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BUSINESS

Shell to Cease Oil Exploration in Alaskan Arctic After Disappointing Drilling Season

Company becomes latest big oil player to abandon region amid low crude prices

Shell said it would stop drilling offshore Alaska. **PHOTO:** UDO WEITZ/EUROPEAN PRESSPHOTO AGENCY

By Sarah Kent

Updated Sept. 28, 2015 7:51 pm ET

LONDON— Royal Dutch Shell PLC is quitting its $7 billion Arctic campaign after drilling just one well with disappointing results, becoming the latest big oil company to abandon the riches under the northern seas in the face of stubbornly low crude prices.

The Anglo-Dutch energy giant's decision, announced Monday, caps a yearslong foray off Alaska's shores that once was considered full of promise but was questioned by investors, environmental groups and religious and political figures.

Shell had viewed the Arctic—one of the few remaining unexplored oil frontiers—as a prize too great to walk away from, despite the recent plunge in oil prices and an unsuccessful effort in the region three years ago that ended with one of its rigs running aground.

But the company changed its mind after the well it drilled in the Chukchi Sea this summer—an area Shell had identified as particularly promising—showed only traces of oil and gas.

“This is a clearly disappointing exploration outcome for this part of the basin,” said Marvin Odum, Shell’s upstream head in the Americas.

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Shell’s Arctic drilling efforts had kicked up protests over the potential ecological effects on the Chukchi Sea’s pristine waters north of Alaska and became part of the U.S. presidential campaign when Hillary Clinton tweeted that oil exploration there was “not worth the risk.”The Archbishop of Canterbury in July said he was concerned about the recent push to drill in Arctic Ocean waters.

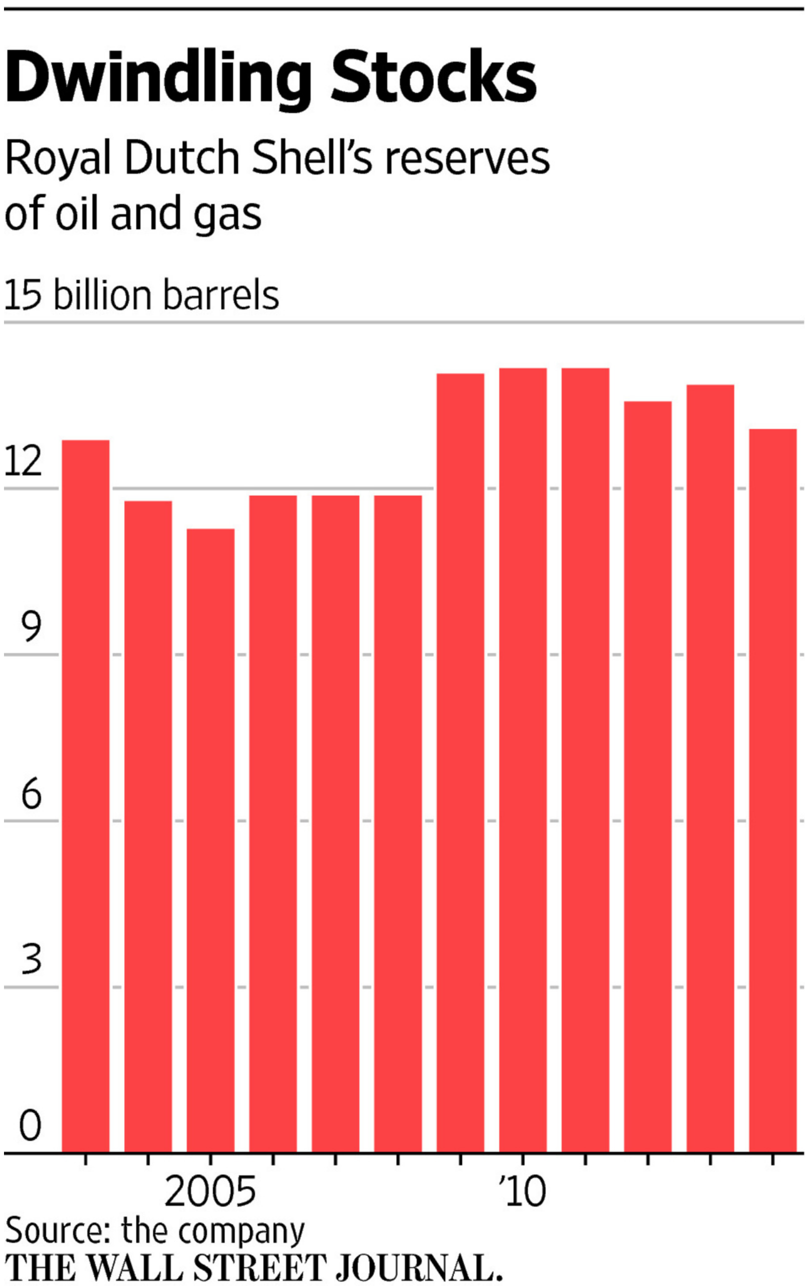
Oil companies have looked longingly at the Arctic for years, but its often icebound seas and treacherous weather make exploring expensive and dangerous. Shell’s decision could spell the end of Arctic drilling for some time, although low oil prices and geopolitics—not environmental concerns—are the main reason.

“This is bad for Shell, but also bad for the industry and bad for the U.S.,” said Oppenheimer & Co analyst Fadel Gheit, calling it among the most expensive failed ventures ever for the industry. “You have to see higher oil prices in order for companies to be tempted to go back into the Arctic.”

Exxon Mobil Corp. XOM **0.96%** ▲ shelved its plans to drill in the Russian Arctic after the U.S. imposed sanctions on Moscow’s energy industry following the annexation of Crimea last year. Chevron Corp. has put its Arctic exploration plans on hold because of low oil prices. A consortium including Exxon and BP PLC suspended Canadian Arctic exploration in June, citing insufficient time to begin test drilling before its lease expires in 2020.

Even if Shell had found oil in the Arctic, the challenges of bringing those resources to production have been underscored by a project in the Barents Sea. Italy’s Eni SpA and Norway’s Statoil ASA are moving closer to production on the giant Goliat field—15 years after it was discovered.

Shell obtained its licenses to explore the Chukchi Sea in 2008 and pushed ahead with the project when oil prices were historically high—more than $100 a barrel. The portion of that sea where it was exploring this summer could hold the equivalent of 29 billion barrels of oil and gas, according to the U.S. Bureau of Ocean Energy Management, though Shell was drilling in only a small area of that region.



Shell had hoped that its best prospect, a drilling area called Burger-J, would prove the region's huge potential. Instead, the field became one of the industry's most expensive dry holes. Shell put the balance-sheet value of its offshore Alaska holdings at $3 billion, with a further $1.1 billion of future contractual commitments. That could translate into big write-downs when the company reports its third-quarter earnings, due Oct. 29.

It is expected to repurpose some of the contracts for rigs and ships it has already paid for to other projects to help mitigate the financial impact, but the blow could be significant. Shell's net profit in the second quarter this year was $3.4 billion.

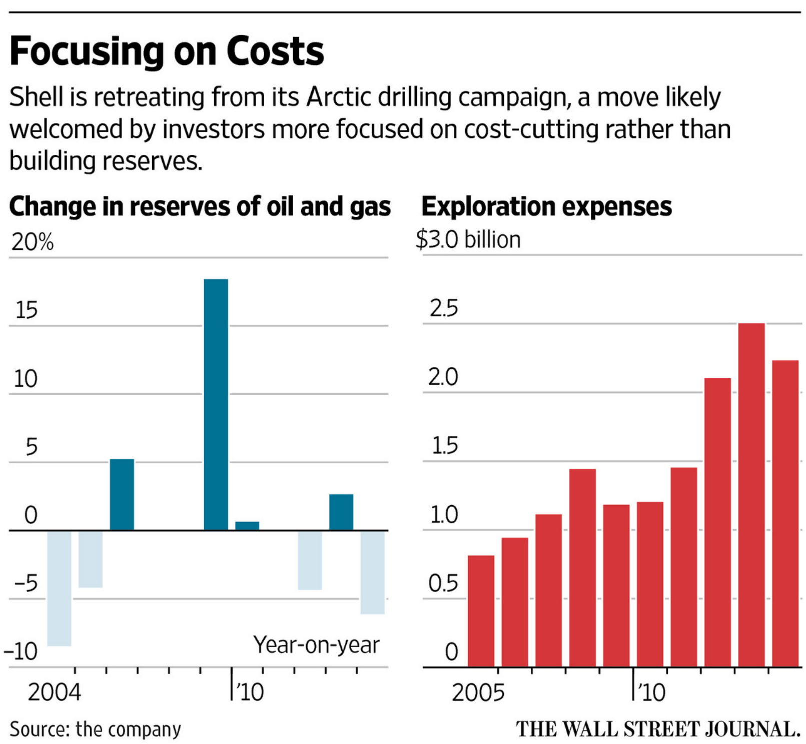
Shell always maintained that it would likely walk away if it failed to find oil this summer.

The project was plagued with challenges from the start. In 2010, Shell had to push back plans to drill in the region after BP's fatal spill off the Gulf of Mexico sparked a government crackdown on offshore drilling.

On Shell's last voyage to the Arctic in 2012, it wasn't able to drill to depths where oil could be found because its spill response system was damaged during a test. At the end of the season, one of its drilling rigs ran aground as it made its way back to Seattle. The crew had to be helicoptered to safety and the rig was scrapped.

This time, Shell said it had upped its game in terms of safety measures and spent months garnering regulatory approvals to drill offshore from Alaska.

But some investors weren't happy about the company's decision to move forward with a big capital expenditure in the Arctic at a time when crude prices were crashing. After the company's announcement on Monday, its stock price moved in line with its competitors.



"Investors don't want Shell to deliver more capex into Alaska," said Bernstein research analyst Oswald Clint. "I imagine investors will be OK with a $1 billion hit versus tens of billions in the future."

Mr. Clint estimated that exiting the Arctic will bring Shell's annual exploration expenses below $3 billion, a move likely to be welcomed by investors more focused on cost-cutting than reserve-building in the current price environment.

Though a find in the Arctic would have given Shell a comfortable cushion of oil supply in the next decade, nearer term it has plenty to focus on as it completes its $70 billion acquisition of BG Group. The purchase is intended to streamline Shell's focus on Brazilian offshore assets and liquefied natural gas, moving Arctic exploration down the company's list of priorities.

Environmental activists treated the decision as a victory on Monday, following a sustained campaign in opposition to Arctic drilling that ranged from London to Seattle. Fearing that Shell's drilling could lead to an ecological disaster like the 1989 Exxon Valdez spill off the Alaskan coast, activists staged protests on kayaks that accompanied the company's rig on its journey to the Arctic.

"It's a major bloody nose for Shell," said Ben Ayliffe, an activist who worked on efforts at Greenpeace to derail Shell's Arctic exploration. "Given the extent to which they went out on a limb in the Arctic, I think that would then cast major doubt over the viability of these Arctic projects in the future."

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Corrections & Amplifications:
Royal Dutch Shell PLC spent about $7 billion on its Arctic exploration program since 2007. An earlier version of this article incorrectly said Shell had spent roughly $9 billion on the program. 09/28/2015

Northern Exposure

Several oil and gas companies have looked at opportunities in the Arctic.

SOURCE: U.S. GEOLOGICAL SURVEY VIA ENI

Chukchi Sea