# Alaska's Oil and Gas Tax Credits: An Investment in Alaska's Future

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# Main Points – Applicable to Cook Inlet

- Tax Credits have worked well
- A solid investment in Alaska's future
- New field developments are needed
- But additional time is needed for projects now underway
- Immediate cessation or severe reduction:
  - Already-committed development contracts
  - Loss of jack-up rig
  - Reduced gas supplies – shortages, higher prices
  - Agrium, in-state LNG, new industry
- BlueCrest's suggestions



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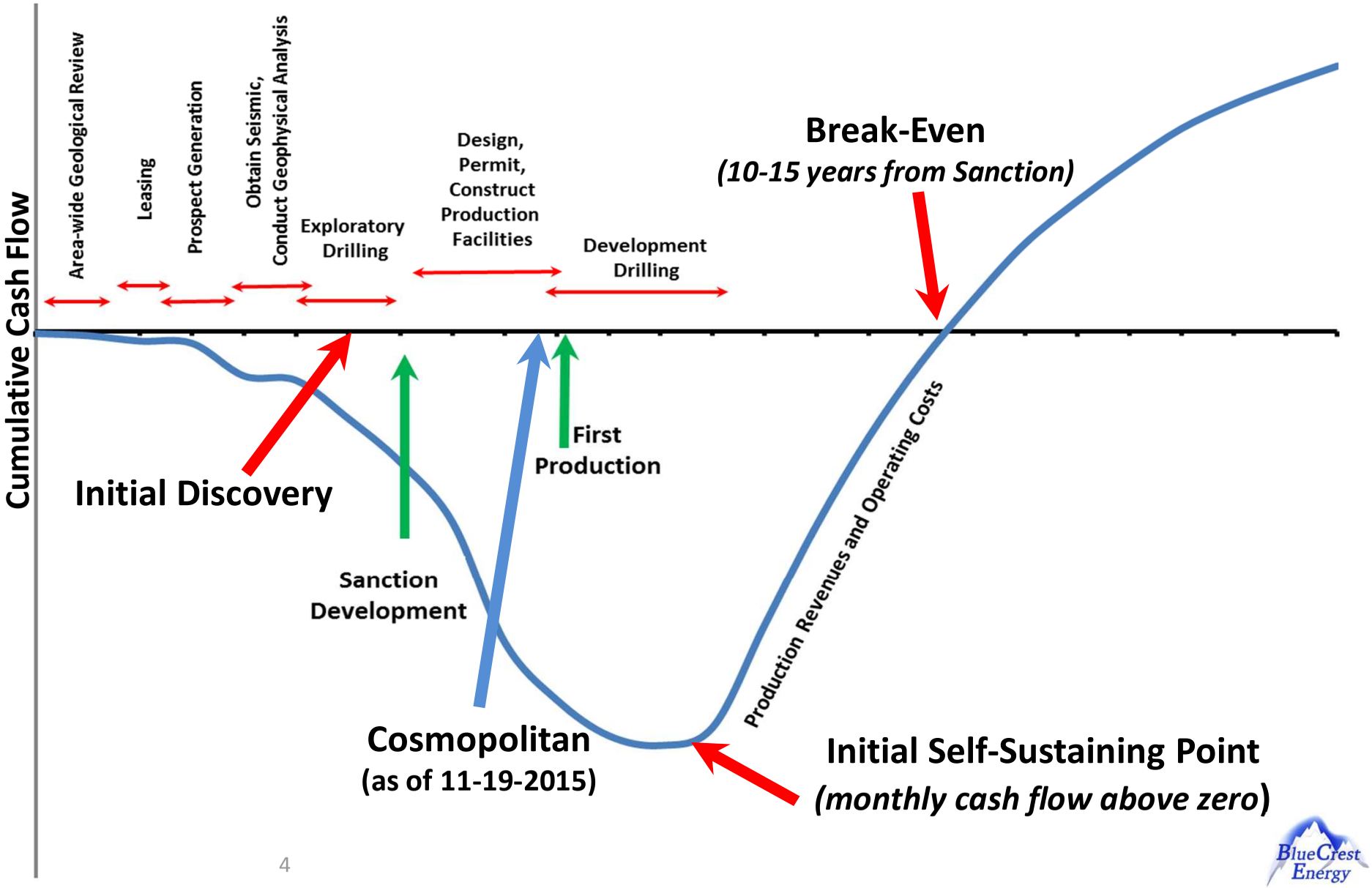
# Typical Project Life-Cycle Cash Flow

## Exploration discoveries do not guarantee production!



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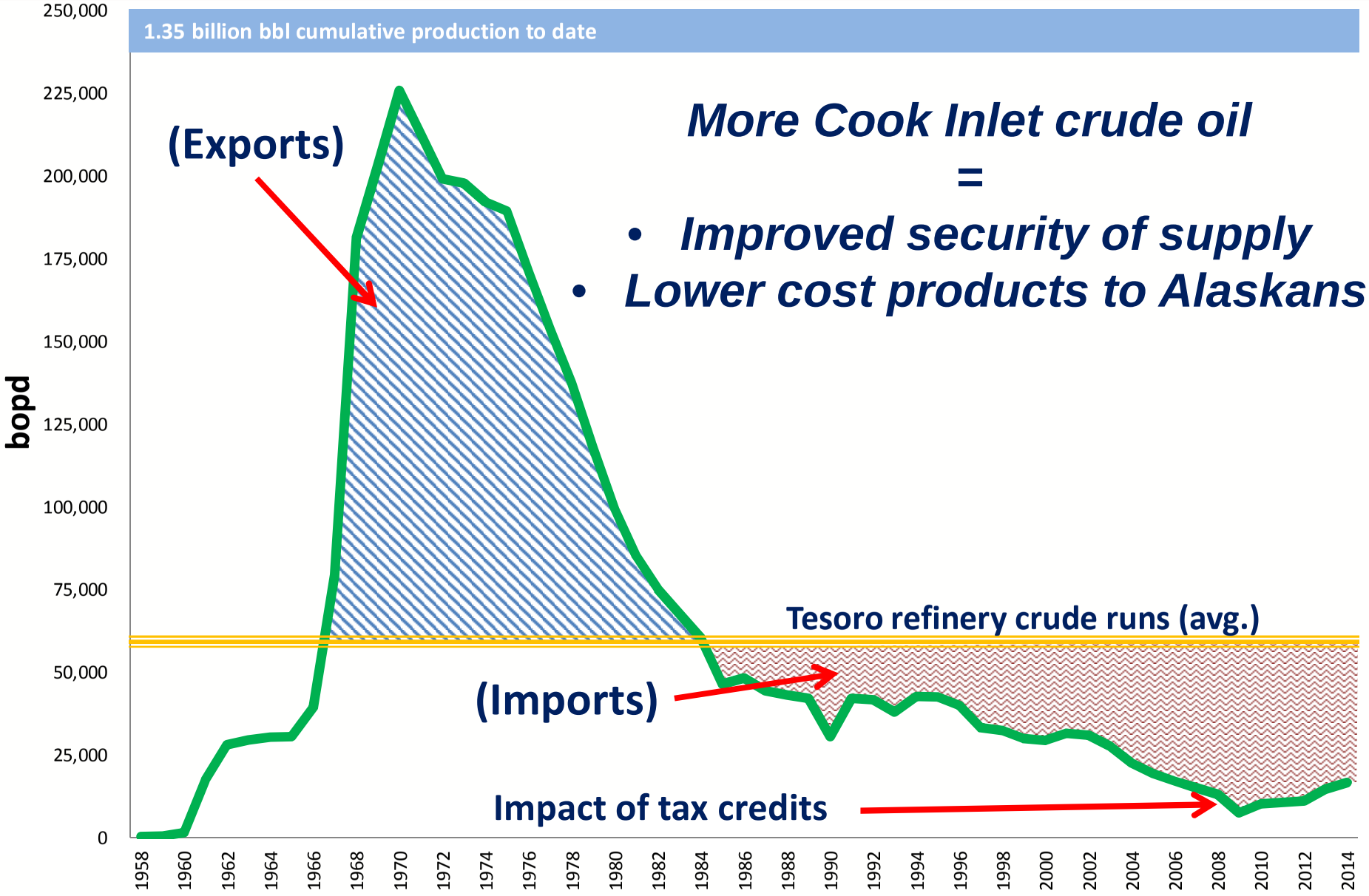
# Cook Inlet Crude Oil Supply and Demand History



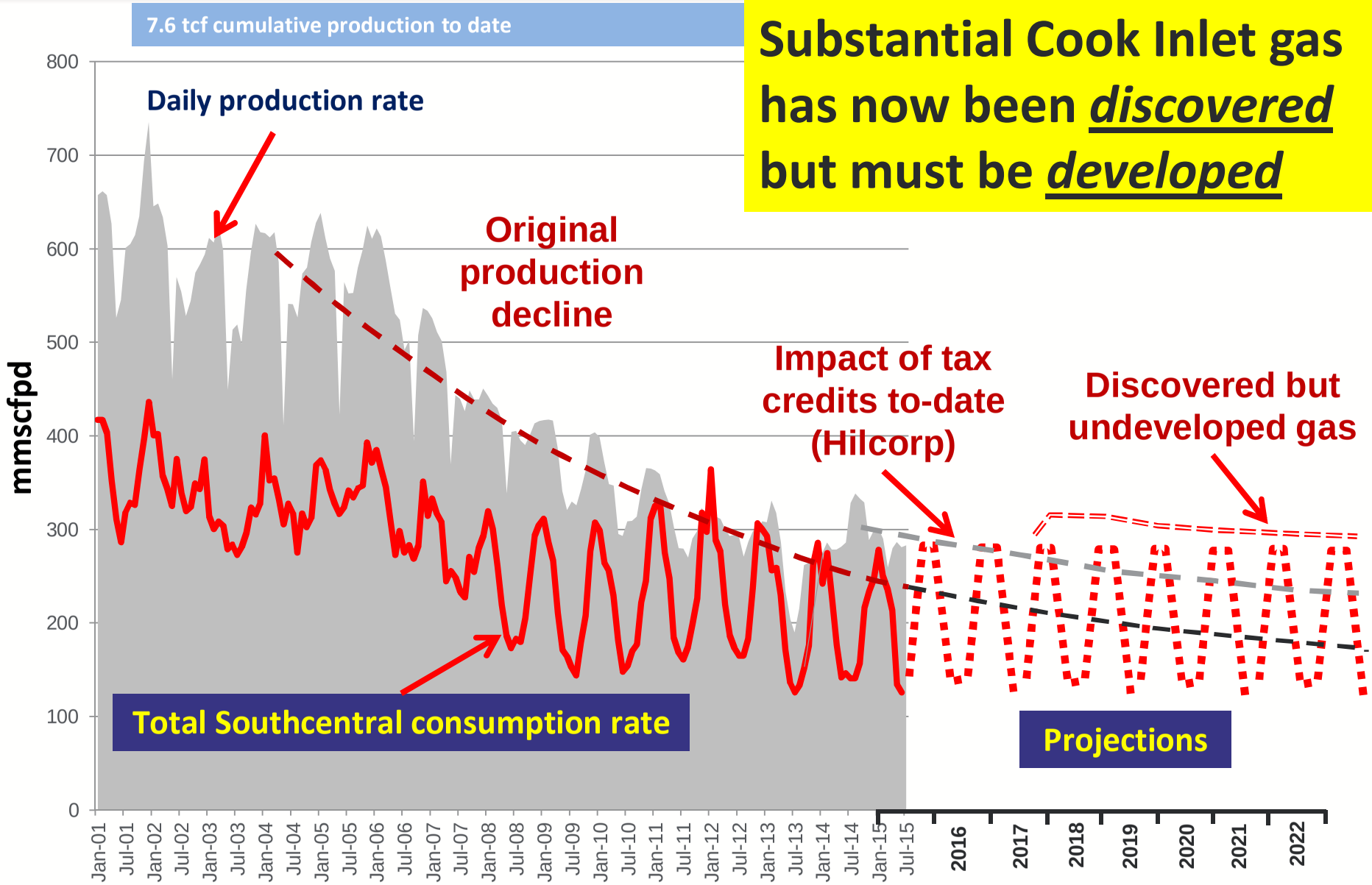

***More Cook Inlet crude oil***

***=***

- ***Improved security of supply***
- ***Lower cost products to Alaskans***

Source: State of Alaska Department of Natural Resources.

# Cook Inlet Natural Gas Supply and Demand History/Forecast




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



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# Cook Inlet Gas Supply and Demand

- **Without the tax 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**
  - **Physical limitation on available gas supply**
    - **No easy way to import gas**
  - **Substantial new supplies would take 3-5 years**
- **New gas must be developed *now* to ensure *future* supply**
- **Markets for sales of excess capacity are necessary**
  - **Fairbanks/Interior, Agrium, New in-state LNG, exports**

# Tax Credits Brought BlueCrest to the Cosmopolitan Unit

- Examined many domestic acquisition opportunities
  - Evaluated comparative economics 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)
- The Cosmopolitan State #1 well was successful
  - Proved up more Cosmopolitan <u>oil</u>
  - Discovered substantial new <u>gas</u>



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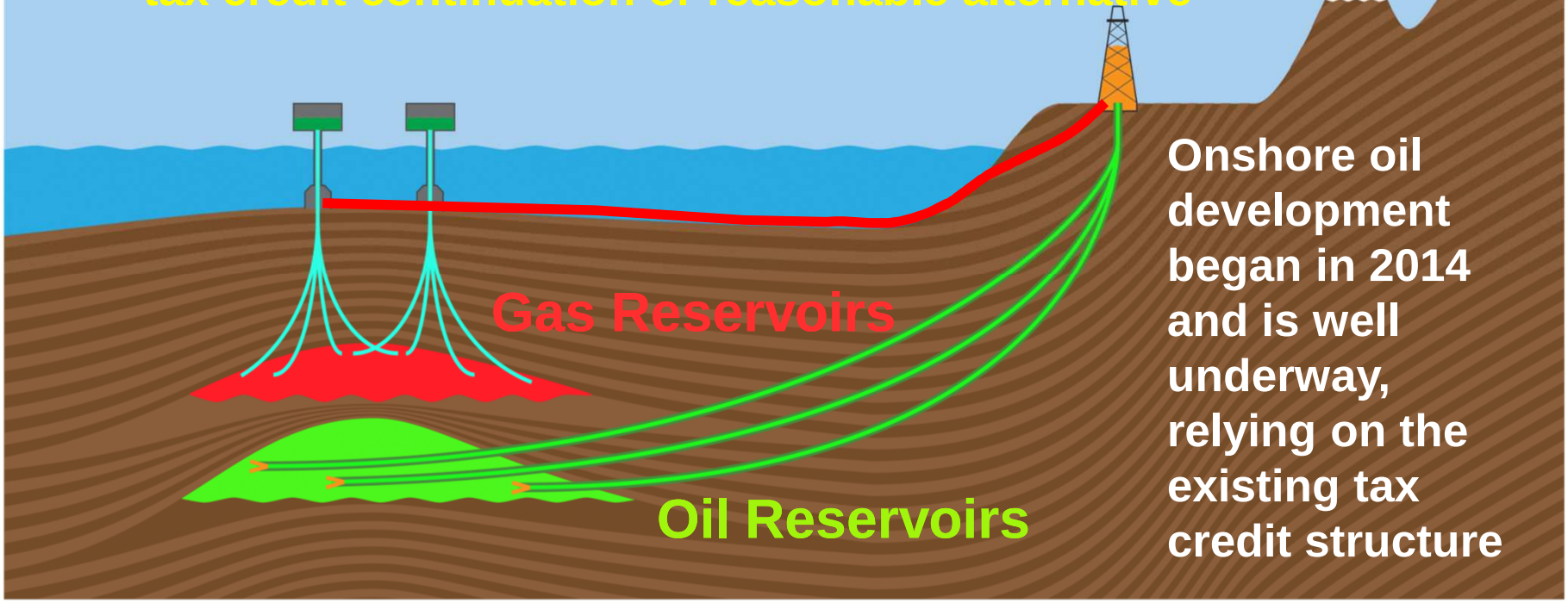
# Cosmopolitan Unit Development Concept

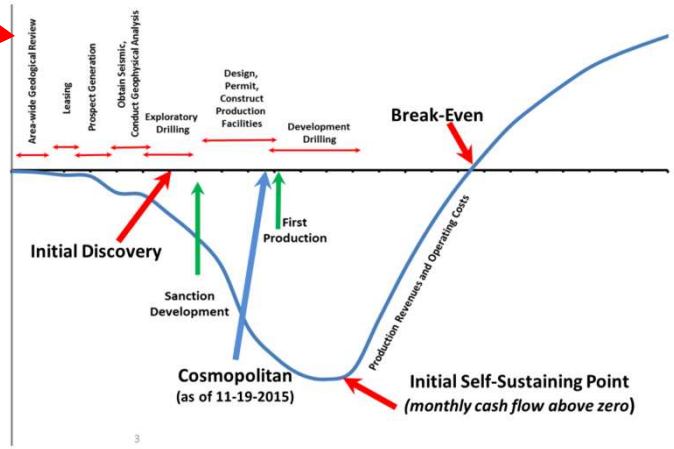
- **Separate oil and gas reservoirs are located approximately three miles offshore in the Cook Inlet**
- **The oil reservoirs can be reached by drilling wells from onshore**
- **The gas reservoirs are not as deep and can only be reached with offshore wells and platforms**
  - **Gas development is now on hold, pending confidence of tax credit continuation or reasonable alternative**




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

# Cosmopolitan Unit Oil Development

- Requires approximately $525 million total investment before production is self-sustaining (re: prior slide)
  - All major contracts have been awarded (turnkey)
  - Facilities and drilling rig all close to completion
  - 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 already-committed contracts**



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# Cosmopolitan Offshore Gas Development

- WesPac joint development plan:
  - First wells drilled in 2016
    - Funding decision needed by early 2016
  - First gas production/sales in 2018
- All long term gas sales arrangements uncertain, pending tax credit confirmation
  - 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
- Entire Gas development is on hold for now, pending confirmation/stabilization of tax credit program

# Spartan 151 Drilling Rig – *Critical Path to Offshore Development*

- Now the ***only*** offshore rig in the Cook Inlet
- The two known large gas discoveries are offshore
  - Kitchen Lights & Cosmopolitan
  - At least one jackup rig is required for any more wells
  - Multiple rigs needed for 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 works 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 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

# Factors to Consider for Tax Credit Changes

- **Benefits to the State of Alaska must outweigh costs**
  - **Security of supply, jobs**
  - **Direct financial benefit**
    - **Reductions/elimination of tax credits *will* result in lowered future state revenues**
      - **What is the appropriate balance between current state incentives and future State revenues?**
- **Take a long-term investment approach**
  - **All new developments take years to become productive**
- **The analysis should include all benefits/costs (taxes *and* royalties)**
  - **Cosmopolitan basic example (including *only* oil royalties):**
    - **50 million barrels oil at $58/bbl, State royalties = $362mm, credits $120mm**
    - **Benefit/Cost ratio = 300%**
- **Consider risks versus rewards**
  - **Development is low risk, exploration is higher risk**
    - **But exploration is the *only* source of future developments**



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# Factors to Consider for Changes in Tax Credit Program

*(Continued from previous slide)*

- **Honor commitments to those who have already committed large sums for development of known fields**
  - **Low-risk, quantifiable benefits to the State of Alaska**
  - **Contracts were entered into based on existing tax structure**
- **Stability of tax structure is vital for continued industry investments**
  - **Alaskan projects are typically very long-term**
  - **Potential investors must have confidence in future tax regime stability**
  - **A crisis in confidence -- immediate and lasting withdrawal of Alaska activity**
  - **A retroactive change would be devastating to Alaska's future**

# BlueCrest's Suggestions for Development Project Credits

- NO RETROACTIVE CHANGES!
- Fully fund filings based on statutes at time of filing
- Reasonable time to phase into any new system
- Developments now in progress:
  - Continue all current-law credit provisions, with phased expiration
    - Existing credits for 2 years (including NOL credit)
    - Phase-out after revenues exceed costs
- Alternative: State guarantees loans
  - For new projects not currently underway
  - Third-party investment requires no immediate State funds
  - Non-recourse loans for low-risk/high-reward projects
- Time is of the essence for clarifying changes



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