STRUCTURE COMPARES TO SIMILAR OIL PROVINCES AROUND THE GLOBE; AND A DISCUSSION OF COSTS

#### **PREVIOUS COMMITTEE ACTION**

No previous action to record

#### **WITNESS REGISTER**

#### **ACTION NARRATIVE**

**CHAIR RALPH SAMUELS** called the Legislative Budget and Audit Committee meeting to order at 10:37:01 AM. Representatives Samuels, Doogan, Chenault, Joule and Senators Hoffman, Ellis, Therriault, Huggins and Green, were present at the call to order. Representative Kelly arrived as the meeting was in progress.

#### ^PRESENTATIONS BY DR. PEDRO VAN MEURS - PROPOSED REVISIONS TO THE PPT

CHAIR SAMUELS announced that the first order of business would be a presentation by Dr. Pedro van Meurs, and invited opening statements.

10:39:19 AM

SENATOR ELLIS: I appreciate just being able to make a brief statement. There is something that's been bothering me, and I need to get it off my chest and at the risk of putting the damper on some of the good feelings of all of us being back together to revisit this issue and the upbeat mood this morning. I have to say that I'm upset and somewhat stunned that Mr. van Meurs is back before us. At the outset, last year, I was impressed with his international credentials. Actually, once documents came out, I believe it was Representative Kerttula on

behalf of her caucus - and I will address my comments to you [Chair Samuels] in respect to our guest today. I'm upset about him being invited back, based on the track record. And I will be brief. But the documents that we requested, or that Representative Kerttula requested on behalf of her caucus, showed that Mr. van Meurs was saying, in private, things that I've found out since that were more in agreement with my position during the PPT (petroleum production tax) debate, and that in public, were very different. I felt intentionally mislead; the press, the public, the Alaskans. And was distraught to see that Mr. van Meurs was basically making my arguments in private with the previous executive on the 20percent vs. 25percent: he was, he was for 25percent tax rate and then changed to 20 and was an enthusiastic cheerleader for 20percent. On the issue of Alaska being treated as a banana republic, it's all in a document here that I would be happy to provide to any of the legislators who would like to see it. This is instructive. These comments are meant to be instructive, an object lesson for some of the newer colleagues among us. So, I will take Mr. van Meur's presentation with a grain of salt, based on not just suspicions but the actual documents that show that he was giving good advice to the previous executive in private and saying something very different in public. When a legislator does that to me, and it's happened to me before, that a legislator intentionally mislead me - I'm done with that legislator. When a hired consultant does the same thing - I'm done with that consultant. So, we'll listen to the presentation today. I'll try to be respectful and take from it what I can, but I just want everyone to be mindful that private advice and public advice were very different in the very important PPT debate that we're back here to revisit. And we should keep that in mind.

10:41:45 AM

CHAIR SAMUELS: OK, thank you for the comments. To let the public and the members who were not in attendance at the last LB&A (Legislative Budget and Audit)[Committee] meeting, I've had requests for both Dr. van Meurs and Mr. Johnston separately. And the agreement I made after discussion at the LB&A meeting was I would try to hire both Mr. Johnston and Dr. van Meurs, or I would hire neither. Going from this point forward, I've had requests at various committees for one of them, or the other one of them. And as far as LB&A goes, there are plenty of other people in this building that have a budget that can hire whomever they want. As far as this committee goes, I will not hire either one or the other. And I have respect for both of

their opinions. I had dinner with Mr. Johnston and Dr. van Meurs last night, and, I want to make this absolutely clear and I told them both this and I want to be absolutely clear in front of everybody, I said 'I have no opinion on what you say. I want you to tell me what you think about the state of the world and the economics of this.' We talked about some of the memos. I'm sure that Dr van Meurs will be able to answer some of those questions. Everybody in this debate, for those of you, once again for the new members: everybody in this debate has baggage attached to them, in some way shape or form; every consultant, probably most of the legislators, that were here. I'm hoping that for the next thirty days that all of us tend to listen to the issues again. I've gotten the feeling already a lot of people are backed into their corner already and saying 'I thought this way last time and I'm going to continue to think this way.' And I hope we get more information. So at the last LB&A meeting, the agreement that I made, and it was sheer luck of the draw that they're both available on this day, sheer luck of the draw. Dr. van Meurs is leaving tomorrow, Mr. Johnston has one extra day, I believe - where are you Daniel [identified in the gallery by a raise of the hand], and so I've got the two of them. And I still think it was best to try to get, particularly for the new members, all of the information, how we got to where we are and where we should go forward with this. So that's the balance that I tried to strike. I appreciate your comments. Are there any other opening comments that anybody would like to make? I'd like to go through the presentation and if there is a quick question to ask on clarifying a term, or something, then I think we can interrupt and go down that road. I'd rather wait 'til the end to ask any questions on the substantive policy. At the end of Dr. van Meurs presentation, we'll probably take a lunch break and then Mr. Johnston can come forward and we'll just kind of see how it goes. But at the end, if there are disagreements or agreements between what their two statements are, we can have them up here together and they can try to hash out (indisc). So we have a general idea of the varying opinions we have on a global stage. One other announcement to make is the LB&A web site, and I don't have the exact address for that web site. We've attempted to put everything from the governor's proposal, on that web site, all of the presentations that have been given to us, any memos that have come out of LB&A. We've tried to have all of that information on a kind of a one-stop-shop so you can be at both the legislative side and the administrative side, and we'll work with Ms. Davis to make sure ours is updated, we'll give her any information so if people are going to that web site. So everybody should have access to all of these presentations and

any correspondence that goes back and forth between the legislature and any committees, as well as, we'll (disc) presentations on the LB&A web site presentations that are made in either the Senate committees or the House committees. We'll do our best, we can, so that you can go to one place if you want to pick out Dr. van Meurs presentation, the governor's presentation, an oil company or who ever, we should try to get everybody on there for ease, as best we can. With that, welcome back Dr. van Meurs, and the floor is yours.

10:45:42 AM

DR. VAN MEURS: Mr. Chairman, what a wonderful pleasure to be back in Juneau and discuss PPT all over again; round two. That is a very interesting experience. 'Tis wonderful to reacquaint myself with all the friends and colleagues we had. I must also say, I'm very happy, as I mentioned to you, to escape from the battle of Alberta [Canada], because it is so nice to come back to a place that is so quiet and so peaceful, as we have here. So consequently, that is a wonderful experience. What I like to do is lead you through my views on the PPT. First I like to explain why the PPT was the way it was, then I like to make some comments on the legislation that the bill, that I understand, is going to be introduced.

10:46:45 AM

DR. VAN MEURS: Firstly, what I would like to say is I would strongly recommended not changes to make any changes to the PPT law, other than a number of very good transparency provisions that I have found in the law, that I found very encouraging and stimulating and that I think are very appropriate. Let's not forget, Governor Murkowski changed the rules Prudhoe Bay, then the PPT was introduced. If now, in another year later, we make amendments again to the PPT, quite frankly you become a basket-case of instability, and I think from an international perspective it would be very, creating a very negative image, I think, for Alaska if you are being perceived to making fundamental changes to such an important package kind of every year. And consequently basically, therefore, I would definitely not recommend to make any changes.

10:48:02 AM

DR. VAN MEURS: Also, I would not recommend to make any changes because the legislature, in it's great wisdom, already passed provisions in the previous law, that provide for a review period

in the year 2011. And consequently, why was the year 2011 chosen, why was that year picked. That year was chosen because, by that time, it was felt that we would have enough information, there would have been one or two audits done, we would have maybe at least two completely audited years, we would have enough information to really know how this law actually, how the PPT actually works. And consequently, it was always contemplated that in 2011 that there would be a review of this. It was clearly spelled out how that would work, and consequently, and that I still believe is the right moment to do so. That is the time when we really will know what the actual costs were, that is the time when we really will know how much investments is really stimulated by this law and what the administrative difficulties and problems are. So consequently, I still believe that there was great wisdom in including that review clause, and I simply believe that is what the legislature should stick with. Let me explain what the current system was, why was the PPT introduced, what was the effect on the overall government take.

10:49:37 AM

DR. VAN MEURS: Here you see what I call a government take map. Actually, this is taken directly out of my report for the government of Alberta. As you know Alberta is currently reviewing the royalties on the oil sands, as well as the conventional oil and gas, and consequently in particular with respect to the oil sands the Alaska fiscal system was an important bench mark because it was a recently introduced fiscal system. And consequently, what I did is I compared say the fiscal system in the oil sands with the fiscal terms that had been recently passed in Alaska. Here you see the average government take, the figures are maybe somewhat difficult to see, but in your handout you can see that approximately the undiscounted government take is about 60percent or so. And if you - what is very important, if you go from the top to the bottom of this chart, you've got increasingly higher prices. If you go from the left to the right, you get into increasingly lower costs. So cost level seven is about \$20 a barrel cost level, one is about \$9 a barrel, and that represents the entire scale of cost - cost per barrel and capital cost and operating costs on the North Slope. So you see any feasible possible combination and permentation of cost and revenues on that chart. What you see from that chart, is that if you go from the top to the bottom that, once you exceed about \$60 U.S., then government take very gradually goes up and reaches about \$66; call that as we discussed so many times before in this legislature, a price

progressive system. If you go from the left to the right, from the most costly to the least costly project, you see that the government take goes up slightly not very significantly, so the system is slightly progressive with costs. Now, the last, both features of that government take are of fundamental importance. The first fact that the government take goes up this price is an international phenomenon. And we wanted to see the costs going up, most governments around the world like to see the government take going up at this price, because it is fair for the owner of the resource to get a higher share of the wealth of that resource if the resource is more profitable as a result of higher prices. And this legislature included the price progressive feature, and by the time we get to very high prices that price progressive feature is upsetting the effect of the royalty, which is regressive in its nature and actually creates a somewhat progressive system (indisc.) price in totality.

10:52:52 AM

DR. VAN MEURS: What is more important for the understanding of the PPT is what happens from left to right. Let's not misunderstand - the PPT was designed for a very important reason. And the PPT was designed to make the next large generation of oil deposits on the North Slope, the half-year oils, economic. Now, these resources are also more costly, and consequently the concept of the PPT was to stimulate these more costly resources. And how was that done? That was done with the particular features that you approved - the 20percent credits that we had and the carry forward credit - and consequently this was done by providing incentives for these higher cost fields, so that these higher cost fields would become economic and could contribute to reducing the drop in production from the North Slope. That was, and as you look at this chart, what you see is that the government take is slightly less ... for the expensive fields than for the less expensive fields. Now, if you would have, for instance, just a flat royalty, or for instance as I understand some legislators also at that time proposed that maybe you would just have a 10percent flat, say, severance tax or production tax, what would happen? Then you would create a very regressive system, and for the high cost fields the government take would ... go up, and for the low cost fields it would go down, and you would achieve exactly the opposite of what you want to achieve. That means the high cost fields will become uneconomic, and it will not be attractive to produce the heavy oils from the North Slope. So that is why this system was specifically designed to incentivize oil companies to work on the technology and make the investments in

the next generation of resources. The only generation of resources that, up to now, we know we have.

10:55:09 AM

The next slide shows exactly the same table, but now at the 5 percent discount rate. Government often likes to see a 5 percent discount rate, because that reflects, kind of, the discount rate of governments. What you see here is the table looks relatively similar - at increase, this price; although, in this case, the cost situation is somewhat flattered. So, consequently, what is very important is: the current system was designed to be sensitive to costs, and thereby make the investments into heavy oil develop in subtractive. It was also designed to make a price progressive.

10:55:54 AM

DR. VAN MEURS: A very important unique feature of the PPT that, that, that really was unique for Alaska was the tradable credits of the 20 percent on the capital expenditures and as well the tradable credits on the loss carry forward which made it very attractive for new companies to come in and to start working on the North Slope. Because, at the time, it was explained to me that an important objective of Alaska was to not only incentivize the new but incentivize investment. Also, Alaska wanted to find a broader range of investors, particular investors that probably were interested in the ... smaller opportunity; medium-sized companies interested in smaller opportunities. Now, it is difficult to say after one year or one-and-a-half year what the effect is, but for sure we are already seeing some remarkable developments in the North Slope with Pioneer and others that clearly seem to respond to this kind of legislation. In order to encourage the reinvestment in further heavy oil development, an important feature of the PPT, contrary to some other profit sharing systems in the world, is that the PPT was completely consolidated.

10:57:41 AM

DR. VAN MEURS: That means you only present one PPT return for all of Alaska with the objective that it doesn't matter where you make your profits in Alaska, it doesn't matter where you reinvest in further development of the resources. Whenever you have these capital investment you can benefit from these credits, and you can use them directly against your PPT payable. Consequently, the consolidated effect of this PPT was very

important, it was a very important instrument to encourage the reinvestment in Alaska. Now, as we all knew, and as we all again, as we see today coming back after a year it is indeed very indicative oil production is declining and, obviously, if this goes forward for another 10 or 20 years and if there is no gas development, obviously Alaska will be in very difficult shape. And consequently we, we absolutely have to find ways of maintaining oil production at a higher rate. And that was the core philosophy of the PPT - maintaining production, creating a future by developing the technology to develop the higher-cost resources that are the only large rates resource that we know of in terms of oil on the North Slope.

10:59:15 AM

DR. VAN MEURS: As I mentioned, when I read the proposed law, the bill, I was very pleasantly surprised by a real effort that seems to go into that bill to create a higher degree of transparency which I think is, is very important. As I said I'm just coming out of the battle of Alberta and the lack of transparency there was severely criticized by the Royalty Review Panel and consequently that is definitely something that people are looking for. They like to know how things are administered, they like to see the figures, they like to know the cost, they like to have the information on the basis of which, say, in 2011 you can then change the fiscal system. It is also good (indisc.) absolutely excellent measures being proposed in this legislation to exempt, to, to make auditors an exempt class so that you really can attract the best people to administer this, this law. I personally believe that the initiatives in this bill for greater transparency, for stronger administration, for better administration, should all be strongly supported. And if the only thing you do this month is approve together stronger support for your administrators, then you've done a good thing. So consequently that is a very important feature of the law.

11:01:00 AM

DR. VAN MEURS: And I believe those changes you can implement without making the impression that you are changing fiscal terms every year, because they don't go to the matter of fiscal terms, they go to the matter of the administration and the transparency of the fiscal terms, and, certainly, that needs to be improved. So, I think, I personally welcome enormously those very good initiatives in the bill. Senator Ellis made comments that I made comments in private that I didn't mention in public.

11:01:29 AM

DR. VAN MEURS: Now, I'd like to say I published reports that were available for everybody. So, consequently, my comments, what my advice was on the PPT, [were] well documented. I have three reports that I'd like to mention here and consequently what my opinion was on the PPT was crystal clear. I not only told you about it, there are extensive reports that were submitted to legislators and to the governor for release and that are in your possession, so consequently I think you had a perfectly crystal clear view as to what my personal opinions were as far as the PPT. Now, if you want to make changes - as I said, I'm not recommending making any changes - but if you want to make changes, I would simply invite you to go to my previous reports and read them, and then simply implement them. That's all you need to do, I think, to get to a good PPT. So consequently that is what I would invite you to do. Let me go through some of the recommendations that I made in February and in March in writing.

11:02:48 AM

DR. VAN MEURS: Firstly, in my February 14 report, it was well documented that I recommended a 25 percent PPT rate. And, then, in the discussions between the governor and the oil companies in his wisdom he decided to make it 20/20. But there is no question about it that I recommended 25/20 - it is in writing - so consequently that was my recommendation. Today that recommendation is still up-to-date. What has happened in the world, we have seen indeed the tendencies that I explained to this legislature that government takes are going up all over the world, and by going to 25 percent Alberta certainly doesn't lose competitiveness - as I also testified in front of you. Therefore, today, I simply reconfirm this recommendation. If you want to go follow my recommendation that I made earlier and go to 25 percent, that is what I recommended in the first place. So if that is what you want to do, I wish you good luck. That is perfect as far as I'm concerned. Also in my February 14 report, I did not recommend the claw back position. And I like to underline that very clearly. You can read that again. I did not recommend the claw back position. Again, in the negotiations with the oil companies, the governor decided that it was better to include the claw back provision, but I did not recommend it, that is black and white. So, consequently, if you like to delete these transitional investment expenditure credits, I think it is a good step. That's what I recommended in the first place. So consequently if that is what you like to

do, all power to you. I think that is a very good recommendation in the new bill, it merely crystallizes the recommendation that I made earlier.

11:04:51 AM

DR. VAN MEURS: So consequently if you believe - as I said I'm not recommending any changes in the law - but if you want to change the law, and if the legislature believes it is important to change the law, then, scrapping these transitional investment expenditure credit is a good measure. It doesn't make any sense, in my opinion, to have these credits. You don't reward companies for past performance. You don't give Oscars for nice oil companies in the form of \$200 million here and \$200 million there.

11:05:32 AM

DR. VAN MEURS: That is not the role of government. The role of government - past investments and some costs cannot be changed anymore, and consequently fiscal systems are always based on from now forward. Now, with the help of this legislature - as you know the claw back was designed originally just as a blanket claw back because I felt strongly about the fact that companies should invest in order to earn these credits - the legislature modified this feature with the famous 2 for 1 feature, which was then accepted in the legislature, and that was a good feature to, to at least ensure that companies that would obtain these credits would do some extra work for it as a minimum. So, that was a good change. But, as I said, I never recommended the claw back in the first place; that is black and white. So, consequently, if the new governor likes to scrap this, that's fine. I have this perfect recommendation.

11:06:37 AM

DR. VAN MEURS: That brings me to the progressive feature, that brings me to the progressive feature: As soon as the 20/20 was adopted by the governor, the governor asked me to look at the possibility for the progressive feature, and I published, on March the fifth, a report that was also distributed in the legislature and to the governor and even to my friend, Daniel Johnston, here, to make sure he had kept -- looked at it and discussed it with me. So, consequently, I published a report as to how to include a progressive system.

Now, it was interesting to see that a new governor says the PPT should have a gross component and a net component. Now, go to my March 5 memo, and that is exactly explained how to create a gross component and a net component. I already recommended that to the legislature. So, consequently, if you want to know how to do a gross component and a net component, just go to my March fifth memo and you will find it.

What did I propose on March the fifth? I don't personally like progressive systems based on nets as were finally adopted. My recommendation was to base a progressive system on the gross. So, what was my recommendation on March the fifth? On March the fifth, my recommendation was to have a two-tier system: One, to have a basic production tax based on the gross, and that would be a normal windfall profit tax, plus the PPT.

11:08:34 AM

DR. VAN MEURS: So, that was my recommendation on March the fifth. What was my recommendation for the progressive, basic, production tax? Now, here you see the formula from the report. I recommended that the rate would be based on West taxes intermediate, minus 50, times .25. Now, I actually should have updated this slide ... again. I set at the current price of 84, it is now 86. But at the price of 84, if you would have followed my recommendation of March the fifth, what would you receive today? 8.5 percent on the gross, plus 25 percent on net. Now, that is what I call a combination of a gross and net system. So, consequently, that was the recommendation of March the fifth, inviting to this legislature, and that was the recommendation based on this recommendation. Further proposals were circulated in the legislature that based some of the scales on gross, but basically, it was a variation on what I had here. But basically, I believe strongly in a system that consists of gross plus net; that's what I proposed at the outset. So, consequently, that's a good idea. The gross should be a windfall profit tax based on West taxes intermediate, minus 50, times .25 percent.

11:10:26 AM

DR. VAN MEURS: As I said, today, you would be collecting 8.5 percent on gross, and then in addition, you would be collecting 25 percent on net. But I had recommended that this basic production tax would then be a deduction for the profits tax. Now, you would be sitting pretty today, had that been implemented. So, that is, I think, a far better recommendation

than this government was coming forward with, where they say, "We're going to combine net and gross, but you don't see the gross; the gross is just in floor somewhere down there, which only applies under certain conditions." No, I proposed a real gross, plus a real net. That is gross plus net, not some kind of wishy-washy kind of ceiling of \$10, say, only on the gross fields. That only clicks in under certain conditions. Today, with this recommendation, you would have received 8.5 on gross, plus 25 percent on net. Now, at \$84 a barrel, aren't we in good shape, and what are you getting? So, consequently, that is why I think, I still believe today this was a good recommendation. It think this is a -- personally, I believe that windfall profit tax structures work better than sliding scales based on net. So, consequently, this idea of just dropping the 40 to the 30, I don't think is very effective. This is a far more effective measure.

11:12:09 AM

DR. VAN MEURS: So, consequently, this idea of just dropping the 40 to the 30, I don't think is very effective. This is a far more effective measure. As you may have read in the newspapers, I recommended exactly the same concept as a bitumen tax on the oil sands in Alberta. That recommendation was accepted by the royalty review panel, and that recommendation is now in front of the premier of Alberta. As a result, I don't see much purpose in this proposal of simply dropping the 40 to a 30. I consider that just -- that's just a band aid measure; that is not what you call a very strong measure, particularly - and I forgot to put that on the slide - particularly if you realize that event he slope is reduced at the same time from .25 to .2.

11:13:05 AM

DR. VAN MEURS: So, consequently, you're almost gaining nothing. So, consequently, that is a very inefficient, unpredictable measure that I don't think is very strong recommendation from the current government. I still believe that I like to reiterate that I like to reconfirm my own recommendation of March the fifth as a good measure. I think that was far stronger way of combining gross and net, and a way that applies to everybody equally.

11:13:52 AM

DR. VAN MEURS: Don't try to just select these oil companies that you like to hit and not other oil companies that you don't

like to hit. I mean, if you do something, always try to maintain a level playing field. That is sound; that is good policy. So, I proposed a level playing field: gross plus net for everybody. That is fair. If oil prices are \$84 a barrel, everybody can pay.

11:14:24 AM

DR. VAN MEURS: Now, I like to highlight that if I would make this recommendation again, I would probably modify it a little bit to give some better support for the heavy oils, because definitely, the gross plus net is nice concept, but you would have to, you would have to, be somewhat more mindful of the high cost of heavy oils, and consequently, you don't want the gross plus net system to destroy the opportunity and destroy the upside that may exist on these heavy resources. So, I would say, the formula that I suggested to you in the first place I think is a good formula, but, in hindsight, if I had some more time to work on it, I would definitely suggest some further modifications in that to make it more applicable to a wider range of fields - in particular the heavy oils.

11:15:38 AM

DR. VAN MEURS: There was another important recommendation that I made in my May 1 report, which was discussed, vitally discussed, among you and was not excepted, but I still believe that if you want to change the PPT, that is a very important change to make. So, a very important change to make. I recommended on May the first the so called gross review exclusion, whereby, for PPT purposes, 64 percent of the gross value for all the gas would be a deduction for the calculation of the PPT. In other words, I feel strongly that you cannot apply the same PPT that you have for oil to gas that are entirely different resources. If you want to export gas, you should by now know that you need a very expensive transportation system, and consequently that exporting gas from Alaska and exporting oil from Alaska are entirely different challenges for any investor that likes to pursue that.

Most nations that export gas over long distances, like my client Trinidad, for instance, or like Malaysia, or like Indonesia, or like Qatar - all the nations that have been very successful in bringing gas to the Lower 48 - my client Trinidad has been extremely successful. They now supplied or in 2006 they supplied two-thirds. Just think about that: a tiny little island in the Caribbean is supplying two-thirds of the LNG imports of the United States. Just think about that. And why

were they successful and why is Alaska not successful now? The reason is very simple. Trinidad and Tobago understood that gas is very different resource than oil, and if you want to be successful in the export market, your fiscal system - your government take for gas - should be less than for oil. And consequently, that is why I recommended the gross review exclusion, and that is why I still would recommend that today.

11:18:14 AM

DR. VAN MEURS: The gas project today, as we will discuss later, is obviously in deep trouble. The costs have escalated beyond belief. If you want to have any hope of exporting some time over the next 20 years some gas from Alaska, you have to become realistic about the fiscal terms for gas. And that means making the government take for gas less for gas than for oil. As I mentioned, that is why I like to reconfirm today my recommendation for the gross review exclusion.

11:18:58 AM

DR. VAN MEURS: Over the newspapers I heard much discussion about these consultants to this government - the past government - that failed to understand the enormous cost increases that were going to occur. And I had -- saw even a quote, and I don't want to attribute that directly to the governor, but I saw a quote in the newspaper that said [it is] incredible that these consultants didn't know that there were going to be cost increases.

11:19:39 AM

DR. VAN MEURS: Now, let me tell you, I provided you with ample and precise information about all the cost increases. I'm going to show you a slide that I showed you nicely in the hall down, down from here, when we were discussing the gasoline. Look at my slide. I said the economic evaluations are based on the \$21 billion project; however, costs have already escalated significantly. In particular, steel prices and regional escalation in Alberta now. So, I told you: costs have already escalated significantly. So, how can the government, the government say that nobody told us? I told you.

Now, at that time, you didn't want to believe that, because, of course, you all thought, "Oh, Pedro's just selling the gasoline, so, consequently, that's probably not true." No, it was true. Costs were escalating like crazy, and consequently, that is why

I put that in front of you. In fact, I made an even stronger slide in the same presentation to you when we introduced the gasoline. I said, "The combination of gas price risk and cost overrun risk creates a possibility that the project may not be built in the next decade, even with [a] stranded contract.

Now, where are we today? I tell you: Even with a stranded gas contract today, this project is not economic. So, this has happened. When I made this presentation, Econ1 ridiculed me. They said, "Here is [Pedro]" - now we just had gone through Katrina - they said, "Here is Pedro predicting the perfect storm: cost increases and price difficulties - the perfect storm. The chance that that ever happens is 1 percent." Now, see where we are today? It has happened. The perfect storm has happened. I told you it was Econ1 who said that it was not going to happen. I told you.

11:22:08 AM

DR. VAN MEURS: Let me give the next slide when I defended myself this Econ1. I summarized the views of Econ1. Econ 1, in their presentation said last year a 50 percent cost overrun [was a] very low probability. Low gas prices: very low probability. Project uneconomic: very low probability. What did I tell you? 50 percent cost overrun: very likely. Low gas prices: fair possibility. Project uneconomic: fair possibility.

REPRESENTATIVE RAMRAS: Mr. Chairman, what does FIF stand for?

11:22:52 AM

DR. VAN MEURS: Sorry?

REPRESENTATIVE RAMRAS: FIF.

DR. VAN MEURS: Oh, that was the fiscal review finding.

CHAIR SAMUELS: Fiscal interest finding.

DR. VAN MEURS: Interest review finding.

DR. VAN MEURS: So, I definitely predicted strong cost escalation; I told you strong cost escalation has already occurred; and I foresee further strong cost escalation.

11:23:29 AM

DR. VAN MEURS: Now, my friends, you cannot have it two ways. You cannot on the one hand say the gas pipeline deal was so bad because there was no cost escalation and then say the PPT was so bad because there was cost escalation. Like, you can't have that. The new commissioner of revenue make this report, and he said to his surprise there was 50 percent cost escalation. All he had to do was look at my slides and he could have known. It was no surprise.

So, now, what was very interesting on the part of the report of the new commissioner is that he seems to except already the fact that there were enormous cost increases in the North Slope. Now, let me tell you: that's not necessarily proven. The situation is: cost increases are not the same all over the world. If you go to deep water Gulf of Mexico, yes, deep water drilling rates quadruple. In 2003, the rates were \$150,000; ... today you pay a half a million dollar a day for the deep water rate. If you go to Alberta, around Fort McMurray, labor crews tripled in cost. But my client, Kuwait, for instance, that I did careful cost analysis for, rig rates and cost increased only 30 percent over the same period. Now, I didn't see, in 2006, great evidence of enormous stress on the North Slope, with respect to costs.

11:25:25 AM

DR. VAN MEURS: So, for me, it is not yet proven that there has been significant cost increases on the North Slope, as the commissioner of revenue already accepted. Now, normally, it is not so good to say that the cost increased already before you even do an audit. What you are supposed to do, is do an audit first, and then decide whether there were cost increases and how much they were. So, consequently, that is why I greatly admire this government for hiring better auditors. But if you cannot go out at the same time and say we are hire all these better auditors, but we already now there is 100 percent cost increases, then you don't need your auditors anymore. So, consequently, the fact that you go out and hire all these auditors is that you didn't know what the cost increases were. And that is precisely what it is. I wouldn't be surprised if four years from now suddenly there is this small announcement in the newspaper that says, "We now redid our 2005 and 2006 returns and we collect the few hundred millicn dollars more." I wouldn't be surprised.

11:26:41 AM

DR. VAN MEURS: I therefore believe that before you make these drastic conclusions that here has been these enormous cost increases on the North Slope, that it is imperative that you do your audits first, before you reach that conclusion. That is why the date 2011 was there, because today, there is no proof of anything. Today there is no proof of anything. Yes, we know international all kind of cost increases - I told you about that - but that doesn't mean that there is 100 percent cost increases in the North Slope. That could very well be companies over-declare. If you start a new tax system, all those companies try you out; they always try you out. Let's see what they go for, you know, and then you have to send the auditors in and then you fight back. That's always the way it works. Now, have we already given up on the battle? Of course not.

11:27:52 AM

DR. VAN MEURS: What I'm concerned about is that actually the price for declaring more costs has been lowered by this legislature. The legislature actually lowered the interest rate applicable to late payments. Now, it's now, right now you only have interest, normal U.S. kind of regular interest rate, so, consequently, the penalty of over-declaring is not very high. And if you are going to improve the law today, apart from the good transparency measures that a new government is proposing, and the stronger measures to create a very better administration, I think in addition you should look at the whole penalty systems. Companies should not get away with over-declaring and then letting you fight for five years, you know, to get your money back. So, that is something I didn't discover in the new bill; and I think it is necessary to put that in if you really want to have a strong system of accounting.

11:29:11 AM

DR. VAN MEURS: Let me then just make some few more comments on some of the other provisions on the law. As I mentioned, this 10 percent floor really, I think, I think is a political floor; it is really nothing like a real floor. It is kind of a nice feature to have, but it doesn't do anything good for you. If want a gross plus net system, do a gross plus net system, don't do a net system and then under the precise circumstances that may occasionally occur you have a gross system. That is no good. So, consequently, if you want a gross plus net system, as I mentioned in March the fifth, do a gross and net system. I think it is a good recommendation. But don't do something that looks like a gross and net system but is not a gross system.

So, consequently, either do something substantive and real or just forget this floor. This floor makes no sense administratively.

11:30:25 AM

DR. VAN MEURS: We are having a tax that is consolidated. Se just discussed that it is difficult enough to administer a consolidated tax. Now, if you want to start ring fencing and taking all kind of pieces in the Arctic that should be separately accounted for with cost allocation procedures as the law says. There's got to be all kinds of cost allocation procedures. You are now creating an exponential growth of the difficulty of administration, for what purpose. For no purpose. So, this whole recommendation makes no sense.

11:31:12 AM

DR. VAN MEURS: Tax credits. Under the law, under the PPT, we had a clear tax credit. And we said if you go after these heavy oils, in the year you investment you get your tax credits, the full 20 percent. The new law says we made the enormous improvement - now you get it over two years. What is that going to do? The government wastes the same amount of money and you lose now the whole incentive of what this tax credit is designed for. So, what good is that? This displayed as an enormous improvement in this bill. This does nothing, as far as I'm concerned. The government get the same money and you lost now all the incentive to reinvest because only get half in the year that you invest. For small companies that's really important, particularly since this is tradable. So, now you have the tax credit with no effect or a very much reduced effect, but you still pay the same as Alaska over the two years. Why do you want to do this? This is just a bean counter's invention to kind of look smart, but, really, it doesn't do in practice.

11:32:43 AM

DR. VAN MEURS: Then there is the corrosion issue. And I think the corrosion issue - when we had the PPT debate, we all were greatly dismayed by all the news that reached us about the poor maintenance of the pipelines and gathering lines in the Arctic. And of course, I can understand the emotion and say we should not allow the deductions for that because this was mismanaged. And, I feel this is great politics and I can understand the emotion, but for administrators this is very difficult to do. Just thin of this poor 26 year old that has just gone through

college and has to check the forms of cost and now she ... or he has to decide whether these pipelines were properly repaired or not. Now, this doesn't work. So, consequently already when this issue came up last year I suggested, and I'm very happy that this legislature adopted this, I said, "Look, please make it easy for your administrators. Let's just \$0.30 a barrel and have it over with to show our displeasure about the poor state of repair." And that was accepted and I am proud it was accepted; it was a good measure, it was an expression of the discontent about this matter. And we got our money back already. Now, you can debate the \$0.30. If you want to make \$0.50, if you want to make it \$0.50 for capital costs and operating costs, also good. Maybe the figure should be updated. But that \$0.30 was an expression of this legislature that they felt it was unjustified to deduct costs for poor maintenance, and it was easy to administer, just one little line on the form and say you don't get it. So consequently, that is why this was introduced and I still think that is a good measure, we should stick with that. The figure was calculated very quickly because we were in the last hours of this session. Could the figure be improved, yes, maybe with all the information we have today maybe we should change this figure, or we should make it a figure applicable to five years, or we should make it an other figure. I'm not proud of the figure, we needed it to do an immediate measure and I'm highly recommendable to investigate whether this is the right figure. But, once you have established this figure I think you have expressed your displeasure about the fact that Alaskans should not pay for unjustified repairs. And I think that is entirely justified; that is entirely good. And that was the whole idea of the \$0.30 and it is already in there.

11:35:57 AM

DR. VAN MEURS: Extra incentives for exploration. Actually, the current PPT law already included some extra incentives which I was never much in favor of. I told this legislature repetitively, on certain questions, that it was my recommendation not to go much further than a 20 percent credit. And the reason is by the time you start to pay a 40 percent credit or other high credit and you give the PPT deductions and you give the tax deductions, you reach the point where the State of Alaska and the federal government are pretty well paying the entire well. And that's not leading to efficient oil companies. A very important objective of the State of Alaska should always be to promote efficiency. You don't do that by paying 80 percent or 70 percent or 90 percent of an exploration well.

11:37:06 AM

DR. VAN MEURS: Joint Administration. I was pleased to see, as I saw better exchange of information. That is just excellent. I think these are good provisions. I would highly recommend that you pass them because, yes, when I was working with DNR and DOR, there were occasional problems because of confidentiality. And because of this we could not exchange information and, obviously, that is something that can be improved. So, I welcome those kind of provisions. However, the bill seems to tip toe into something that I would be very worried about. And that is somewhat of a joint administration of this PPT. That would be very bad. My experience around the world is as soon you two governments in charge of administering a single tax, it becomes all clogged up in administrative procedures. And that is not to the benefit of anybody. You don't need two government departments. Now, I'm not saying that that was the intention of the bill, but there seems to be a little bit of atmosphere of that in the bill. So, consequently I would strongly recommend DNR has the role to collect royalties and they should do the best possible job on that. DOR has the role to collect the PPT, and they should do the best possible job on that and there should not be all kinds of crossovers that could result in delays and other complications. Mr. Chairman, that is all I have to report to you. Again, I like to express my great gratitude for coming here and discussing a very exciting law or bill, rather. The only thing I hope is that this will not become another eight-month session as we had last year.

11:39:07 AM

CHAIR SAMUELS: From your lips Dr. van Meurs. To "capsulize" then, you don't think we should change it now so that the tradeoff then becomes the potential of perceived by investors as unstable versus if we do change it now, you think there's probably a little bit money left on the table. But, the balance that is struck. That's what I got out of the presentation. I lived through it for the eight months so I understand a lot the technical things. But, on the big picture thing, the balance then, as you see it, is are you going to miss out on a couple of projects and a couple of investments because people are going to sit there and go, "Well, we'll wait, they might do it again next year. We'll see what happens with revenue figures, we'll see how much production figures, they might do it again, they might do it again versus move ahead and move it forward. How stable will that number be?"

11:40:07 AM

DR. VAN MEURS: Mr. Chairman, that is exactly my concern. As I mentioned, I think the recommendations that I made in the past were good recommendations. Of course, you can increase your government take, particularly under high prices if you go for the gross plus net system. Particularly, if you look at today at \$86 a barrel, that seems, you know, attractive. Nevertheless, you start to run the risk that investors become wary of making strong decisions about Alaska. And the whole purpose of the PPT was to encourage investment, the whole purpose was to start developing the heavy oils. It will require enormous investments to development of five billion barrels of heavy oil will, much of that has to be done over the next 10 years. If you create an environment where people say, "Now, who knows. Let's look what happens next year?", then you create an environment of uncertainty. And all of the benefits that you tried to grant with the tax credits, with the PPT credits, as so on fall by the wayside because investors start to perceive risk in Alaska, generally. Now, some studies have been published by Wood Mackenzie that portray Alaska at the absolute bottom pole of risk. I strongly disagree with those conclusions because I think they're highly exaggerated and the methodology of reaching that conclusion was extremely poor. But, nevertheless, yes, if you change your taxes every year, you get a bad name. That is just the way it is. And consequently, that will make investors hesitant to commit the big blocks of capital investment that are going to require and all you're going to get, more and more, is small incremental investment just for this year to see how it goes next year. And that's not, I think, the atmosphere you want to create. The PPT was a great upheaval, but from now on you'll like to re-establish that Alaska is a good place to invest, it is a good partnership to be in Alaska, there is understanding in Alaska of the complexities of developing the North Slope oil. And that is definitely a message that has to go out. So, ... I absolutely agree with your conclusion, Mr. Chairman. My bottom recommendation, my base recommendation, is don't change anything, wait until 2011, see what happens, see whether maybe some further changes need to be made. But if you want to make changes, yes I invited you to make changes, I think. And my recommendations from last year are a good indication of the kind of changes you can make. And you would collect more money, you would collect significantly more money at \$84. And that's, then, the decision the legislature has to make.

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CHAIR SAMUELS: Okay, just as a side note. The Wood Mac study that was referenced - and I've seen it in various comments by the various factions here - is between Marcia Davis at the Department of Revenue and myself. We've split the costs so the State of Alaska has bought it; similar to when Senator Therriault also purchased one. It is a confidential document. Wood Mac is a company that goes and does a report, and then sells it off the shelf. So, if the first person that buys it makes it public, they're obviously going to run out of customers in a very quick ...

11:44:10 AM

DR. VAN MEURS: Yeah, my comments, Mr. Chairman, were because I had independent access.

11:44:17 AM

CHAIR SAMUELS: Yes, yes, and I wanted to make sure I clarified that. We're still clarifying also. When we first purchased the Wood Mac agreement, we were hoping that some of the Alaska-only documents would be made public. And now there appears to be some ambiguity. And we're talking to Wood Mac, ... my staff and myself will have a call with Wood Mac tomorrow. One way or another we will have the report. Legislators will have to sign a confidentiality agreement to go read it. We will have somebody, Senator Therriault and myself, I believe, probably four years ago now hired Chuck Logsdon who had then just retired from the Department of Revenue to, essentially, explain it to us. Because to just read the document, I can tell you right now, it might have well been in Greek. This one, I don't know how readable it is. We will have somebody there to try to do the same thing: to walk us through what the numbers mean. And then we will -- it still remains to be seen whether or not we will have some of this to go public. And I appreciate the help that we've gotten from Marcia Davis and the administration on trying to get this report, and get all the information to all the policymakers that are out there right now. And we'll have more information, I'm guessing, by Monday. Talking to London, you get a little lag on the information, obviously. So, as a side note. Further on to questions, I've got Senator Hoffman and then Representative Ramras.

11:45:32 AM

SENATOR HOFFMAN: Thank you, Mr. Chairman. One of the reasons that this administration brought this revision ... to PPT is that it was perceived that this tax revision was made under the "cloud of corruption." Does it matter to the investors if we change the law and use that as a reason? Does that change the environment of uncertainty or stack the tax instability in the State of Alaska, by the investors?

11:46:09 AM

DR. VAN MEURS: Yes, Senator. Personally, I believe that it is a fundamental error to design fiscal systems based on fiscal targets, as is proposed. Like, Okay, we promised \$2 billion ...

CHAIR SAMUELS: Based on what, you think it's a mistake to base them on what? The audience couldn't hear what you said.

DR. VAN MEURS: Sorry, if I interpret your question right. Last year, presentations were made and said under those conditions; we are going to collect \$2 billion or something and then it was \$800 million short, or whatever. I believe Alaska should extract a fair share from the resources; it should not be based on how much you need in your budget. It should not be based on what, you know, what the budget objectives. ... was less received than was anticipated, yes. Firstly, we don't know why because will still need to do the audit. And I think the audit could very well point that another \$400, another \$500 million will be recovered. Secondly, did costs go up beyond the projections that were made. Yes, as I told you, these costs were in strong inflation, strong escalation and some that was not taken into account in the forecast. But, I think it creates a bad impression on investors if you say, "We like to collect so much and we just get it out of your pocket." It is like a landlady telling you, ... "I like to collect so much ... and the rent this month is double because I need the money." Like, that is not the right way. The rent for the apartment should be a competitive, fair share, fair basis, fair commercial basis, it should be competitive whether the landlady needs money or doesn't need money or had expected more money last year. This should not be an issue. And consequently, that is how I think fiscal systems should be designed. They should be designed of competitive fairness not on government requirements.

11:48:43 AM

SENATOR HOFFMAN: Just a clarification. Thank you, Mr. Chairman. That was one of the reasons, you know, that we did

not get what we anticipated. That was one of the reasons the administration came forward with this legislation. The other one was the rates were set under a "cloud of corruption." And does that matter if we decide to change the rates for that reason; does that matter to the investors and how do they view that? Will they still view that Alaska as an unstable tax structure regime.

11:49:18 AM

DR. VAN MEURS: No. Of course, I'm not familiar with the details of the corruption scandal. I've heard about it and I have heard some names. As I recall well, these were the people that voted against all the proposals that I had for a better share. So consequently, we got the better share despite them. So consequently, I don't know how much clout this causes on the fiscal system. The fiscal system was passed with them voting against it and it was passed by the majority. And consequently, they didn't seem to win their battle. So consequently, I don't understand what the cloud is. The law was passed by those people who felt this was a fair system, which have not been accused of anything. And so, it was the best deal for Alaska. And those who voted against it, fine, that's no problem.

11:50:18 AM

SENATOR HOFFMAN: I understand that, but how is that viewed if we use that as the reason, the justification, in changing anyway. Are we still viewed ... as unstable state?

11:50:35 AM

DR. VAN MEURS: ... Firstly, as I said, I have not been involved in the details of this investigation. But from what I saw happening in the legislature last year, it is the opposite. The law was passed despite maybe certain things going on. So, there is no argument to begin with. Nevertheless, yes, if you say every time we discover corruption in the nation, we have the right to change the fiscal system. I mean, I can think of a lot of countries where the fiscal system has to be changed perpetual. I'm not sure whether that's a good philosophy.

SENATOR HOFFMAN: Thank you, Mr. Chair.

CHAIR SAMUELS: Thank you. Representative Ramras and then Senator Therriault.

11:51:13 AM

REPRESENTATIVE RAMRAS: Thank you, Mr. Chairman. Pedro, nice to see you. Two questions that overlap with one another. For those of us that are familiar with paying a quarterly taxes rather than federal withholdings from paychecks, the IRS code is explicit and it's punitive. And, I believe, if it's correct, I pay 110 percent of may last year's tax liability and that should I opt to deviate from that and I end up paying less than 90 percent of the next year's tax liability, the penalties are rigorous and, I would say, punitive. And that's why we quarterly taxpayers abide by the IRS tax code. So, I would like for you to be a little bit more explicit if your recollection is strong enough to talk to us about the penalties and where we may have failed in that regard. And then secondly, I'm familiar with the offshore, the deep water offshore drillers. Transocean and Global Burning Santa Fe are in a merger to try and monetize the fact that they are backed up to the year 2010 or 2011 for all of their deep water rigs. They can't build them quick enough. And for those of us that live in a universe where the CPI index is 3 percent or less, when they include food and energy - which always amuses me about Alaska because we're all about food and energy - it is difficult for lay people, for legislators to digest. To borrow Hilary Clinton's statement, "Without willing suspension of disbelief, that inflation in certain pockets of certain industries could possibly run 30 percent, 50 percent, 100, 300 percent annually. So, can you merge these two issues, which is this nature of punitive or a failure to be punitive in the interest for over reporting or underreporting of expenses along with the fact that we have this unusual inflation around the world. And even if it is a lesser inflation than the State of Alaska, it's still extraordinarily significant compared to say, the CPI index for Anchorage or around the United States.

11:53:47 AM

DR. VAN MEURS: It's a great pleasure to respond to that. To begin with, my ... suggestion is that this legislature could use the new law from the perspective of what happens to somebody that over declares, say, \$200 million and goes through the whole process. What are the penalties for over declaring, what are the penalties for delay, etcetera. What I recall very well was that there were actually in the original production tax, Draconian penalties for this. And in the current tax, the current legislation, this was for a late payment, a lot of that was softened. Now, that might have been a good measure, I'm not

an expert in tax administration. However, my recommendation would be that you X-ray the procedures. And say, in the hypothetical case of somebody over declaring \$200 million and after four years of auditing we find it and he finally pays his PPT, what happens? And I think - is that fair and what exactly, as you say, is that similar to what would happen to a normal U.S. citizen that under declares or over declares his taxes. As far as the international situation is concerned, I think yes it is very difficult to understand these enormous swings. What I like to highlight is these swings are up and down. Rig rates come down as fast as they go up. And consequently, the reason that this relates to temporary shortages in the services market and in the labor market, sometimes, that cause people to simply ask for the best price. And these rig rates, therefore, and not just rig rates but other service industry rates as well have had a tendency of swinging rather wildly if there are events that cause a major shift in demand for those drilling services or other petroleum services. So consequently, it is quite well established, normal economic behavior that that is how the market works. That's how the market for services work. This is also one of the reasons, I typically am against the overall concept that people say, "Oh yes, if oil prices go up, costs go up." Yes, costs go up in the short term because there is shortages of services. But in the long term there has always been a downward trend in cost in the oil industry because of the enormous progress of technology. The reason that we talk today about very extensive heavy oil production in the North Sloe is precisely because technology has now made that production far lower cost per barrel than it was in the past. So, the long-term trend is for efficiency, is for technology improvement. In the short term there are wild swings and they're well documented and that is not anything of (indsic.). There are wild swings in particular markets like rigs, like petroleum services, like certain labor crews, like supply vessels, anything that is in short supply and has a limited kind of inventory, and consequently if price goes up suddenly prices double, triple, or quadruple. The experience is all you have to do is go back to the early '80s. I still remember when I was drilling wells in Alberta. The cheapest well I every drilled was - and that was in 1986 when the oil prices had completely collapsed - driller came to me and say, "As long as you pay for the fuel and the labor, you have my rig." And that was the cheapest well I drilled, which proves that cost come down as well, if prices decline or if suddenly there are too many rigs in the market stimulated by the high prices. So, these costs go up, costs go down. That makes it so important for auditors to be well-trained because you sit there, and now you have to approve a

half million dollar a day bill rather than \$125,000 a day bill. And you have to understand whether that is a reasonable rate, yes or no. And that is why I really like the initiative of this government to really strengthen the auditing and put every possible power into high quality auditors so that you get people that understand these kind of movements.

REPRESENTATIVE RAMRAS: Like everyone else, I have a hundred more questions. Thank you, Mr. Chairman.

CHAIR SAMUELS: Senator Therriault.

11:58:55 AM

SENATOR THERRIAULT: Thank you. Pedro, with regards to ... the situation in Alaska, whether it is in fact stable. In the memo that you wrote on February 1st, which has been called the banana republic memo. You have a small paragraph in there that says, "Despite the boisterous politics of Alaska, the state has never adjusted fiscal terms to the producers in a way that is unreasonable, compared to international practices in developed nations. On balance, the State of Alaska has been a reliable business partner with respect to the law and with a well functioning democratic system." And then you go on to say, ... "There is absolutely no need to treat Alaska like a banana republic in order to get the gasline." Now, you made that statement after the governor had done his aggregation, and having in mind that PPT was going to pass. So, two changes to the system and you say, "The State of Alaska is a very fair, reasonable business partners." Now we're contemplating perhaps one more change, and with that one more change you say, "The state will run the risk of getting thrown into the category of being a basket case of instability." It just doesn't seem to me that you can write a memo that says that with the aggregation, with PPT, we're fair, we never have done anything to disrupt ... the fairness ... that we display operating with these major producers. How can this one thing throw us now into the category of being a basket case of instability.

12:00:40 PM

DR. VAN MEURS: And I absolutely agree with the memo that I wrote. The memo that I wrote was written from the perspective that Alaska really had not made any major change in its production tax for, I think, since not 1989 or something like that, if I recall the year correctly. So, 16 years of managing a fiscal system without any major change is stability in my

mind. This law proposes a dramatic further change, so consequently, change every year is very unstable. I'm not recommending you wait another 16 years before you make your next change. I think 2011 would be, as I recommended, a reasonable date and the legislature agreed ... that 2011 would be a good date to review that. That is why, I think, 16 years of fiscal stability as Alaska had, was a very good track record. Many governments, like Britain, Norway, made more frequent changes. Alberta, where I know have been advisor over the last six months, definitely made more frequent changes. It's not unreasonable to make an important fiscal change every 10 years or so. But to make an important fiscal change one year and the next year, that is very unstable. And I still believe if Alaska wants to be perceived stable, my recommendation is to do what the legislature decided last year and say, "Let's look at all of this again in 2011." We put the companies on notice already, so if they want to make investment today, they know already we're going to look in 2011 at this whole fiscal system again. And if there is fair reasons for changing it, as I believe that may very well be at that point in time, then, I think, you should change. But, I feel very troubled by, you know, making such an important change after 16 years. As I said, that's fair; most developed countries, most developed jurisdictions around the world make those kind of changes every ... 10 years or so. Making two very important changes, one after another, particularly because it seems to be for politically motivated reasons rather than for other reasons; that's very troubling.

12:03:24 PM

SENATOR THERRIAULT: Mr. Chairman, a couple other questions. I think, though, that, certainly my sense of my colleagues is we're not interested in getting into a situation where we're changing the tax every year. We're looking for that fair system, taxation system, that will give us another ... 10, 15 years of stability. But if the system is not equitable on both sides, it is internally destabilizing. If the system doesn't derive a fair share for the sovereign, then the people will clamor for a change. If the system takes too much, on the other side, then you shut down the investment. And it, again, forces a change. So, I think what we're looking for is that next system that will give us 10 or 15 years or maybe longer of stability. I don't know that promising that we won't look at it for another four years, I don't know that that offers a whole lot of surety to the producers. It seems like we should come up with a system that we believe, right now, is fair for the

long haul, for the sovereign, and for the producers. And I think that's what the governor has proposed here.

12:04:43 PM

DR. VAN MEURS: My view is that today you don't have the information to make that change. That is why 2011 was chosen. You haven't even done your first audit yet. How do you know how much money is missing? How do you know whether you received less than you should have? You don't. And consequently, you don't know what the impact on investors will be. You don't know how much interest is going to be shown over the next four years in new drilling and new activity on the North Slope. So, you don't have the information today to make a dramatic change that will last for 15 years. In 2011 I think you will have that information. Is it fair? The reason that I believe it is fair to look at 2011 all over again: yes, Alaska made a dramatic shift in structure in its production tax. And consequently, there was great concern around the legislature: will this system work; will this actually deliver; will this bring the investment; will this raise the income? So yes, if you introduce something completely new, is it good to do a reality check after a few years and say, "Did it deliver what we expected it to deliver?" That's a good policy. Then once you have all the information and once you have all of the facts, and ... you have done all your audits, and you have accurate information about the cost .... I'm very supportive of the governor in the transparency area - if you publish good data for the public to know exactly what the costs are so that people don't have to react to rumor, now everybody in the state would have the basis for a good discussion. I do not agree necessarily that the current PPT is completely out of whack, it is not a disastrous kind of PPT. You have collected more, people are investing, the law is doing what it was supposed to do. And consequently, I do believe that the law seems to be delivering what was intended. Could everyone be 100 percent happy? No, but it is not ... a complete discrepancy between an ideal system and what you have today. So consequently, ... people may feel unhappy about the fact that certain things were not coming out for the moment. Who knows later on if we'll prove wrong, but for the moment it didn't seem to come out in revenue collection as expected. But today you don't have the information to make a major change that will last for 15 years. In 2011 you have all the information to establish a fair system for Alaska, for the long term, and to regain the status of fair stable partnership between Alaska and the industry. And I think that is a fair program.

12:07:50 PM

SENATOR THERRIAULT: Mr. Chairman, a couple more things while Mr. van Meurs comments are fresh in our mind. With regard to the \$0.30 per barrel deduction for the maintenance, in your memo of August 5th you talk about, it says: "(Indisc.) the \$0.30 per Btu equivalent barrel is based on reasonable capital maintenance costs for fields for which I have confidential information." It seems like the debate at the time and basically your suggestion on how to fix it was: there were going to be shutdowns. There's going to be shutdowns that stem from lack of proper maintenance, you just have to accept that and we're going to offset that by this \$0.30 percent barrel deduction. But what I think the administration is trying to do is come up with a system where we don't just accept that they are going to be, for lack of a better term, bad acts as far as maintaining the infrastructure as it should be. That we provide some incentive for the companies to expend money as a reasonable and prudent operator would do, so we don't have unexpected shutdowns. So, we don't have the leaking pipes. And although I've not bought off completely on the suggestion that the administration has made, it seems like if there's a way of doing that so that you don't just say, "Well, there's going to be a bad actors, just get over it and live with it." - that we should investigate that possibility. But the \$0.30 just seemed to me throwing up the hands saying, "Can't help it, can't avoid it. You can't police well enough to keep bad acts from occurring."

12:09:29 PM

DR. VAN MEURS: Now, to begin with, as I stated, the \$0.30 was meant to crystallize the displeasure of the legislature that ... unnecessary costs were incurred and that those costs should be taken into account in a design of the PPT. And consequently, the costs for those heavy repairs should not be repaid. As I said, I'm not proud of the number, it had to be generated in a very, very short time. I'm perfectly willing to accept that a better number could've be generated with more information and maybe that is what we should do. Now, yes, ideally you should only allow companies to deduct costs that reflect an ideally good operation. I really don't know operations around the world that have degree of perfection. And consequently, does it occur everywhere in the world that certain mishaps occur. Are humans making errors? Of course, all the time. Are misjudgments being made? Are companies sometimes cutting things short? These things happen all the time. I'm not saying they're good. On

the contrary, I think a regulatory system in the state, and particularly with the federal government, should be on top of enforcing the highest possible environmental and health and safety standards, obviously so. But that is basically a regulatory task. From a fiscal point of view, you can say look we know that so much percent of your operation seems to be no justified. And therefore, we put that figure, make the life of our administrators easy and we say that is a non-deductible expense. That doesn't mean that you accept the fact that good practices occur. On the contrary, obviously, it's primarily a federal task. Obviously, regulations should always be such to make sure that companies adhere to all of the standards. And, as I said, unfortunately around the world that doesn't always happen. But, Alaska shouldn't pay for that. I agree with that ... concept. It's just how do you implement that concept. And I believe it is easier to look at the facts, do some economic study, say now what percentage seems to be unjustified. That's the percentage we're not going to allow. And that percentage, ideally, should go down over time. And that is a practical measure that I think achieves the same -- I agree with the goal, it is just I think the way it is crystallized in this law is very difficult to administer, will lead to a lot of court cases, will lead to a lot of stress on the administration, will ask people to do things they really shouldn't be doing as administrators. So, that's the reason. I'm not disagreeing with your philosophy, it is just how do you do this in practice to make this work in a way administrator three levels down the line can administer.

12:13:08 PM

SENATOR THERRIAULT: Mr. Chairman, is it your intent to have open question and answer later, after both presentations.

CHAIR SAMUELS: ... we've got Senator Huggins and then I've got a question. After, we'll probably take a lunch break and then Mr. Johnston has ... about an hour presentation, a little bit of Q and A and then I can have both of these gentlemen back up together. ... I'm assuming they're going to agree on some things, they're going to disagree on some things, and they can both ... give their rationale on why these things are. So, there's more opportunity. We'll be here as long as there are questions to be asked. We've got these guys for one day. And we're paying a pretty penny for them.

12:13:44 PM

SENATOR THERRIAULT: One more, one more question. Pedro, I think that where you, perhaps, got into trouble with your credibility amongst legislators is when it became apparent to us that you were going to issue your original report with a tax rate of 25 percent. And in my own notes I kept in my office, you and Mr. Johnston got together on February 12th and agreed that 25 percent, with the 20 percent credit was fair and reasonable.

DR. VAN MEURS: That's correct.

SENATOR THERRIAULT: But then you were instructed by the administration to change your report.

DR. VAN MEURS: No.

SENATOR THERRIAULT: And where you got in trouble is you changed your report.

12:14:28 PM

DR. VAN MEURS: My February 14 report reports 25 percent rate, and that has never been changed. So, my report -- in fact, I asked the governor specifically, "You just announced 22 and my report says 25." He said, "Go ahead, publish it." So, ... my report is clear. I recommended 25, I agree absolutely with your history. I wanted to feel myself certain that my recommendation was right on the 25. So, I met with Daniel Johnston and I asked him to confirm what his feelings was and he confirmed, "Yes, that is a good number." That's why I recommended it. And I never changed my February -- there is no report after February 14th where I changed my personal opinion. The governor, of course, accepted 20:20. And then in the legislature a lot of debate took place whether 20:20, 25:20 would change a lot in the amount of activity. And as you recall, I kept saying "I don't see very much difference in activity between 20 and 25." I testified to that a number of times. But, yes, the governor announced 20:20 in his good judgment after discussion with the oil industry that I was not completely part of, I was tied in for a few minutes. ... therefore, I have some idea about the background of this, but that's what a governor is supposed to do. He's supposed to govern and make decisions. And as a consultant, you're only an advisor. And if the governor decides differently, that that is exactly what government is all about. But that doesn't mean that my report was changed. No, my report was there. I, as I said, you're entirely correct, I reviewed my report with Tony Finizza also, of Econ One. I felt just because

I changed my own recommendation from 20:15 to 25:20 because I felt the international competitiveness justified that. And consequently, I wanted to get confirmation from the other consultants and they agreed with me that ... they felt confident about that number. So, consequently that is why I recommended it. And that report has never been changed.

SENATOR THERRIAULT: Thank you, Mr. Chairman. I'll have more questions later.

CHAIR SAMUELS: Thank you. Senator Huggins.

12:16:57 PM

SENATOR HUGGINS: Pedro, for the record, I started at 22.5, voted for 22.5 and it is 22.5. So, you know, to be quite frank, I was not in the mix as far as really hooking and jabbing coming to the results, but I had my opinions. And based on some things that you said and other people said to synthesizing that, I feel comfortable with what we ended up with. But, number one, I would say to you you're May 10th slide, slide number 21, which you talked about the huge risk - I'm going to get back to that - was, of all the things that I've heard you say were down ... in the hall going through our educational period for a number of days, and you said that it may not be economically feasible to build this gas pipeline based on the variables. And then you refreshed my memory on that and I thank you for that; and it stuck in my mind. We were going through AGIA, I had that same concern. Now, you are hear today, and I'll just say for the chairman and other people on LB&A, I sat around in a meeting and we talked about how to best spin people up. And we agreed, I think without dissent, that bringing yourself and Daniel Johnston here was probably as good as we could do because you were the architects and the advice that we were getting. And I say on that, I sustain I supported that. And I still do today and I thank you for that.

12:18:30 PM

SENATOR HUGGINS: My question for you, though, going backwards is, back to slide number 21 - I want to make sure I heard you correctly. You then extrapolated from slide 21 that ... Alaska's gas pipeline today is not economically feasible. Did you say that?

DR. VAN MEURS: Yes .... I can give you some explanation on that.

SENATOR HUGGINS: And I will, and ... let me just say that in traveling with and talking to Representative Samuels, you are a unique character. And talking to people ... of international renowned, but doing business in oil and gas. I mean you bring two things to the table, one is international experience and the other is expertise. There some people in here that like to hear what you had to say and some don't. But, you know, in my estimation the business of professionals is not whether you like what they have to say, it's about whether or not they have those two ingredients. And I can tell you, and I'll say this not to compliment you, but they're a number of people in the continental United States, some of them outside of it, that says that Pedio, doesn't matter whether you like him or not, he's one of a kind. And he has expertise that probably can't be come by. Once again, I get back to slide 21 and ask you again if would just for a moment reflect on your statement of -- because in my mind, we're debating about oil taxes and what we're going to do. That's a stop-gap measure. The future of this state is with gas. I think we all agree on that. The question is, you know, we have agreed for some things in a structure called AGIA. I'm concerned because of your statement and I would just like to hear from you on that.

12:20:21 PM

DR. VAN MEURS: Thank you for you very ... kind comments Senator, to begin with. I'm deeply concerned about the gasline because as you probably remember from ... the discussions in the hall, I presented to you how the pipeline was completely uneconomic at the ... cost of 2001 and the prices of \$3.25 per million Btu. Today, the costs of 2001 have doubled so you need twice the price to get the same economics back. Today, the price in Alberta is \$5.50 and Henry Hub it is \$6.50, \$7.00. So, today we actually have the economics that I presented to you, that prove that the line was uneconomic. ... so consequently at those levels and those rates that is immensely troubling for Alaska. You may recall that I spent some time - here you see the slide I said gas price risk and cost overruns - and I used the word gas price risk rather than just the gas price because there were two aspects to this gas price risk. One: the price itself. But far more important is the structure of the current market in North America.

When I presented to you the economics of the pipeline, I presented to you a forecast of gas prices that over the 20 years was equal to 95 percent of the Btu equivalent of oil because

that had been over the last two decades, the typical average in the United States. Today, we are talking about 40 percent or 35 percent. So, gas prices today have cratered relative to oil prices, on a Btu basis. What is causing that? There are many causes for that. Firstly, conventional supplies are somewhat stronger in Canada and the U.S. than expected. But, also other states in the United States have now started to realize that in an energy crisis that we face, that they like to develop their coal resources. And states like Montana, and Wyoming, and New Mexico are really strongly promoting their coal resources for their electricity generation. Now, electricity generation was supposed to be the big market for the gas. Clean coal can be produced today at \$2.00 per million Btu. That is what we are competing with. LNG can be landed for \$4.00 per million Btu and LNG imports are rapidly increasing. That is what we are competing with. So, it seems that a dramatic permanent change has changed in the North American gas market that is far more dangerous than just an occasional low price. What has changed is the entire structure of supply and demand over the last three years. And if that change prove to be true, there is no hope for an Alaska line. And consequently, that is something that is greatly troubling and that you should carefully consider. In fact, if you look at the situation today with \$5.00 or \$6.00 in Alberta and maybe \$4.00 transportation cost to get it to Alberta, the netback at the well is \$1.00 or \$2.00 per million Btu. In an environment where you have gas that is only worth \$1.00 or \$2.00 per million Btu and an oil price that is \$86, the most logical economic use to monetize gas in Alaska is gas-to-liquids because you need 10 mcf of gas for every barrel of oil. That means you can produce liquids for \$20 a barrel, in terms of input. And consequently, that is a much more fruitful avenue today, I think, to explore, than trying to look at even more costly, say, project for LNG exports that would create even a lower netback. So, consequently, is gas in trouble in Alaska? It is in deep trouble, not because you did not approve the gas contract, not because of that. Because the world has changed and that is something that, I think, Alaska needs to focus on. I think Alaska needs a new approach to how to monetize the enormous gas resources of the Arctic. You need to rethink what you're doing; that would be my conclusion.

SENATOR HUGGINS: Thank you, Pedro. If I might, Mr. Chairman. ... I think that we have received a challenge here that the future destiny of our state economically has some question marks. And we need to answer those. And I appreciate what you said and whether ... 100 percent, 90 percent, 75 percent true,

the validation and the exploitation and exploration of what you said, I think, is important for us. So, I say thank you Pedro.

DR. VAN MEURS: Thank you.

12:26:49 PM

CHAIR SAMUELS: Thank you. And I have a question on other clients of yours. And I have been following Alberta. Linda, I get three e-mails a day on all sides of the issue in Alberta. And if we think we play bloody politics, just read in the papers. We're not in their league, as far as the fight that's going on ... the royalty board, which you are the advisor to, to drastically raise the royalties in Alberta. And my question is, not only for Alberta, and I asked you and Mr. Johnston the question over dinner last night and I'm going to ask him the same question after lunch when he testifies. In most of the other jurisdictions where you deal with, where you don't have, you know, a production sharing agreement, where it's - you got 85 percent and it's going to be 85 percent. You know, you've got a lot better situation or lack of [REDACTED] a worse situation, as the case may be. Our economy is so small and we are so closely tied to two factors. We are closely tied to the federal government and we're closely tied to the oil and gas spending and that money that circulates around. They just dwarf everything else in our economy. Is Alberta similar to that or are your other clients around the world, are they so centered on this one industry where a hiccup, a mistake, a something, a shutdown at Prudhoe Bay because of the feeder lines. Are others as dependent where their economy is just so fragile and so small? Are your other clients like that? Are all oil jurisdictions similar or is there a wide spectrum where some are like us and some are -- I assume in Texas, I think I read, that it's 5 percent of their economy, the production not the refining and all that, but the production. So if, you know, it imploded, then they take a little hit, but ....

DR. VAN MEURS: I would ... oh sorry.

CHAIR SAMUELS: No, go ahead. You kind of get the gist of where I'd like you to make some comments on. I'm going to ask the same question of Mr. Johnston, here after lunch.

12:29:02 PM

DR. VAN MEURS: I would say the Alberta economy or the Alberta oil and gas industry, obviously like in Alaska, has an

overwhelming impact on the government budget. And consequently,  
...

CHAIR SAMUELS: Not just the government budget. I mean the economy as a whole.

DR. VAN MEURS: The economy as a whole and the government budget. Contrary to Alaska, Alberta is not receiving many transfers from the federal government. So, they are in a stronger position. Also contrary to Alaska, there is 140 billion barrels of economic oil sands to go. And that is why the fight for the royalties, for the appropriate share for Alberta on that massive resource, equal to the oil reserves of Saudi Arabia, that is why the fight for obtaining a fair share for Alberta, on these massive resources is very vicious and very, very difficult. And as you could've seen in the newspaper, ... definitely very, very difficult time to get that fair share for Alberta. I would be happy if I got for Alberta the same what you already have in the PPT, and that is what I recommended to them. So consequently, that is only a dream for the Albertans to get that high. So consequently, that is ... the fight that we are having. Alberta, though because of the huge resource base does not compare with Alaska. Alaska compares more to two other clients I have: One famous Trinidad and Tobago - an island with a limited population and a limited resource base that only has a few opportunities to expand that resource base, maybe with deeper water, and interestingly also in Trinidad and Tobago the heavy oils. My other client for many years, Newfoundland, which also has a limited resource base and almost the same population as Alaska has. So, in both of these jurisdictions there is great agony about the future, just as there is in Alaska. And consequently, it's therefore that in fact that the government of New Foundland, just recently, the last months, changed the fiscal terms for oil - upped the fiscal terms for oil - and is trying to develop a new gas policy. As I said, Trinidad and Tobago is gambling on deeper prospects just as you are gambling on heavy oils. It is a very troublesome future that Alaska has based on limited oil resources, essentially uneconomic gas resources at this point and time, unless you liquefy it, and a declining great dependence on federal funds. And consequently, it was very important of this legislature to ... honestly look in the future and ... start organizing the affairs of Alaska in a way that creates a sustainable development for this state.

CHAIR SAMUELS: Okay. If there's no more questions, I think we'll break for lunch. ... It's 12:35 right now. Mr. Johnston,

... you said you had ... about an hour presentation that you make plus some Q and A. However much time you need. Why don't we come back here at let's say a ... quarter to two, give us a little more than hour. And we'll reconvene and then Mr. Johnston will give a presentation and then we'll have a chance then to have both of the presenters for questions. With that, we're at ease.

[DANIEL JOHNSTON presentation to be inserted later].

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3:31:01 PM

REPRESENTATIVE DOOGAN: One of the ... inherent problems with the PPT is that it's a sort of a one-size-fits-all tax. And we've heard testimony from the Administration that they have had, as they were coming up with this proposal, they had difficulties figuring out those trade-offs, that that clearly, you know, the difference between oil that's coming out of the ground regularly in predictable amounts, qualities and grades is different from oil that, if you poke a hole in the ground might be there and might not. So, if we didn't have a one-size fits all tax, what would that look like?

3:32:10 PM

MR. JOHNSTON: You'd have a separate situation for the legacy fields, and you'd have, a separate situation, you could almost treat it like another state. I mean to a certain extent for Cook Inlet, for sure, and for exploration up in the North Slope and other parts of Alaska. And, they could be dramatically different, there's no doubt about that in my mind. And quite a few other governments are doing, doing this around the world. They, Indonesia, that, they have a different type of system for oil versus gas, they have a different system for old rocks, pre-tertiary rocks, they have different terms for deep water, they have different terms for the western conventional basins that were known, producing. And they have different terms for the eastern frontier. And they accommodated all of these differences and had a system that was relatively unique to each of those environments. And in my mind, that could have clarified all, well, almost all of the problems, because, because the one-size fits all had enough unique, slightly different characteristics. It was unique enough, it made me extremely nervous. Anytime I see, in a contractual relationship between a government and an oil company, even one new thing, something new, I get very, very nervous, because it takes a

while to figure out where that thing might go wrong. So, if I see a system that has two or three things, bells and whistles that seem fairly innocuous, then I'm even more worried. In India, the one, the mistake they made, the one funny little thing that they did was they actually simply disclosed a little bit more information to the industry. They simply gave them a little bit more information into how they were going to evaluate the bids. But once the oil companies saw that they saw a way to pervert that system; it was the most amazing license round you've ever seen, and these crazy bids came in. It, but it, turned out that the craziest, the crazier the bid was the more likely it was to win because of the peculiar characteristics of how they were evaluating. So they just provided more information to the industry, that sounds innocuous, doesn't it? And yet, it was just, not only painful, but embarrassing to the Indian government. So, here you're doing things that are more significant than simply disclosing additional information. That's the problem with one-size fits all. Pedro deserves a moment on that.

3:34:28 PM

DR. VAN MEURS: Yeah, no. Basically, around the world there are two models of how you should go about designing a fiscal system. Some nations, Norway is probably the best example, some nations prove to be the extreme example with the one-size fits all model. And they try to design the fiscal system in such a way that it has some sensitivity to different economic conditions. Other nations, like Indonesia or like Egypt or, or Yemen or, or other nations, let's say Algeria, which was one of my clients, actually try to extract from each block or each field, the maximum government take. They may do that through negotiations or they may do that through other ways. Or in other words, one nation that, that does things block by block looks kind of like an, you know, a mosaic of, of, of leases and or contracts, there's different terms, and then the higher terms are in the more attractive areas and the lower terms are in the less attractive areas. That is a system that also could lead to, to optimization, from, from a government point of view. And Alaska, for the PPT could, could basically opt for both. In fact, the original PPT, sorry, the original ELF, former, that you probably heard about, the original, was actually, kind of a field by field; it was kind of the mosaic concept. Consequently, now what was concluded is that that mosaic concept as the ELF was, actually didn't seem to work. I mean, people had nicely put the formulas together but then, even Kuparuk field, based on that formula didn't seem to pay a reasonable

amount of, of share. So, consequently, the problem with doing it block by block is that you have to design some kind of terms for that block, specifically, or on the basis of some kind of formula that tries to optimize that. Those systems, you know, could be out-dated, as, as what happened in Alaska. When one of the main focuses of the PPT was to enhance investments in Alaska. So, the, but, it's very important to realize this.

3:37:14 PM

DR. VAN MEURS: Yes, optimization of government take was important, but the other important factor was to encourage investment in Alaska. That, consolidated systems tend to stimulate re-investment better than non-consolidated systems, as they call it, this mosaic system. Because if you have this mosaic system you can typically not take a cost from one piece of the mosaic and deduct it from the other piece of the mosaic. So, consequently, you have what you call ring-fencing going on in technical terms. Ring-fencing doesn't stimulate investment. Since the main objective in Alaska was to stimulate investment and particularly re-investment, of the companies that were already here, a consolidated system is a good solution for that particular objective. It, I'm not necessarily denying that other nations could be very successful with the, let's say the mosaic system, as well. I think everybody recognizes that Norway has been unusually successful with their one-size fits all system. Today, Norway has a petroleum fund that has 317 billion dollars in it. For 4.6 million Norwegians on the basis of excess funds from precisely a tax that operated somewhat similar to the POT.

3:37:14 PM

DR. VAN MEURS: So, can nations be highly successful with the one-size fit all? Yes, they can. We have many examples of that. So, it, it is really a choice. It is really a choice on the part of the nations that is if your main focus is extracting optimal government take from each piece of the mosaic, say, a ring-fence system, a, definitely has a lot of merit. If you want to design a broader system that, that encourages companies to look all over the state for investment opportunities. And get the benefits out of it, then a consolidated system has also great merits. So, at this, that, that decision that needed to be made and since, let's say, the ring-fence system hadn't worked pretty well and proved to be difficult to manage from the point of optimization, let's say, this Kuparuk not even bringing in any revenues. It seemed that a one-size fit all concept

would be a good thing to try out. And, consequently, that is what was presented to the legislature. So, but both systems could be successful. And other countries in the world I have recommended ring-fence systems, it depends entirely on the situation. For instance, right now in Alberta, for instance, I made the opposite recommendation. I made the recommendation for having a ring-fencing, or rather of continuing the ring-fencing of the various oil sand plants. So, it depends on the situation. It depends on the situation what seems to be the best strategy in, in each case.

3:41:03 PM

CHAIR SAMUELS: Follow-up?

REPRESENTATIVE DOOGAN: Just one more question for each of you. Dr. van Meurs, you used the term, stability, in your presentation. And Mr. Johnston, I believe you used the term fairness. These are somewhat amorphous terms, yeah, for, for a policy makers, particularly when you stop to realize that the price of stability is going to be, you know, somewhere north of a billion dollars in, in revenue to the State of Alaska. Do you, either one of you, have any guidance for me and the other people who are going to have to make these decisions, as to the question of whether there's, you know, some definition of stability or some definition of fairness, that's, that we can sort of cling to as we go through this process?

3:42:00 PM

DR. VAN MEURS: No. Sorry, sorry "(indisc.)". Fairness for me is a very simple concept. Many people associate fairness with relevancy. You know the fair to the people. I always believe that the fiscal system is fair if it, if it seems to be competitive taking all factors of cost and logistics into account. Just as, if you sell your home and your neighbor gets, you know, four hundred thousand for the home and you have just a slightly bigger lot, maybe it is fair if you get four hundred and ten thousand dollars for your home. So, consequently, government take, the fairness of government take depends on how you compare in a competitive world with other nations. That is why both Daniel and myself are specialized on trying to do this government take work because that that helps you in making up your mind as to whether something is fair or not fair. Basically, I definitely believe that, that the PPT, the whole fiscal system as I presented is in the range of fairness, as I testified today. Could it be improved somewhat? Yes, I think

it could be improved somewhat, but what is fair has a margin of error. Just as you sell your house whether is in ten thousand more or twenty thousand less, you know, there is a margin of error in that. So, it is not a very precise term. But, fairness is not related to how much money Alaska needs. Fairness is related to, you know, what is a fair price for handing over, as resource owner, Alaska being the resource owner, what is a fair price for this particular property. And that is, that is the fairness issue. Stability is a very more difficult concept to define. The, the Wood Mackenzie study, which reads, I think, unacceptably and unfairly Alaska as very low in stability, I would violently disagree with because I think they used methodology that is, you know, unacceptable. Their definition of stability is: Did the government change, over the last few years, the fiscal system? If the answer is yes, then there is no stability. Now that is idiotic. That is an idiotic definition. So, consequently, you know, the, so I totally disagree, let's say with Wood Mackenzie definition of stability. I do believe that for investors stability is important. But, stability, as I said, Alaska has not violently changed the fiscal terms over the last as we just discussed, sixteen years before the PPT changed.

3:45:21 PM

DR. VAN MEURS: I hope that if, say in the future, by 2011 or so the system is more stabilized, as, as Senator Therriault said, what I really hope is that maybe Alaska then goes through another phase of stability for maybe ten or fifteen years. Ten, fifteen years, for a fiscal system, for the, for the, shelf life of a fiscal system I would consider as very stable. You don't need thirty or forty or a hundred years of fiscal stability to, to, to be called stable. If these changes are rational, if the changes seem fair, again, in international competitive concept making changes every ten or fifteen years - even substantive changes - is reasonable. And I'm in the same defense in Alberta. Alberta did not change the terms since 1997. As you may have heard in the past I recommended significant changes for the oil sand. Of course, I am now being accused of "(indisc.)" Chavez of Alberta, and so on, ripping up contracts and things like that, all kind of unfriendly words. But, I'm absolutely convinced that this is a very stable province and once they have revamped their fiscal system that will then, you know, last for another ten or fifteen years. That's what I call stability, so, you know, stability doesn't mean that you can't change. And, no. As Daniel said, in, it depends. If I, if I define stability in the way I just did, that means with respect to

taxation systems which in principle can be changed. No. In Alaska your royalties are stable because it is a contractual relationship and consequently there is never a change in royalties unless it is mutually agreed. So, in Alaska the royalty system is a highly stable system and is not meant to be changed, while the taxes is a stable system as long as you change it every ten or fifteen years. I think you are a perfectly stable example of a good partner of the oil industry. And so, I think that should be the objective.

3:47:56 PM

MR. JOHNSTON: I'm glad that Pedro was so eloquent about the Wood Mackenzie report because I have not seen the report. I don't think that totally disqualifies me of, to say anything about that, but I'll deal, I'll deal with that in a second. On the issue of fairness, in my opinion, there are elements of subjectivity, no doubt, but this government take statistic, when it's used properly, and the proper peer groups are used and stuff, it can provide some substantial insights because the acid test of fairness is where you can look at a country and see that there is oil and gas activity. Obviously, oil companies are signing contracts and working with the government. And often, too, in fact probably more often than not, it's the oil company's bids that determine what the ultimate terms were in those countries. People will sometimes bid royalty rates, they'll bid the profit oil sharing rates and stuff so at the end of the day the government take is kind of the bottom line in determining which license goes, which company, company gets the license, and so you can see o.k. the industry has made a clear and bold statement as to what they think is fair and reasonable in this country and if it's comparable to Alaska, then you have some fairly tangible, and less subjective, measures to use in making your decision. Now, the issue of stability. And I disagree with Pedro on this one thing. If you were to make a change this year as a result of the "cloud", I see that as pure, perfect, understandable justification. And I say understandable in the context of what I mentioned earlier. But we, I think we can give the industry a little bit more credit. And, yeah, there might be a few, there might be a few companies that just feel you're just the rottenest government in the world, but you don't have to make all of the oil companies happy. You have to make enough of them happy, and when we talk about the relative sophistication of the industry, I think it's fair to say that most of the companies represented here in Alaska today really should understand that, if this law wasn't passed in the appropriate way and it really was, if it really was undermined

as it, some people say, I've read the newspapers, than I think there is justification and no problem. And in my mind, too, yes, you changed the terms last year, that is a change, and that registers on my barometer of stability and stuff, too. But then it's, the context too, though is: How many countries are not looking at changing their terms these days? They all are. Now, yeah, some of them might appear as though they're not going to change their terms because some governments looked just like every government did and decided they didn't need too. And that's the thing that you, that doesn't measure. There's a lot of countries in this world where the government take is so darn high, they don't feel so compelled to change. And so the guys like you, that have a relatively low take, and let's face it, you do. Jeez, the license round in Libya not so long ago, and how ... stable can you think Libya is, they just opened their doors? You don't even have a measure of, of stability yet, to a certain extent. And they, the bids for some of those licenses yielded for the government a take on the order of 95 percent. Now, wait a minute. Is Libya that much better than Alaska? You know, that's what you have to ask yourself. And my response is: Well, it must be, I don't know what they got going down there, but Jiminy Christmas, that's spell binding and spectacular. And by the way, too, there is another dimension to the government take statistic. And that's this issue of how up front it is and how much of a royalty they get.

3:51:54 PM

MR. JOHNSTON: Because you have a twelve and one-half percent royalty. That is -- it's a high royalty by world standards, but as I said royalties aren't the only things that do what royalties do. So, in Libya, in addition to those shockingly high government takes, by the way, which are similar to the buy-backs in Iran, and similar to a lot of the operations in the Middle East. There's a company operating a field in Abu Dhabi, and all they get out of producing that oil, 500 thousand barrels a day, sounds kind like, you know, up here; although it is less expensive. They get a dollar a barrel. Now, eighty dollars a barrel, let's say it costs ten dollars to produce that oil. There's seventy dollars in profit, and the oil company's share of those profits is one dollar out of seventy. So, there's some wild stuff happening out there, no doubt. And, and, do you think the government in that contract had any incentive to consider changing that contract? No. So they get all this wonderful credit for being stable? Well, I guess so. It's things like that that don't get measured and one of Pedro's

clients, he mentioned Algeria, we didn't see Algeria on that list did we?

DR. VAN MEURS: No, no. Mackenzie forgot about that one.

MR. JOHNSTON: Let me tell you, that one, because you won't, there was only three or four that ranked worse but Algeria wasn't in there and as much as we both love the Algerians, I've worked for them too, I like them. But then I testified against them awhile back and so I haven't worked for them since, and I testified about the change that they made. And Kazakhstan, that's in the news a lot. We always compare Kazakhstan to you because that huge mega project there is pretty close to the gas pipeline project. On the issue of stability, I think in the long run, yeah, a few people are going to be upset, but I think the general consensus is going to be, if the cloud turns out to, you know, be, you know, I think people are going to understand. I really feel strongly that way.

3:54:01 PM

REPRESENTATIVE DOOGAN: Thank you. Oh, just one more thing. The way you two gentlemen use the term government take it includes federal government taxes, royalties, all of that?

3:54:19 PM

MR. JOHNSTON: yes.

REPRESENTATIVE DOOGAN: OK. Thank you Mr. Chairman.

CHAIR SAMUELS: O.K. I've got Senator Therriault, then Representative Gara, Representative Crawford, and then Senator Ellis.

SENATOR THERRIAULT: Thank you. I just want to check on the governmental take and you've talked about the total life cycle cost or, you know, cradle to grave. You're, you're talking about looking at everything from putting it into production to the end, to the full life of the field. Is that correct, when you're talking about total life cost?

MR. JOHNSTON: Yes. Full cycle, over the life of the field, or as the new reports that we see cradle to grave. Thank you very much.

SENATOR THERRIAULT: So, it's not just, it's just, not just a snapshot because even in, in those, in a production sharing contract you could take a snapshot right now, but maybe the company is still recouping its investment cost, and so the sovereign's take is going to be impacted by that. So you can't just take a snapshot, you've got to look at the total, whole thing.

3:55:29 PM

MR. JOHNSTON: In my opinion, absolutely. It reminds me of a conversation I had with the Uzbek government folks. A guy named Chairman T. Babadzhanov (ph) and they haul me to Uzbekistan to give them some advice on fiscal terms. And of course, remember that they are a land locked country, talk about boundary conditions, and there're gas prone and the wells there are high-pressure, very high-pressure expensive wells, the pressure is almost geostatic pressures; it's a nightmare. And so I'm thinking the terms are going to have to be pretty good and they just couldn't believe the kind of terms I was talking about, so they stopped and said no, this is the way we look at it. We feel that oil companies should get about ten percent of the profit, until pay-out, and then, three percent. Now think about that. Before pay-out what profit are they talking about? You know, until an oil company has got all their money back, there are no true economic profits. And I use, I make the distinction sometimes between economic profits and financial profits, until they've gotten pay off plus their cost of capital, you know, they haven't, there's no true financial profits that have been generated. We can have those situations where accounting profits are generated in those years before a true pay-out occurs. Either way though, in my opinion, it is very dangerous and almost always misleading when we talk about a snapshot of government take you have to be very, very careful about that. And so I have seen that terminology and I, and I am just extremely curious but I, from what I have been provided, and from what I've read, it wasn't, it didn't adequately explain the methodology, or the logic behind it, so I don't know what they have done. So, on one occasion and one occasion only, in my career have I ever quoted take in any other context than full cycle. And that's for Kah Shakan, the Kah Shakan field is just such a monster, and it is such an unusual contract, I felt that was justified in that particular case. So, I'm real leery of that in, and I'm sure Pedro has an opinion on that too.

3:57:15 PM