Butting brains

Two consultants square off on just how much is enough for Alaska to take from its gas pipeline development

Two of the brainiest consultants in the international petroleum industry, Pedro van Meurs and Daniel Johnston, are taking opposite sides in a debate over how much profit or "take" Alaska's government should write into the Alaska Highway Pipeline proposal.

The outcome of their debate has direct consequences for Canada, as three-quarters of the proposed pipeline runs through this country and Canadians stand to benefit with throughput revenue and thousands of jobs if the project becomes a reality—or to lose all of that if Alaskans choose an all-Alaska route.

Paying particular attention to the debate between van Meurs and Johnston is Alaska's Governor-elect Sarah Palin. Before her election, the 42-year old Republican and former mayor of Wasilla championed an all-Alaska route that would run from the producing fields on the North Slope to a liquefaction facility and terminal at the Port of Valdez.

That proposal left Canada out altogether and appealed to Palin's constituents, who saw defeated Governor Frank Murkowski as an elitist who negotiated a contract with Big Oil in secret and gave away far too much of their rightful inheritance.

The debate over how best to get Alaska's stranded gas to market is so important to Alaskans, so vital to their future, that opposing sides hotly disagree.

Since her election, Palin has moderated her stance on the all-Alaska proposal. She now says she will consider all options. Few experts, including van Meurs and Johnston, think an all-Alaska line is economically viable. Her change of heart is also good news for Canadians. "It would greatly work to Canada's disadvantage if the all-Alaska line were to prevail," Bill Corbus, the commissioner of Alaska's Department of Revenue under the Murkowski administration, told *Oilweek*.

Van Meurs, who has a PhD in economic geology from the State University in Utrecht, the Netherlands, is one of the main architects of the terms for what will be the biggest construction

project in American history—a 3,424-kilometre pipeline that will transport 4.5 billion cubic feet of gas per day, increasing the nation's domestic supply by about six per cent.

During the planning stages for the Alaska Highway project, van Meurs spent as much time in Anchorage as he did in his home in the Bahamas.

Among the other international experts that Governor Frank Murkowski called on to review the fiscal terms was Johnston, an economist and professor based in New Hampshire who has advised governments around the world on their fiscal terms.

On van Meurs' advice, the proposal that Murkowski's team presented to the Alaska Legislature contained significant incentives they believed were necessary to persuade ConocoPhillips, BP, and ExxonMobil to support the project.

"The way the Murkowski Administration saw it was that the three sponsors being the owners of the gas and the ones that would have to commit to long-term production of the gas, they would be in the driver's seat," says van Meurs. Among the incentives was fiscal certainty for 45 years.

"We analyzed the gas line project with 60 other projects around the world," said Corbus, who admits he is in "complete alignment" with van Meurs' proposal.

"We looked at government take in a variety of other countries. It ranges between 47 and 57 per cent around the world. We were right in the middle." They made sure to examine the profit negotiated by other governments at a range of prices, from $3.50 to $8.50 per million British thermal units.

In addition, because of looming competition from LNG, the Alaska Highway project is considered high risk. "We are competing with LNG," said van Meurs. "LNG can be delivered for less than $4 per [million British thermal units] to all of the eastern seaboard ports. There is 5,000 [trillion cubic feet] of gas ▶

around the world looking for a market."

"This creates a competitive environment that makes it difficult for the Alaska project to compete. You have to give some incentive to the companies. That was the philosophy of Murkowski's government."


Daniel Johnston

Corbus believes the Murkowski deal was the best they could get. "It is not a stellar deal for producers compared to some of the other proposals they're looking at."

This was van Meurs' conclusion as well. The terms that were negotiated "had to be comparable to terms of pipelines far removed from market," he explained. "There is not much justification for terms such as those Norway or Algeria could get because they are closer to markets." In other words, governments closer to customers—Alaska is closer to the North Pole than to urban centres in need of gas—could obviously negotiate tougher terms with producers.

Murkowski's team got one thing right. The producers were attracted by the "sweeteners" in the proposal and—their confidence buoyed by high gas prices—were committed to serious negotiations.

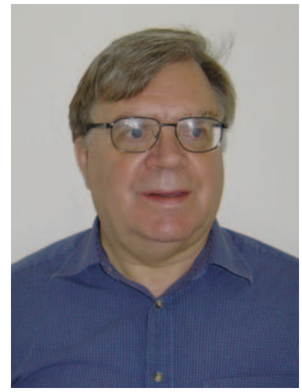
As soon as the agreement was made public, however, a host of critics, including Johnston, emerged to say it was too generous to the producers and left the Alaskan people with too meagre a take from the project. In late 2005, he was hired by Murkowski to assess the proposed contract. After reviewing the proposal, his response to Murkowski was simple: "These proposals are regressive."

> "Within a week of my redesign, seven guys resigned in protest."
>
> — Daniel Johnston

"The oil companies insist they need incentives to build the pipeline. I don't blame the oil companies for wanting fiscal certainty. What they ask, though, is unprecedented worldwide—a sovereignty issue," he argued in an article titled "The Alaska Gas Pipeline Story," published in the *Petroleum Accounting and Financial Management Journal*. His view is that Murkowski "negotiated a pipeline deal that is unfair to Alaska—i.e., too many sweeteners for the oil companies and not nearly progressive enough."

"All governments on the planet right now are [miffed] that they have regressive systems," Johnston told *Oilweek*. "No one contemplated oil prices would go up so high."

Governments around the world realized that the oil companies were benefiting far more by the old terms that governments had been forced to negotiate with heavy doses of incentives when low oil prices made companies choosier about projects they were willing to take on. "Right now, governments are changing their terms and making them better," said Johnston, whose expertise has been sought by many to do just that. "For example, with a WTI oil price of $60 a barrel, the government take should be at a minimum five percentage points greater than it is at $20 a barrel." ▶



Pedro van Meurs

He explains: "One of the reasons why so many governments are changing their terms these days is that their systems are regressive. Alaska is designing contracts of the future particularly with the gas contract so to me it is unthinkable to not include lessons from the past and create a modern system. With the gas pipeline contract, as it is proposed, government take only increases by 1.2 per cent when the gas price goes from $3.50 to $7.50 per [million British thermal units]. This is just barely progressive."

Johnston proposed changes. "At the absolute minimum, the government take should go up at least 10 percentage points."

At this point sparks began to fly between the two sides. "I really dug my heels in. Within a week of my redesign, seven guys resigned in protest." He is referring to the defection of six Department of Natural Resources officials, including Tom Irwin, former Commissioner of the Alaska Department of Natural Resources, who supported Johnston's views.

"By this time, the governor hated my guts and he fired me," Johnston said. The legislature then hired him to help design changes to the governor's proposal. "In the past seven months, I testified four times before the House and Senate Finance Committees as well as the House and Senate Natural Resource Committees."

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— Pedro van Meurs

The debate between Alaskans continues to rage, and the new governor has promised that the issue would be high on her list of priorities after taking office on Dec. 4.

The designers of the original contract stick to their view that it is the best they could get. "Our conclusion is that the contract was fair to the producers and was fair to the state," said Corbus. Van Meurs echoes his opinion. "I don't see room for a much more advantageous deal to the government. Look, a bird in the hand is better than 20 in the bush."

Meanwhile, Johnston has been hired by Governor Palin to advise her administration. "I'm now working for the Alaska Gasline Port Authority. I have this funny feeling I'm working for Sarah now," he told *Oilweek*.

He and van Meurs agree on one thing: time is not on Alaska's side. Johnston notes that he agreed with "Alaska's governor who warned legislators of a narrow window of opportunity because of potential competition from foreign LNG." Van Meurs concurs: "The competition from other sources is getting stronger."

— Andrea W. Lorenz