Great Bear PETROLEUM

House Resources
HB 111
February 24, 2017

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Chief Commercial Officer
and General Counsel

HB 111 – WHAT ARE YOUR TRYING TO ACHIEVE?

HAS IT ALREADY BEEN ADDRESSED? – DOES IT HAVE SIDE-EFFECTS THAT OUT-WEIGH THE OBJECTIVE?

- "The State can't afford to keep paying these tax credits"
- Want to increase State revenue while still attracting new investment leading to production

Are Tax Credit Payment Obligations Still “Out of Control”?

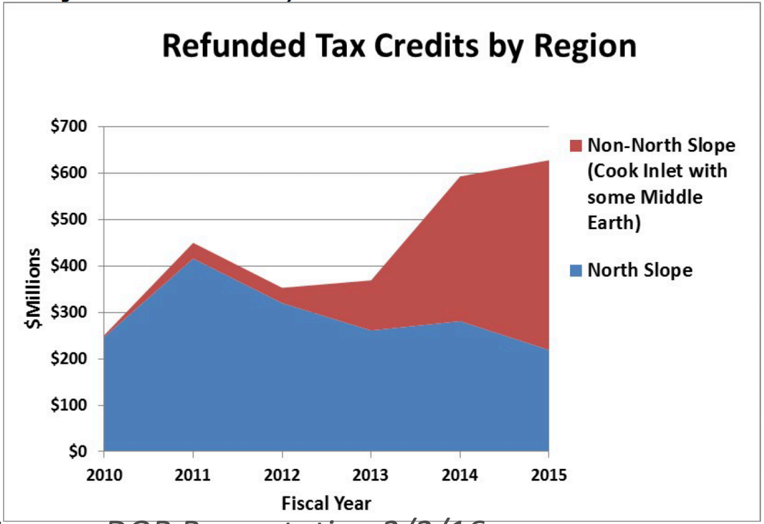
Are Credits Still “Out of Control”?

Most Have Been Eliminated or Expired in the Past Year

How things looked last year…

History of Oil and Gas Production Tax Credits

- Tremendous growth in non-North Slope (almost entirely Cook Inlet) refunded credits since FY10



Source: DOR Presentation 2/2/16

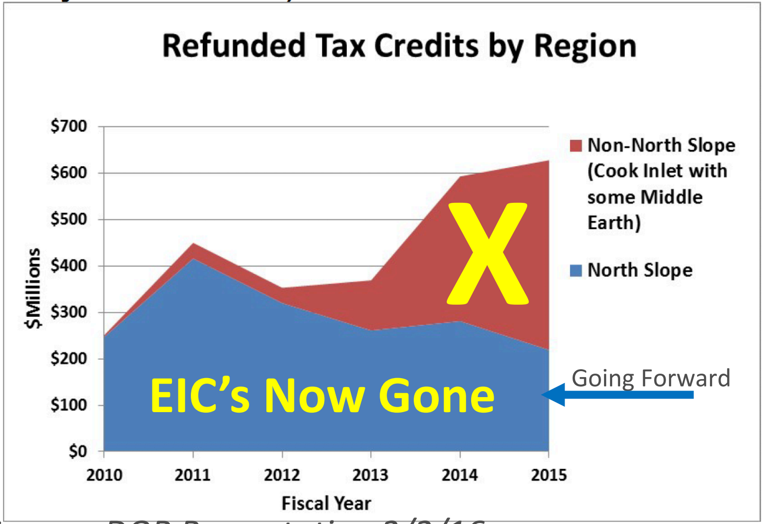
Are Credits Still “Out of Control”?

MOST HAVE BEEN ELIMINATED OR EXPIRED IN THE PAST YEAR

Looking forward…

History of Oil and Gas Production Tax Credits

➢ Tremendous growth in non-North Slope (almost entirely Cook Inlet) refunded credits since FY10



Source: DOR Presentation 2/2/16

- **HB 147 eliminated Cook Inlet Credits.**
- **EIC’s expired last year.**

Most tax credit cash outflows are now gone.

$35M TAX CREDIT REFUND LIMIT WILL HAVE A LARGE IMPACT

STATE'S EXPOSURE TO LARGE CASH OUTLAYS HAS BEEN GREATLY REDUCED ALREADY

History of Oil and Gas Production Tax Credits

FY 2007 thru 2015, $7.4 Billion in Credits

North Slope

- $4.3 billion credits against tax liability
  - Major producers; mostly 20% capital credit in ACES and per-taxable-barrel credit in SB21
- $2.1 billion refunded credits
  - New producers and explorers developing new fields

Non-North Slope (Cook Inlet & Middle Earth)

- $100 million credits against tax liability
  - Another $500 to $800 million Cook Inlet tax reductions (through 2013) due to the tax cap still tied to ELF
- $900 million refunded credits (most since 2013)

$3.0 Billion total cash refunds over 9-years.

SOURCE: DOR Presentation 2/2/16

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$35M TAX CREDIT REFUND LIMIT WILL HAVE A LARGE IMPACT

STATE'S EXPOSURE TO LARGE CASH OUTLAYS HAS BEEN GREATLY REDUCED ALREADY

Bill Analysis: Section 9 (cash limits)

Notes on large annual credits

Over the 2007-2016 history of the tax credit program:

- There has only been **one** instance of a company who ever received **> $200** million in a single year
- **Five** times ever when one company received between **$100 - $200** million in one year
- **11** times ever when one company received between **$50 - $100** million in one year

~ $250M

~ $500M - $1B

~ $550M - $1.1B

~ $1.3B - $2.3B

Would have been spread over multiple years

Of the $500 million existing unpurchased certificates:

- **Three** different companies are holding **$100 million+**

SOURCE: DOR Presentation 2/17/17

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HAS IT ALREADY BEEN ADDRESSED? – DOES IT HAVE SIDE-EFFECTS THAT OUT-WEIGH THE OBJECTIVE?

- "The State can't afford to keep paying these tax credits"
  - The most expensive tax credits have already been eliminated.
  - State's cash exposure has been largely mitigated already.
  - The remaining tax credit (NOL) is there to keep the playing field level between new entrants and incumbent producers.

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KEEPING A LEVEL PLAYING FIELD

LONGSTANDING STATE DESIRE TO ATTRACT NEW PLAYERS/INVESTORS TO THE NORTH SLOPE

- Many of HB 111 provisions will be detrimental solely to new entrants.
- Following the changes incorporated in HB 147 last year, this will further tilt the economic advantages of the production tax system in favor of incumbents.
- Detrimental Provisions Include:
  - Lowering the NOL rate to 15%, below the effective tax rate of most incumbents.
  - Eliminating the refundability of NOL tax credits.
  - Not having a production threshold for the minimum tax floor means small producers who are also explorers will be negatively affected most often.

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How Investments Are Treated – Incumbent vs. New Company

IMMEDIATE TAX SAVINGS FOR INCUMBENT'S INVESTMENT

STATUS QUO & UNDER HB 111

- Assume an Incumbent with production tax obligations pursues a development requiring $1 billion investment
- By reducing their Production Tax Value (PTV), the company **reduces their taxes** by the total expense multiplied by their effective tax rate:

  $1,000 million * (*25%**) => worth $250M

  *Effective tax rate will be different for different tax payers and at different oil prices. 25% is a reasonable placeholder as an example.

$1,000 Million Invested

\- $250 Million (Immediate Tax Savings)

REDUCED & DELAYED TAX BENEFIT FOR NEW ENTRANT'S INVESTMENT

UNDER HB 111

- Assume a new entrant with no current production tax obligations pursues an development project requiring $1 billion in investment
- Company receives a 15% credit for its "tax loss" or "net operating loss (NOL)", worth $150 million
- *State does not refund*

$1,000 Million Invested

- <u>$150 Million (Tax Credit Certificate)</u>

➢ Can apply against tax bill once production starts (so long as it doesn't drop below minimum tax), likely to take years to use

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DELAYED TAX BENEFIT FOR NEW ENTRANT INVESTMENT

STATUS QUO

- Assume a new entrant with no current production tax obligations pursues an development project requiring $1 billion in investment
- Company receives a 35% credit for its “tax loss” or “net operating loss (NOL)”, worth $350 million
- *State might pay this rebate to the Company at $35M per year (subject to appropriation risk).*

$1,000 Million

- <u>$350 Million (Paid over time)</u>

➢ Up to $35 Million per year refunded

➢ Can apply against tax bill once production starts, likely to take years to use

AFFECT ON EVERY ONE'S BOTTOM LINE

Disparate treatment for the same investment

For the next two slides, let's assume the following:

- Incumbent and New Co are 50/50 partners on a $2B project, with each paying $1B.
- Incumbent agrees to buy any New Co tax credit certificate at 90 cents on the dollar.
- Incumbent's effective tax rate is 25%.

AFFECT ON EVERY ONE'S BOTTOM LINE

Under HB 111

Assume Incumbent & New Co partner on $2B project 50/50

Incumbent gets immediate tax savings of $250M, reducing State revenue by $250M

New company earns a tax credit of $150M.

New Co sells the credit to Incumbent for $135M, then Incumbent reduces tax payment to the State by $150M

Incumbent spends **$735M**

$1B - $250M - $15M = $735M

New Co spends **$865M**

$1B - $135M = $865M

Poor Project Alignment

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AFFECT ON EVERY ONE'S BOTTOM LINE

UNDER A "BALANCED" APPROACH – NOL RATE EQUAL TO EFFECTIVE TAX RATE & STATE PAYS CASH FOR CREDITS

Assume Incumbent & New Co partner on $2B project 50/50

Incumbent gets immediate tax savings of $250M, reducing State revenue by $250M

New company earns a tax credit of $250M.

New Co refunds the credit with the State for an immediate cash rebate of $250M

Incumbent spends **$750M**

$1B - $250M = $750M

New Co spends **$750M**

$1B - $250M = $750M

Good Project Alignment

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The “Hard Floor” and Small Producers

THE HARD FLOOR AS DISINCENTIVE FOR PRODUCTION

MUST AVOID A "PRODUCTION PENALTY" STRUCTURE

- Need to ensure that a company with 1,000 bbls/day production is not worse off than if it had zero production.
- Recognize that small producers will be spending on exploration as well. Since there is no ring-fencing, a little production from one field shouldn't erase or de-value NOL's earned through exploration in a different field.
- Retaining production thresholds before a minimum tax would apply can avoid such inefficiencies.

SMALL PRODUCER CREDIT

DESTROYING THE VALUE OF THIS LIMITED CREDIT IS MORE DAMAGING THAN IT'S WORTH

- Not allowing the small producer credit to pierce the minimum tax floor is a mistake.
- No additional companies can become eligible for this credit.
- It will expire for each eligible company at different points over the next 10 years, most sooner rather than later.
- The State's exposure will lessen each year until all eligibility is gone.
- It is not refundable and cannot be carried forward.
- The credit is a large portion of the small producer's return expectation when sactioned the project.
- It is a small item for the State, but a critical life-line for many small companies.

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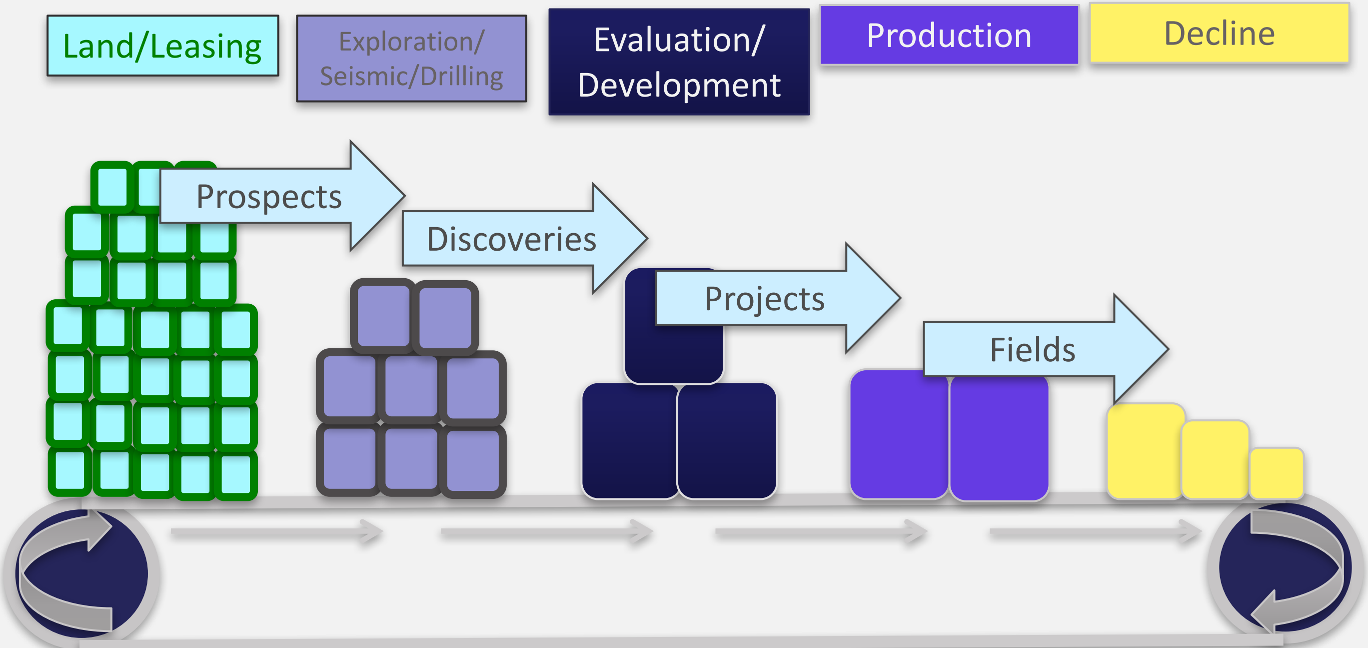
Don’t lose track of the need for exploration

NEAR-TERM PRODUCTION IS A GOOD GOAL, BUT IT'S NOT THE ONLY GOAL

THE STATE'S LONG-TERM INTERESTS DEPEND ON EXPLORATION



A Strong Exploration And Production System Must Keep Feeding the System with New Exploration

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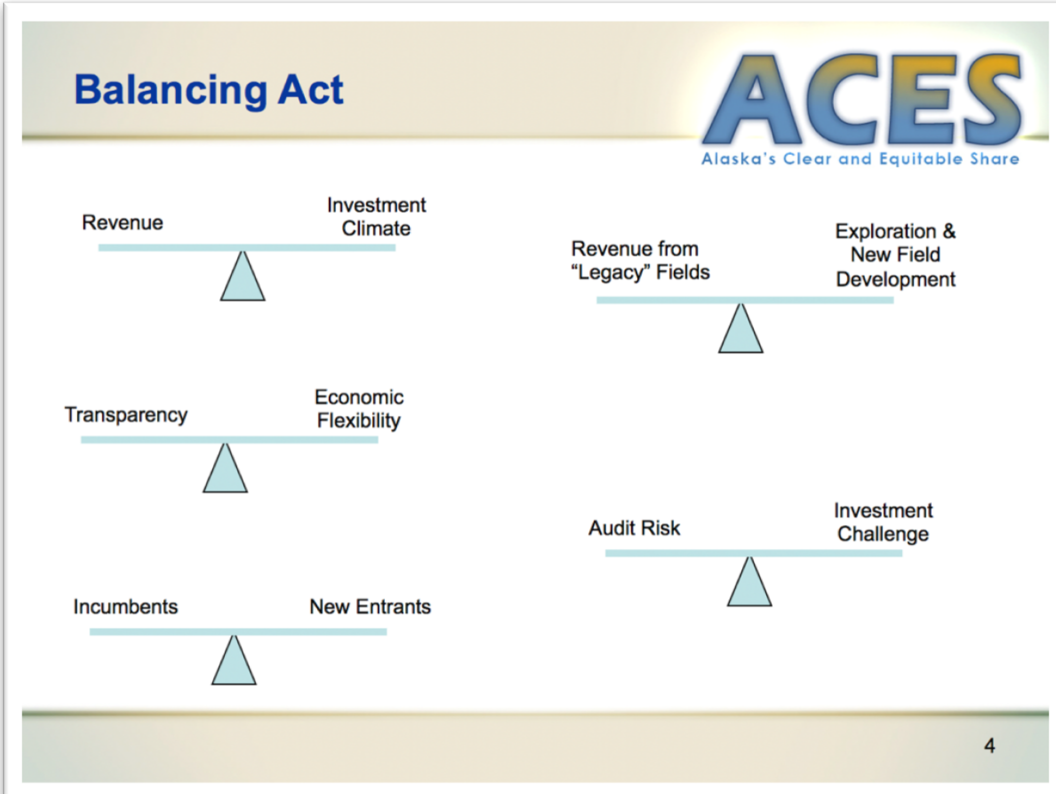
BALANCING REVENUE WITH INVESTMENT CLIMATE

A LONGSTANDING AND CONTINUAL CHALLENGE FOR STATE POLICY MAKERS



1.SOURCE: Presentation to SEN JUD, Oct. 31, 2007, Revenue Comm. Pat Galvin

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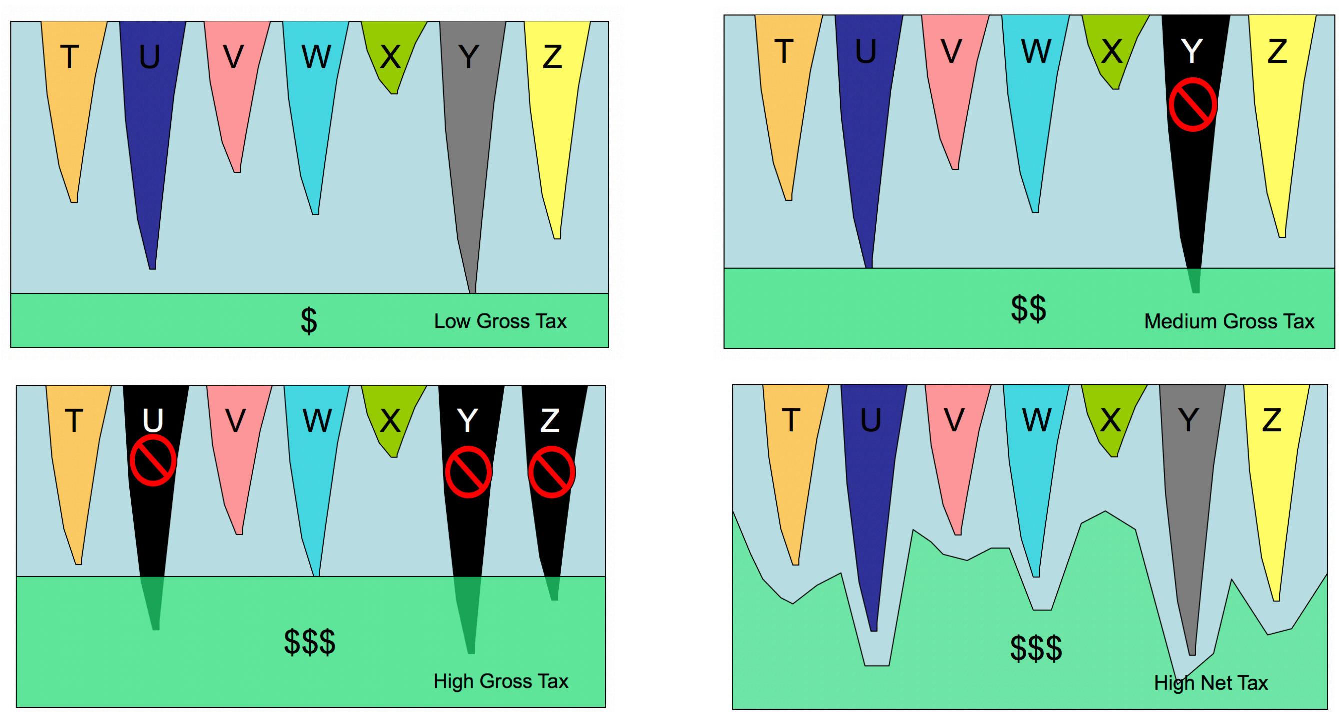

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SUMMARY

NEED TO FIX HB 111

- HB 111 in its current form is fatally flawed.
- Don’t try to fix a problem that is no longer present.
- Don’t put new companies at a disadvantage compared to incumbents.
- Be ever mindful of the trade-off between revenue to the state and impact to investment.
- Don’t make changes that barely move the needle for the state, but create a critical burden for small exploration and production companies.

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