Testimony on HB247 to Senate Finance, May 15, 2016
Presented by Scott Jepsen, Vice President External Affairs for ConocoPhillips Alaska

- COP has historically been one of the state's most active investors and that is especially true since passage of SB21.
  - We have funded and constructed the first drill site in Kuparuk in 13 years.
  - We have increased our rig count from 3 pre-SB21 to 4 to 5 and as high as 6 during exploration. This compares to our current L48 rig count of 3, down from 20+ several years ago.
  - We are also pursuing new developments in NPRA (GMT-1 and GMT-2) as well as additional development of the viscous oil resource in the Kuparuk River Unit.
  - We have been a net severance tax payer and continue to be a net severance tax payer.
  - We continue to be an active explorer and investor, but detrimental changes in SB21 could negatively impact our investment plans both near term and long term.
  - With that as background, I will now talk about the elements of the House bill that impact ConocoPhillips. I will not be addressing the reimbursable tax credits because COP is not eligible for those credits. In case the committee is interested, we have put together a one-pager that summarizes ConocoPhillips' position with regard to the various tax credits. It is our estimate that we will receive very little benefit from any of the tax credit provisions in the next fiscal year. For the sake of time today, I have chosen not to go through the one-pager, but if there is interest, we would be happy to provide it to the Committee.

- With regard to the elements of the bill that affect ConocoPhillips:
  - **GVR** - The changes in the GVR will make new field economics less competitive with other investment opportunities. Developing new fields like GMT-1 and GMT-2 is more expensive than drilling in the L48 simply because we need more infrastructure to bring the wells on line. A three year GVR does little to help the economics of these new developments and even a seven year GVR is only marginally helpful. Changing the GVR as described in the bill passed in the House may negatively impact the likelihood of funding for these types of projects.
  - **Changes to the gross minimum tax** - Changing the gross minimum tax rate from 4% to 5%, even as a function of oil price, is simply sending the wrong signal to investors. One of the key things Alaska can do to maintain its competitive edge is to at least keep the basic tax structure in place. This change represents a

- fundamental change in the tax structure and one that will cause investors like ConocoPhillips to be much more wary about investing in the state.
- **Monthly versus yearly use of the per barrel and other credits** - There is also language in the bill that attempts to change the use of the per barrel and other credits from a yearly basis to a monthly basis. This change is reportedly to address Director Alper's theory of "migrating" tax credits. If one reads the SB21 legislation, it is clear that the intent of the legislation and the regulations that were drafted from SB21 was to make estimated monthly payments but finalize payments based upon yearly results. There is no ability for the tax payer to "shift" tax credits from one month to another – we are simply following the regulations laid out by the State. Attempting to restrict the per barrel and other credits to monthly results versus yearly results essentially turns the tax into a monthly tax which in the end will make tax compliance more difficult with more complex audits. DOR already has issues with completing audits in the six year time frame they have available – this will make it even harder to complete audits and is clearly is reformulation of the intent of SB21 without any overarching tax policy framework other than to increase State take in times of price volatility.
- **NOLs** - While we do not envision that the NOLs by a company like COP are as potentially significant as Director Alper has claimed, it does not make sense to limit NOLs by the large producers to just one year while continuing the NOL provisions for the small producers, non-producers and non-tax payers in perpetuity. The long term investors who have been, and depending upon the tax framework, may continue to invest billions in the North Slope, are the large producers like ConocoPhillips. The philosophy of continuing NOLs for the small and non-producers and eliminating a recovery of NOLs against severance tax liability for the large producers is not consistent and has a potentially differential, negative impact on the State's most consistent investors.
- **Interest rate on amounts owed** - The increase in interest rate for payments owed to the State does not seem reasonable given the very long time frame it takes for the state to finalize audits. We typically do not get audit results for 6 years, and then it can take 3 to 4 years to finally resolve the points of disagreement. We believe the interest rate provisions in SB21 should be left standing until the state can turn around and finalize its audits in a reasonable time frame (for example 3 years).
- **Tax credit disclosures –** Based upon our review to date, we do not see any issues with the tax credits disclosure provisions as described in the House bill.

- Concluding comments
    - Any changes that increase the tax burden, especially in times of low prices when the industry is cash flow negative, will likely result in adversely impacting ConocoPhillips' current and future investments.
    - Significant changes in the tax law would validate concerns regarding the State's ability to implement a stable oil and gas fiscal policy. It has only been about 20 months since voters ratified SB21. Long term investment requires a durable, reasonable fiscal framework. We have had six changes in Alaska's oil and gas tax framework in the last 11 years. Another significant change will negatively impact investor's view of Alaska and could adversely impact long term investment plans.

Tax Credits and Applicability to ConocoPhillips

Tax Credit Type	Total FY17 estimate*, $MM	Total reimbursable*	COP reimbursement	Total used against severance tax liability *	COP used against severance tax liability
Net operating loss	452	370	**0 – Not eligible**	82	**0**. Possible for calendar year '16, but self-correcting.
Exploration	76	76	**0 – Not eligible**	0	Possible for 2016. Expires this year.
Small producer	27	NA	NA	27	**0 – Not eligible.**
Per barrel production credit	16	NA	NA	16	**Depends** upon oil price and expenditures.
Cook Inlet and Middle Earth	337	326	**0 – Not eligible**	11	**0.** Assumes sale of the North Cook Inlet Unit. Kenai LNG operations not deductible.
Total	908	772	**0 – Not eligible**	136	Potential for an NOL. Dependent upon oil price and expenditures.

- In 2015, COP incurred obligations (royalty, severance tax, property tax, income tax) to the State of Alaska of +$665MM. Net cash flow greater than -$100MM**.
- In 1Q 2016, incurred obligations of +$77MM. Net cash flow ~ -$100MM**.

*From DOR Spring 2016 Revenue Sources Book
**Note: Net cash flow does not necessarily equate to a net operating loss. There are significant expenses that are not deductible for severance tax purposes.

May 15, 2016 ConocoPhillips