

CS SB 130: IMPACT ANALYSIS

Senate Resources Committee
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CS SB 130 SUMMARY

North Slope Provisions: 'Old' Oil

- Continue ability of NOL to reduce taxes below 4% gross floor
- Continue annual basis of tax assessment

North Slope Provisions: 'New' Oil

- Continue ability of NOL, \$5/bbl and Small Producer credits to reduce taxes below 4% gross floor
- Continue annual basis of tax assessment
- Remove impact of GVR in calculating NOL to ensure 35% support for North Slope spending
- \$85mm per-company cap on refunds to protect against potential liability of major new developments
- 5-year time limit on GVR

CS SB 130 SUMMARY

Cook Inlet Provisions

- Reduce all Cook Inlet credits starting January 1 2017 (WLE to 20%, QCE to 10%, NOL to 15%)
- from 1 January 2018, sunset all credits and exempt Cook Inlet from production tax

Middle Earth Provisions

- Grandfather existing .025 frontier basin credit until 2022, phase down WLE, QCE and NOL

General Provisions

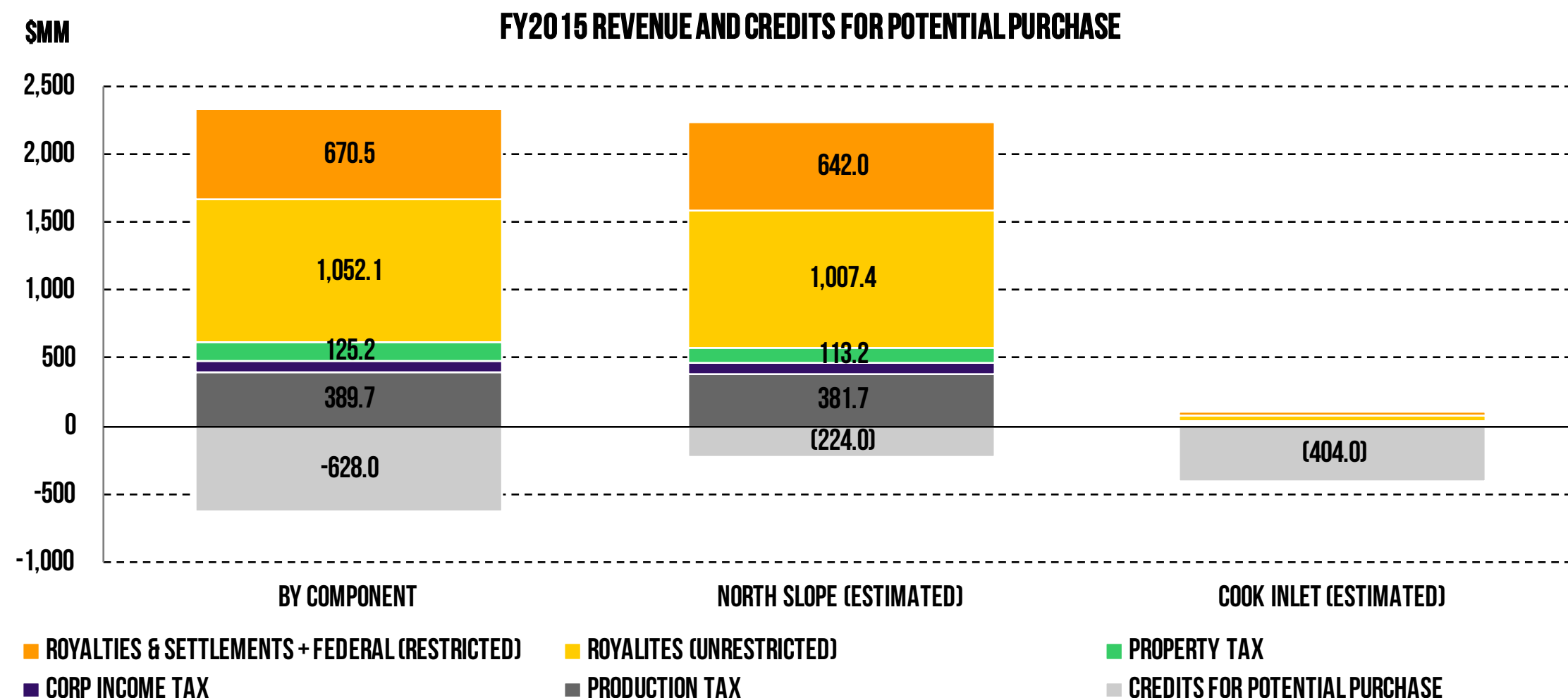
- 7% quarterly compounded Interest on delinquent taxes - but only for 3 years
- Existing liabilities to state from oil & gas production withheld from refundable tax credits
- Alaska hire linked to credit refund priority, not amount
- Surety bond (\$250K) to protect local creditors

BIG DIFFERENCE BETWEEN NORTH SLOPE AND COOK INLET

The majority of refundable credits go to Cook Inlet producers

Cook Inlet production, however, generates limited direct revenue for the state

Credits on the North Slope are more limited but also a far smaller fraction of total value generated



SOURCE: ALASKA DEPARTMENT OF REVENUE, REVENUE SOURCES BOOK; TAX DIVISION; ENALYTICA ESTIMATES

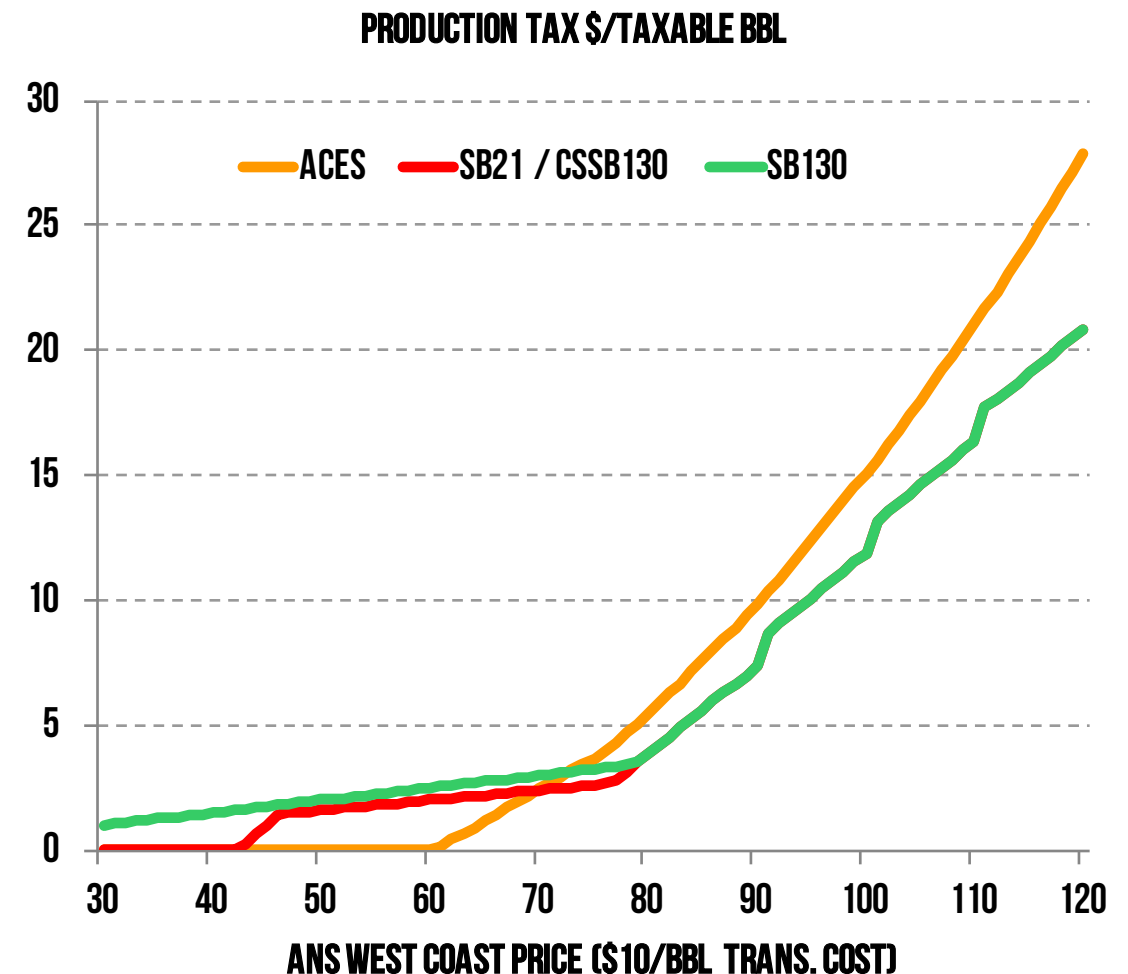
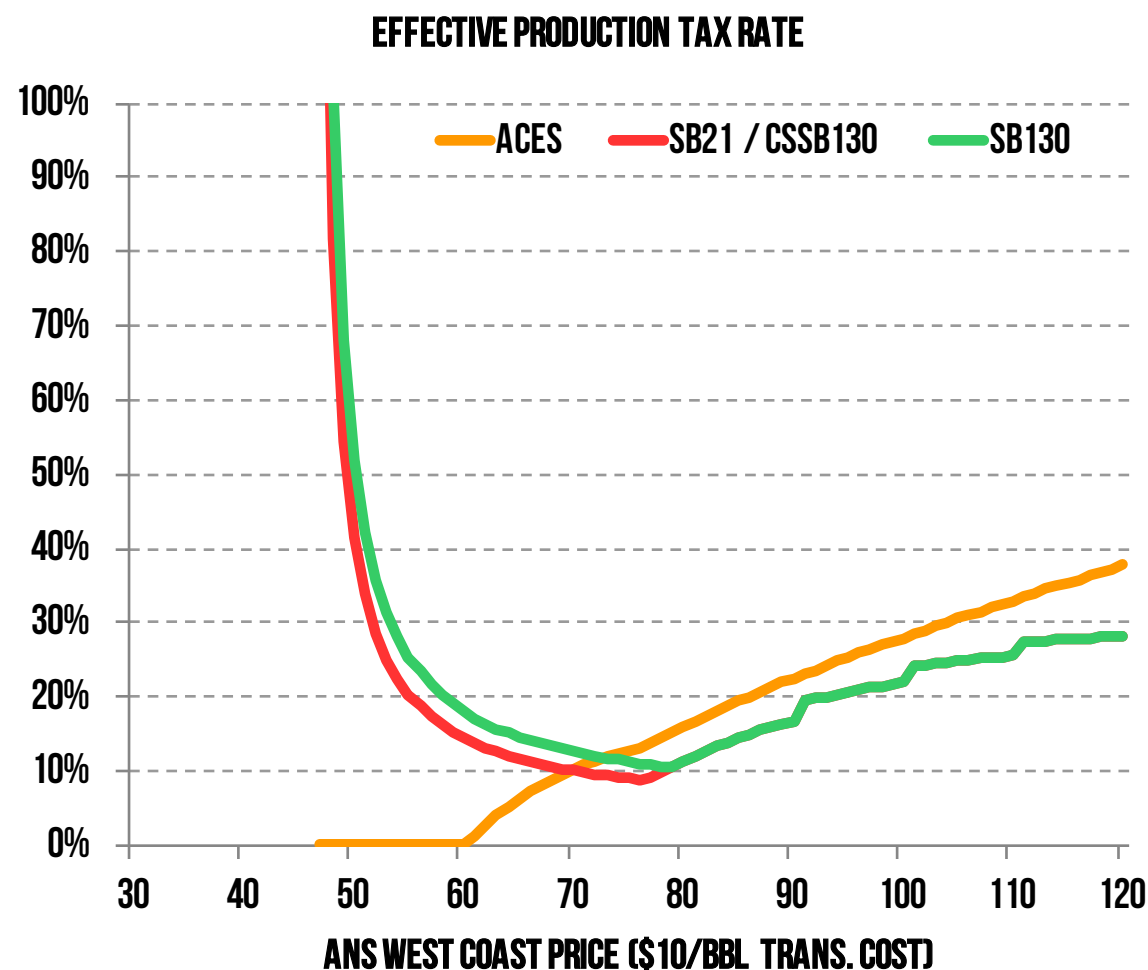
CS AVOIDS RAISING TAXES ON LOSSES

Effective tax rate under ACES could fall to zero because capital credits were applied after gross floor

SB21 applied a **hard gross floor** under \$/bbl credits - meaning skyrocketing net tax rate at low prices

Concern to **protect state at low prices** always valid, but must **balance risk and reward** at low and high end

Preventing NOL credit from 'piercing' floor **moves state revenue from future to present**; total is the same



KEEPING ANNUAL CALCULATION AVOIDS TAX HIKE

Under volatility, **gross minimum** tax may apply to some months, while annual remains **net profit**-based

In 2014, gross minimum would have applied Nov & Dec, but not full-year⁺

Enforcing monthly gross minimum would have netted additional ~\$100mm⁺

	ANS WC	TRANSPORT	OPEX	CAPEX	PTV/BBL	35%*PTV/BBL	LESS \$8/BBL	4% OF GVPP	PROD TAX / BBL	LIABILITY \$MM
ANNUAL										
2014	97.74	10.42	19.30	20.29	47.73	16.71	8.71	3.49	8.71	1,440.32
MONTHLY										
JAN-2014	103.82	10.42	19.30	20.29	53.81	18.83	10.83	3.74	10.83	
FEB-2014	106.30	10.42	19.30	20.29	56.29	19.70	11.70	3.84	11.70	
MAR-201	107.91	10.42	19.30	20.29	57.90	20.26	12.26	3.90	12.26	
APR-2014	107.36	10.42	19.30	20.29	57.35	20.07	12.07	3.88	12.07	
MAY-2014	108.06	10.42	19.30	20.29	58.05	20.32	12.32	3.91	12.32	
JUN-2014	110.76	10.42	19.30	20.29	60.75	21.26	13.26	4.01	13.26	
JUL-2014	107.63	10.42	19.30	20.29	57.62	20.17	12.17	3.89	12.17	
AUG-2014	101.78	10.42	19.30	20.29	51.77	18.12	10.12	3.65	10.12	
SEP-2014	96.05	10.42	19.30	20.29	46.04	16.12	8.12	3.43	8.12	
OCT-2014	84.91	10.42	19.30	20.29	34.90	12.21	4.21	2.98	4.21	
NOV-2014	77.41	10.42	19.30	20.29	27.40	9.59	1.59	2.68	2.68	
DEC-2014	60.90	10.42	19.30	20.29	10.89	3.81	(4.19)	2.02	2.02	
								9.31		1,540.94
INCREASE								0.61		100.62

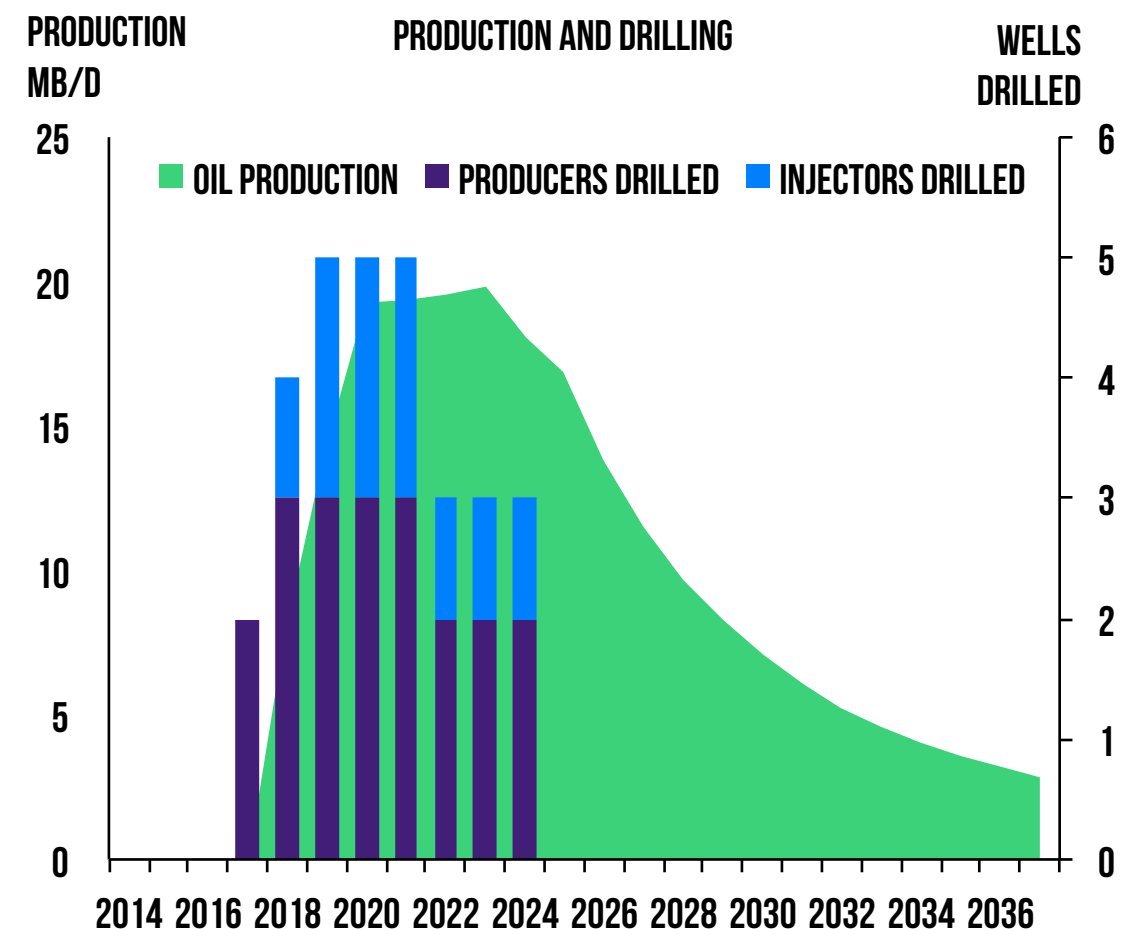
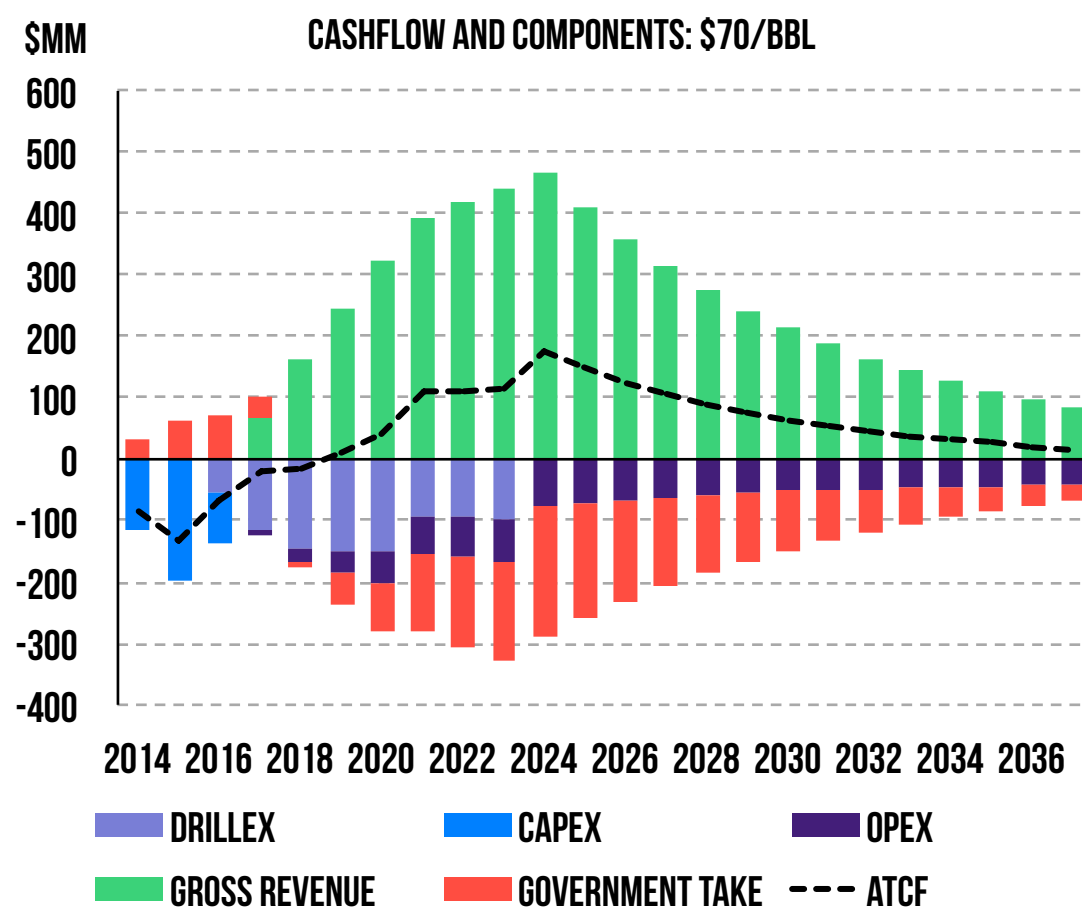
⁺single-taxpayer, taxable-barrel-based approximation, FY2014 DOR RSB costs, assumes no taxable production GVR-eligible

HOW DO CHANGES IMPACT NEW FIELD DEVELOPMENT?

Sample NS investment: Cumulative CAPEX and DRILLEX of \$1.3 bn; average annual OPEX of about \$15/bbl

Peak production of 20 mb/d; 30 wells (production and injection) drilled over 8 years

Ongoing DRILLEX in early years means **bulk of tax liability occurs only after several years of production**



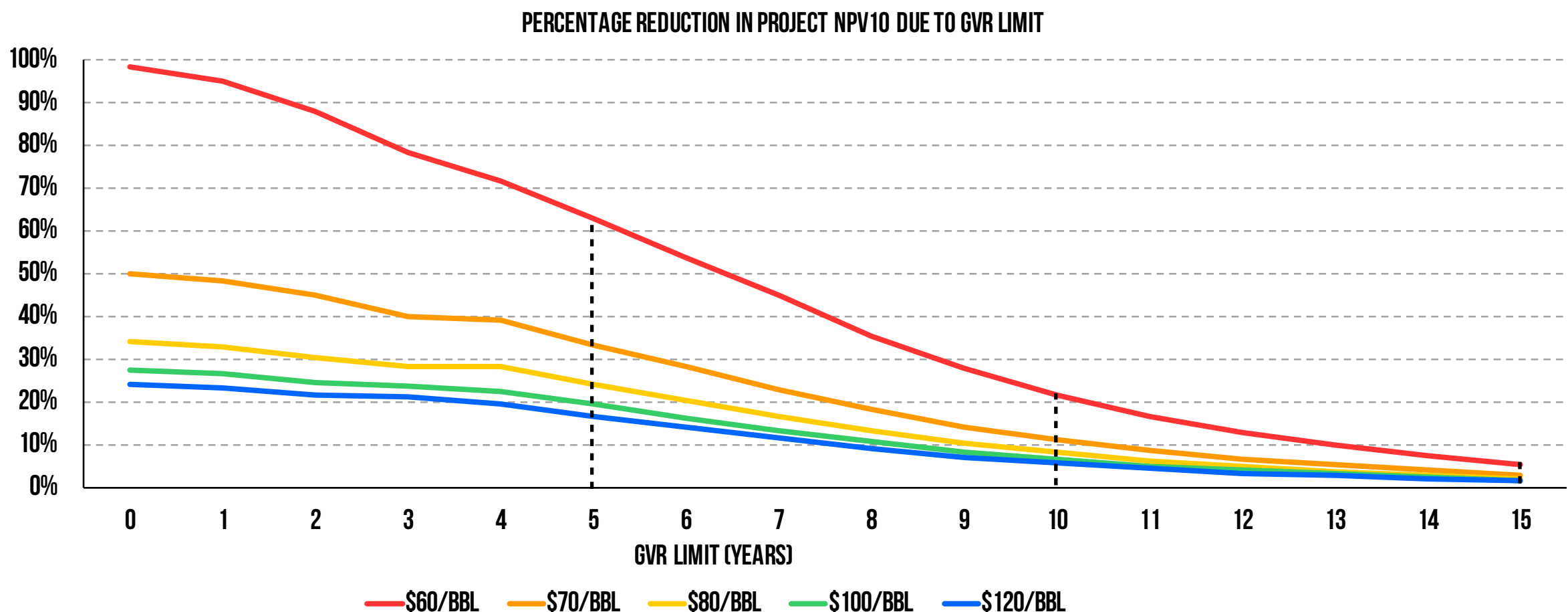
5-YEAR GVR LIMIT HAS MAJOR IMPACT ON PROJECT VALUE

Project is marginal at \$60/bbl; elimination of GVR can **wipe out** all value at that price

Because most tax liability occurs after end of major spending, **short GVR limit provides little benefit**

5-year GVR limit destroys over **60% of project value** at \$60/bbl, relative to status quo

Impact of 10 year limit much lower; 15 year limit preserves almost all of status quo value

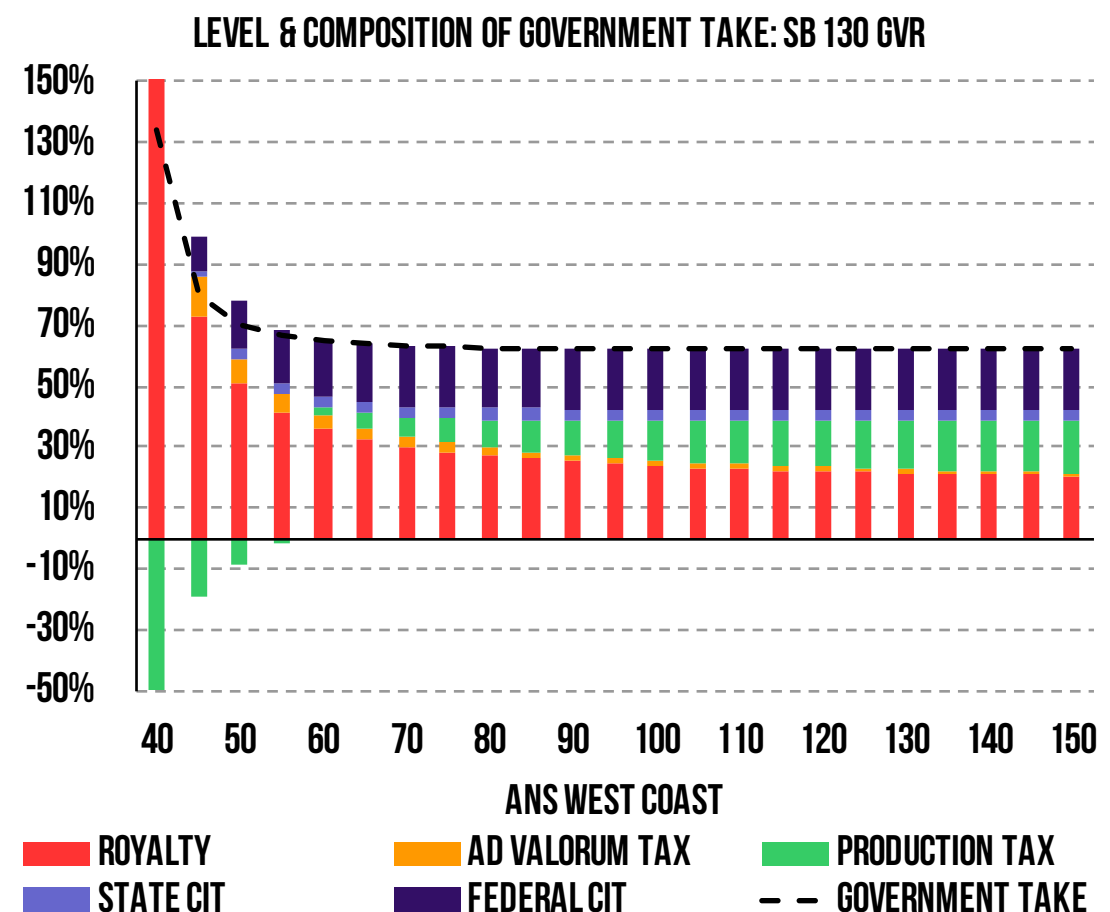
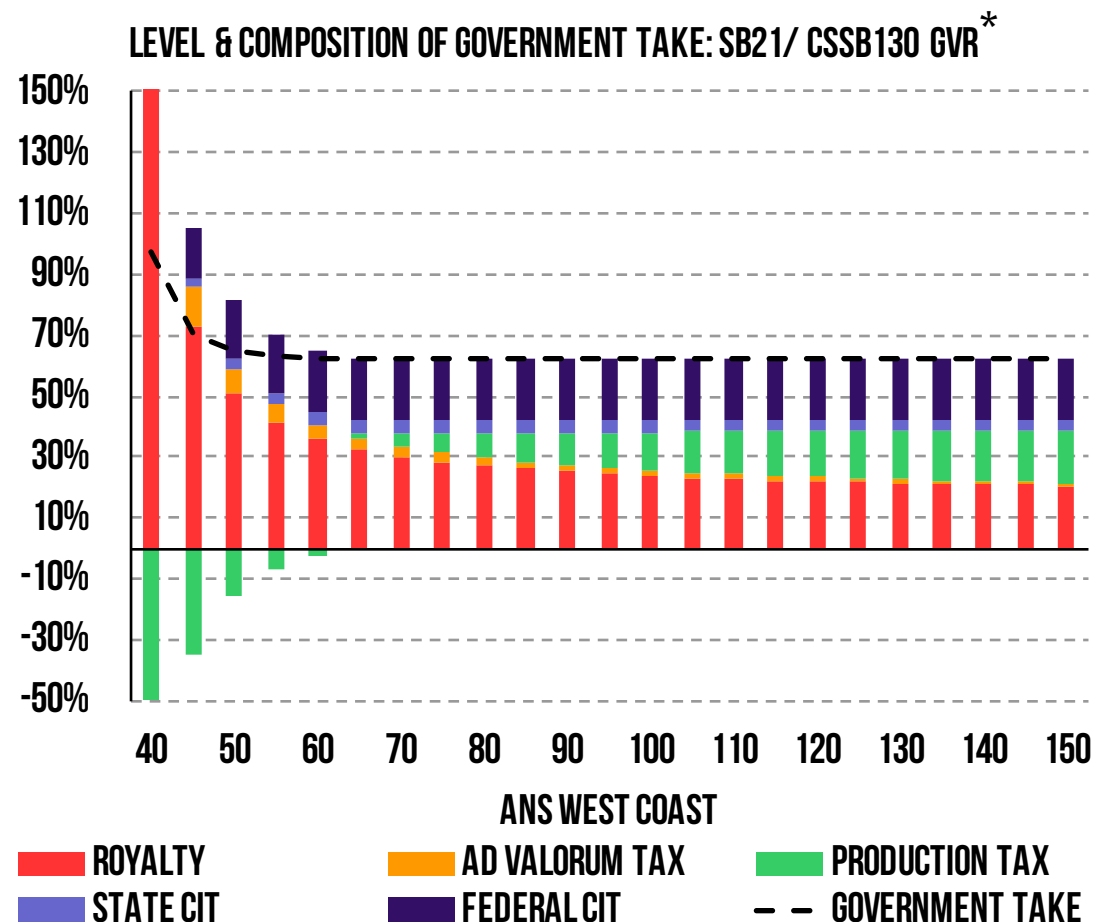


CS AVOIDS MAKING REGRESSIVE SYSTEM EVEN MORE SO

State of Alaska making negative production tax in today's prices; but overall gov't take is still high

Floor hardening of original bill shifts up government take in lower oil prices

In times of high investment / low prices (as in 2016), **effective government take exceeds 100%**



* EXCLUDES IMPACT OF 5 YR GVR LIMIT

FIX FOR NOL CREDIT ABOVE 35% OF ACTUAL LOSS

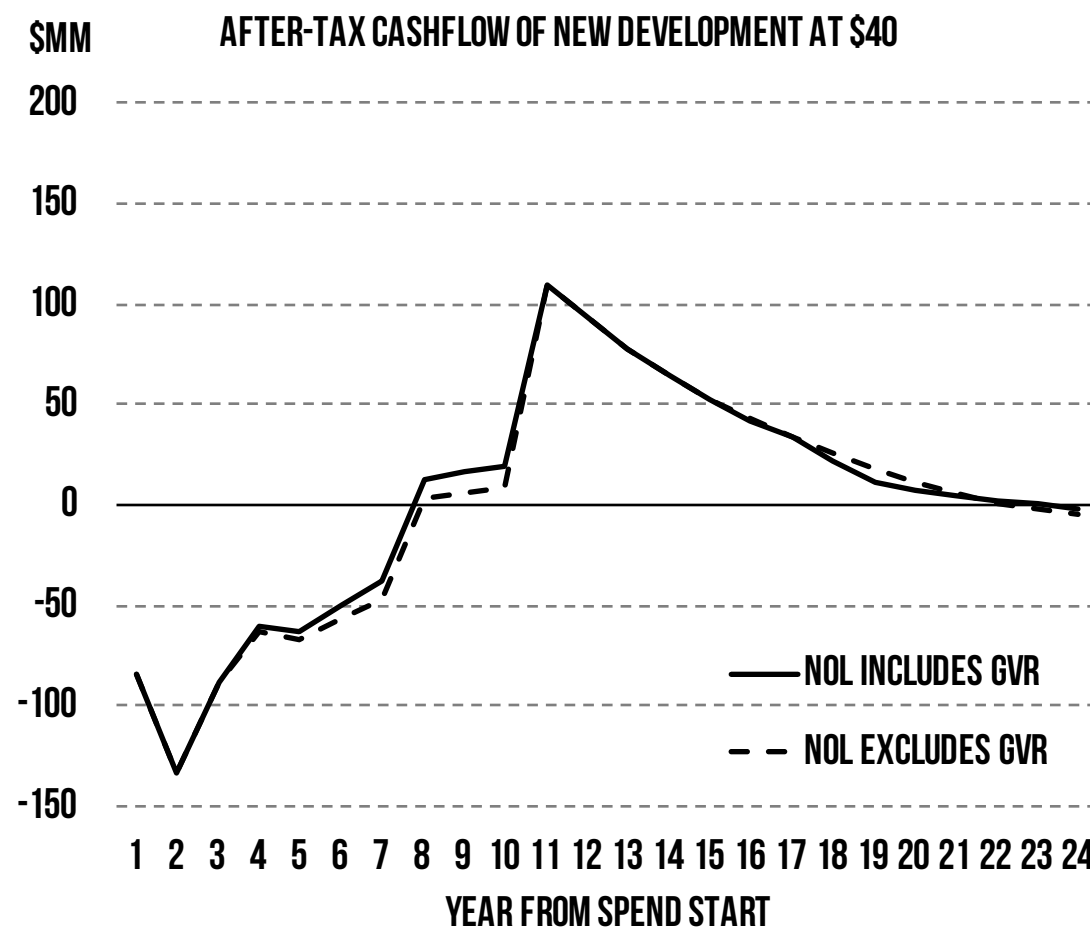
The purpose of the Gross Value Reduction (GVR) is to **lower the effective tax rate** on new production

One surprising and counter-intuitive effect is to **raise the effective rate of the NOL** credit

Issue after production from new development starts, but ongoing drilling costs mean NOL eligible

Exacerbated at low prices, but impact <\$10mm yr for 20mb/d new development

	SB 21 GVR	HB 247
ANS WC	40	40
TRANSPORT	10	10
GVPP BEFORE GVR	30	30
GVPP AFTER GVR	24	24
OPEX	18	18
CAPEX	18	18
PTV/BBL BEFORE GVR	(6.0)	(6.0)
PTV/BBL	(12.0)	(12.0)
NET TAX RATE	35%	35%
NET TAX	-	-
4% GROSS FLOOR	1.0	1.0
\$/BBL CREDIT	5.0	5.0
TAX BEFORE NOL	(4.0)	(4.0)
NOL CREDIT	4.2	2.1
TAX AFTER CREDITS	(8.2)	(6.1)
CREDIT % PTV (BEFORE)	-70%	-35%



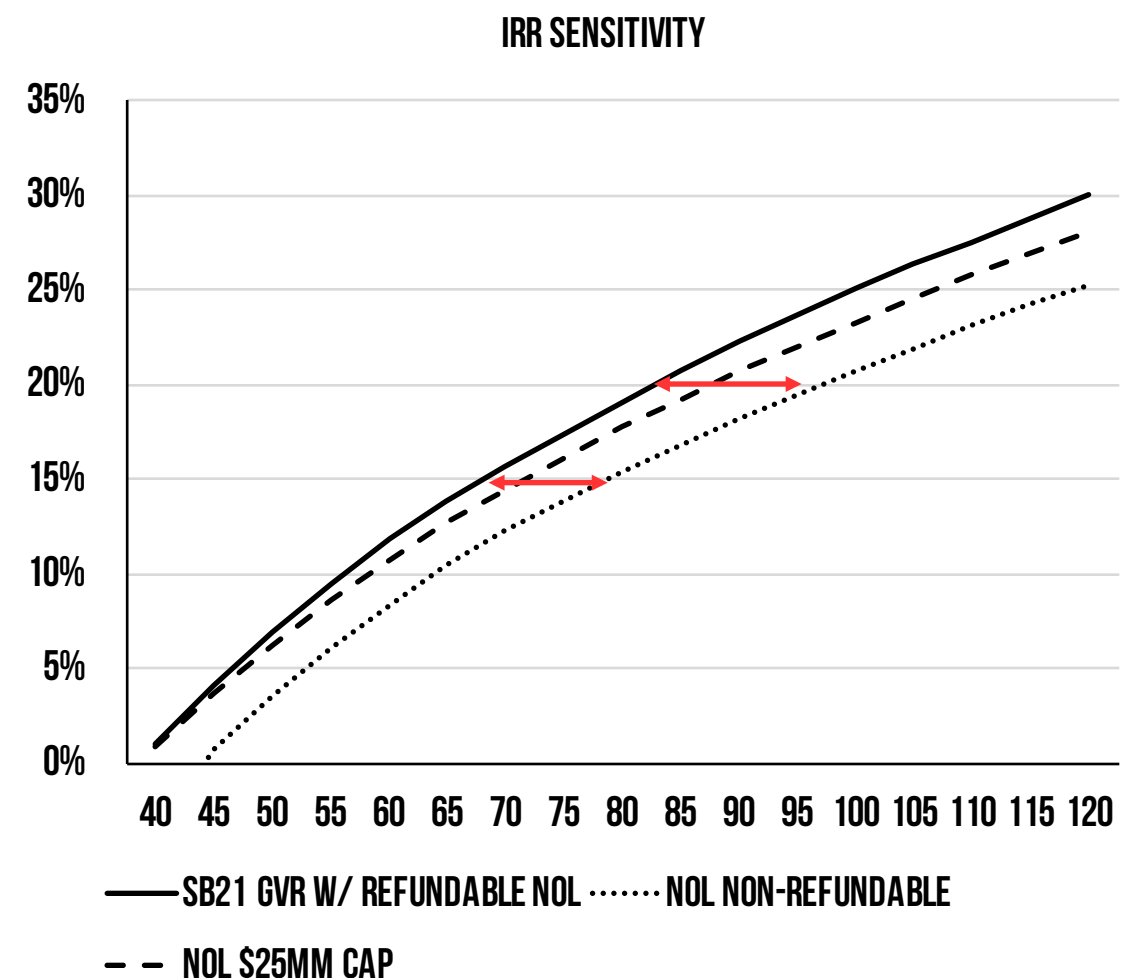
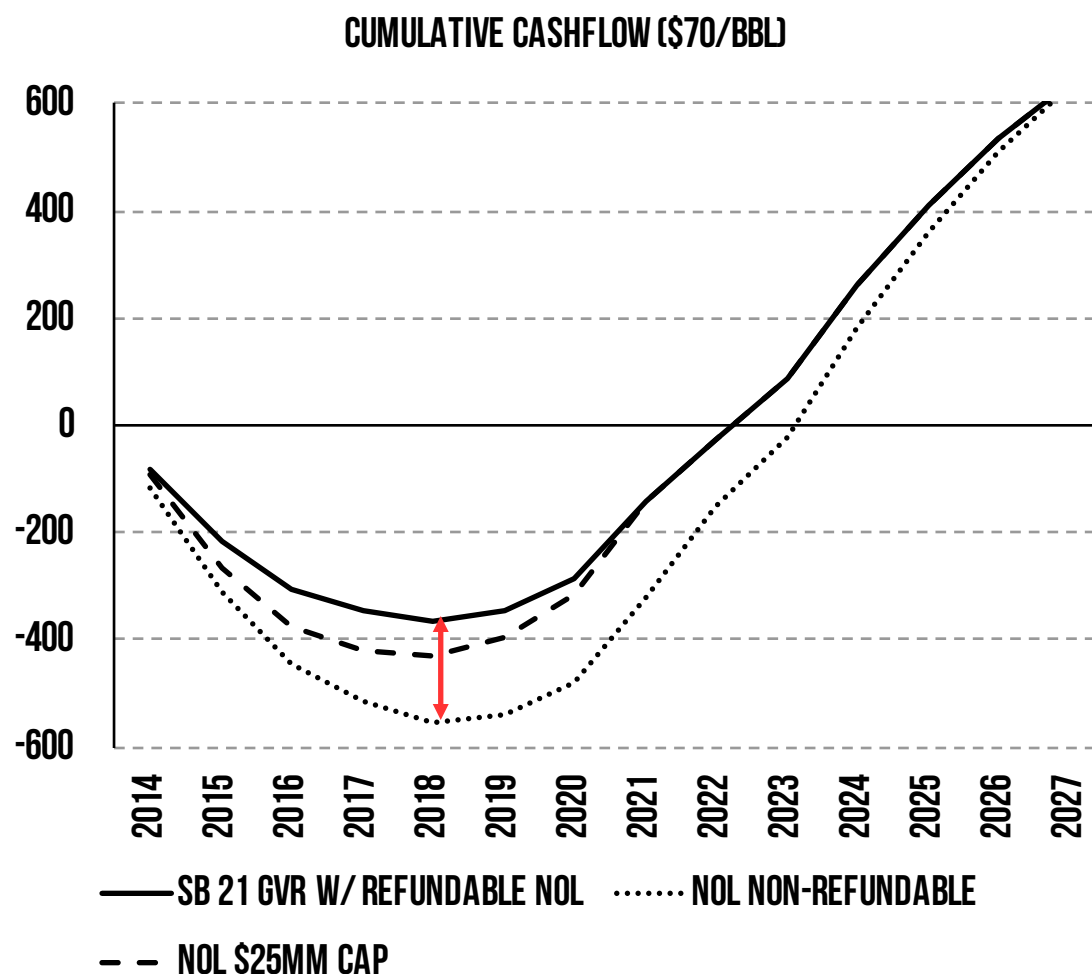
REFUND LIMITS BOOST CAPITAL NEEDS AND LOWER IRR

Strict refundable limit would **increase capital needs** by up to 50% (from \$350mm to \$400–\$550mm)

Application to projects currently under development could have **major adverse impacts**

Near-Kuparak-sized new development could easily incur **>\$2bn in NOL credits** in development years

If per-company limit on refundability is the solution, what is the right level? \$85mm? \$100mm?



REDUCTION IN COOK INLET SPENDING SUPPORT

Currently 3 credits in Cook Inlet

- 25% NOL credit for carried-forward annual loss, 'stackable' with either:
- 20% QCE credit for all qualified capital lease expenditures; or
- 40% WLE credit for well-related capital lease expenditures

On 'average', roughly **55% support for spending** under **status quo**

Under CS, reduced to 15% NOL, 10% QCE, 20% WLE in 2017, then sunset from 2018 onward

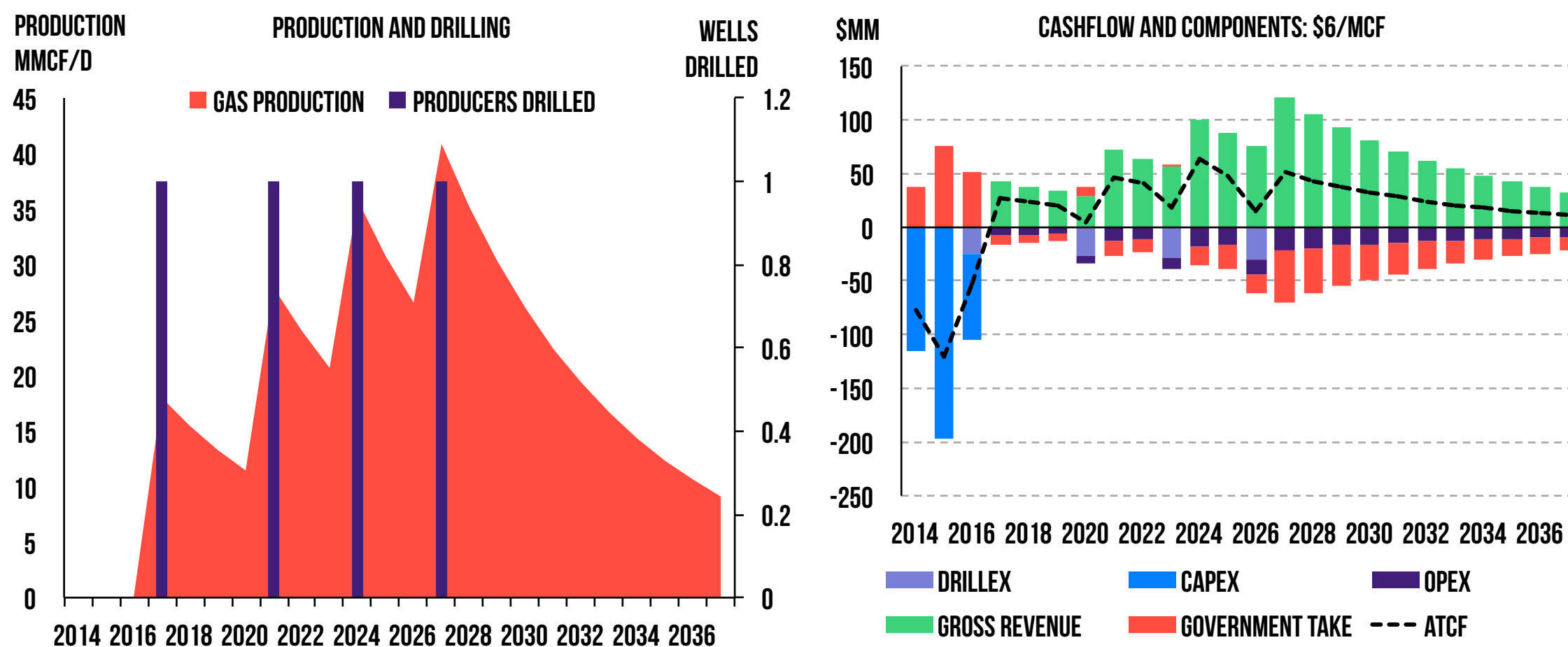
No production tax in Cook Inlet from 2018 onwards - shift to **low-government take, free-market approach**

Crucial question: **Will changes be seen as durable?**

COOK INLET #1: MARKET CONSTRAINED (ASSUMPTIONS)

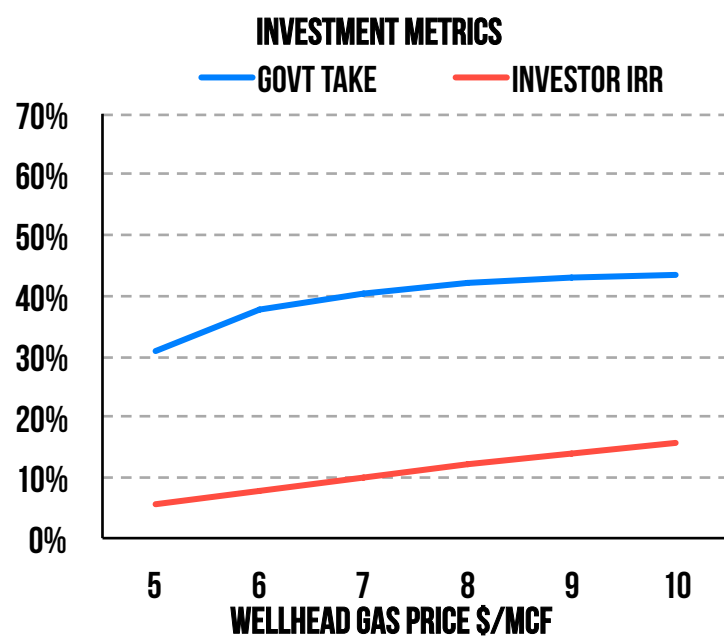
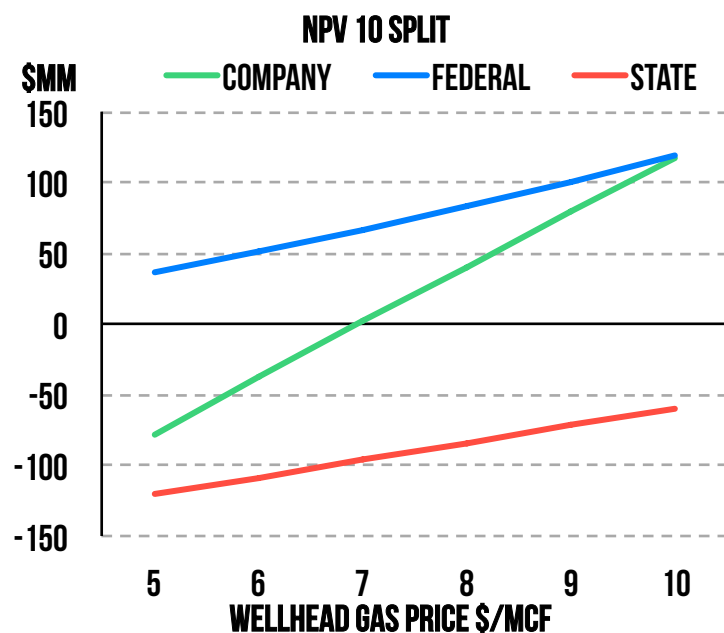
Large upfront investment but constrained gas market

Limited ability to sell gas: can only drill a well every few years

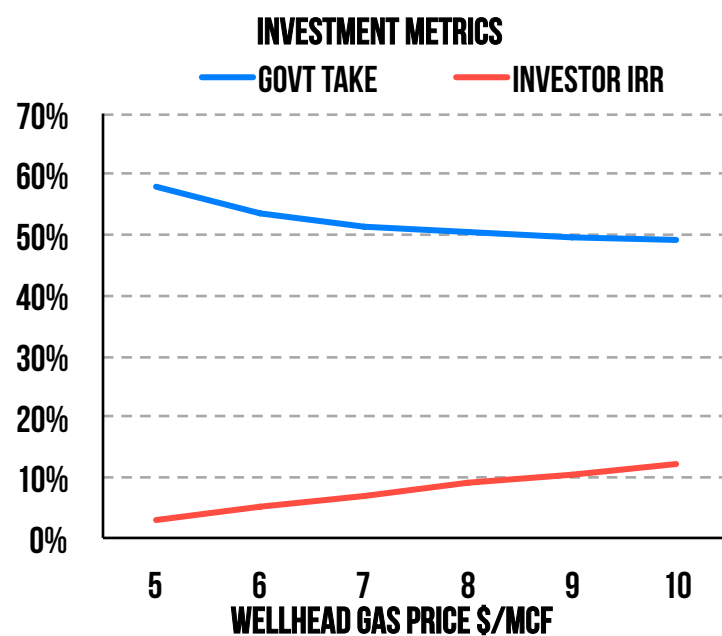
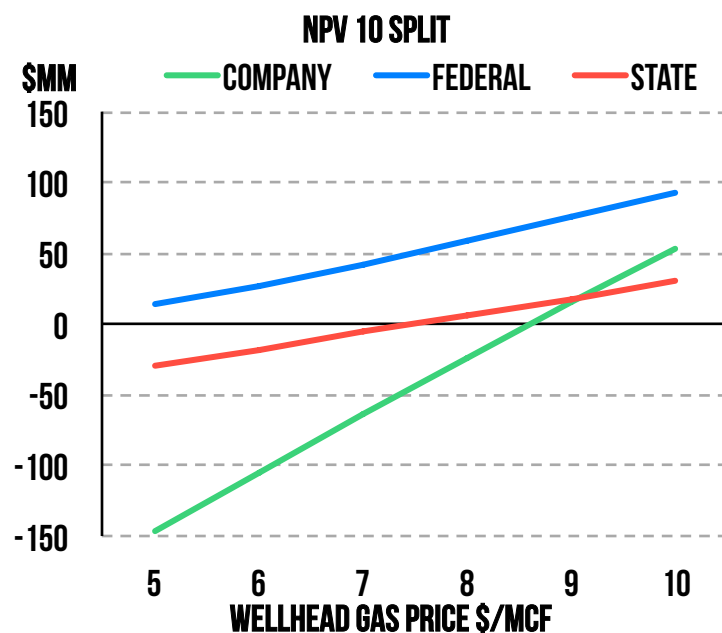


COOK INLET #1: MARKET CONSTRAINED (RESULTS)

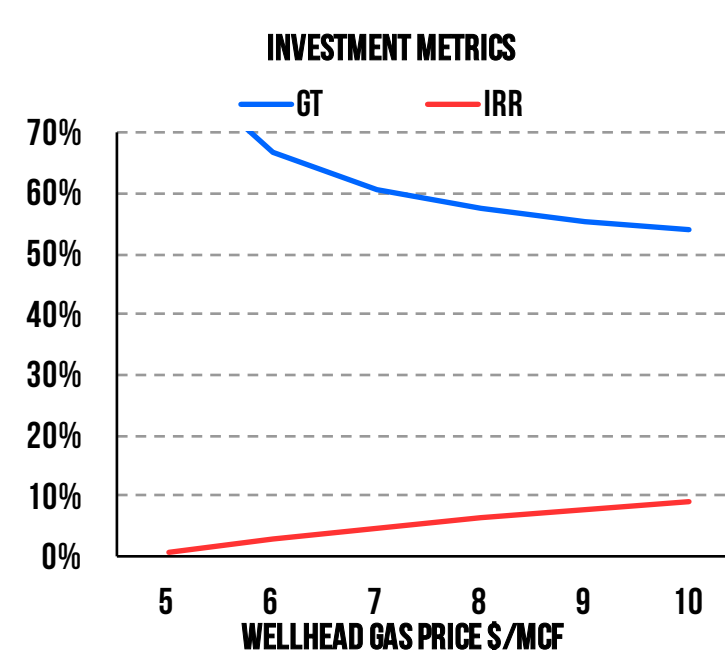
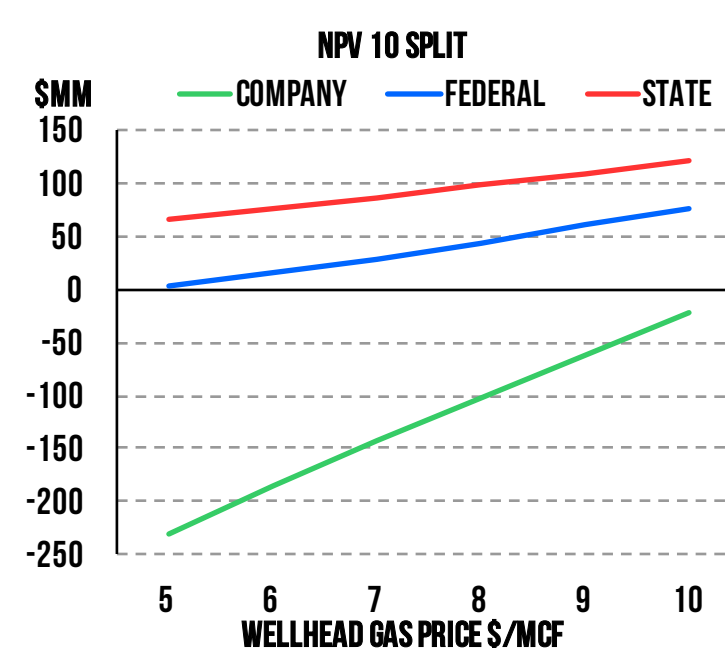
STATUS QUO



SB130: NOL ONLY



CS SB130: NO CREDITS

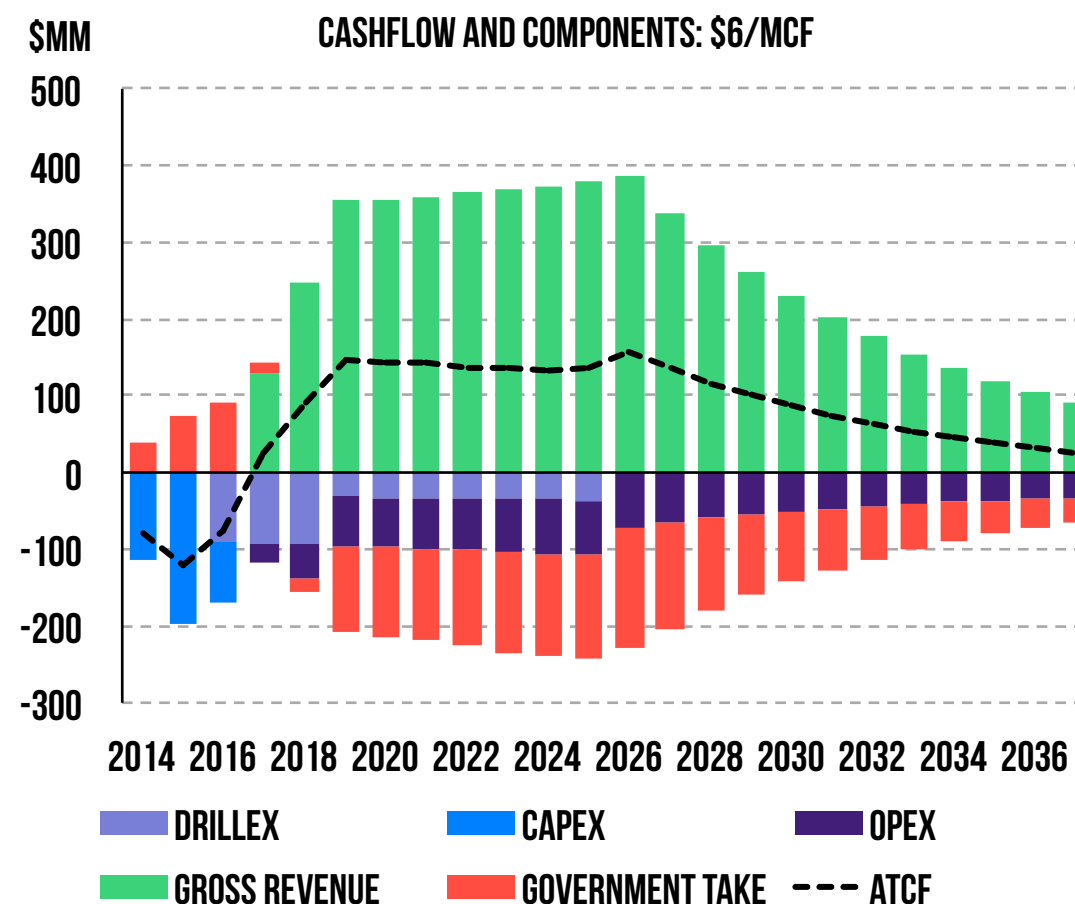
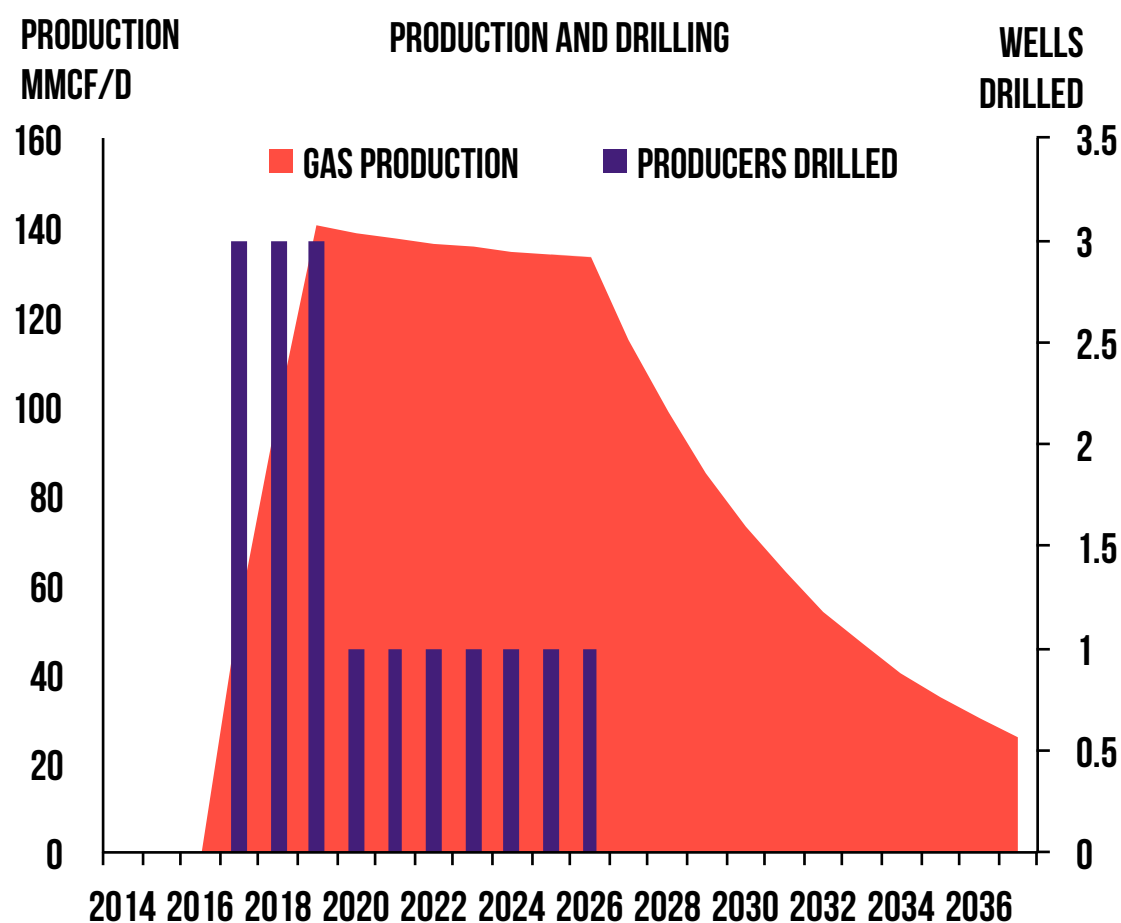


COOK INLET #2: UN-CONSTRAINED (ASSUMPTIONS)

Large upfront investment but un-constrained gas market

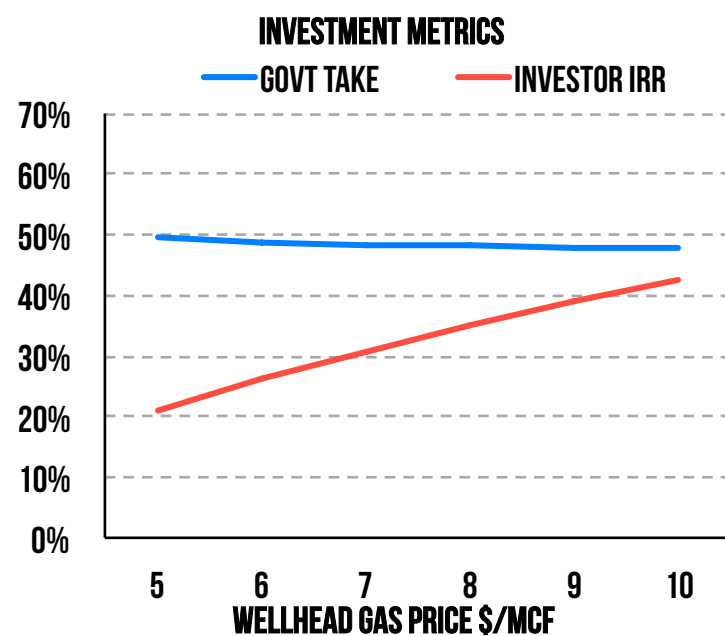
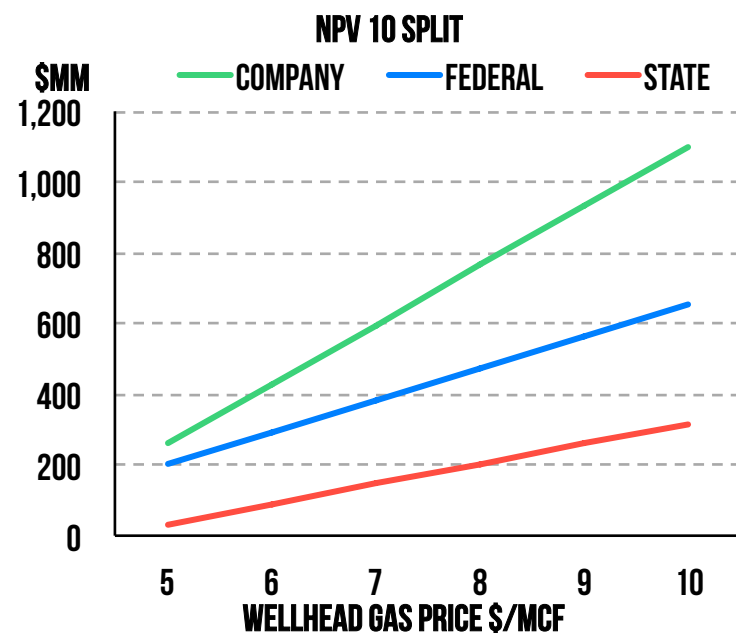
Continued drilling lead to a plateau of 130 mmcf/d

Scenario would require a step change in existing supply-demand dynamics in Cook Inlet

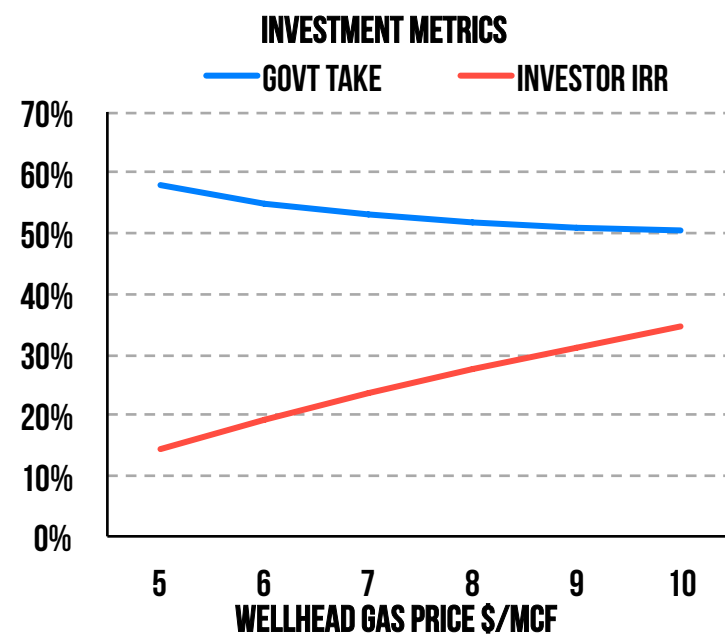
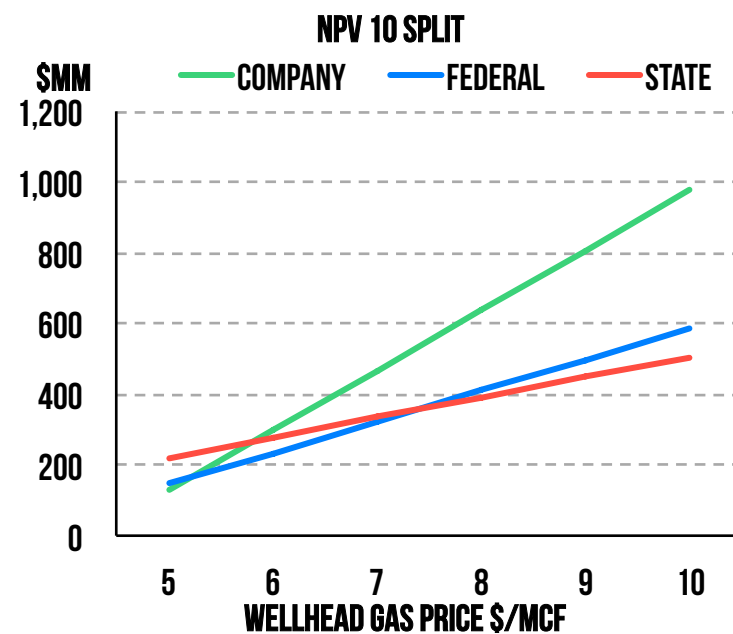


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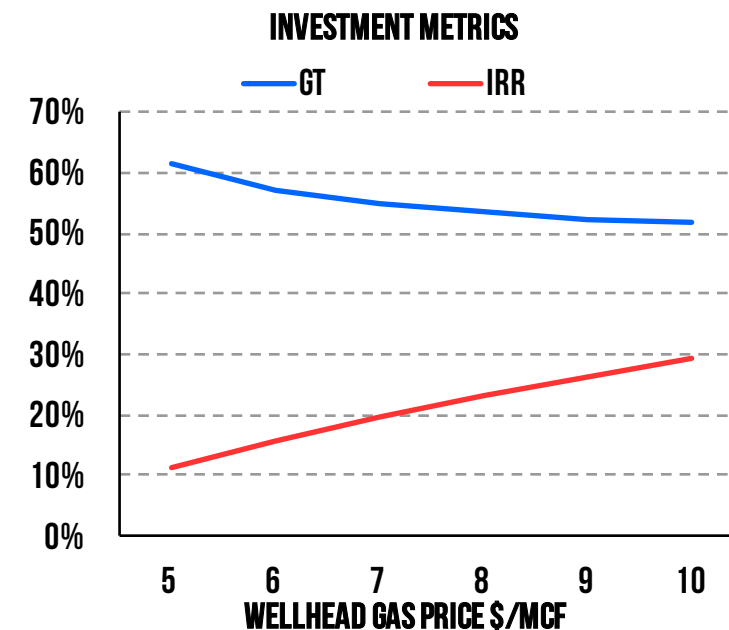
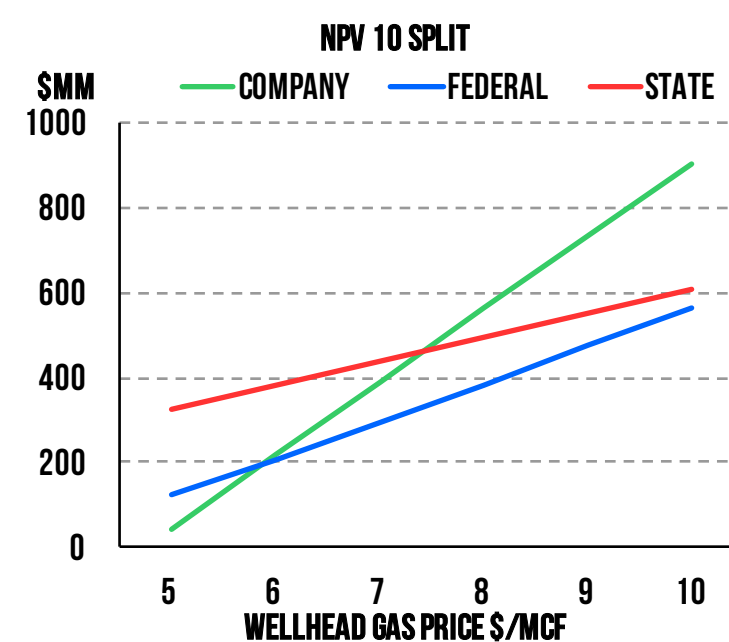
STATUS QUO



SB 130: NOL ONLY



CS SB 130: NO CREDITS

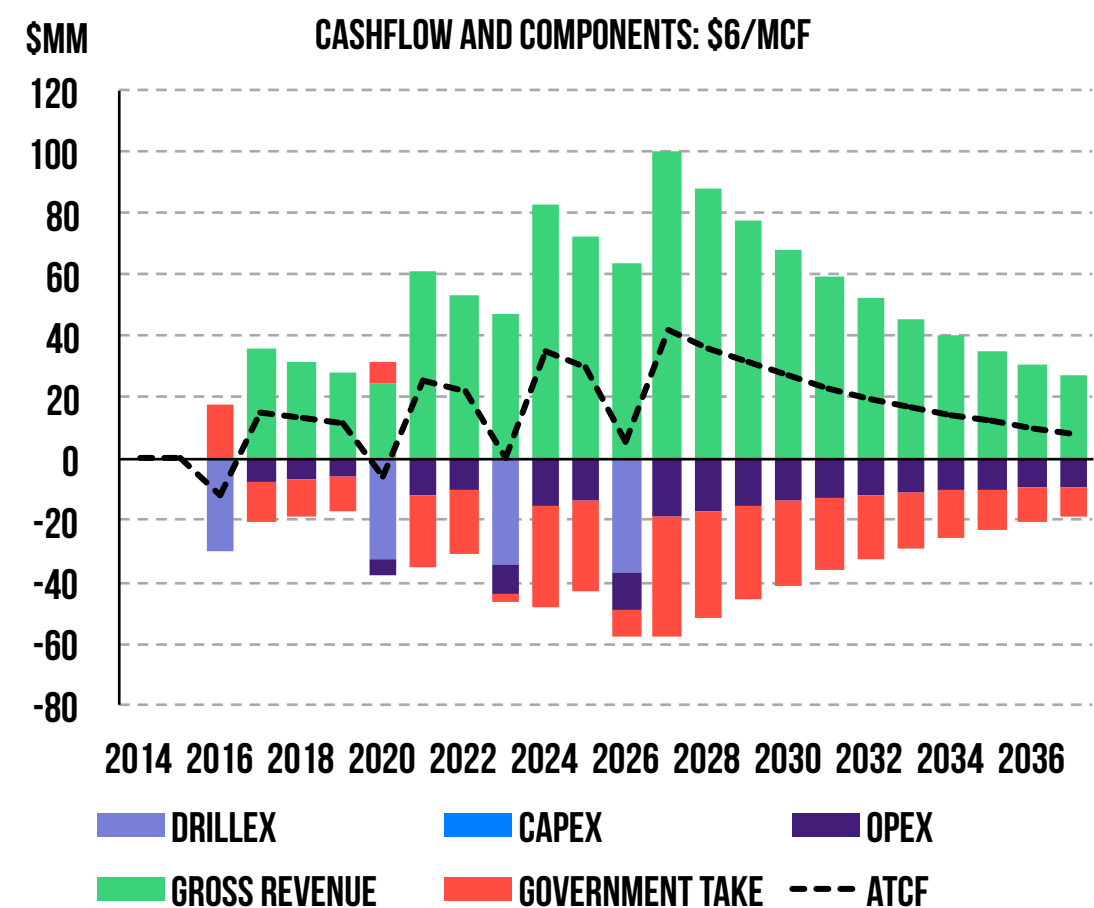
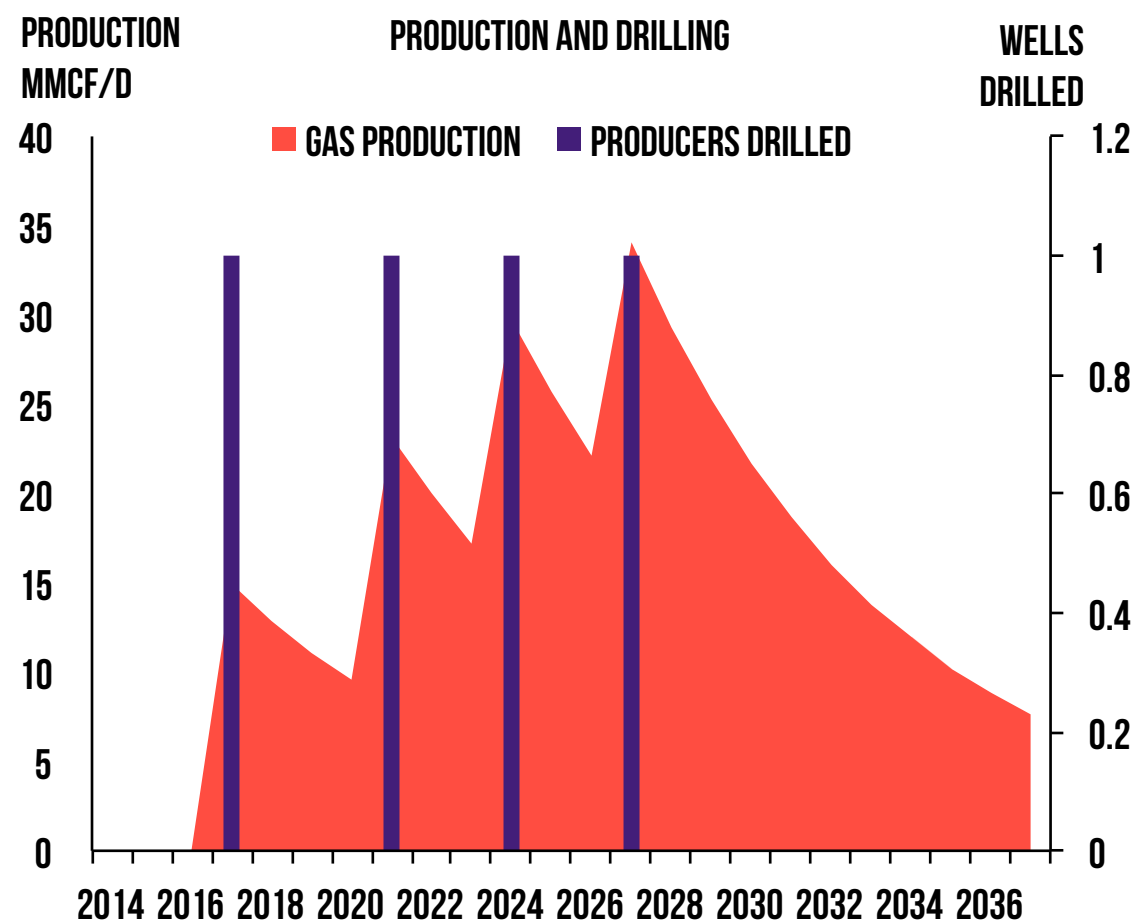


COOK INLET #3: DRILLING EXISTING FIELD (ASSUMPTIONS)

Drilling expenditures at existing production—smaller upfront investment

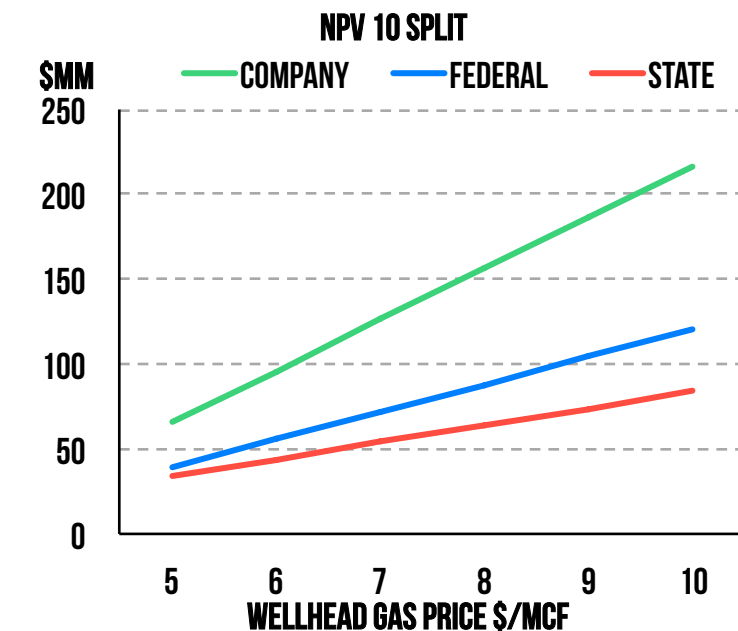
No market constraints assumed

This is a point-forward analysis—it ignores sunk, entry or acquisition costs



COOK INLET #3: DRILLING EXISTING FIELD (RESULTS)

STATUS QUO



SB130 & CS: NO CREDITS

