



Alaska Oil and Gas Tax Credit Working Group

BlueCrest Energy - Cook Inlet Presentation

J. Benjamin Johnson

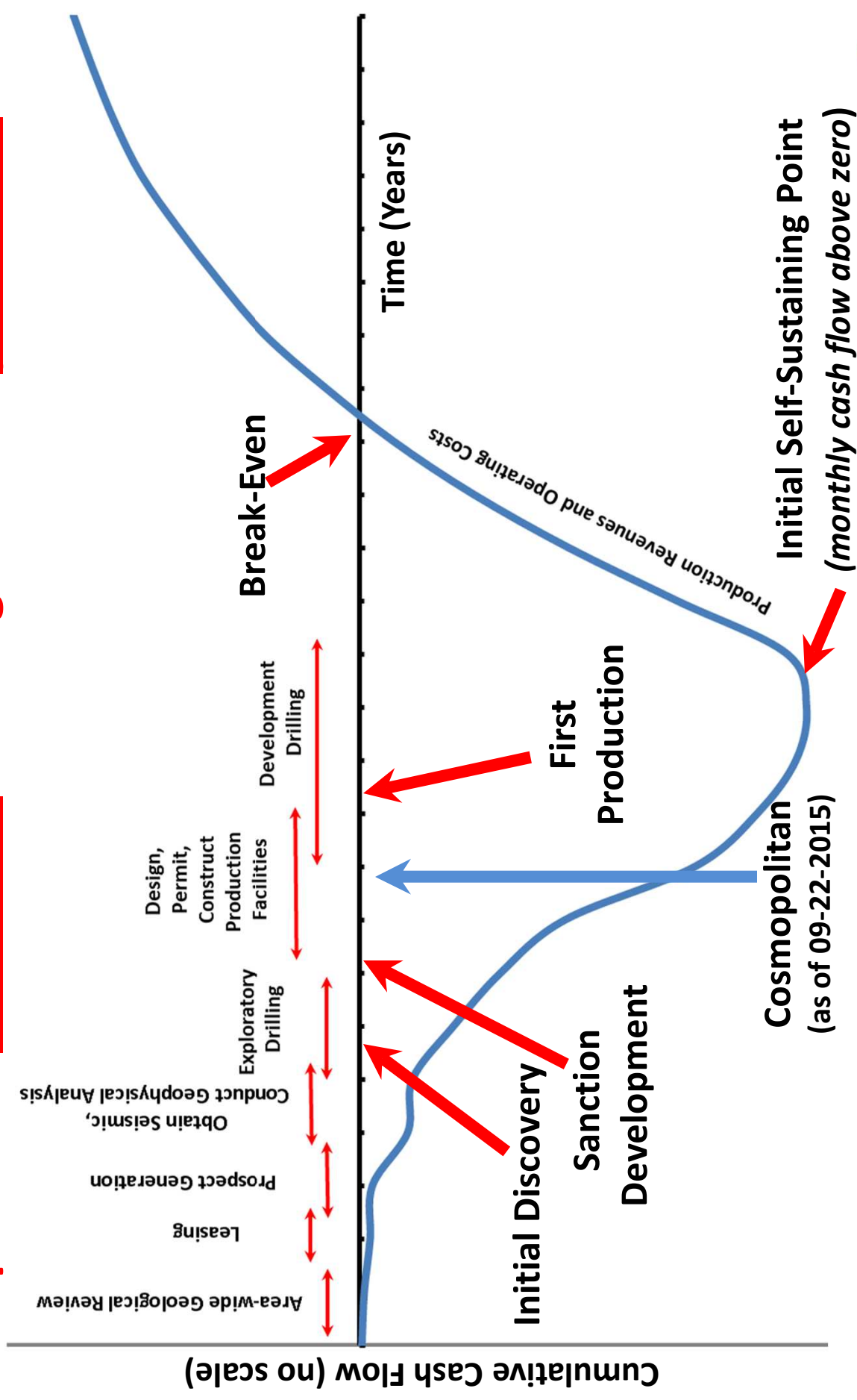
Anchorage, September 22, 2015

Main Points – Applicable to Cook Inlet

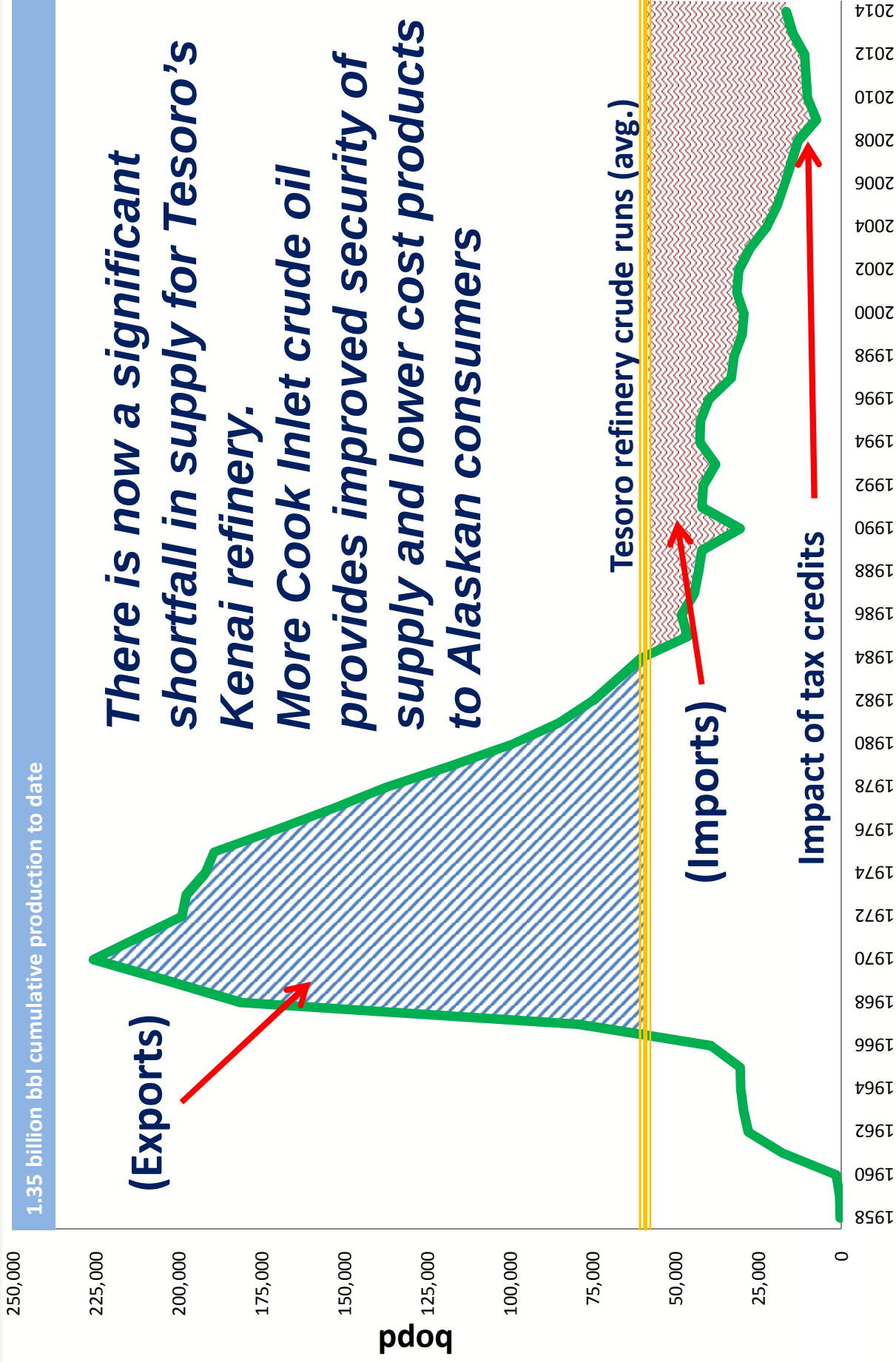
- It is too early to declare victory
- The tax credit program has been very effective so far --- But ---
- The Cook Inlet still requires additional time for development of recent discoveries before a *future* gas shortfall can be mitigated
- Current Cook Inlet markets and market growth
 - Current market is stranded with few viable options for excess gas (LNG export)
- Immediate cessation or severe reduction in Cook Inlet tax credits will result in:
 - Crippling shortfalls in payment ability for already-committed development contracts
 - An immediate loss of Spartan 151 jack-up drilling rig
 - Pending gas sales agreements delayed or abandoned
 - Higher gas prices
 - Lower diversity of gas supply
 - New markets will be stymied indefinitely (Agrium, in-state LNG, new industry)
- Cosmopolitan Unit development status
- Recommendations for changes in Cook Inlet tax credit program

Typical Life-Cycle Project Cash Flow For Development of an Exploratory Success

Exploration discoveries do not guarantee production!



Cook Inlet Crude Oil Supply and Demand History

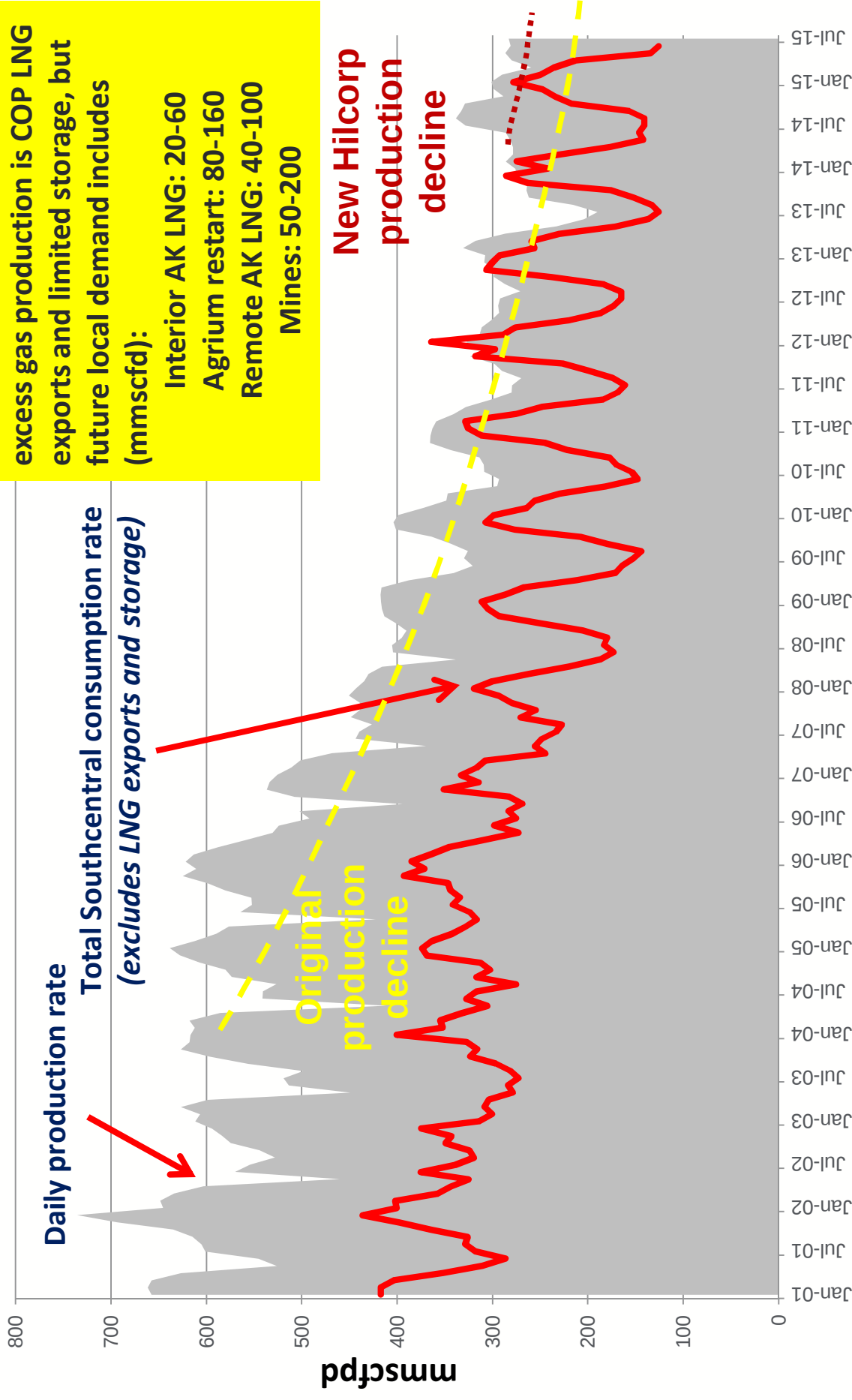


Source: State of Alaska Department of Natural Resources.



Cook Inlet Natural Gas Supply and Demand History

7.6 tcf cumulative production to date



Source: State of Alaska Department of Natural Resources and US Energy Information Administration.



Cook Inlet Gas Supply and Demand

- Without the credits, there would have already been a severe shortage
- Probably now have enough gas for 4-5 years' local demand
 - Very close balance between supply and demand
 - Any disruption could have severe consequences for Southcentral consumers
- Cook Inlet gas market does not exhibit typical elasticity of supply
 - There is a physical limitation on available gas supply to meet demands
 - No easy way to import gas to meet shortages
 - Even with much higher prices, large new gas supplies would take 3-5 years to develop
- New gas must be developed *now* to ensure supply into the future
- In order to have new supplies of gas available as-needed, attractive markets for sales of excess capacity are necessary
 - Fairbanks/Interior
 - Agrium
 - New in-state LNG
 - LNG exports

Tax Credits Brought BlueCrest to the Cosmopolitan Unit

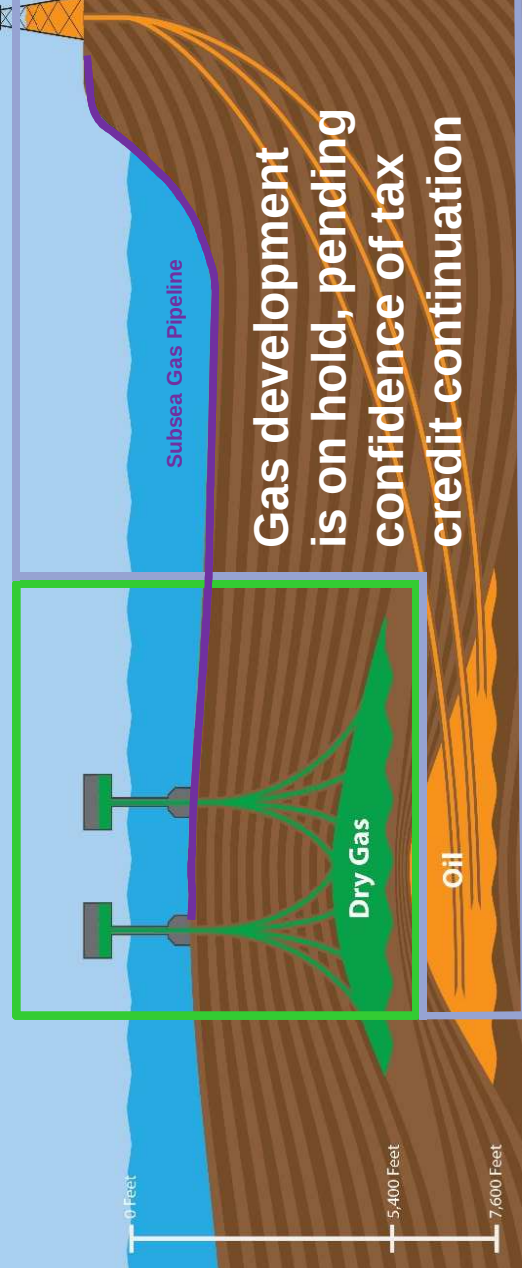
- BlueCrest examined many domestic acquisition opportunities
 - Evaluated comparative economics of Alaska versus Lower-48
 - Alaska costs are 3-5X higher
 - But Alaska's tax credit program made the difference
- Employed the Endeavor rig (funded by AIDEA)
 - Cosmopolitan State #1 was the only well drilled with the rig
- The Cosmopolitan State #1 well was extremely successful
 - Proved up more Cosmopolitan oil than previously identified
 - Discovered substantial new proved and probable gas reserves

Cosmopolitan Unit Development

Offshore gas wells contain no liquid hydrocarbons and produce the dry gas that is too shallow to reach from the shore

“Extended-Reach” oil wells drilled safely from onshore produce the deeper offshore oil with no danger of an offshore oil spill

.5 Miles
3 Miles



Onshore oil development began in 2014 and is well underway, relying on the existing tax credit structure

Gas development is on hold, pending confidence of tax credit continuation

Cosmopolitan Unit **Oil** Development

- Requires approximately \$525 million total investment before production

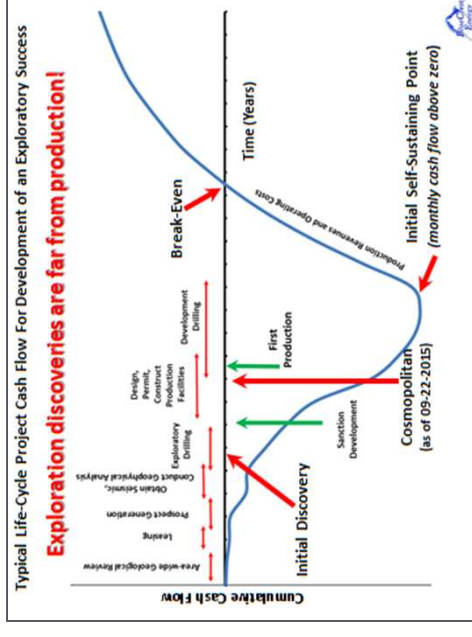
is self-sustaining (re: previous slide)

- All major contracts have been awarded (turnkey)
- Facilities and drilling rig are all close to completion
- Anchor Point construction/installation now underway
- Startup in April 2016

- Cosmopolitan funding plan (\$525 million):

- Funding sources are based on the existing tax laws
- BlueCrest has already invested \$200 million in cash (equity)
- Have received ~\$25 million to-date in tax credits
- AIDEA loan (\$30 million) for purchase of onshore drilling rig (\$44 million total cost)
- Projected future tax credits (three years 2016-2018): \$120 million
- Committed to a large private loan for the balance

Future tax credits (2016-2018) under existing law are integral to funding the committed development contracts

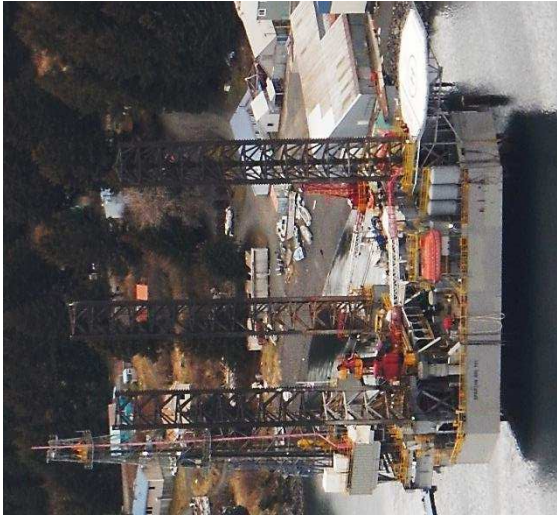


Cosmopolitan Offshore Gas Development

- Now on hold, pending confirmation/stabilization of tax credit program
- WesPac joint development plan:
 - First wells drilled in 2016
 - Must commit funding by early 2016
 - First gas production/sales in 2018
- All long term gas sales arrangements in limbo
 - Multiple Southcentral utilities (at lower prices than current alternatives)
 - Agrium (needs to make decision by year-end 2015)
- Development of Cosmopolitan gas would also provide ample gas for LNG distribution throughout the state
 - Fairbanks/Interior
 - Lowered energy costs for villages, fish processors, other new industry

Spartan 151 Drilling Rig

- Now the only offshore rig in the Cook Inlet
- The two known large gas discoveries are offshore
 - Furie: Kitchen Lights (platform complete, 1 well drilled)
 - BlueCrest: Cosmopolitan (development on hold)
 - At least one jackup rig is required to drill any more wells
 - Multiple rigs needed to drill both exploration and development
- Furie has now released the rig
- Spartan kept rig in Alaska to drill 2016 Cosmopolitan gas
 - Spartan rig has depth limitations, but perfect for Cosmopolitan
- Spartan cannot keep rig standing-by in Alaska without 2016 use
- Once the rig leaves, costs to mobilize a new rig to Cook Inlet will be very high
- Funding commitment for 2016 on Spartan 151 rig must be made by early 2016
- BlueCrest and WesPac cannot commit to Cosmopolitan gas development without economic advantage of existing tax credits
 - Or a reasonable alternative
- No funding commitment for 2016 offshore drilling can be made without confidence of ability to complete the entire development
 - Long term confidence of tax environment and stability is required



Factors to Consider for Changes in Tax Credit Program

- Recognize that reductions in tax credits will result in lower future state revenues
 - Benefits to the State of Alaska must outweigh costs
 - Direct financial benefit to the State
 - Security of supply
 - Jobs
 - Any analysis must be forward-looking
 - Take a long-term investment approach
 - Recognize that any developments take years to become productive
 - Any analysis must include all benefits/costs (royalties and all taxes)
 - Cosmopolitan example (including *only* oil royalties):
 - Assume 70 million barrels oil at \$55/bbl (conservative)
 - State royalties = $(70\text{mm bbl}) \times (\$55/\text{bbl}) \times (12.5\%) = \481mm
 - Assume total 2016-2018 tax credits of \$120mm
 - Benefit/Cost ratio = 400%
 - Consider risks versus rewards
 - Development is low risk, exploration is higher risk
 - But exploration is the only source of future developments
- (Continued on next slide)**

Factors to Consider for Changes in Tax Credit Program

(Continued from previous slide)

- Honor commitments to companies who have already committed large sums for development of known fields, based on the existing tax structure
 - Low-risk, quantifiable benefits to the State of Alaska
- Recognize that stability of tax structure is vital for continued Alaskan industry investments
 - Alaskan oil and gas projects are typically very long-term
 - Potential investors must have confidence in future tax regime stability
 - A crisis in confidence could result in a quick and very long-term withdrawal of Alaska activity

•Recommendations for Future Tax Credit System

- Allow reasonable time for any new system to go into place
 - Phase-in any changes
- Continue modified credit program for new developments already in progress
 - Qualified by field or Unit
 - Strategic field approval by DOR and DNR:
 - Benefits projected to outweigh cost of credits
 - Approved DNR Plan of Development
 - Proved and Probable reserves certified by DNR-approved independent engineering firm
 - Use current-law credit provisions, but allow for phased expiration if required by fiscal constraints
 - Even under current law, NOL credit already automatically reduces as first production revenue begins and goes away completely when revenues exceed costs
 - Begin phase-out of all credits some time after revenues exceed costs
- Provide State of Alaska guarantee for qualified loans as an alternative
 - Allow producer to choose either modified credit program or new loan program
 - Would use third-party investment and require no immediate State funds
 - Interest rates would be lower than typically paid by small independent producers
 - Non-recourse loans only made for low-risk/high-reward projects
 - Require substantial (>25%) equity investment by borrower
- Create new funding program(s) for strategic exploration programs
- Recognize that time is of the essence for reaching a consensus