State of Alaska AS 43.55 Credits

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Commonwealth North

Fiscal Action Coalition

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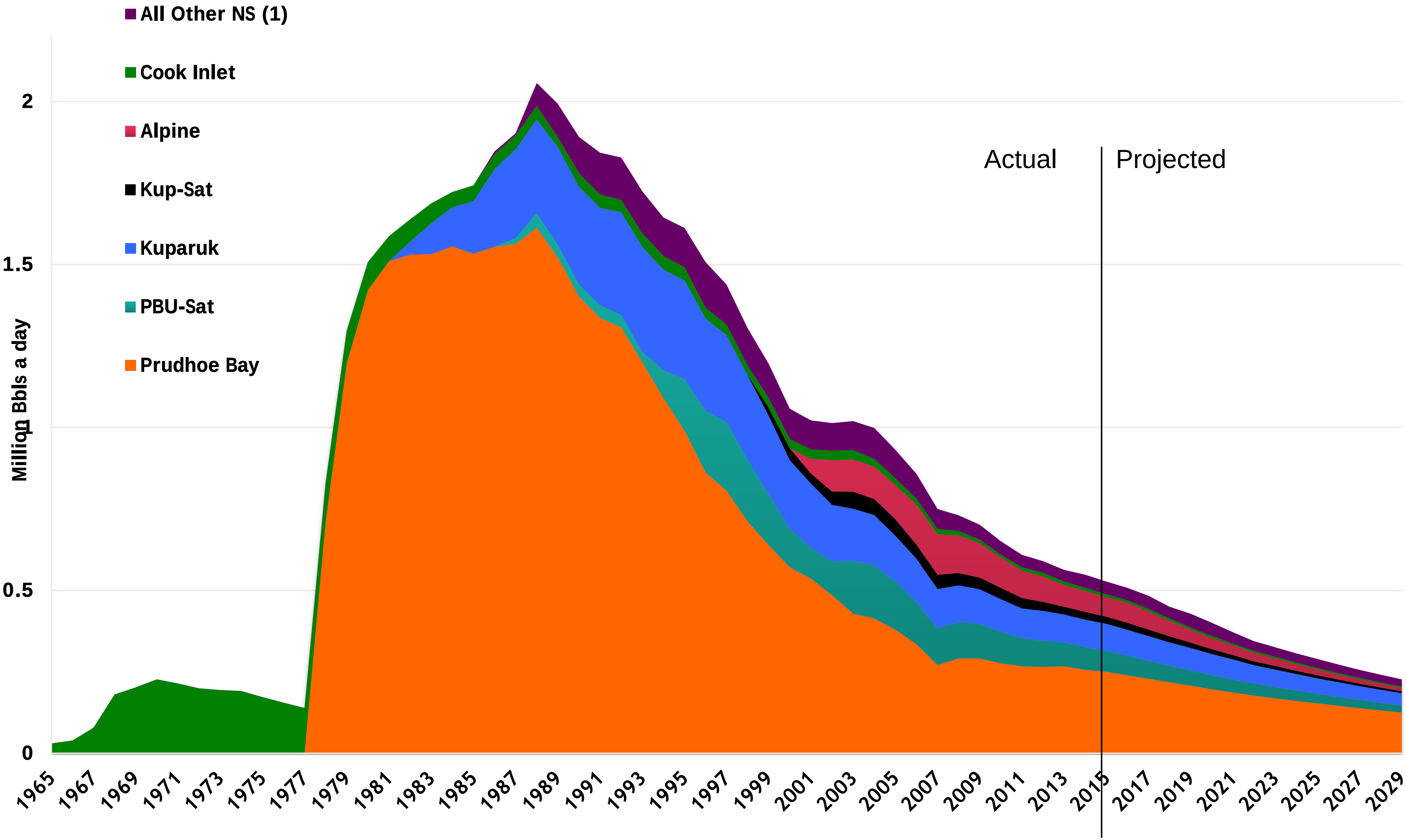
Take Aways

1. Distinction between
- Credits that reduce state revenue/lower taxpayer's taxes and
- Refundable credits for which the legislature must appropriate money to pay/reimburse/subsidize/incentivize explorers, developers and producers.

2. Sense of the complexity of the rules that have proliferated over the last 12 twelve years.

3. Role of finance – opening Alaska to new investors and new explorers developers and producers

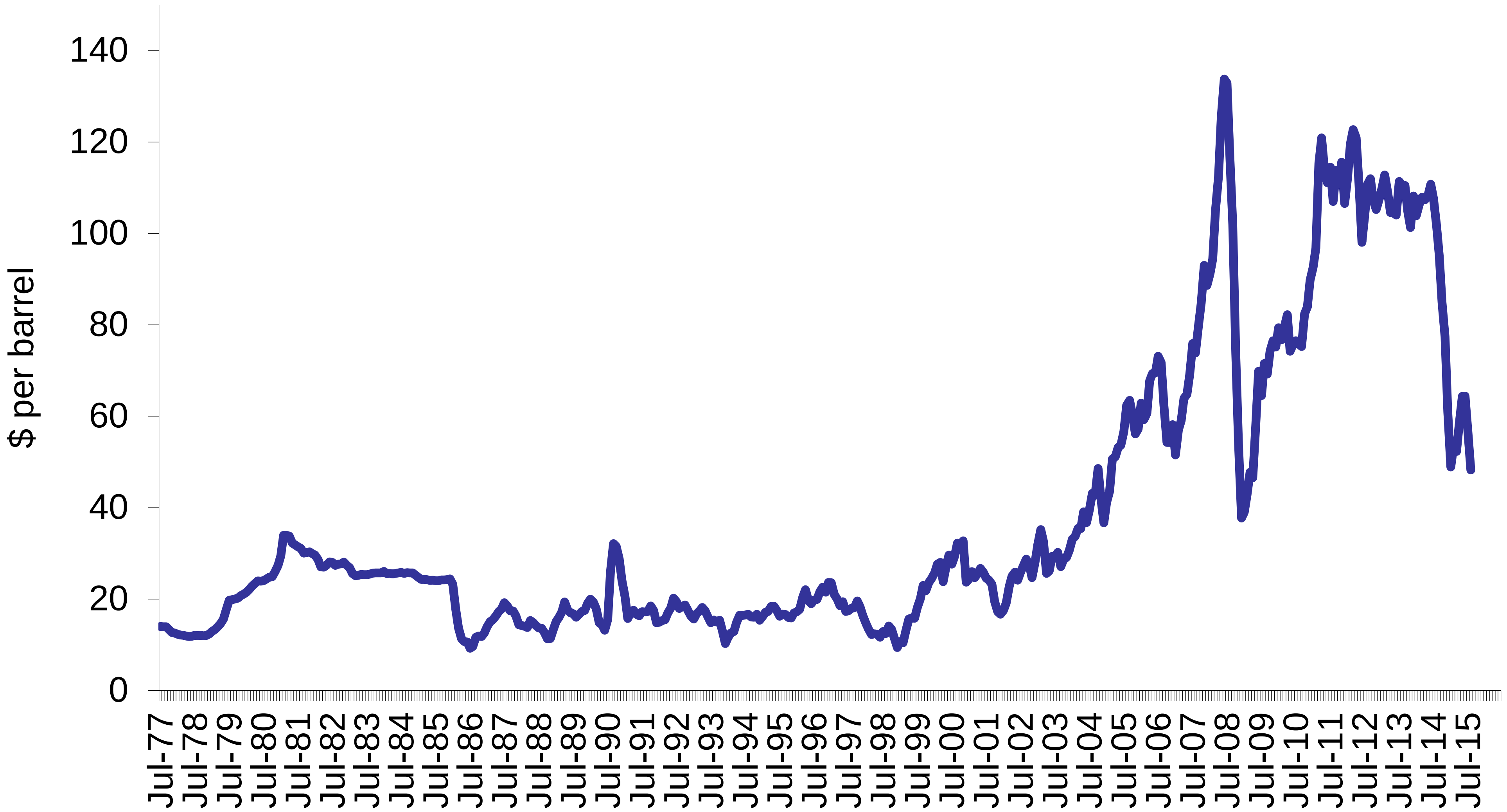
Alaska Oil Production 1965 - 2029 (Projection)



Source: Alaska Department of Revenue, Fall 2013 Revenue Sources Book.& earlier RSB, DNR 2007 Oil and Gas Report (projected out to 2029)

(1) Cook Inlet, Duck Island, Milne Point, Liberty, Pt Thomson, Fiord, Nanuq, Oooguruk, Nikaitchuq and NPRA.

ANS West Coast Price July 2017 - August 2015



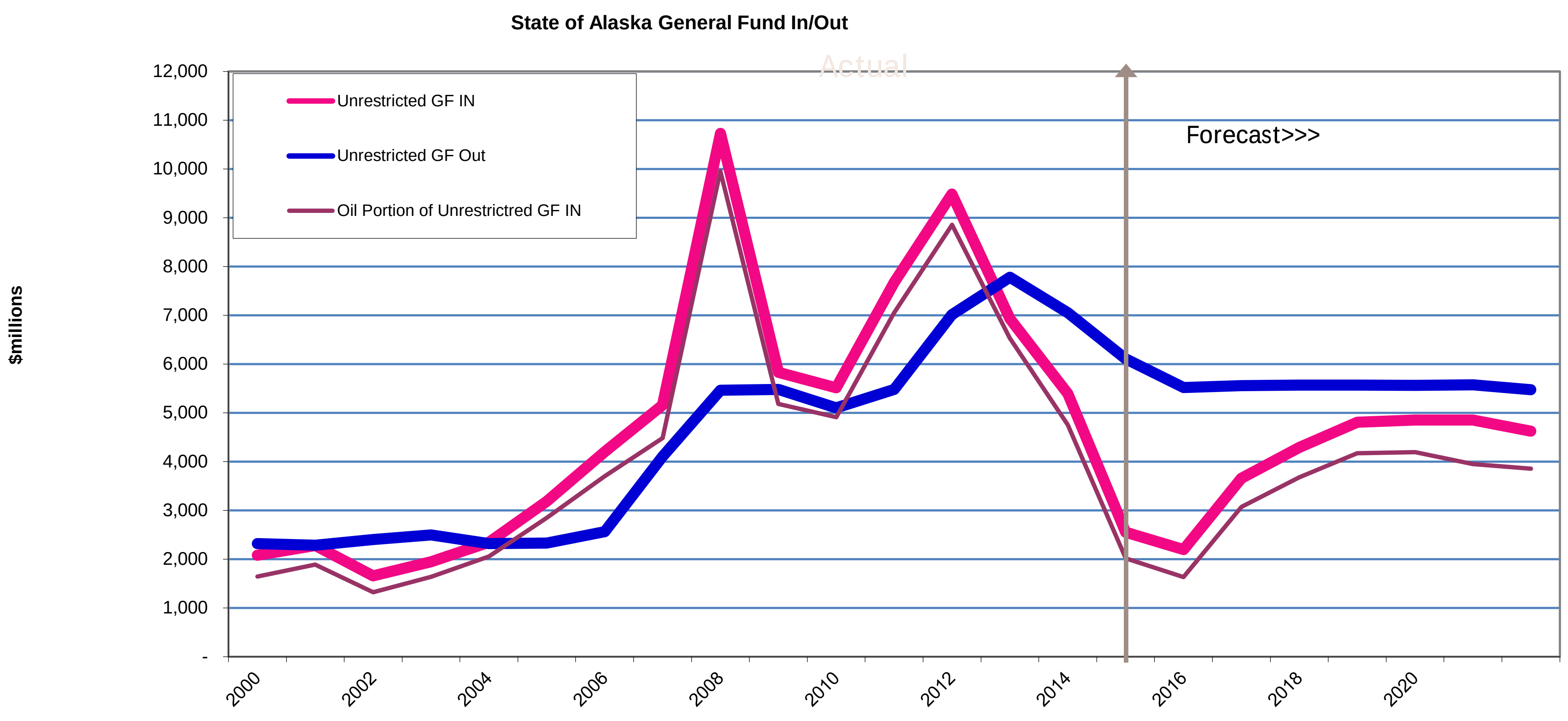
Source: Alaska Department of Revenue, Tax Division

Incentives to Invest in Alaska

"Its widely agreed … Alaska's incentives are among the best in the world. " – Tim Bradner, economist

Source: Bradner, Tim State, industry duel over oil tax, Anchorage Daily News 2/14/2010

State of Alaska Unrestricted General Fund In & Out



Sources: Revenue: DOR Fall 2014 RSB, Past Spending Annual Leg Finance Fiscal Summaries, Future

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Incentives to Invest in Alaska

Tools (Production Tax)

(1) Differential Tax Rate

(2) Caps on Tax (CI and gas used in state thru 2022)

(3) GRR (Gross Revenue Reduction) for new oil

(4) Tax Credits for investment and production

Other Programs

Education Tax Credit 50% of First 100K, 100% of second

Royalty Incentives

- AS 38.05.180(i)
  - Dormant since 1994
  - AS 41.09.010 Exploration Incentive Credit (completed by 2007)
  - AS 38.05.180(j) Royalty Reduction available through 7/1/2015

ANITA Incentives

- 25% of qualified exploratory gas drilling and 'services' in CI

Fundamentals 2: Who gets cash for credits?

AS 43.55.028(c)(4) “average daily production … during the calendar year preceding…was no more than 50,000 bbl. a day”

	Bbls a day in FY 2014	
	Oil bbls	Gas in boe
Conoco Phillips	200	10
BP	145	
Exxon	102	
ENI	20	
Anadarko	13	
Hilcorps	12	25
Chevron	10	
Pioneer	6	
15 others	5	7
Total	513	42

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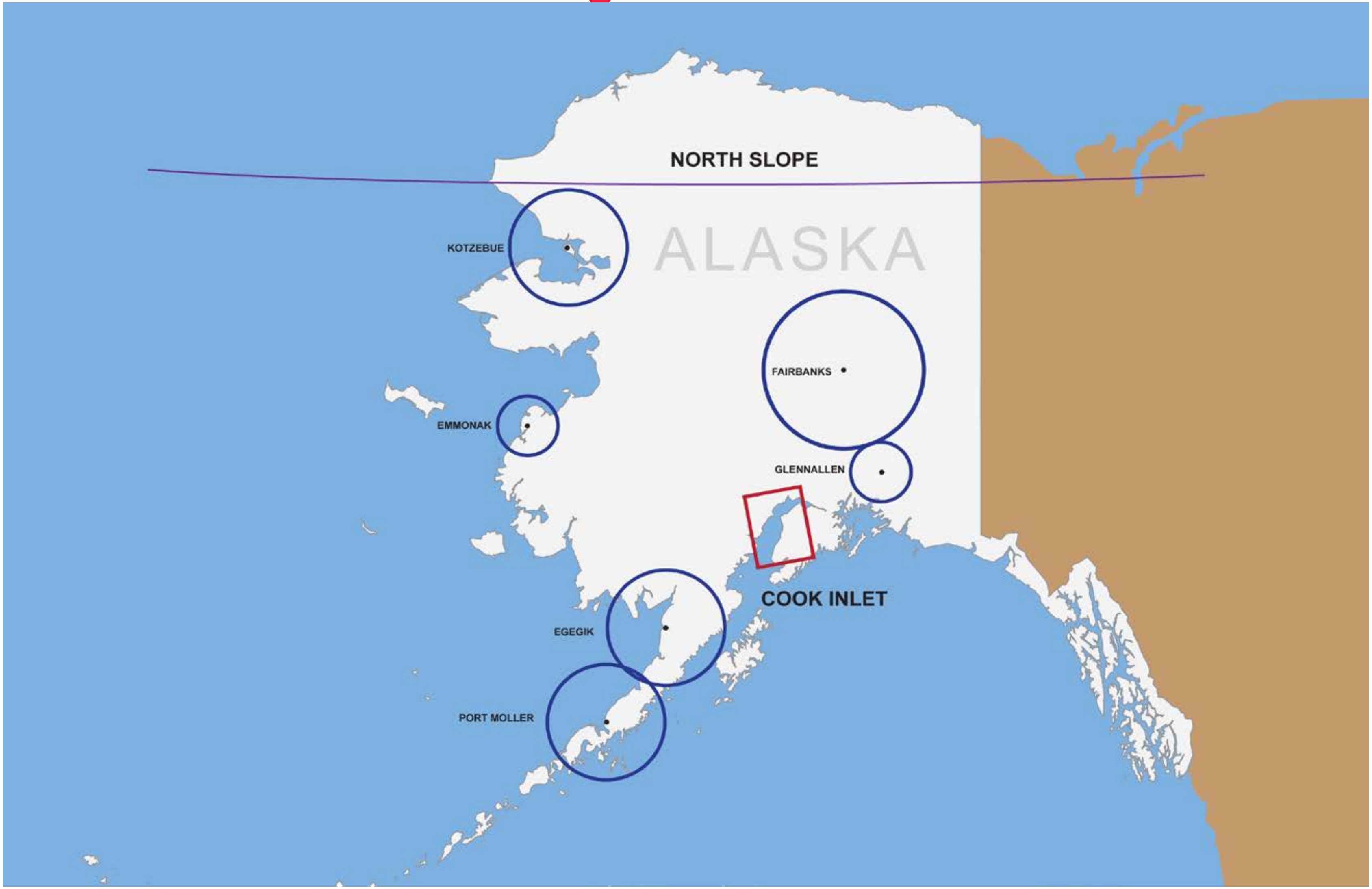
Fundamentals 2: Who gets cash for which credits?

	Production<50,000 bpd	Production>50,000 bpd (BP, CP, EM)
AS 43.55.023	**Cash out available**	No cash out available
AS 43.55.024	Non- Transferable / Refundable	Non- Transferable / Refundable : No cash out Available
AS 43.55.025	**Cash-out Available**	No cash out available

Fundamentals 1: Tax Regions in Alaska



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Fundamentals – ? Classes of credits

	Credit	Common	Difference
1	AS 43.55.023(b) Loss Credit	Available for ME, CI, and NS	45/35% for NS 25% for ME/CI
2	AS 43.55.023(a) & (l) 20% & 40% investment Credit	ME and CI	Not in NS (after Dec 31 2013)
3	AS 43.55.024(c)	$12 mm/y credit for a "small producer"	
4	AS 43.55.024(a)	$6 mm/y credit	ME Only
5	Old AS 43.55.025 Exploration Credits	(c) - 3 miles test (d)- (e) - Seismic work outside a unit	(c) (d)-25 mile test NS & ME, 10 miles CI (e) -
			Expires 2016 NS & CI, 2022 in ME
6	AS 43.55.025 Hot Spots	Confusion about overlap with other credits	NS - No CI - Jack Up rig ME - 6 Hot Spots
7	AS 43.55.024 (i)	$5 a produced barrel credit	DOR website says only NS qualifies
8	AS 43.55.024 (j)	$0 -$8 a produced barrel credit	NS Only

Fundamentals 3: 3 Classes of Credits – AS 43.55.023

- **AS 43.55.023** – Generally, currently cashed in – increase in spending/appropriation.
- Began in 2006 – no sunset
- Measured by spending (or spending less revenue)

	CI/ME	NS
023(b) loss	25%	45% thru 2015, 35% thereafter
023(l) (IDC)	40%	n/a
023(a) (Tang QCE)	20%	n/a

Fundamentals 3: 3 Classes of Credits – AS 43.55.024

AS 43.55.024 – No Sale/Transfer No Carry forward: - Reduction in Revenue - only

- Small Producer Credits 024(c) (2016 start sunset) – up to 12 million a year if production less than 50,000 bbl. a day (phases out over 50,000 – 100,000 bbl./day)
- SB 21 Production credits (024(i), 024(j)) – Production based (introduced 2013 - no sunset) can range from 0 to $8 a barrel produced.
- ME Credit 024(a) Sun sets in July 2016 – would have had to have production

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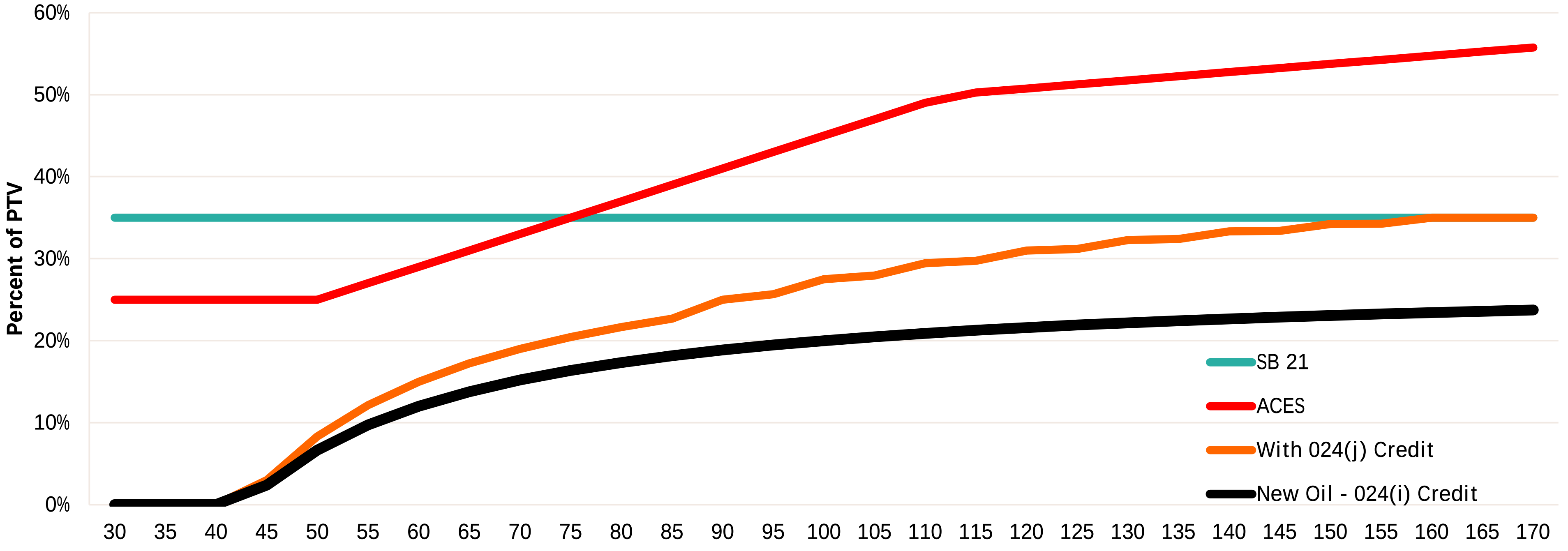
Mechanics of 024 (i) and (j)

If production qualifies as new oil, then receives Gross Revenue Reduction of 20% to 30% **and** credit of $5 a barrel.

Production that does not qualify as new oil receives a credit of up to $8 a barrel: The $8 applies when the gross value at the point of production (GVPP) is less than $80 a barrel. It phases out until no credit if GVPP is more than $150 a barrel



Gross Value at the Point of Production
(Assumes PTV=GVPP-$20)

Fundamentals 3: 3 Classes of Credits – AS 43.55.025

- **AS 43.55.025** – Exploration Credits – transferable - Mixture of cash in and application against taxes owed
- Measured by spend
- Sun setting June 2016 Except ME where they are limited
  - Originated in 2003
    - (c), (d), (e) – Sunset July 2016 for NS/CI, remain in ME until 2022: 30% to 40% for frontier exploration wells and seismic
    - (l) (started 2010) Cook Inlet Jack up rig credit 100% or $25 million to first qualifying well, plus two more at lower rates
    - (m) & (n) (started 2012) First four qualifying ME “hot spots”:
    - (m) exploration wells 80% limited to $25 million per ;and
    - (n) seismic projects 75% limited to $7.5 million per

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Credits That Reduce Revenues

Annual Budget is (partial) function of DOR's estimate of revenues	
Unrestricted General Fund FY 16 –	
Oil and gas production taxes	910.2
024(i) and (j) by big three producers in heritage properties	**(590)**
& small producer credit	
Oil and Gas property taxes	125.2
Corporate Income Taxes (Special oil and gas provisions)	148.6
Oil and Gas Royalties	1,039.6
All other unrestricted revenues (investment, taxes, licenses, permits etc.	572.1
Total Unrestricted General Fund Revenue Projection	**2,205.7**

Assuming 520 mbbls a day, at a price of 66.03/bbl

Source: Legislative Finance, FY 2016 Summary of appropriations

Credits That Increase Appropriations/Spending

Legislature sets level of funding	
Unrestricted General Fund FY 16 –	
Agency Operations	4,091.0
Statewide Obligations:	
Fund Capitalization: Oil & Gas Production Tax Credit Fund	***500.0***
Other Statewide	470.7
& other small producer credit	
Unrestricted General Fund portion of Capital Appropriations	118.4
Pre Transfers Authorization	5,180.2
Unrestricted General Fund Revenue from prior slide	2,205.7
Surplus (Deficit)	(2,974.5)

Source: Legislative Finance, FY 2016 Summary of appropriations

Relative Size of components

FY 2007 thru FY 2014

	North Slope	Non North Slope	Totals
Reduce Tax Revenues	3.7	.1	3.8
Cash out	1.8	.5	2.3
Totals	5.5	.6	6.1

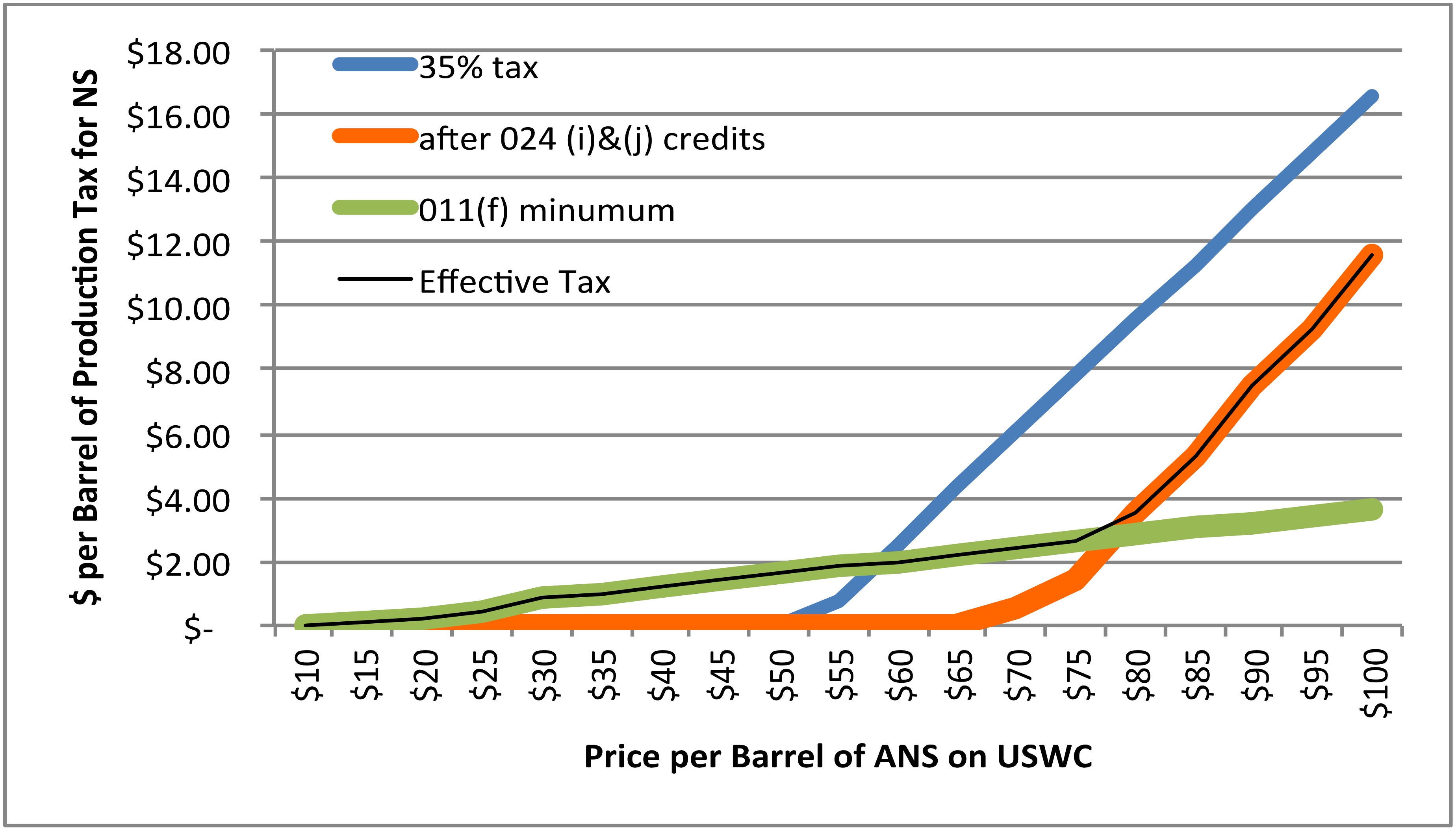
FY 2015 thru FY 19 Forecast

	North Slope	Non North Slope	Totals
Reduce Tax Revenues	4.7	.1	4.8
Cash our	1.1	1.1	2.2
Totals	5.8	1.2	7.0

All figures in Billions of Dollars

Source: Merrill, Mackenzie (DOR economist) Production Tax Credits Detail FY 2007 to FY 2019, 4/15/2015

Effect of Minimum Price: AS 43.55.024(i) & (j)



Source: PTV is USWC ANS Price less $9.31 Transportation, $19.62 Opex and $23.78 in Capex, sourced from Fall 2014 Revenue Source Book pg XX) (50/50 (i) & (j))

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AS 43.55.024 (i) & (j)

At prices below about $60 a barrel: the gross minimum tax will determine the tax paid – as if no 024 (i) and (j) credits.

At prices between about $60 and $75 the 024(i) and (j) credits push the taxes down to the minimum tax: Without credits, tax revenues would be higher.

At prices above about $75, credits determine taxes. Minimum tax no longer plays a role. Without credits tax revenues would be higher

Role of Finance

Great deal of interest in financing Exploration, Development and Production, where pay off comes from SOA, not future hydrocarbon revenues.

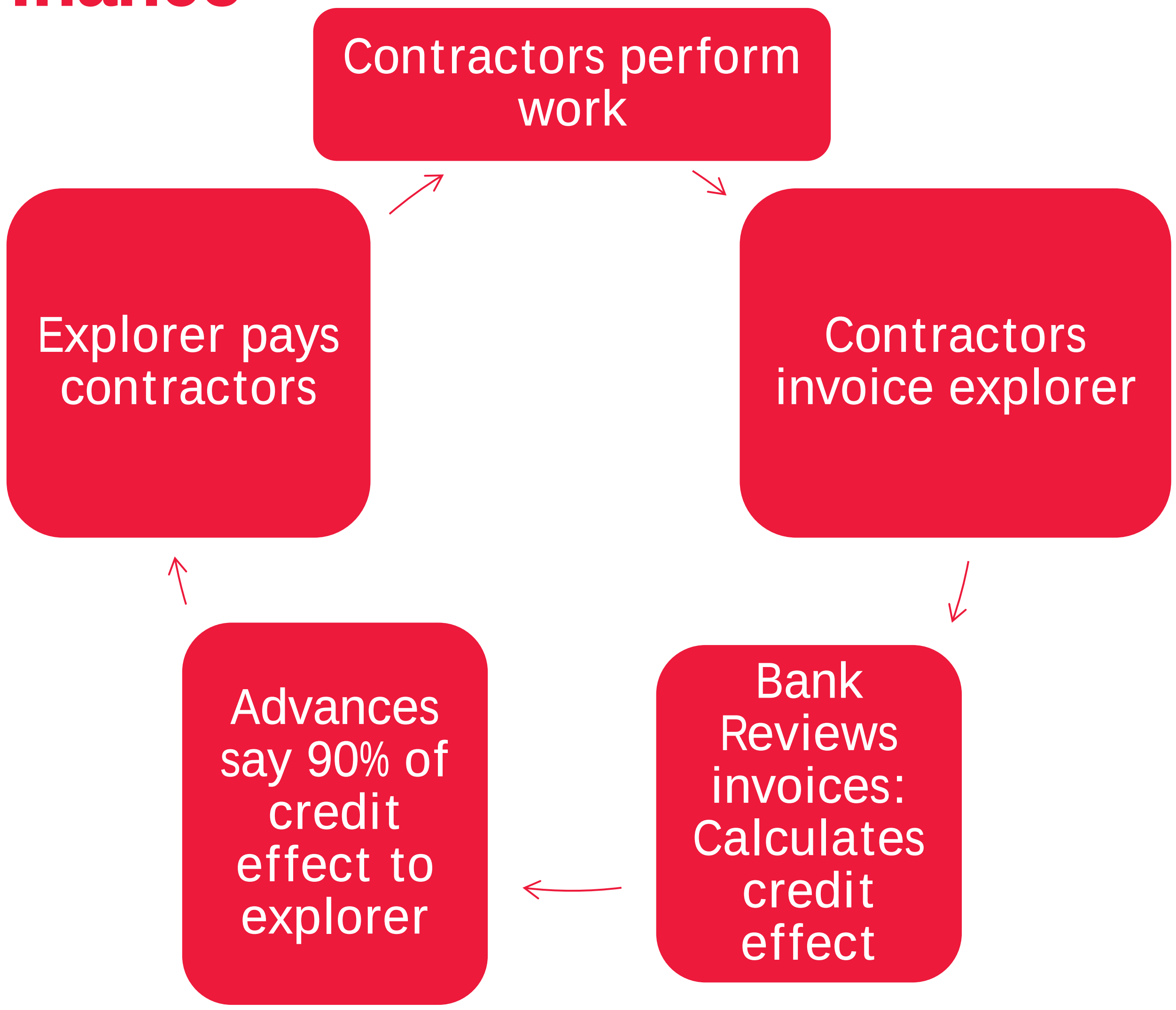
Cost of money drops significantly.

That brings in new sources of money.

Great deal of interest in exploring, Developing and Producing, when cost of money is low. (Future higher prices will bring huge upside)

That brings in new explorers, developers (and producers) that could not get their ideas financed before

Role of Finance



3. Gross Revenue Reduction for New Oil

AS 43.55.160(f) criteria for 20% Gross Revenue Reduction for new oil:…(1) the oil or gas is produced from a lease or property that does not contain a lease that was within a unit on January 1, 2003; (2) the oil or gas is produced from a participating area established after December 31, 2011, that is within a unit formed under AS 38.05.180(p) before January 1, 2003, if the participating area does not contain a reservoir that had previously been in a participating area established before December 31, 2011;(3) the oil or gas is produced from acreage that was added to an existing participating area by the Department of Natural Resources on and after January 1, 2014, and the producer demonstrates to the department that the volume of oil or gas produced is from acreage added to an existing participating area.

AS 43.55.160(g) Further 10% reduction if royalty rate > 12.5% for all leases

3. Gross Revenue Exclusion for New Oil

AS 43.55.160(f) Translation:…

(1) Oil or gas from new units (that don't contain certain bits of old units)

(2) Oil or gas from a new participating area in an old unit (that don't contain certain reservoirs)

(3) Oil or gas from new acreage added to an old participating area, (but producer has to demonstrate oil is from new acreage)

(4) Omitting any reference to "lease or property"

AS 43.55.160(g) - A further 10% reduction in the Gross Value if royalties> 12.5%

Geography of Credits

<table>
<tr><th></th><th>AS 43.55.023</th><th>AS 43.55.024</th><th>Old AS 43.55.025</th><th>AS 43.55.025 Hotspots</th></tr>
<tr><td>North Slope</td><td>(b) only</td><td>(c), (i) (j) all apply</td><td>Sunsets 2016</td><td>n/a</td></tr>
<tr><td>Cook Inlet</td><td rowspan="2">(a), (b) and (l)</td><td>(c) and maybe (i) apply</td><td>Expires 2016, slighlty different rule for (c)</td><td>Jack up Rig rules: Sunsets 2016</td></tr>
<tr><td>Middle Earth</td><td>(a), (c), and maybe (i) apply</td><td>Sunsets 2022</td><td>Six hotspot rules: sunsets 2016</td></tr>
</table>

Per 15 AAC 55.335 (d) AS 43.55.024(i) applies only to NS

For Middle Earth

Baseline – qualifies for roughly 65% in credits under known AS 43.55.023(a) and (l) and AS 43.55.025(d) rules

Federal IDCs (generally) and Seismic outside units will qualify for 40% (AS 43.55.023(l) & AS 43.55.025(d). Eventual workovers may also qualify under AS 43.55.023(l)

Other costs – production and development equipment and tangible well costs qualify for 20% credit under AS 43.55.023(a).

All those costs then qualify under AS 43.55.023(b) for inclusion in the loss calculation leading to 25% credit.

- Direct costs generally get 4.5% overhead,
- New Entrant without production costs=loss.

Extension of "Old" 025 credits

These 30% and 40% credits have been extended out until 2022 for ME.

However, except for 'seismic outside of a unit' generally the terms and conditions generally are better under AS 43.55.023.

Cook Inlet focuses on 43.55.023 Credits

Baseline Credits during Development

New well costs (exploration or development) that would be IDC under federal rules qualify for a 40% credit under AS 43.55.023(l).

The tangible portion of the well – casing, as well as production facilities, gathering lines, and any other investment upstream of the point of production qualifies for a 20% credit under AS 43.55.023(a)

If during development (or exploration) company has a loss as that is defined in AS 43.55, then after grossing up the costs with an overhead allowance of 4.5%, qualifies for a 25% credit under AS 43.55.023(b)

So CI investments in wells will generally qualify for a 66% credit, with some items at 46%

Other –

Eventual workovers may also qualify under AS 43.55.023(l).

New Entrant without production costs = loss. AS production ramps up, ability to take loss fades. (Caps still in place through 2022)

Seismic outside units will qualify for 40% only under AS 43.55.025(e).

For North Slope

In general, in 2014 & 2015, non frontier exploration credits stay at 45% (were 20% Capital + 25% loss, now 45% loss)

In 2014 and 2015 Certain North Slope Frontier Exploration will qualify for 85% refundable Tax credit -

Combination of 40% Exploration credit

45% Loss Carry Forward Credit

Then in 2016, AS 43.55.025 expires and AS 43.55.023(b) drops to 35%.

Existing Producers: AS 43.55.024(i) and (j) reducing taxes to minimum

Thank You

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Fundamentals: Alaska Law I

<u>Alaska Law</u>

Statute –for example AS 43.55.165 (e)

- Title 43 – Revenue – of the Alaska Statutes
- Chapter 55 – Production Tax
- Section 165 – Lease Expenditures
- Subsection (e)

Regulations – for example 15 AAC 55.171 (a)

- Title 15 – Revenue – of the Alaska Administrative Code
- Chapter 55 – Production Tax
- Section 171 – Prevailing value for Oil
- Subsection (a)

Also legislation – for example – SCS CSHB 2001(FIN) may contain uncodifed law such as transition provisions

- Lettered Subsections may not match because definitions are always moved to end, and if more than one bill is passed pertinent to a Section
-

Fundamentals: Alaska Law II

Alaska Law on the web: state.ak.us > Departments ("My Government") >Law>Department of Law Home Page>Law Resources> Alaska Statutes and Regulations

- *Delivers you to* BASIS (see BTMF, live streaming)
- Alaska Statutes –> by year use most recent
- Alaska Information –> Alaska Administrative Code *has regulations*
- Bills and legislation by session

Book Form: LexisNexis Alaska Oil and Gas Laws and Regulations Annotated (updated annually)

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Fundamentals 1: Tax Regions in Alaska

NS – North Slope

- North of 68 degrees North Latitude

CI - Cook Inlet

- 11 AAC 83.1049 “Cook Inlet” means the area bounded by
  - (A) the north boundary of Township 18 North, Seward Meridian;
  - (B) the Seward Meridian
  - (C) the south boundary of Township 7 South, Seward Meridian; and
  - (D) the west boundary of Range 19 West, Seward Meridian

ME – Middle Earth

- Everywhere Else

Fundamentals 2: Tax Regions in Alaska

ME – Middle Earth

Includes 6 hot spots defined in AS 43.55.025(0)

(1) 100 miles from 66.896128 degrees North, -162.598187 degrees West;

(2) 150 miles from 64.839474 degrees North, -147.72094 degrees West;

(3) 50 miles from 62.776428 degrees North, -164.495201 degrees West;

(4) 50 miles from 62.110357 degrees North, -145.530551 degrees West;

(5) 100 miles from 58.189868 degrees North, -157.371104 degrees West;

(6) 100 miles from 56.005988 degrees North, -160.56083 degrees West.