ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE
September 13, 2021
3:31 p.m.

MEMBERS PRESENT

Senator Joshua Revak, Chair
Senator Peter Micciche, Vice Chair
Senator Gary Stevens
Senator Natasha von Imhof
Senator Jesse Kiehl
Senator Scott Kawasaki

MEMBERS ABSENT

Senator Click Bishop

OTHER LEGISLATORS PRESENT

Representative Tom McKay
Representative Mike Cronk
Representative Geran Tarr

COMMITTEE CALENDAR

PRESENTATION: ASSESSMENT OF RECENT TRENDS IN UPSTREAM OIL & GAS AND THE STATE OF ALASKA'S COMPETITIVE POSITION BY GAFFNEY, CLINE & ASSOCIATES

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

MICHAEL CLINE, Strategy Advisor/Legal Counsel
Gaffney Cline & Associates
Cobham, England, United Kingdom
POSITION STATEMENT: Presented an assessment of recent upstream oil & gas trends and the State of Alaska's competitive position.

ACTION NARRATIVE

3:31:56 PM

CHAIR JOSHUA REVAK called the Senate Resources Standing Committee meeting to order at 3:31 p.m. Present at the call to order were Senators Micciche, Kiehl, Stevens, von Imhof, and Chair Revak. Senator Kawasaki arrived immediately thereafter.

He recognized that Representatives McKay and Cronk were in the audience.

Assessment of Recent Trends on Upstream Oil & Gas and the State of Alaska's Competitive Position**PRESENTATION BY GAFFNEY, CLINE & ASSOCIATES: ASSESSMENT OF RECENT TRENDS IN UPSTREAM OIL & GAS AND THE STATE OF ALASKA'S COMPETITIVE POSITION**

3:32:49 PM

CHAIR REVAK announced the committee would hear a presentation by Gaffney, Cline & Associates on recent trends on oil and gas and Alaska's competitiveness in the marketplace.

3:33:06 PM

SENATOR KAWASAKI joined the committee.

3:33:09 PM

At ease

3:34:02 PM

SENATOR REVAK reconvened the meeting.

3:34:17 PM

MICHAEL CLINE, Strategy Advisor/Legal Counsel, Gaffney Cline & Associates, stated the presentation would cover key developments in the oil and gas industry that impact Alaska in the global context and considerations on tax policy.

3:36:45 PM

MR. CLINE paraphrased slide 5:

Volatility and Disruption in the Oil & Gas Industry

- The oil & gas industry has been battered by deeply disruptive events in recent years, including the oil price collapse of 2014-2016, the COVID-19 pandemic, the emergence of alternative energy platforms, and a related shift in the long-term prospects of the industry.
- Oil and gas companies have performed poorly, while investors have demanded better financial

performance and action on energy transition. - Divestments and restructurings have occurred and are ongoing, a renewed focus on capital discipline and investor returns has meant fewer projects are sanctioned, and there is a laser focus on strategy and core assets.

- Resource owners are finding it challenging to attract capital and good operators.
- For governments and states, lower prices and decelerating demand has meant reduced revenues and tax receipts and contraction of the tax base.

3:39:33 PM
MR. CLINE stated that the chart on slide 6 visually represents the volatility of oil caused by disruptions ranging from 2000 to present. From 2015 to 2016, growing inventories of crude oil worldwide and a weakening of the US economy led to low oil prices. Shale production in the Lower 48 caused the prices to drop further.

From 2019 - 2021 widespread economic dislocation caused by COVID and disputes among OPEC nations have resulted in oil prices tanking. The transition to other types of energy and the financial performance of oil has caused banks and investors to consider project lending carefully.

3:43:16 PM
MR. CLINE moved to slide 7 and presented the following points regarding the transition of energy:

Energy Transition and Oil & Gas

- Many technologies essential to the transition to alternative energy platforms are still in development, and face significant hurdles in terms of addressing intermittency, energy storage and the sheer complexity and cost of implementation.
- While the transition period is uncertain (circa 20-to-40 years), the trends are clear:
  - Innovation and investment focus are leading to new applications and rapid cost reduction.
  - Renewables and other sources of clean power generation are growing rapidly, electric vehicles are established and on the cusp of rapid growth, and decarburization has been

elevated to 'core strategy' for businesses from ExxonMobil to Blackrock.
  - The debate is no longer whether energy transition will happen but how quickly it will happen.
- For resource-rich governments and states, the question is how to address the knock-on impacts of energy transition and, in particular, how to optimize oil and gas resources in a responsible manner while transitioning to alternative energy platforms.

3:47:11 PM
MR. CLINE stated that energy transition is a substantial financial issue. Investors and developers have firmly grasped this realization. Over eighty global financial institutions restrict lending, and over one hundred are divesting from fossil fuels. Slide 7 provides a partial list of those institutions.

MR. CLINE said that in response to the impact of carbon intensity, oil and gas companies assess portfolios to decide if carbon assets should be kept, sold, left undeveloped, or transferred to smaller companies. Company restructuring is part of the energy transition process that will occur over time and cause heavy oil to be valued differently.

3:50:06 PM
MR. CLINE advanced to slide 10 and paraphrased its content:

Decelerating Demand and the Competition for Investment Dollars

- The trends relevant to Alaska and other oil producers are increasingly clear:
  - The lowest cost producers (Saudi Arabia and Gulf countries) will have an increasing advantage in a lower demand environment, with strong drivers to maximize production to meet budgetary requirements, and a goal to extract as much value as possible from their oil and gas resources while they can.

MR.CLINE added that countries like Saudi Arabia can produce oil for $9 per barrel, it a fierce competitor.

  - Shale oil will remain a potent force with its ability to react quickly to demand/price

  spikes, which will restrain upward price pressure.
  - Decelerating demand and a muted price environment will likely mean less upstream investment and activity through 2050, especially for 'big ticket' long lead time investments.
- For oil and gas producers such as Alaska, the competition for oil and gas investment dollars is fierce and getting fiercer.
  - Oil and gas companies will impose high profitability / return hurdles for upstream investment.
  - Oil and gas companies are making decisions today that will determine the extent to which Alaska is able to monetize its oil and gas resources in the future

3:56:08 PM

MR. CLINE paraphrased slide 11:

Government Actions to Promote Investment and Production

- Governments compete on the global stage for exploration and development capital, which provide the long-term basis for tax revenues.

- In response to such changes in market conditions, it is common for proactive governments to reassess existing fiscal terms and to consider incentives to ensure continued exploration and development in the domestic energy sector.

MR. CLINE added that incentives offered by governments are often tax-related, such as Norway's accelerated depreciation and the UK's tax rate reductions. Many government responses are structured to be temporary.

- There have been substantial changes made to upstream oil and gas terms stemming from the change in market conditions in 2014 as well as some responses to the price decrease observed in 2020.
- It should be noted that due to the time required to review and approve fiscal changes,

particularly at a national legislative level, there is often a delay in their implementation and a time lag after implementation before they have effect.

3:58:42 PM
SENATOR MICCICHE asked if the idea of leaving oil in the ground for future value has been abandoned.

MR. CLINE said he had not heard that argument recently because the future's outlook has changed. He opined that the current converse philosophy is to monetize assets sensibly and take advantage now.

SENATOR VON IMHOF reiterated that the deceleration of demand, discussed in slide 10, makes it the goal of Saudi Arabia and Gulf countries to extract as much value as possible from their oil and gas resources before the pivot to alternative energy occurs. She opined that this would cause a supply glut over the next 10-20 years. She asked Mr. Cline if her recapitulation of slide 10 supports the idea that assets should be monetized. Senator Micciche didn't make a statement. He asked a question.

MR. CLINE said that is correct. Supply and demand issues are challenging due to diverse national interests and the complexity of forecasting demand. OPEC's goal is to take as much advantage of its resources as possible.

4:02:09 PM
CHAIR REVAK asked if proactive oil states and governments are incentivizing increased production rather than taxing it as SB3002 proposes.

MR. CLINE answered there are various ways to incentivize investment or recapture costs to encourage investment. What has been done in Alaska is one way. Other countries have used other measures to promote investment, such as accelerated depreciation and immediate recapture of costs.

CHAIR REVAK agreed that it has become more difficult to keep people busy and invested.

4:03:56 PM
SENATOR KAWASAKI said the slide titled Energy Transition an Issue for Markets mentions that financial institutions have been divesting or restricting lending to Arctic drilling for several years. He asked if financial institutions are divesting and

restricting lending to Arctic drilling because it appears riskier and what are the decision-making factors at that level of investment.

MR. CLINE opined that Arctic drilling is more challenging and costly. Also, environmental concerns may increase over time. So, investors question where to put their money when other assets are reasonably available. Decision-making is a mix of financial and other considerations.

4:05:42 PM
SENATOR KAWASAKI asked, from an economic standpoint, how favorable would Alaska's tax policy need to be to make it an attractive place to invest, and do financial institutions consider taxation policy when making determinations to divest.

MR. CLINE answered that tax policy is a factor in the economic decision-making chain for investors. It is not at the top of the chain, but it is well known that tax policy influences investment. Tax policy can improve or worsen an investment environment.

4:07:47 PM
SENATOR KAWASAKI asked if capital market lenders look far enough down the economic chain to consider whether tax policy is favorable; if so, could it stop divestment and rekindle investment.

MR. CLINE stated his belief that lenders assess to a certain level where companies invest and whether it is advantageous. This may occur in the Arctic. For example, in recent years, from a high-level perspective, offshore exploration was not a desirable investment; wells were expensive, it was risky, and prospects were long-term. Companies heavily invested in offshore oil fields would be considered higher risk from a lender's perspective. He opined that the view level of a financial company is to consider whether an oil company is great or overrated.

4:10:04 PM
MR. CLINE resumed the presentation on slide 13, Alaska's Oil and Gas Sector is Maturing and Facing Headwinds. He stated Alaska had been a fantastic place for oil and gas businesses due to the scale of its resources, market access, skilled workforce, and deep service company base. In recent years Alaska has faced the challenges of maturing assets, like Prudhoe Bay, that produce less than previously. It has also faced the challenges of new

assets, like Willow, where development is being debated. Alaska is a high-cost environment that is also facing the global price volatility of oil. He opined that some actions taken by Alaska, such as the per barrel tax credit, appear to have stabilized production decline.

4:13:08 PM
MR. CLINE stated that less oil production from maturing assets coupled with declining oil prices impacted the state. However, oil production in Alaska is still healthy and provides substantial revenues to the state.

MR. CLINE said the state should take two actions to offset oil production declines. It should protect and extend the life of its maturing assets, so they continue to produce. Simultaneously, the state should develop new projects to fill the revenue gap as mature projects continue declining. Another point for the state to consider is the cost of transitioning to alternative energy platforms. New developments will be needed to subsidize transition costs that are estimated to consume fifty-one percent of oil revenues.

Although Willow is a large investment, it is an example of a new project that will bring thousands of construction jobs and hundreds of permanent jobs. It is a 600-million-barrel resource that would produce 165,000 barrels a day. The Repsol Oil Pikka Project is another large, expensive undertaking that, if modified, could assist in sustaining the economy.

4:17:24 PM
MR. CLINE paraphrased slide 16:

Protecting the Petroleum Tax Base and the Economy

- Petroleum-related revenues are a significant contributor to Alaska and have been and will continue to be under pressure as the industry changes with a move toward alternative energy systems, increasing asset maturity, and other factors.
- To sustain those revenues and the high paying jobs provided by the industry, Alaska needs the participation of as many companies as possible, from the very large to the small, to explore, develop and produce its diverse resource base and sustain and build the tax base.

  - Large projects like Willow and Pikka are essential and require significant investment, application of human and technical resources, and an appetite for risk - which typically requires large companies making long-term strategic commitments.
  - Mature assets are essential too, and the participation of smaller, nimble companies is key to optimizing these assets and tax revenues from them.
- Attracting oil and gas investment and participation is a 'competitive activity', with major producers in the US and globally competing for the same participants and investment dollars – considerations around tax burden and overall costs are critical in that competition.

4:19:38 PM
MR. CLINE paraphrased slide 17:

SB 3002: The Per Barrel Credit

- SB 3002, Section 6 allows a sliding scale tax credit against a producer's tax liability for each barrel of taxable oil.
  - The sliding scale is designed to offer a relatively higher tax credit in lower oil price environments and less credit (or no credit) in higher price environments.
  - Overall, SB 3002 is intended to reduce the tax credit available to producers.
  - How the tax credit is set is important to avoid deterring investments and activity.
- Gaffney Cline has not had the opportunity to model the impact of the proposed provisions, and suggests careful analysis to ensure that the tax provisions do not have unintended consequences of discouraging new entrants and investment.

4:21:23 PM
MR. CLINE paraphrased slide 18:

Tax Policy Considerations
- Alaska's strategy to extract more revenues from the oil & gas sector will need to consider not only near-term revenue capture objectives, but

also medium- and long-term impacts on oil and gas development and production and the tax base

- Ensure that companies are not discouraged from taking on big investment, step-change developments that will replace declining revenues from existing fields; and
- Ensure that existing companies and new entrants continue to invest in mature fields, and so extend the productive life of existing assets.

MR. CLINE added it is important to consider the sensitivities of different companies when framing tax policy.

- Global experience suggests that if the taxes are too high:
  - Companies will seek to exit and/or go into 'harvest mode', and – Invest in other more tax friendly jurisdictions.
  - All of which will contribute to reduced investment and activity in the oil and gas sector and to production declines.
- Tax policy must be crafted and sufficiently nuanced to support effective revenue capture while maintaining healthy participation across the different asset types.

4:24:22 PM

MR. CLINE paraphrased slide 20:

The Existing Tax Credit and Alaska's Competitive Position

- For Alaska, the key has always been striking the right balance between tax revenue capture and maintaining a healthy and vibrant oil and gas sector that is competitive with other major oil and gas producers around the world.
- Is Alaska competitive with its current tax structure in today's global supply and demand market?
- This is a complex question but the indications suggest that Alaska has a competitive fiscal system at this time.
  - Stabilization of production levels from the steady decline pre-MAPA is positive.

  - New entrants taking over large mature assets and the willingness of companies to invest in big projects like Willow and Pikka are positive.
- Important to note that Alaska's competitiveness is not a given or static - the competitive landscape changes constantly and continuing assessment is necessary to ensure that Alaska's fiscal terms capture robust revenues for the state, while at the same time promoting exploration, development and production of vital oil and gas resources.

MR. CLINE stated his belief that the More Alaska Production Act (MAPA) assisted in stabilizing production and attracted both large and small oil companies to the state.

4:27:26 PM
SENATOR VON IMHOF opined those questions posed in the presentation, such as Alaska's position in the global market and determining an optimal tax policy, are concepts that the legislature may need help answering. She stated it would be helpful if Gaffney, Cline & Associates returned to present an in-depth analysis and suggestions for managing Alaska's oil and gas resources.

MR. CLINE replied that as a consulting agency Gaffney, Cline & Associates is willing to investigate further.

SENATOR MICCICHE asked if a schedule of replacement exists that shows what portion of oil will be replaced by renewable energy; also, what demand will remain for the manufacturing of plastics and air and shipping transportation. He asked, as innovation and renewable energy efficiency improve and costs come down, at what point does the state enter harvest mode.

MR. CLINE answered that replacement schedules are being studied under a multitude of scenarios. Uncertainty is wide now but will narrow over time. The best that can be done is to understand various scenarios, use informed judgment to guide decision-making, and adjust as needed.

4:31:30 PM
SENATOR MICCICHE asked how Alaska would factor into its scenarios the unwillingness of traditional funding organizations to invest in the state.

MR. CLINE replied that Alaska should use global trends and financial institutions' inclinations to determine how to optimize assets and projects within those boundaries. If Arctic exploration were disfavored, then Alaska would need to focus on what could work for it.

4:33:35 PM
CHAIR REVAK noted that Representative Tarr was in the audience.

SENATOR KIEHL agreed that a detailed analysis is needed. He recalled that, when current tax policy was a bill seven years ago, a BP representative said proposed changes would not attract investment or change the decline curve. That statement was inaccurate. He asked Mr. Cline if SB3002 makes Alaska's mature fields more competitive.

MR. CLINE replied he had not studied the proposed amendments. He recommended that assessment be done before making changes to legislation.

CHAIR REVAK informed members that Mr. Cline was asked to broadly address whether production at North Slope is becoming more expensive and difficult to produce and what considerations Alaska should contemplate regarding tax policy.

4:36:00 PM
SENATOR STEVENS asked that Alaska be compared globally to its competitors.

MR. CLINE responded that low all-in cost producers are the most competitive. The Middle East has lower costs than everyone. The lower 48 states offer significant competition from shale and lower transportation costs. Alaska needs to recognize its challenges and strategize.

SENATOR KIEHL asked what role prospectivity and geology play in determining Alaska's competitiveness.

MR. CLINE replied that prospectivity is the essential component of the oil industry. Oil companies will not invest if the rock is not good. Alaska has attractive resources, even when mature. This is positive for Alaska in terms of competition. A challenging operating environment, transportation costs, and taxes make the resource less attractive.

4:40:05 PM
CHAIR REVAK thanked Mr. Cline for presenting on short notice.

4:40:34 PM

There being no further business to come before the committee, Chair Revak adjourned the Senate Resources Standing Committee meeting at 4:40 p.m.