

OIL & GAS COMPETITIVENESS REVIEW BOARD

May 26, 2016

9:00 a.m.

Taken at:

Alaska Gasline Development Corporation
3201 C Street, Suite 604
Anchorage, Alaska

OIL & GAS COMPETITIVENESS REVIEW BOARD:

G. Wyche Ford, Chair
Commissioner Larry Hartig
Commissioner Randy Hoffbeck (via telephone)
Acting Commissioner Marty Rutherford
Tom Maloney
Bob Pawlowski
Kara Moriarty
Vince Beltrami
Tom Walsh
Steve Davies

Others participating/in attendance:

Stephanie Alexander, Department of Revenue
Dr. Atul Arya, Energy Insight, HIS Inc.
Elwood Brehmer, Alaska Journal of Commerce
Tim Harper, Department of Revenue
John Tichotsky, Department of Revenue

PROCEEDINGS

CHAIR FORD calls the Oil and Gas Competitiveness Review Board to order at 9:00 a.m. He states that the first item on the agenda is approval of the agenda. He proposes a modification. Commissioner Hoffbeck has a conflict this morning and will give his legislative update in advance of this morning's presentation. He asks Ms. Alexander to call the roll.

MS. ALEXANDER calls the roll.

CHAIR FORD states that next on the agenda is approval of minutes from the prior meeting.

MR. MALONEY makes a motion to approve the minutes from the prior meeting.

MR. PAWLOWSKI seconds.

There being no objection, the motion is approved.

CHAIR FORD asks Commissioner Hoffbeck for a quick update from the current legislative session.

COMMISSIONER HOFFBECK states that the bill that is probably most important to this committee, the Oil and Gas Tax Credit Reform Bill, was resurrected by both the House and the Senate in votes over the last two days. He continues, that means it is in a conference committee that will negotiate a compromise package between the House and the Senate versions of the bill. He adds the hope that there will be something to put before the full House and full Senate early next week. He states that there is one very significant piece in that which relates directly to our report that is due for the next legislative session, which is a review of the Cook Inlet tax structure. Currently, the Senate bill establishes a tax for Cook Inlet which essentially takes the transitional tax on gas, about an average of 17 cents per mcf, and makes it a permanent tax. It then uses a barrel oil equivalent for oil and sets the tax at a dollar a barrel. This fixes the tax and states that it will be the tax for Cook Inlet. He adds that it is taking what was intended to be a temporary tax and making it permanent. He states that the House version repeals the sunset of the tax exemptions and accelerates it from 2022 to 2019. The underlying tax structure in Cook Inlet will go through January 1, 2019; which also puts in place a legislative committee to come up with recommendations for a new Cook Inlet tax structure. He continues that it becomes a different task depending on how the issue is finally resolved and whether our report becomes a basis for the new tax structure or just simply information on how the tax structure relates to others.

CHAIR FORD states that there is uncertainty here. He continues that the primary delivery as tasked in SB21 for this commission is currently being debated ahead of that planned report in January of next year. He adds that there will be more information available over the next week to 30 days.

MS. MORIARTY states that on the agenda for the Legislature today is an LB&A meeting to hire oil and gas consultants. She continues that she understands that the contract with ANALYTIC expired. She asks if Commissioner Hoffbeck has any sense of who is being considered.

COMMISSIONER HOFFBECK replies that he does not know.

CHAIR FORD asks for any further questions. There being none, he states that Dr. Arya is next on the agenda.

MS. MORIARTY states that the AOGA contacted IHS Energy looking for a presenter with a good perspective on the Alaska oil and gas business and how that fits in the global market. She thanks Dr. Arya for coming.

DR. ARYA thanks all and states that he will briefly talk about and give a perspective on how the world of energy markets is shaping up. He will then focus more on the competitiveness issue that is being dealt with in Alaska. He continues that IHS Energy acquired PFC Energy about three years ago. PFC Energy had a contract with the State to do updates and provide the consulting work. The people who were involved in that split off from IHS after acquisition. He

adds that the work for the State had to be relinquished because of a conflict with other clients from the oil and gas sector; they chose to remain with the core client, particularly ExxonMobil, a key client in Alaska. He states that the issue of oil price and where the price goes is probably the biggest challenge for the industry. He begins his presentation with the important role OPEC has played in managing that price, and that has changed very significantly. He explains this in greater detail, focusing on the challenge of this in Alaska.

MR. BELTRAMI asks for longer price horizon estimates.

DR. ARYA replies that the reason the price will go up after the next 18 months is because there will be a big shortfall in projects for more expensive oil projects such as offshore oil expense. He adds that the investment is being cut very significantly, which he explains more fully.

MR. PAWLOWSKI asks how fragile the price of oil is to Mideast activities.

DR. ARYA replies that there is a definite impact of the Middle East activity. The thought as to what may happen is that there will be very wide fluctuations in the price, rapid ups and downs, like those that have been seen this year. He thinks that Iraq is going to have a challenge even maintaining its current production because of conflict. He also thinks that Venezuela is going to implode before any of the Middle East countries implode because the situation there is highly volatile. He states that they are focusing on what is happening to their electricity generation. If the electricity production stops, there will be a big impact on everything else in Venezuela, including oil production.

MR. MALONEY asks how much of the \$2 trillion reduction capital was in the United States of North America.

DR. ARYA replies that the \$2 trillion is over the next five years, or from 2015 to 2020. He continues that about \$1 trillion of that was in the U.S. The estimate is that half of that could be cost efficiencies; the costs are a function of price. As the prices come down, costs will also come down. He explains this more fully with examples. The costs for gas production have continued to come down, and the gas companies are continuing to do very well. He continues his presentation, explaining as he goes along.

MR. BELTRAMI asks about the projection.

DR. ARYA replies that there is a way to find market for Alaska gas in 2023 and beyond. The challenge will be twofold. One is that gas has to be contracted now before the projects can get sanctioned and people started to make investments. Buyers now want smaller volumes and shorter contracts. The second challenge will be stopping investors from building more LNG in the Lower 48 at any point in time.

A short discussion ensues.

DR. ARYA states that LNG is a complicated business and a complex operation. He explains this more fully.

MR. BELTRAMI asks if there is any kind of breakdown on companies that either have a presence or are doing work in Alaska that are involved in competing projects around the world.

DR. ARYA replies that he does not have a detailed breakdown, but Exxon is involved in some of them, as well as Chevron, which is a big player in Australia.

A short discussion ensues.

DR. ARYA continues his presentation, explaining as he goes along.

MR. PAWLOWSKI states that there is a crowned industry board or consortium, Petrinex, in Alberta. He asks if this is part of the potential improvement because of closer work with the industry.

DR. ARYA replies that there is CAPP, the Canadian Association of Petroleum Producers, in Canada, which is a very active association working with the government. He states that they had a very big impact because they are producing very expensive oil. He explains that a very proactive action was taken with a request to consulting companies to work on proposing a new structure.

The discussion continues.

DR. ARYA states that everyone has different needs and different drivers; political, social, and what is happening is highly variable. He continues that new capital investments are going to be very challenging, at least for the next few years. He adds that it is about maintenance and about using existing infrastructure; the established players are all in the same situation.

MR. PAWLOWSKI asks if there is opportunity in existing infrastructure where there is capacity; will investments follow where there is existing infrastructure and capacity to fill.

DR. ARYA replies not necessarily and thinks that the incumbent players are the ones who will look at those opportunities. Using the North Sea as an example, he states that people are doing everything to postpone the abandonment. He continues that environmental evaluations are more stringent, making the cost of abandonment and getting everything back to the way it was is quite expensive.

MR. BELTRAMI asks if there is a standard or internal rate of return the industry requires on infrastructure.

DR. ARYA replies that they all vary and he would say it has to be in double digit. He explains this in greater detail.

CHAIR FORD asks for any other questions.

MS. MORIARTY states that the mission is to evaluate competitiveness of both the North Slope, the Cook Inlet and other regions and make recommendations back to the Legislature. She asks what other factors should be looked at and what other regions should we be compared to.

DR. ARYA replies that one great asset is that these companies have people that are knowledgeable on how best to double up or explore with this field. He strongly recommends leveraging that and thinking about getting some support from the operators to fund the study. He continues that the second thing is that there is a lot of great technology already in place which should be used. He states that the hotbed of low-cost innovation is China. He explains that the Chinese have been producing at about 3 million barrels or so for 15 years. Only this year the production has come down, mainly due to not investing enough money. He adds that the Chinese companies are in trouble for all the same reasons, but have done a great job of squeezing the last drop of oil out of their mature fields. He continues that another really mature place is Russia. He explains that Russia is currently producing more oil than Saudi Arabia, and continues to surprise everyone.

COMMISSIONER RUTHERFORD states exception to a few things said. She continues that the one thing that the State of Alaska has done relatively well in the last few years is actually bringing some additional new investments in the form of Repsol, Armstrong, Caelus. With the exception of ConocoPhillips, the primary exploration parties have been up on the North Slope and Hilcorp. She adds that Hilcorp has purchased some assets and have been doing a good job of expanding production from those assets; the new activity has been remarkable. She states that the economic climate has affected current investment and how aggressive the strategy for development will be; but some of these players are going into new areas, new reservoirs, and new technologies that are very exciting for the State. She continues that balancing the production tax plans between the legacy producers versus how to employ credits and incentives is important to bear in mind for the future.

A discussion ensues.

CHIAI FORD thanks Dr. Arya and calls a break.

(Break taken.)

CHAIR FORD moves back to the agenda and states that next is the scoping for the future deliverable. He reads: “The deliverable due January 15, 2017, is a comparison on the State S tax structure and rates of oil and gas produced south of 68 degrees’ north latitude.” He continues that it is basically looking at the rest of the tax structure of the state other than the North Slope production area. “The tax structure takes into account the unique economic circumstances for each oil- and gas-producing area south of 68 degrees’ north latitude. A reduction in the gross value at the point of production for oil and gas produced south of 68 degrees’ north latitude that is similar to the reduction in gross value at the point of production under Alaska Statute”... as read here ... “consider other incentives for oil and gas production south of 68 degrees’ latitude.” He states that is the report discussed this morning which is obviously targeted toward the start of the next legislative session for next year. The intent was to provide an unbiased framework of tax regime structures for the Legislature to consider. He continues that, given actions going on currently in Juneau, some of this may be changed depending on what happens in the next week or so. He adds that the scope is not very clearly defined at this point, and there is probably a bit of time over the next 30 days to see what comes out of this legislative session to form the basis for this work as the agenda is getting reorganized and updating the subcommittee structure that was established previously. He suggests looking at getting reassigned under the structure that was talked about at the previous meeting; to be

prepared to begin the work once the starting point is known, which is probably in the next 30 days. He states that previously work groups were established around the regulatory permitting committee, labor workforce committee, infrastructure committee, and the fiscal tax regime committee. He continues that previously the regulatory permitting committee was chaired by Kristin Ryan with the participation of Cathy Forester and Mark Myers. He asks how that committee may be restructured.

MR. BELTRAMI states that he does not think the participation in any of the committees by people was limited to one of them or how many on each committee.

CHAIR FORD replies that it is more based on interest and time available. He states that there were no predetermined requirements for participation.

MR. PAWLOWSKI states that he had been assisting Kristin and Steve when he was at DNR on the regulatory. He believes that Kyle Smith and others at DOG are more than competent to carry that forward.

COMMISSIONER HARTIG states that it is logical to have AOGCC, DNR, and DEC on that, and adds it would be nice to have somebody from the industry on that, too.

MS. MORIARTY asks if the board would entertain expanding the committee instead of trying to limit it to three per group. She states that she is willing to provide input, but not necessarily be part of the committee. She continues that she would probably designate the regulatory counsel, environmental counsel, Josh Kindred, to provide the support for that because it is his area of expertise.

COMMISSIONER HARTIG and MR. DAVIES concur.

COMMISSIONER RUTHERFORD notes, from DNR's side, the regulatory work is primarily done by Deputy Commissioner Ed Fogels. She continues that Ed and his support team can be provided for this. She adds that his value would be more associated with the fiscal and tax regime side.

A discussion summarizing the members of the regulatory permitting committee ensues.

COMMISSIONER RUTHERFORD states that Ed Fogels will be involved, but it will mostly be Sarah Longan, who actually coordinates projects both from the state and the federal side.

COMMISSIONER HARTIG states that for DEC, it will be a combination of Kristin Ryan and himself. He continues that he could help coordinate among all the different program divisions and also maybe help provide that nexus in evaluating the federal side of things.

MR. DAVIES states that, from AOGCC, it would be Cathy Foerster supported by himself.

CHAIR FORD states that previously DEC chaired that group. He asks if that is still the approach, or will that group self-select how to organize themselves.

COMMISSIONER HARTIG replies self-select.

CHAIR FORD states that the next subcommittee previously structured was the labor workforce committee. He asks Vince Beltrami to chair.

MR. BELTRAMI replies yes.

CHAIR FORD states that Rodney Brown and Tom Maloney were on that. He asks Mr. Maloney to continue in that role.

MR. MALONEY agrees. He states that particular group needs a lot of information from the Department of Labor and wants to look at some potentially individual companies with the reporting.

MR. BELTRAMI suggests getting Heidi and asking who she would like to staff it.

MS. MORIARTY states that a well-trained workforce is important.

CHAIR FORD states that Heidi has a good overview of those resources and what is currently active in the state, both private, as well as state-sponsored.

MR. WALSH asks to help out on that from the professional society standpoint.

CHAIR FORD thanks Tom Walsh and moves to infrastructure.

MR. PAWLOWSKI states that he dealt with the major mapping project for the North Slope at DOG and is very interested in the whole infrastructure issues. He adds that he is willing to be part of the board on that subject.

CHAIR FORD agrees.

MR. WALSH volunteers for that committee as well.

COMMISSIONER HARTIG states that DEC can be put on that tentatively.

CHAIR FORD moves to fiscal and tax regime which previously had Peter Stokes, Commissioner Hoffbeck and Kara Moriarty. He states that Commissioner Hoffbeck and Ms. Moriarty will continue to work in that area. He asks for anyone else interested.

COMMISSIONER RUTHERFORD replies herself or Corri Feige.

MS. MORIARTY states that is a valuable addition because DNR brings a viewpoint that was not there previously.

MR. MALONEY also volunteers. He discloses that he works at AHTNA and will not participate in anything related to Middle Earth types of things. He adds that the company is directly affected by that.

COMMISSIONER RUTHERFORD states that she would like Mr. Maloney to participate in Middle Earth issues. She adds that perspective would be worthwhile for part of the discussion.

MR. BELTRAMI asks if he can participate without actually being on the committee.

CHAIR FORD replies that there are not limitations and it is structured this way so that it is simply clear about who is primarily accountable for working these issues. He states that if other board members are available to provide support and input, they can take it on.

MR. PAWLOWSKI asks if Stephanie can let the board in on meeting dates and options.

MS. ALEXANDER states that the reason there were three members is because, per the Open Meetings Act, if there are more than three board members together, the meeting has to be noticed. She continues that it makes it a bit more complicated, but can definitely be done. It would just need to be organized how each of those committees moved forward.

MR. PAWLOWSKI rephrases and asks if board members can be cc'd on fiscal tax, specifically.

CHAIR FORD states that the request was to be copied on all of the work of that subcommittee and when the meetings are.

MR. PAWLOWSKI adds that it will probably require that meeting actually be public-noticed because it can instantly get to more than three people if that is the focus of this report.

A discussion ensues.

CHAIR FORD states that if that is a requirement, then we should probably continue to limit the subcommittee meetings to only three board members.

COMMISSIONER RUTHERFORD states that the only exception to that would be the fiscal and tax regime committee. She continues that there are various perspectives to be embraced or wrapped into the discussion, and that one would probably be worth expanding.

MS. MORIARTY states that she sees that committee as one of the whole. It is going to require some in-depth, very structured meetings moving forward so that the board can make appropriate and vetted recommendations to the Legislature per the mandate, regardless of what the Legislature does or does not do.

The discussion continues and then moves to outlining a standing meeting day and a block of time going forward.

CHAIR FORD asks if everyone is in agreement to schedule a meeting Wednesday, June 29th, morning session.

Everyone agrees.

CHAIR FORD states that concludes the agenda for today and asks for any other items for discussion.

MR. MALONEY states that there is a lot of good work by various consultants related to this fiscal tax regime. He continues that the board should think about what will help us. What helps to accomplish this deliverable with a lot of good work that other people have already done. There are incredible sources.

MR. PAWLOSKI agrees and states that the Division of Oil and Gas Resource Evaluation did an update of what the resource was in Cook Inlet and what it would need to be able to continue at a level that would support development.

COMMISSIONER RUTHERFORD states that one of the things she wants to do is see what the latest update is for the analysis of current supply and how long it lasts given the demand scenarios. She adds that is from resource eval at Division of Oil and Gas.

MR. MALONEY reminds all that there is a website.

MS. MORIARTY comments on Dr. Arya's presentation and what Commissioner Rutherford had mentioned.

A short discussion ensues.

CHAIR FORD asks for any other discussion. There being none, he asks for a motion for adjournment.

MR. MALONEY makes a motion to adjourn the meeting.

MR. BELTRAMI seconds.

(Meeting adjourned at 11:28 a.m.)