

BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

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| In the Matter of: |) | |
| |) | |
| TESORO CORP. f/k/a TESORO PETROLEUM |) | |
| CORP., <i>et al.</i> |) | OAH No. 05-0155-TAX |
| |) | |
| <u>Tax Years 1994-1998</u> |) | |

I. Introduction

The taxpayer, Tesoro Petroleum Corporation and its affiliates and subsidiaries (Tesoro), appeals the informal conference decision of the Alaska Department of Revenue Tax Division (Division) on Tesoro’s 1994 – 1998 income tax assessments. Tesoro was assessed additional income taxes, interest and penalties when the Division determined Tesoro Petroleum Corporation, its affiliates and subsidiaries were unitary. Tesoro appealed and the Division conducted an informal conference and issued a decision, dated January 8, 2005, which assessed taxes, interest and penalties of \$10,789,138.¹ Tesoro appealed the informal conference decision.

The administrative law judge issued an order on the parties’ motions for partial summary adjudication on April 24, 2008. The Division had sought summary adjudication affirming the Division’s application of its Three Factor Alternative Apportionment Methodology. Tesoro had sought a finding that AS.43.20.072 is unconstitutional, a finding that the Division’s general application of Three Factor Alternative Apportionment Methodology was an invalid regulation, a finding that separate accounting methodology was required in Tesoro’s case as a matter of constitutional law, and a finding that the Division was prohibited from assessing failure-to-pay and negligence penalties to any deficiencies because of Tesoro’s constitutional challenge. The order granted the Division’s motion and denied Tesoro’s motions. An evidentiary hearing followed on the remaining matters at issue.

After the record closed, the Division filed a motion to strike certain exhibits as well as an assertion in Tesoro’s Post-Hearing Reply Brief. The motion is denied because there is no chance that the Division was prejudiced by what the Division sought to strike.

¹ DOR 4 (Informal Conference Decision), pages 1-74, Tr. DOR 0004002-75.

There are four discrete issues in this case. First, Tesoro disputes the Division's determination that Tesoro and its subsidiaries are one unitary business. Second, Tesoro objects to the Division treating its income from the Bob West Field as business income and as apportionable for its Alaska taxes. Third, Tesoro contends that adjustments should be made to sales apportionment factor, and fourth, it challenges whether the Division correctly assessed penalties.

This decision first examines the unitary business question, concluding that Tesoro failed to show that the Division's determination that Tesoro was unitary during the audit period was incorrect. Relatedly, the decision concludes that income from the Bob West Field was indeed business income. The questions of whether the Tennessee Gas settlement income should be excluded from the sales factor and included in the apportionable base, and whether certain Bolivian taxes should be included in the apportionable base, are dealt with separately, with only the exclusion of part of the Tennessee Gas settlement income from the sales factor being resolved in Tesoro's favor.

The issue of interest and penalties is addressed in a final section below. This issue appears to have narrowed to whether the Division appropriately assessed failure-to-pay and negligence penalties. The aggressiveness of Tesoro's positions in its filing history shows that penalties were appropriately assessed for Tesoro's deficiencies.

II. Background.

Tesoro was an expanding mid-sized integrated oil and gas company prior to the Texas oil crash in the mid 1980s. Tesoro's businesses included exploration all over the world, refineries, and national retail.² During the oil crash in the mid-1980s through the early 1990s, Tesoro's losses and debt were so great that there was talk of breaking the company up.³ By the early 1990s Tesoro's principal remaining assets were its gas exploration segment, which had a field in Texas under a profitable gas contract, and the Alaska refinery.⁴

In the face of reduced business activities, pressure from dissatisfied shareholders, and outside takeover attempts, Tesoro had drastically restructured its management.⁵ After the restructuring, Tesoro's corporate headquarters office was located in Texas, collocated with the

² Tesoro 1984 10-K, Tr. TES 0070002-12.

³ International Directory of Company Histories, Tr. DOR 08550006.

⁴ Testimony of Bruce Smith, Tr. May 9, 2008 7:2-6.

⁵ International Directory of Company Histories, Tr. DOR 08550006.

Exploration and Production (E&P) segment which had its activities also primarily in Texas. Tesoro had a relatively insignificant marine service segment, which had its activities primarily located in Louisiana and Texas, and a Retail and Marketing (R&M) segment, which had its activities primarily located in Alaska.

After the restructuring, the activities of Tesoro's E&P segment were dominated by its interest in the Bob West gas field in Texas. Under a contract, Tennessee Gas Pipeline Company (Tennessee Gas) was required to pay a significantly over-market price for gas produced on part of that field. Successful drilling in this area increased the amount of gas that Tennessee Gas was contractually obligated to purchase. Tennessee Gas filed suit in 1990 seeking relief from the contract, but ultimately lost in the Texas Supreme Court in 1996. Tennessee Gas then agreed to a buyout of its remaining future obligations under the contract. Following the settlement and buyout of the Tennessee Gas contract, E&P expanded and diversified its reserve portfolio outside the Bob West Field. Tesoro ultimately decided to sell its E&P segment in 1999.

After the restructuring, the activities of Tesoro's R&M segment were dominated by ownership of a petroleum refinery in Alaska, and to a lesser degree by its retail gasoline chain in Alaska. Although during the audit period Tesoro's R&M activities were primarily located in Alaska, Tesoro's R&M segment engaged in the transportation, refining, and marketing of petroleum and petroleum products outside Alaska as well.⁶ Tesoro's R&M segment operated a petroleum refinery in Kenai, Alaska, and, by 1996, had the largest retail gasoline chain in Alaska, including "7-11" stores, now known as Tesoro "2Go" stores. By the end of the audit period, R&M was also the main wholesaler of jet fuel for airlines on North Pacific and trans-polar flights. Finally, R&M was a direct supplier to the large marine market in Alaska.⁷

Tesoro's R&M's Kenai refinery refined crude oil purchased from third parties into petroleum products and marketed those products in both the wholesale and retail markets.⁸ At the start of the Audit Period, the Kenai refinery was Tesoro R&M's only refinery. Tesoro R&M's retail operations were solely in Alaska, and it operated four bulk-market terminals on the U.S. west coast.⁹ After the sale of its E&P segment, Tesoro expanded its refinery operations, purchasing refineries in Hawaii and Washington State.

⁶ DOR 16 (Agreed Stipulation of Facts), No. 5.

⁷ DOR 17-22 (Tesoro's Annual Reports, 1994-1998).

⁸ Tesoro 1995 10-K, Tr. TES 0100005.

⁹ Tesoro 1993 10-K, Tr. TES 0080007.

In describing its business activities during the Audit Period, Tesoro Petroleum Corporation and its operating companies can be divided into five segments: Corporate, Finance, R&M, E&P and Marine Services.¹⁰ As indicated above, during the audit period, Tesoro's R&M and E&P segments' activities were centered in different geographical locations, and centered on different aspects of the Oil and Gas business.

Tesoro filed as unitary in Alaska from the time it began doing business in Alaska in 1969 until 1994. In 1995 Tesoro bought a pipeline operator in Kenai, Kenai Pipeline Company ("KPL"), which changed Tesoro's Alaska tax status. Acquisition of KPL rendered Tesoro's businesses that were unitary with KPL subject to AS 43.20.072. Tesoro was aware of this issue prior to the purchase of KPL and its corporate tax department began to work on strategies to mitigate the tax impact of this change. This issue was of special concern to Tesoro because some of its non-Alaska business realized large profits after the KPL acquisition due to the court settlement. Tesoro's tax department developed some suggestions for changes that would help support its position that its non-Alaska and Alaska businesses, particularly its R&M and E&P segments, were not unitary. The strategy Tesoro eventually settled on to avoid paying Alaska tax on these profits was twofold: first, to argue that DOR should allow Tesoro to file using separate accounting as a form of section 18 relief; and second, to argue that if Tesoro was not allowed to file in Alaska using separate accounting under section 18, that Tesoro's business activities inside and outside Alaska were not unitary.

The issue of allowing separate accounting as section 18 relief was dealt with in this appeal by upholding on partial summary adjudication the Division's denial of Tesoro's request to use separate accounting methodology. The parties presented evidence and briefing at the hearing on the remaining issues, including whether Tesoro should be treated as a single unitary business.

III. Standard of Proof

AS 43.05.435 establishes the applicable standards of review and burdens of proof:

Sec. 43.05.435. Scope and standards for decision. The administrative law judge shall hear all questions *de novo* under AS 43.05.405-43.05.499. The administrative law judge shall

- (1) resolve a question of fact by a preponderance of the evidence or, if a different standard of proof has been set by law for a particular question, by that standard of proof;

¹⁰ See Description of Tesoro's structure at DOR 40-Informal Conference Decision, pages 3-7.

(2) resolve a question of law in the exercise of the independent judgment of the administrative law judge;

(3) defer to the Department of Revenue as to a matter for which discretion is legally vested in the Department of Revenue, unless not supported by a reasonable basis.

There is only one issue left in this case where deference to the Division is an issue. That is in the imposition of penalties. The Division correctly argues that 15 AAC 05.220(a) vests it with discretion to impose penalties for negligence or intentional disregard of the law. However, whether Tesoro acted with negligence or intentional disregard is a question of fact, which must be found by a preponderance of the evidence standard after *de novo* review, before the exercise of the Division's discretion in imposing that penalty against Tesoro is reviewed with deference to the Division. Therefore, the Division oversimplified the standard of review in arguing that the rational basis test applies to the determination of whether penalties were appropriately assessed.

A taxpayer who attacks the Division's finding of unity to prevent the application of an apportionment formula must do so by clear and cogent evidence.¹¹ Not only did Tesoro fail to meet this heavy burden, the Division showed by a preponderance of the evidence that Tesoro and its subsidiaries were unitary during the audit period.

IV. Tesoro's Business Segments Were All One Unitary Business

A. Unitary Business Concept

The definition of a unitary business is a judicial concept designed to limit state taxation to constitutionally permissible boundaries:¹²

“As a general principle, a state may not tax value earned outside its borders.” *Asarco, Inc. v. Idaho State Tax Commission*, 102 S.Ct. 3103, 3109, 73 L.Ed.2d 787, 794 (1982). However, with multistate businesses, it may be impossible to attribute certain income to a particular state by use of a geographical accounting method. Such accounting may fail to account for contributions to income resulting from functional integration, centralization of management and economies of scales. These factors of profitability arise from the operation of a multistate business as a whole and therefore such income does not have a single identifiable source. *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 438, 100 S.Ct. 1223, 1232, 63 L.Ed.2d 510, 521 (1980). In order to segregate this type of income according to its source and to avoid multiple taxation, states have developed apportionment formulas. These formulas attribute an appropriate fraction of the total multistate business income to the taxing state. *Hellerstein, State Income Taxation of Multijurisdictional Corporations: Reflections on Mobil*,

¹¹ *Earth Res. Co. of Alaska v. State, Dep't of Revenue*, 665 P.2d 960, 971 (Alaska 1983).

¹² *Earth Resources.*, 665 P.2d at 965.

Exxon, and H.R. 5076, 79 Mich.L.Rev. 113, 117 (1980). It is only when these “‘factors of profitability’ ... exist and evidence the operation of a unitary business, [that] a state can gain a justification for its tax consideration of value that has no other connection with that state.” *F.W. Woolworth Co. v. Taxation and Revenue Department*, 458 U.S. 354, 102 S.Ct. 3128, 3135, 73 L.Ed.2d 819, 828 (1982). Therefore, a finding of unity is prerequisite to the constitutional application of Alaska's apportionment formula.^[13]

In order for different parts of a business to be unitary there must be centralized management, functional integration, and economies of scale. These factors create significant unquantifiable flows of value between parts of a unified business that make it difficult to attribute the appropriate income to a particular state through separate accounting. There must be sufficient connection or nexus between taxing authorities, in this case the state of Alaska, and corporation's income in order for Alaska to tax that income. As the Division's expert, Professor Pomp, explained in his report, the unitary business concept provides that nexus between corporate income earned outside of Alaska by a unitary business that operates both inside and outside Alaska.¹⁴ By apportioning the income of a unitary business that operates both in and outside Alaska, the portion of that unitary business income that reflects the corresponding portion of the corporation's business activities that take place in Alaska is taxable by Alaska, even if the income was more directly related to activities that took place outside Alaska.¹⁵

To the taxing authorities that use it, apportionment has some advantages over separate accounting. When an enterprise operates in different taxing jurisdictions, it is often not practical to attempt to assign an accurate value to the contributions that the different segments of a unified business make to the profits those segments earn. The difficulty of accurately accounting for these contributions to profits through separate accounting also creates the potential for taxpayers to shift profits to lower-taxing jurisdictions.¹⁶

An apportionment approach to state taxation of a unified multi-state business creates issues surrounding which of the segments of the business are unitary and must be apportioned, and what portion of the unified business's income should be attributed to and taxed by Alaska. Tesoro's appeal focuses on which segments of Tesoro must be apportioned between Alaska and the other jurisdictions where it earned income during the audit period.

¹³ *Earth Resources.*, 665 P.2d at 966.

¹⁴ DOR 842 (Pomp Report).

¹⁵ DOR 842 (Pomp Report).

¹⁶ DOR 842 (Pomp Report).

B. Three Factor Test

The Division focuses on evidence that Tesoro's filing as non-unitary was part a strategy developed to limit liability after the pipeline acquisition, and Tesoro does not directly dispute this. Except in the context of the penalty assessment addressed at the end of this decision, however, the issue in this case is whether Tesoro's claim that it is entitled to nonunitary filing is correct, rather than how the taxpayer came to make that claim. As noted above, the Alaska Supreme Court has adopted the United States Supreme Court unitary business test.¹⁷ That test looks for "factors of profitability" which evidence a unitary business.

The unitary business test is "whether contributions to income" of Tesoro's business segments resulted from functional integration, centralization of management, and economies of scale. If these three factors exist, a finding that Tesoro was a unitary business is required.¹⁸

Given the facts regarding Tesoro's business structure and its activities during the audit period, and the Alaska case law on the factors bearing on business unity, one could imagine a case with significantly less evidence the operation of a unitary business than is present here, yet would still support a unitary finding. While Tesoro did present evidence that there was little transfer of personnel or goods between its E&P and R&M segments, and these segments acted with a certain degree of autonomy in their day-to-day operations, the evidence also showed that Tesoro's business segments realized significant contributions to their income from the other segments and their component parts through functional integration, centralization of management and economies of scale. This observation is not meant to imply that Tesoro's position on the unitary issue was argued in bad faith, but rather that it is an aggressive position, in that its success appears to be contingent on moving the Alaska Supreme Court away from existing precedent in the direction of the views on evidence of the operation of a unitary business supported by its expert witnesses.¹⁹ The aggressiveness of Tesoro's position on the unitary issue, as illustrated in the discussion below, has relevance to assessment of negligence penalties, addressed at the end of this decision.

¹⁷ *Earth Resources*, 665 P.2d at 967.

¹⁸ *Alaska Gold Co. v. State, Dep't of Revenue*, 754 P.2d 247, 251 (Alaska 1988).

¹⁹ *Se, e.g.*, Tesoro's Pretrial Brief at 8 n.28, where Tesoro argues that the Alaska Supreme Court's analysis in *Earth Resources* 665 P.2d at 969 regarding the import of majority ownership of a subsidiaries stock and sharing directors is inconsistent with the U.S. Supreme Court's holding in *F.W. Woolworth Co. v. Taxation and Revenue Department*, 458 U.S. 354 , 362 (1982).

C. Expert testimony on Tesoro's Business Operations during the Audit Period

There was not a great deal of evidence in dispute in this case. The focus during the evidentiary hearing was on which facts regarding Tesoro's business activities and organization were more significant in determining whether Tesoro's business segments were unitary. In general, the Division's experts' testimony and reports on the issue of whether Tesoro was unitary provided by Professors Smith and Pomp were very persuasive. Both of these experts demonstrated an impressive understanding of Tesoro's organization and business activities during the audit period and were able to provide strong, but objective, opinions about where there was and was not centralized management, functional integration, and economies of scale between Tesoro's business segments and the extent to which these factors created significant unquantifiable flows of value between Tesoro's parts.²⁰ Tesoro's experts were less convincing.²¹

Tesoro's experts tended to be dismissive of evidence of Tesoro's centralized management, and characterized it merely as evidence of owners acting in the role of overseeing their investment. They focused on Tesoro's management team's limited ability to run the day-to-day operations that had not been centralized. When faced with evidence of functional integration, Tesoro attempted to shift the focus to the lack of transfer of goods between segments, and the undisputed propriety of Tesoro's accounting for transfer pricing practices for centralized services for federal tax purposes. When faced with evidence of economies of scale, Tesoro attempted to shift the focus to its increase in share prices when the E&P segment was sold.

In general, it is fair to say that the Division and its experts focused on, while Tesoro and its experts tended to divert the focus from, indicators of a unitary business that the Alaska Supreme Court has determined to be significant.

D. Centralization of Management

Centralization of management is one of the three factors in a unitary business that create unquantifiable flows of value or profitability from the parent to the subsidiary. Evidence of centralization of management is important in determining whether different business segments are unitary because this evidence indicates that significant, but difficult to quantify, flows of

²⁰ DOR 842 (Pomp Report).

value went from the parent to the other segments in the form of management, coordination, and expertise. These are factors of profitability that arise from operating the business segments together as a whole, which would not occur in business segments operating independently and autonomously.

The Alaska Supreme Court has held that, when the other two of the three factors were present, sufficient centralization of management existed simply by virtue of the parent's majority ownership of the subsidiary and extensive ties between the management of the parent and the subsidiary to support a finding of unity. A parent's majority interest in a subsidiary is enough to indicate that the parent in fact exercised control over the management of the subsidiary.²²

The Alaska Supreme Court has also found strong evidence of centralized management in the fact that the parent's chief executive officer was responsible for hiring the president of the subsidiary, which gives the parent a means of maintaining control over the subsidiary.²³ The Alaska Supreme Court has found evidence of centralized management in centralized services provided by a parent to a subsidiary.²⁴

During the audit period, there was evidence of significant centralization of management of the types that the Alaska Supreme Court has held are indicative of a unitary business. As one would expect from its success and the obvious competence of its management team, Tesoro's business segments appear to have been centrally managed by Tesoro Petroleum Corporation (TPC) in areas where centralized management benefited the corporation as a whole, and were operated independently and autonomously in areas where centralization of management would not create factors of profitability.

During the Audit Period, TPC wholly owned virtually all of its operating companies.²⁵ In a unitary analysis, significant contributions to the income of subsidiaries through centralization of management can be shown by the parent's controlling share ownership of the subsidiary and the extensive ties, such as overlapping directors and officers, between the

²¹ See, e.g., 5/10/08 Hearing Tr. at 47:23 -126:8 (cross examination of Brian Pedersen), in which the Division showed Mr. Pedersen's failure to give adequate weight to the factors the Alaska Supreme Court found significant in its unitary analysis in *Alaska Gold* and *Earth Resources*.

²² *Alaska Gold*, 754 P.2d at 251.

²³ *Earth Resources*, 665 P.2d at 969.

²⁴ *Earth Resources*, 665 P.2d at 969 & 970.

²⁵ DOR 16 (Agreed Stipulation of Facts), Exhibits 1, 3, 5, and 7; 5/13/08 Hearing Tr. at 161 (Dr. James L. Smith). Only two Tesoro subsidiaries were not wholly owned. These subsidiaries were the Starr Zapata Pipeline (in which Tesoro had a 50% interest) and the Starr Country Gathering System (in which Tesoro had a 70% interest). They were owned jointly with Coastal. See DOR 359 (Smith Report) at Exhibit 1.

management of the parent and the subsidiary. The Alaska Supreme Court has noted that exceptions to a determination of centralization of management in the case of a parent's majority ownership of the subsidiary might be found where the controlling parent had agreed not to exercise its full voting rights or where there was no sharing of officers and directors during the relevant time frame and none of the subsidiaries' officers was a current or former employee of the parent.²⁶ Neither of these exceptions applies to Tesoro during the audit period. The fact that TPC wholly owned the portions of its business that the Division has found to be unitary is therefore a strong indication of the centralized control that Tesoro was one unitary business during the audit period.²⁷

Centralized management of Tesoro business segments is also evidenced by overlapping directors on the boards of Tesoro and its subsidiaries and the fact that the boards of the subsidiaries rarely met.²⁸ During the audit period Tesoro's subsidiaries' boards all were managed and controlled by Tesoro's executive management team.²⁹ For example, during 1996 almost all of Tesoro's subsidiaries were governed by the same three directors, and the same six officers were included in the officer slate for each subsidiary.³⁰ The senior officers comprising each subsidiary's board were Bruce Smith, who served as each subsidiary's CEO, William Van Kleef, who served as each subsidiary's Executive Vice President of Operations, and Jim Reed, who served as each subsidiary's Executive Vice President, General Counsel, and Treasurer.³¹

Centralization of Tesoro and its segments' management and flows of value to the segments was shown by the evidence of the control the Tesoro board exercised over the subsidiary boards the operations of the subsidiaries. Tesoro's subsidiaries' boards rarely met.³² In the five years of the audit period, Tesoro Marine Services Company was the only board that met at all, and this board only met twice.³³ CEO Smith testified that major decisions relating to

²⁶ *Alaska Gold Co. v. State, Dep't of Revenue*, 754 P.2d 247, 251 (Alaska 1988) citing *Earth Resources*, 665 P.2d at 969 and distinguishing *F.W. Woolworth Co. v. Taxation and Revenue Department*, 458 U.S. 354, 102 S.Ct. 3128, 73 L. Ed. 2d 819 (1982).

²⁷ See *Container 423 U.S. 159, 17.*, and again See *Alaska Gold Co. v. State, Dep't of Revenue*, 754 P.2d 247, 251 (Alaska 1988) citing *Earth Resources*, 665 P.2d at 969 and distinguishing *F.W. Woolworth Co. v. Taxation and Revenue Department*, 458 U.S. 354, 102 S.Ct. 3128, 73 L. Ed. 2d 819 (1982). The Alaska Supreme Court in *Alaska Gold* noted that in *Woolworth* "none of the subsidiaries' officers ... was a current or former employee of the parent."

²⁸ See Tesoro Officers and Directors, Exhibit to the Agreed Stipulations of Fact, Tr. TES 0550003-04.

²⁹ DOR 359 at 14. (Dr. James L. Smith Report).

³⁰ 5/9/08 Hearing Tr. at 47-50; 75-77; 95-97 (Bruce Smith); DOR 16 (Agreed Stipulation of Facts) at Exhibit 9; DOR 359 (Smith Report) at Exhibit 2.

³¹ 5/13/08 Hearing Tr. at 164-66 (Dr. James L. Smith); DOR 359 at 14. (Dr. James L. Smith Report).

³² 5/9/08 Hearing Tr. at 121-22 (Bruce Smith).

³³ DOR 359 at 15, n.7.

the subsidiaries' activities were always made at the TPC board rather than the subsidiary board level.³⁴

The TPC board was actively involved in making decisions on the general governance of all Tesoro business segments.³⁵ The TPC board was directly involved in approving business plans and budgets of its segments and subsidiaries, setting their general direction and goals and approving certain purchases.³⁶

Business that had to be conducted by the subsidiary boards was done via written consents and resolutions that were simply passed down to the necessary subsidiary officers and directors for signature, without debate or discussion on the action being taken.³⁷ These written consents were all prepared by changing the names of the subsidiaries as appropriate and distributing the result to the subsidiary boards for approval.³⁸

TPC also established three non-operating subsidiaries, which were governed by different officers and directors. These were Tesoro Gas Resources Company, Victory Finance, and Tesoro Financial Services Holding Company. These three subsidiaries were created for the purpose of sheltering income related to the Bob West Field from taxation in Texas, California and Alaska.³⁹

Tesoro's tax strategy required that these companies incorporate in Delaware, maintain a staff of officers and directors who were not residents of Texas to serve as officers and directors, and provide a non-Texas address, fax number, and telephone numbers. The officers supplied by the Delaware management company Tesoro hired to provide these services received only a small fee for performing their services and were excluded from Tesoro's incentive programs in which the directors and officers from the other subsidiaries participated.⁴⁰

The Alaska Supreme Court has also recognized the significance of centralized control that is evidenced by the centralized hiring the leadership of subsidiary businesses. This occurred with Tesoro as, for example, Steve Wormington was first offered the job of R&M President by

³⁴ 5/9/08 Hearing Tr. at 121-22.

³⁵ DOR 359 (Smith Report) at 15-18; 5/13/08 Hearing Tr. at 172-88 (Dr. James L. Smith).

³⁶ 5/13/08 Hearing Tr. at 172-88 & 223.

³⁷ 5/13/08 Hearing Tr. at 165-68 (Dr. James L. Smith); DOR 359 (Smith Report at 15-16).

³⁸ *Id.* at 167-68.

³⁹ DOR 359 (Smith Report) at 18-21, 28-30, 5/13/08 Hearing Tr. at 169-72 (Dr. James L. Smith); 5/12/08 Hearing Tr. at 226-30 (John Moore).

⁴⁰ DOR 359 (Smith Report) at 20-21; 5/13/08 Hearing Tr. at 170.

former TPC CEO Michael Burke, and later accepted the position when it was offered again by TPC CEO Bruce Smith.⁴¹

Tesoro argues that evidence that TPC's executive management was principally trained in finance and lacked the operational expertise or experience to run the operating segments demonstrated lack of centralized management. Tesoro provided a great deal of evidence, largely uncontested, including testimony from management, to support its position that operational expertise of E&P's and R&M's day-to-day operations did not exist at the level of Tesoro's top management team.⁴² The flaw in Tesoro's argument is that it mischaracterizes what operational expertise means and why operational expertise is significant in the context of the determination of whether a business is unitary. The issue is not whether CEO Bruce Smith and his team were best qualified to take over E&P's and R&M's day-to-day operation, but whether that team possessed expertise about these businesses and their operations that enabled the team to provide unquantifiable flows of value to the subsidiaries.⁴³ In particular, the team provided financial operational expertise that benefited the segments.

The U.S. Supreme Court laid out the distinction between the types of flows of expertise that can lead to a finding of unity and those that do not.

We made clear in *F.W. Woolworth Co.* that a unitary business finding could not be based merely on "the type of occasional oversight-with respect to capital structure, major debt, and dividends-that any parent gives to an investment in a subsidiary" 458 U.S. at ----, 102 S.Ct. at 3138. As *Exxon* illustrates, however, mere decentralization of day-to-day management responsibility and accountability cannot defeat a unitary business finding. 447 U.S. at 224, 100 S.Ct. at 2120. The difference lies in whether the management role that the parent does play is grounded in its own operational expertise and its overall operational strategy.^[44]

Tesoro's management team's contributions of expertise to its business segments were not merely the expertise shared through occasional oversight of an investment. Even with respect to capital structure and major debt, the contributions of expertise and flows of value from TPC and its management team to the business segments went far beyond what would be due from mere

⁴¹ Testimony of Steve Wormington, Tr. May 5, 2008 221:8-20.

⁴² See, e.g., Testimony of Bruce Smith, Tr. May 9, 2008 6:16-7:25, 31:25-32:4; Testimony of Bill Van Kleef, Tr. May 13, 2008 4:12-8:1.

⁴³ *Container*, 463 U.S. at 180 n 19 (citing *Exxon*, 447 U.S. at 224).

⁴⁴ *Container*, 463 U.S. at 180 n 19.

oversight of an investment.⁴⁵ Significant unquantifiable flows of value went to E&P and R&M as the result of Tesoro's top management team's expertise of the operations of those subsidiaries. CEO Bruce Smith's testified with justifiable pride about his and his management team's efforts and success taking Tesoro from its brush with bankruptcy to its current level of success.⁴⁶ His and his team's operational expertise in both segments was further demonstrated when he led the company through its second drastic reorganization since its brush with bankruptcy, deciding to sell the E&P business and expand R&M's from one to three refineries.⁴⁷ Other evidence of CEO Bruce Smith and his management team contributing operational expertise to both E&P and R&M that created significant unquantifiable flows of value to E&P and R&M is found in Mr. Van Kleef's management of subsidiaries.⁴⁸

Further, because Tesoro had centralized the management of many of the administrative and other functions that its subsidiaries would have had to provide for themselves if those subsidiaries were independent businesses, E&P's and R&M's leadership's focus for day-to-day operations were on the day-to-day operations functions that had not been centralized company-wide. This does not mean that TPC's management did not have operational expertise that contributed to its segments' profitability. It means that Tesoro's management not only possessed but used its operational expertise to increase its E&P and R&M segments' profitably through these centralized functions, and gave E&P's and R&M's leadership independence to run the other day-to-day operations of their segments. If Tesoro had truly set E&P and R&M adrift to function independently, those segments would have had to expand and manage their own day-to-day operations to include their cash management, credit, administrative services, and other functions that were centralized and centrally managed in Tesoro.

⁴⁵ Capital transactions can serve either an investment function or an operational function. *See Container*, 463 U.S. at 180 n 19. Some of Tesoro's centralized management of its segments' capital structure and major debt appear to have been operational functions. The coordination of these actions increased Tesoro's overall strength and profitability. *See* CEO Smith's testimony regarding his efforts and the TPC board's concern about restructuring Tesoro's capital and debt structure. 5/9/08 Hearing Tr. at 6-9, 89-91, 160-63, 165-67 (Bruce Smith). *See also* Dr. Smith's testimony regarding the value of CEO Smith and his team's improvements to Tesoro's capital and debt structure. 5/13/08 Hearing Tr. 244: 5-18 (Dr. James L. Smith).

⁴⁶ 5/9/08 Hearing Tr. at 6-9, 89-91, 160-63, 165-67 (Bruce Smith).

⁴⁷ 5/9/08 Hearing Tr. at 47-50, 95-97 (Bruce Smith).

⁴⁸ *See, e.g.*, DOR 709 (7/18/96 memo from Bruce Smith to the TPC Board explaining the restructuring and that Mr. Van Kleef had acquired a good understanding of all operations from his work with the operating units). *See also* 5/13/08 Hearing Tr. at 215-16 (Dr. James L. Smith). DOR 16 (Agreed Stipulation of Facts), No. 173, 5/9/08 Hearing Tr. at 75-77, Van Kleef Deposition at 86-92. *See also* 5/13/08 Hearing Tr. at 225-27 (Dr. Smith's summary of Mr. Van Kleef's testimony).

Tesoro's witnesses characterized its executive management team as being focused on addressing Tesoro's precarious financial position during the audit period, providing high-level oversight of the subsidiaries, and relaying operating segment information to the TPC Board, financial community, and shareholders. Tesoro's witnesses testified that TPC's executive management team was not involved in what Tesoro characterized as running the day-to-day operations of the segments.⁴⁹

The evidence in the record shows, however, that it was TPC's executive management team and TPC's board members who made final budgetary decisions and were the ultimate decisionmakers for other important financial decisions for Tesoro's business segments operations.⁵⁰ TPC's executive management team made strategic decisions and prioritized between Tesoro's segments operations for the business as a whole.⁵¹ TPC's executive management team briefed the TPC Board about Tesoro segments' operations.⁵²

TPC's executive management team engaged outside consultants to review the operations of the Alaska refinery to get independent advice on operational improvements. When senior management and outside consultants perceived opportunities in the refining sector, TPC's merger & acquisitions group looked for potential refinery acquisitions.

Along with the TPC Board, it was TPC's executive management team who determined that Tesoro would continue to operate all three of its operating business segments throughout the audit period, and decided in the year following the audit period that Tesoro would sell its E&P operations, sell its Marine Services operations in 2000, and ultimately concentrate solely on R&M operations.⁵³

Centralized management of Tesoro's business segments was also evidenced by the centralization of services, which allowed TPC's management to standardize and control certain types of operations throughout Tesoro's business segments. TPC established a subsidiary, Tesoro Petroleum Companies, Inc. (TPCI), which provided management, professional, technical and

⁴⁹ Testimony of Bruce Smith, Tr. May 9, 2008 116:25-117:24; Testimony of Bill Van Kleef, Tr. May 13, 2008 8:13-18.

⁵⁰ 5/9/08 Hearing Tr. at 6-8, 11-12, 16, 30-31, 39-45, 47-55, 57, 60-62, 95-97 (Bruce Smith); 5/13/08 Hearing Tr. at 172-203 (Dr. James L. Smith).

⁵¹ 5/9/08 Hearing Tr. at 95-97 (Bruce Smith); 5/13/08 Hearing Tr. at 175-88; 202-03 (Dr. James L. Smith).

⁵² 5/13/08 Hearing Tr. at 175-89 (Dr. James L. Smith).

⁵³ 5/9/08 Hearing Tr. at 47-50; 95-97 (Bruce Smith); 5/13/08 Hearing Tr. at 53-56, 61 (William Van Kleef).

other services to all of its subsidiaries.⁵⁴ Tesoro formed TPCI prior to the Audit Period.⁵⁵ TPCI charged fees to the subsidiaries and TPC for services that previously had been provided to the subsidiaries or former divisions of TPC by TPC itself for no charge. All subsidiaries were required to enter into the Administrative Services Agreement (“ASA”) with TPCI and TPC.⁵⁶ The costs charged under the ASA were not necessarily the fair market value for these services, which allowed some cost shifting between segments.⁵⁷

The Division also showed that Tesoro maintained centralized control over its segments’ finance and treasury operations by planning financial strategies on a corporate-wide basis, arranging credit facilities to support general corporate operations.⁵⁸ The funds obtain through these credit facilities were made available to the subsidiaries through central accounts and were secured with corporate-wide assets.⁵⁹ Tax strategy was also centrally managed on a corporate-wide basis.⁶⁰ Purchasing certain goods and services were also subject through Tesoro’s Policy Manual to a degree centralized control.⁶¹ Significant flows of value between Tesoro’s business segments also resulted from Tesoro’s credit facilities and intercompany guarantees.⁶²

Tesoro was sufficiently centrally managed and controlled, despite the fact that top management team was not involved in some of the more production oriented aspects of the day-to-day operations of its business segments, to conclude that, with the functional integration and economies of scale it realized, as discussed below, Tesoro operated as a single unitary business.⁶³

E. Functional Integration

Functional integration between business segments is another of the three factors in a unitary business that create unquantifiable flows of value or profitability between segments. Evidence of functional integration is important in determining whether different business segments are unitary because this evidence indicates that there are flows of value, or flows of

⁵⁴ DOR 16 (Agreed Stipulation of Facts) at No. 139, Exhibits 10, 11 and 12.

⁵⁵ 5/12/08 Hearing Tr. at 259-61 (Joe Faifer).

⁵⁶ DOR 16 (Agreed Stipulation of Facts), Exhibit 11.

⁵⁷ DOR 359 (Smith Report) at 71-73

⁵⁸ DOR 359 Report of Professor James L. Smith at 26-28.

⁵⁹ DOR 359 Report of Professor James L. Smith at 26-28.

⁶⁰ DOR 359 Report of Professor James L. Smith at 28-29.

⁶¹ DOR 359 Report of Professor James L. Smith at 30-31.

⁶² *Container*, 463 U.S. at 180.

⁶³ *Container*, 463 U.S. at 180 (citing *Exxon*, 447 U.S. at 224).

business, in the form of shared or integrated business activities that would not occur if the segments were performing all business functions autonomously.⁶⁴

The Alaska Supreme Court has looked for evidence of functional integration in the parent's provision of shared administrative services such as tax preparation and insurance coverage; evidence of financial management and cooperation, such as limits on a subsidiary's capital expenditure without the parent's approval; integrated finances, such as a parent's involvement in the finances of a subsidiary by making direct loans to the subsidiary and acting as a guarantor on loans and other obligations; and other flows of value from integration, including the movement of goods from one business segment to another.⁶⁵ The Alaska Supreme Court has also found evidence of functional integration in the establishment of shared employee compensation plans, company pay scales, and retirement plans.⁶⁶

The Alaska Supreme Court has held that no highly integrated flow of business between the business entities is required to find that a business is unitary.⁶⁷ During the Audit Period, there was evidence of significant functional integration of the types that Alaska Supreme Court has held are indicative of a unitary business. Although there was no flow of goods between Tesoro's business segments, the Alaska Supreme Court has held that while a flow of goods is indicative of functional integration, the lack of such flows does not disprove that there is not sufficient functional integration to support a finding that a business is unitary.⁶⁸

As with centralization of management, Tesoro's business segments appear to have been organized to take advantage of functional integration in areas where Tesoro's management team had determined that such integration would create factors of profitability. Tesoro's business segments were not performing its business functions autonomously and independently of each other and the parent company.

While centralization of management creates flows of value from a parent to subordinate business segments through such factors as the transfer of operational expertise, or through profitability that is attributable to control and coordination, functional integration creates flows of value between business segments by factors such as reducing redundant efforts and pooling resources. There are, however, elements of both functional integration and centralized

⁶⁴ *Id.*

⁶⁵ *Alaska Gold*, 754 P.2d at 251-252.

⁶⁶ *Earth Resources*, 665 P.2d at 969.

⁶⁷ *Id.* at 968.

⁶⁸ *Id.*

management in areas where management is both shared and centralized or where shared centralized services facilitate a parent's control of, and the transfer of expertise services to, subordinate segments, while reducing duplicative effort and increasing opportunities to share resources.

Evidence of centralized management may, therefore, also be evidence of functional integration, as in the case of the functional integration between Tesoro's business segments that was evidenced by integration of management functions such as budgeting and planning. Tesoro's current year budgeting and longer term strategic planning regarding whether the operations of certain subsidiaries would grow or shrink was "integrated at the top corporate level."⁶⁹ Tesoro's top management initiated, defined the scope of, formulated guidelines for, and otherwise determined the scope of planning and budgeting for all subsidiaries.⁷⁰ After these guidelines were set, Tesoro applied a "bottom-up budgeting approach".⁷¹ The operating subsidiaries formulated a budget consistent with a budgeting plan and sent it to the central planning office.⁷² All of the budgets were then pulled together into a consolidated budget and representatives from all of the subsidiaries would come together for a meeting.⁷³ There was extensive discussion and review of the budgets with the TPC Board prior to final approval.⁷⁴

Once the budget was approved, each operating subsidiary filled out a "report card," on a monthly basis, with its actual operating results compared to the budget, noting any variances.⁷⁵ The report card contained detailed "operating physical information" as well as financial information.⁷⁶ Top management reviewed the information to see whether the approved budget required any changes.⁷⁷ The report cards were all consolidated into one report which was then shared with all subsidiaries.⁷⁸

Another centralized integrated function in Tesoro was corporate-wide planning and execution of financial strategies.⁷⁹ Tesoro's business segments jointly guaranteed major loans or

⁶⁹ DOR 359 (Smith Report) at 173.

⁷⁰ DOR 359 (Smith Report) at 275-80.

⁷¹ DOR 359 (Smith Report) at 174. 5/14/08 Hearing Tr. at 256.

⁷² 5/13/08 Hearing Tr. at 174 (Dr. James L. Smith).

⁷³ 5/13/08 Hearing Tr. at 175.

⁷⁴ 5/13/08 Hearing Tr. at 175-88; 280 (Dr. James L. Smith).

⁷⁵ 5/13/08 Hearing Tr. at 189.

⁷⁶ 5/13/08 Hearing Tr. 189-93.

⁷⁷ 5/13/08 Hearing Tr. at 192 & 202-03.

⁷⁸ 5/13/08 Hearing Tr. at 193.

⁷⁹ 5/13/08 Hearing Tr. at 196 (Dr. James L. Smith).

“credit facilities” during the audit period.⁸⁰ CEO Smith explained that the purpose of these credit facilities was to keep the entire corporation going and that the credit facilities were not dedicated to a particular business segment.⁸¹ Tesoro’s central management used the funds obtained from the major credit facilities to finance purchases by individual subsidiaries as well as to provide working capital for general corporate purposes.⁸² The heads of R&M and E&P were not involved in obtaining financing to fund their operations because these functions were performed by CEO Smith, Mr. Van Kleef and the corporate finance department.⁸³

Tesoro’s management of cash was also centralized and integrated.⁸⁴ Various bank accounts were used during the course of the audit period to receive customer remittances.⁸⁵ However, at any one time, a single, shared bank account was used to receive remittances from customers of all the subsidiaries.⁸⁶ Funds belonging to the respective subsidiaries were all directed to the same account so that these funds were available to fund the working capital needs of all Tesoro subsidiaries.⁸⁷

The Division showed that Tesoro and its segments shared centralized environmental, safety, financial reporting, computer services and technology, internal audit, legal affairs, planning and budgeting, insurance/risk management services, tax strategies, purchasing and other services. Although the subsidiaries were charged for some of these service, it cannot be reasonably disputed that these centralized shared services resulted in significant flows of value that could not be, and were not, accurately quantified by the transfer pricing charges posted to Tesoro’s segments for these services.⁸⁸

The centralized services provided through the ASA did not just show centralized management. Because the functions provided by these services were shared by Tesoro’s business segments these centralized integrated services also show functional integration. TPCI provided services to all Tesoro subsidiaries under the ASA.⁸⁹

⁸⁰ 5/13/08 Hearing Tr. at 196-197(Dr. James L. Smith).

⁸¹ 5/9/08 Hearing Tr. at 118. (Bruce Smith)

⁸² DOR 359 (Smith Report) at 60-67; 5/14/08 Hearing Tr. at 189-90 (Dr. James L. Smith).

⁸³ 5/13/08 Hearing Tr. at 197-198 (Dr. James L. Smith).

⁸⁴ 5/13/08 Hearing Tr. at 268-72; 5/14/08 Hearing Tr. at 7-11 (Dr. James L. Smith).

⁸⁵ 5/13/08 Hearing Tr. at 270.

⁸⁶ 5/13/08 Hearing Tr. at 270.

⁸⁷5/13/08 Hearing Tr. at 10, 41 (William Van Kleef); DOR 359 (Smith Report) at 49-51.

⁸⁸ DOR 359 (Smith Report).

⁸⁹ DOR 359 (Smith Report) at 22-60. *See generally* 5/13/08 and 5/14/08 Hearing Tr. (testimony of Dr. James L. Smith).

TPCI's centralized human resources provided the administrative activities and record-keeping associated with workers' compensation, EEOC filings, fringe benefits, pensions and retirement plans in which virtually all subsidiaries participated.⁹⁰ Uniform stock option plans were offered, and end-of-year bonus awards and other incentive compensation plans were collectively administered and made available to all Tesoro employees.⁹¹ TPCI conducted salary surveys and issued salary guidelines for all subsidiaries, and deviation from such guidelines required approval from TPCI.⁹²

Other centralized integrated functions included environmental and safety activities, accounting, financial reporting, computer services and technology, internal audit, legal affairs, planning and budgeting, insurance/risk management services, tax strategies, purchasing, and other services.⁹³ Accounting was also centralized and integrated, even though both E&P and R&M had some specialized accounting functions that were handled by their own accounting departments.⁹⁴ TPCI maintained a general ledger with accounts for all of the subsidiaries, regardless of whether the accounting was done on the specialized R&M and E&P systems or the general system.⁹⁵

Tesoro argues that the lack of functional integration between its segments, particularly its E&P and R&M segments, distinguishes Tesoro's business structure from the companies in which U.S. Supreme Court has upheld a unitary finding. In making this argument, Tesoro again focuses on the limited exchange of products or expertise between its segments. Tesoro again minimizes the significance of flows of value that ran through Tesoro to the segments such as cash flow and loan guarantees. Tesoro minimizes the significance of flows of value that ran from Tesoro to the segments from management expertise. Tesoro argues that elements of vertical or horizontal integration were necessary to make a unitary finding and that DOR failed to give adequate weight to Tesoro's lack of vertical or horizontal integration.

A unitary business consists of similar enterprises operating separately in various jurisdictions but linked by common managerial or operational resources that produce economies of scale and transfers of value.⁹⁶ The significance of vertical or horizontal integration in the case

⁹⁰ 5/13/06 Hearing Tr. at 252-55 (Dr. James L. Smith).

⁹¹ DOR 359 (Smith Report) at 33-36.

⁹² DOR 359 (Smith Report) at 34-35.

⁹³ DOR 359 (Smith Report) at 37-49; 52-60; *see generally* 5/13/08 Hearing Tr. at 172-300 (Dr. James L. Smith).

⁹⁴ DOR 359 (Smith Report) at 39-43.

⁹⁵ DOR 359 (Smith Report) at 260-61.

⁹⁶ *Container*, 463 U.S. at 166.

law is that there are likely to be significant unquantifiable flows of value between segments of a business that are vertically or horizontally integrated. Vertical or horizontal integration are therefore indicators of a unitary business, but vertical or horizontal integration (except in the sense that all flows of value are a form of vertical or horizontal integration) is not required.⁹⁷

Tesoro correctly points out that there were not significant flows of product or personnel directly between E&P and R&M. Furthermore, despite the Division's point that the both E&P and R&M fit under its regulatory definition of "petroleum business" as oil and gas businesses, it cannot be denied that E&P was a gas business, while R&M was an oil business, and that the two segments were in many ways dissimilar.⁹⁸ The most significant result of this dissimilarity, for the purpose of a unitary analysis, is that there were not many of the common types of flows of value directly between E&P and R&M that one would expect to see in a company with vertical or horizontal integration. DOR correctly admits this, but this is not a particularly costly admission. Although there was not a substantial flow of goods between Tesoro's E&P and R&M segments, those segments were similar enough to realize significant flows of value from functional integration.⁹⁹ These flows of value went from TPC to each of its segments in the form of integrated management functions, and more directly between the segments in the form of shared cash flow, loan grantees and shared services.¹⁰⁰

F. Economies of Scale

Evidence that business segments benefited from economies of scale through their affiliation with each other and or the parent is the last of the three factors in a unitary business that create unquantifiable flows of value or profitability. The Alaska Supreme Court has looked for evidence of economies of scale in reduced costs of borrowing through using combined assets to secure loans, realizing scale economies by getting better rates through consolidated purchasing in areas such as insurance coverage and car leasing, and economies that result from a parent's provision of administrative and management services to subsidiaries.¹⁰¹

⁹⁷ *Container*, 463 U.S. at 967-70.

⁹⁸ Expert Report of James Smith.

⁹⁹ See *Alaska Gold*, 754 P.2d at 252 n.8 ("The Supreme Court held that a bright line test for unitariness based solely on a flow of goods was improper. The Court never suggested that an examination of the flow of goods was not a relevant consideration. In fact, the Supreme Court indicated that the flow of goods could be indicative of an integrated business. '[S]ubstantial inter-dependence can arise in any number of ways; a substantial flow of goods clearly is one but just as clearly not the only one.' *Container*, 463 U.S. at 179, 103 S.Ct. at 2947, 77 L.Ed.2d at 562.").

¹⁰⁰ Testimony of James Smith, Tr. May 13, 2008 at 158-161.

¹⁰¹ *Alaska Gold*, 754 P.2d at 252-253 .

As with functional integration and centralization of management, evidence of economies of scale is important in determining whether different business segments are unitary because the income that is results from these savings cannot be attributed to any particular geographical source.¹⁰²

Tesoro attempted to show that areas where there was lack of integration between its business segments actually caused “diseconomies of scale” by making it difficult for Tesoro to attract shareholder interest and raise capital through the equity markets. Tesoro’s expert economist, Dr. Scott Jones, asserted that Tesoro’s stock was discounted by analysts because the lack of horizontal and vertical integration between the E&P and R&M segments confused the stock analysts. Dr. Scott Jones asserted that because these analysts failed to understand Tesoro’s business model, any savings in interest paid on debt was offset by the discounted prices Tesoro received when it sold stock to raise capital. In Dr. Jones’s opinion, Tesoro’s costs due to this “equity discount” of Tesoro’s share prices that was attributable to its diversified business segments measured \$20 to \$50 million.¹⁰³ Rather than contradicting the Division’s evidence that there were significant factors of profitability due to economies of scale, functional integration, and centralized management as Tesoro was actually structured and run during the audit period, however, Dr. Jones’s testimony about the equity discount simply compares Tesoro to a company that did not exist until after the sale of the E&P segment. The object of the inquiry into whether business segments were unitary is to discover what economies of scale were realized as a result of those segments coordination that would not have been realized if they acted independently, not to discover potential savings that would have resulted had the segments been more integrated.

CEO Smith also testified regarding his frustration with stock analysts’ inability to understand how the Tesoro’s business segments worked together to create value, and his testimony was very credible. The limitations of the value of the evidence of a share price discount was highlighted by the admissions of CEO Smith in his candid testimony about the cause and significance of the perceived equity discount. When asked if it was his impression that Tesoro shares were being discounted because of the problems with low integration, CEO Smith replied:

¹⁰² *Earth Resources*, 665 P.2d at 970.

¹⁰³ 5/7/08 Hearing Tr. at 160-63 (Scott T. Jones).

Not really. I mean -- I think -- really, the -- I mean, there was low integration, but I wouldn't agree that that was causing the discount. I think it was truly the confusion in the fact that its two different businesses, and the capital needs are so different. I mean, I would have argued with Michael at the time. But it has -- I think that's factually true. We didn't have much in the way -- we weren't really downstream. One refinery doesn't make you a downstream company; it just gives you a downstream asset. And when we created a system, we had a downstream company.^[104]

Thus, CEO Smith perceived that any equity discount was not due to lack of functional integration, but to the lack of downstream production assets, which was remedied by the purchase of more refineries.

When speaking of the motivations for the sale of the E&P segment, CEO Smith again spoke candidly about insignificance of the perceived equity discount to that decision, explaining that Tesoro's continued ability compete successfully in the oil and gas exploration and production area was the deciding factor in the sale. He explained:

On the E&P side, we had two great people. One individual who had found the Bob West Field, but we were competing against a huge number of companies that had bigger staffs, bigger capital and much more prospects in that treadmill game of having prospects to go out and drill so that they can create new value, and we just didn't have the capital to do that.^[105]

* * *

In the sector, by that I mean in the exploration -- independent exploration and production sector. There are way too many companies and there were many more that were good at the business and we were going to be an also ran. So the decision, in my view, was about separating where we could be successful versus where we couldn't be successful. Had nothing to do with pleasing analysts. That was an ancillary benefit.^[106]

Of course, if CEO Smith was correct in this view, the perception in the stock market that Tesoro made the right call in removing itself from the competition in the oil and gas exploration and production area when it announced the sale of E&P is likely to have had more influence on Tesoro's share price than the mere reduction in diversification that would result from the sale. Even if the evidence of depressed share prices due to diversification was more convincing, it would not contradict the evidence of functional integration and resulting economies of scale presented by the Division. At best it shows that Tesoro was more integrated after it sold E&P and acquired two more refineries.

¹⁰⁴ 5/9/08 Hearing Tr. at 58:1-16.

¹⁰⁵ 5/9/08 Hearing Tr. at 48:11-18.

¹⁰⁶ 5/9/08 Hearing Tr. at 142:4-14.

Tesoro obtained significant economies of scale through centralized and integrated services.¹⁰⁷ Tesoro also obtained significant economies of scale from collective financing of its operations.¹⁰⁸ Tesoro avoided redundant costs of negotiating separate loans.¹⁰⁹ Mr. Van Kleef also recognized that Tesoro’s increased access to capital markets stemmed from the “size/scale” of its overall business and its “diversified asset and revenue base.”¹¹⁰ Dr. Smith estimated that Tesoro experienced approximately \$30 million in interest savings through its shared credit facilities.¹¹¹

Tesoro also ignores obvious management cost savings it achieved by its centralized shared services. It is less costly to set and enforce policy for the areas where services are shared when those services are centralized under the control of top management, than it would be to exert the same level of standardization and control over those operations if each segment provided those services for itself. The fact that Tesoro choose to use in-house centralized shared services, rather than allow or require its segments to provide these services themselves or obtain these service from a third party, is an indication that Tesoro itself believed requiring the use of these in-house centralized shared services was generating economies of scale.¹¹²

G. Flows of Value

As discussed above, three factors of profitability, centralized management, functionally integration and economies of scale, arise from the operation of a unitary multistate business. When these factors create flows of value between the components of a single of a unitary business that go beyond the mere flow of funds arising out of a passive investment or a distinct business operation, a unitary finding is appropriate. It is these flows of value, which are not capable of precise identification or measurement, which make formula apportionment a reasonable method of taxation.¹¹³

One of the Division’s experts, Dr. Smith, identified both quantifiable and unquantifiable flows of value between Tesoro’s business segments that resulted from the centralized management, functional integration and scale economies. Dr. Smith also estimated \$100 million

¹⁰⁷ DOR 359 (Smith Report) at 67-68; 5/14/08 Hearing Tr. at 24-25 (Dr. James L. Smith).

¹⁰⁸ DOR 359 (Smith Report) at 60-67.

¹⁰⁹ 5/14/08 Hearing Tr. at 12-13; 17-19 (Dr. James L. Smith).

¹¹⁰ DOR 359 (Smith Report) at 62.

¹¹¹ 5/14/08 Hearing Tr. at 18-22 5/14/08 Hearing Tr. at 84-92, 95-97 (Dr. James L. Smith).

¹¹² See Testimony of Richard Pomp, Tr. May 15, 2008 97:14-17.

¹¹³ *Container 423 U.S. 159, 166.*

in flows of value from TPCI to the operating subsidiaries in the form of the services provided to them through mandatory participation in the Administrative Services Contract.¹¹⁴

Other significant flows of value to the operating subsidiaries were the management and the operational expertise provided by CEO Smith and his management team.¹¹⁵ Value flowed between the businesses segments from savings that were realized from the centralized cash flow system, in which money was collected centrally and then distributed back out to the operating subsidiaries without interest or other charges, and from the shared credit facilities.¹¹⁶

The extensive transfer pricing that Tesoro engaged in through mandatory participation in the Administrative Services Contract can not be accurately quantified even though these transfers were given a price for accounting purpose.¹¹⁷ Dr. Smith detailed numerous forms of transfer pricing in which Tesoro transferred value from one subsidiary to another.¹¹⁸ Both Professor Pomp and Dr. Smith described the extensive flows of value between Tesoro's business segments from centralized management, functionally integration and economies of scale in their testimony and reports.¹¹⁹ These flows of value go far beyond the flow of funds that would arise from a passive investment or mere ownership of a distinct business operation.

V. Bob West Field

Tesoro presented evidence at the hearing on the limits of Tesoro's executive management team's involvement in the operational activities for the Bob West Field (BWF). Tesoro asserted that Coastal Oil and Gas Corporation (Coastal) controlled field operations as the production operator, and Coastal had little contact with any of Tesoro's non-E&P affiliates.¹²⁰

The evidence showed that Tesoro's E&P segment participated in deciding where wells should be drilled in the Bob West Field. E&P reviewed Coastal's daily field operations and the financial records relating to them. E&P analyzed Authorities for Expenditures (AFE) to determine whether a proposed expenditure was sufficiently justified that Tesoro should agree to

¹¹⁴ 5/13/08 Hearing Tr. at 243-46, 284-85(Dr. James L. Smith).

¹¹⁵ See, e.g., 5/9/08 Hearing Tr. at 6-7 (Bruce Smith); 5/14/08 Hearing Tr. at 124-25 (Dr. James L. Smith); 5/15/08 Hearing Tr. at 87 (Prof. Richard Pomp).

¹¹⁶ 5/14/08 Hearing Tr. at 22-24 & 5/13/08 Hearing Tr. at 244 (Dr. James L. Smith).

¹¹⁷ 5/14/08 Hearing Tr. at 26-51 (Dr. James L. Smith).

¹¹⁸ 5/14/08 Hearing Tr. at 26-51 (Dr. James L. Smith). 5/14/08 Hearing Tr. at 26-51. Tesoro's transfer prices fail any sort of market test. 5/13/08 Hearing Tr. at 159-60 (Dr. James L. Smith). DOR 359 (Smith Report) at 71, n. 198. DOR 359 (Smith Report) at 69-76.

¹¹⁹ 5/13/08 Hearing Tr. at 158-60 (Dr. James L. Smith); see also 5/15/08 Hearing Tr. at 60-62 (Prof. Richard Pomp); DOR 842 (Pomp Report) at 20; DOR 359 (Smith Report) at 7-95.

¹²⁰ 5/6/08 Hearing Tr. at 109-10 (Tesoro Opening Statement); Tesoro's Pretrial Brief at 11.

pay 70% of the cost. E&P was involved in arranging sales for all of the gas that Tesoro received in kind from the BWF. E&P and TPC were involved in hedging those sales transactions to produce a less volatile cash flow. E&P and TPC were involved in the operations of BWF to make timely decisions to sell units within the BWF rather than continuing to develop them.

The BWF was named after Tesoro's founder, Bob West. Shortly after acquiring the property on which the BWF was located but before discovering natural gas on this property, Tesoro assigned thirty percent of its interest in certain property to Coastal. In turn, Coastal assigned seventy percent of other property in this area to Tesoro, essentially giving Tesoro a 70% interest in all of the property jointly held with Coastal that eventually came to be known as the BWF and which was divided up into units A through F.¹²¹

Tesoro and Coastal entered into an operating agreement to explore for and develop oil and gas interests within the BWF. Originally, Tesoro was the "Operator" and Coastal was the "Non-operator" and holder of a minority working interest.¹²² During the drilling of its first well in the BWF, Tesoro hit gas. The BWF was one of the largest gas reserves discovered in Texas. Coastal ask to take charge of development and production of BWF.¹²³ Tesoro agreed. Coastal became the "production operator." Tesoro retained the "geological operator" role.¹²⁴ Coastal served as production operator from December 1991 until 1995.¹²⁵ According to John Bissell, the geologist who discovered the BWF for Tesoro and remained responsible for E&P's day-to-day exploration operations until Tesoro sold its E&P business in 1999, Tesoro agreed to this arrangement because Coastal had a large staff skilled in drilling the type of wells needed in South Texas, while Tesoro would have had to increase its staff to adequately conduct the day-to-day drilling operations.¹²⁶

Tesoro justifiably believed that it had a much greater understanding of the geology of the BWF and where gas was most likely to be found than Coastal did.¹²⁷ As "geological operator"

¹²¹ See, e.g., DOR 34 (Expert Report of Michael D. Kotowski ("Kotowski Report")), and maps and documents cited therein; 5/13/2008 Hearing Tr. at 77-80 (Michael D. Kotowski). While Coastal and Tesoro maintained their 30/70 division as between themselves on units A through F, Tesoro's interest in the B unit as a whole was approximately 52% because other third parties also held an interest in this property. DOR 34 (Kotowski Report) at 7-8.

¹²² DOR 39 (9/20/89 Operating Agreement); Bissell Deposition at 20.

¹²³ Deposition of John Elzner ("Elzner Deposition") at 20-21; DOR 34 (Kotowski Report) at 8-9.

¹²⁴ Bissell Deposition at 59-63.

¹²⁵ DOR 54 (1991 Modification of Operatorship); DOR 284 (9/26/95 Termination of Modification of Operatorship).

¹²⁶ Bissell Deposition at 23, 27-28.

¹²⁷ *Id.* at 56-57.

from 1991 to 1995, Tesoro retained significant control over exploration activities.¹²⁸ Tesoro remained responsible for evaluating geological and geophysical data. Tesoro was responsible for proposing and conducting additional seismic operations. Tesoro was responsible for proposing new wells and awarding bids for electric and mud logging.¹²⁹

In 1995, Tesoro believed that the C – F units of the BWF would not be as profitable as they had been in the past, while Coastal valued the future prospects on the C – F units more than Tesoro. On March 1, 1995, Tesoro sold its interests in the C – F units of the BWF to Coastal, realizing a gain of approximately \$64 million from this sale. As a condition of this sale, Tesoro gave up its “geological operator” role. Coastal became the sole operator of Tesoro’s remaining operations in the A and B units in the BWF. E&P became just a majority working interest owner in the two units in which it retained an interest.¹³⁰

As majority working interest owner of the A and B units, E&P continued to manage its interests in the BWF. E&P continued to participate in all major decisions concerning the field.¹³¹ E&P continued to receive and review daily drilling, completion and production reports from the field, and to attend operator’s meetings where drilling results, future expenditures, drilling schedules, recompletions, workovers, regulatory issues and future drilling sites were all discussed.¹³² E&P continued to market its share of the gas produced in the BWF, as the operating agreement required E&P to take its share of gas in kind.¹³³

Tesoro engaged in substantial hedging and related practices designed to insure an even cash flow from its production interests.¹³⁴ E&P continued to make its own decisions on the variety of AFEs that Coastal proposed. E&P was to be responsible for seventy percent of all of the costs of an AFE that Coastal proposed in which E&P affirmatively decided to participate, but would not be responsible for any costs for an AFE that it rejected.¹³⁵

¹²⁸ *Id.* at 42, 48-49, 55-56.

¹²⁹ *See* DOR 54 (1991 Modification of Operatorship) at 4-5.

¹³⁰ Bissell Deposition at 59-66. At the time of the sale, most of the future drilling was going to be on the C through E units, as substantial numbers of wells had already been drilled on the A and B units. *Id.* at 61-63.

¹³¹ 5/13/08 Hearing Tr. at 77, 100-01 (Michael Kotowski); 5/13/08 Hearing Tr. at 160-61, 5/14/08 Hearing Tr. at 64-73, and 5/15/08 Hearing Tr. at 13-14 (Dr. James L. Smith).

¹³² 5/13/08 Hearing Tr. at 77, 86-87 (Michael Kotowski); 5/5/08 Hearing Tr. at 195-96 (John Elzner); Elzner Deposition at 88-92.

¹³³ 5/13/08 Hearing Tr. at 92 (Michael Kotowski). While Coastal had previously marketed some of Tesoro’s gas in exchange for a fee of a penny per MCF, that arrangement ended in 1995 when Tesoro took over all of its own gas marketing. Deposition of Thomas Flowers (“Flowers Deposition”) at 23.

¹³⁴ Flowers Deposition at 26-32; Van Kleef Deposition at 131-32, 139-46; Oliver Deposition at 99-101; 5/13/08 Hearing Tr. at 64-65 (William Van Kleef).

¹³⁵ DOR 34 (Kotowski Report) at 22-23; Bissell Deposition at 74-76.

Tesoro received two additional payouts in 1996 totaling approximately \$127 million related to its interests in a contract with the Tennessee Gas Pipeline Company affecting the A and B units of the BWF.¹³⁶ The A and B units were subject to the long term “take-or-pay” contract under which Tennessee Gas was required to pay a price set by a contractual formula for all of the gas produced on those units.¹³⁷ Tesoro acquired its interest in the A and B units by bankrolling litigation against the prior lessee, and getting the right to develop these units with Coastal as part of the settlement of that litigation.¹³⁸ Tesoro then proceeded to drill a number of extremely successful wells on the A and B units, which greatly increased the amount of gas that Tennessee Gas was contractually obligated to take.¹³⁹

As the formula in the contract required Tennessee Gas to pay a significantly over-market price for these gas volumes, the take-or-pay contract’s terms were significantly disadvantageous to Tennessee Gas, and it filed suit in 1990 seeking relief from its obligations.¹⁴⁰ After protracted litigation, Tennessee Gas lost in the Texas Supreme Court and in 1996 paid Tesoro \$67.7 million as additional compensation for prior gas purchases under the take-or-pay contract.¹⁴¹

Shortly thereafter, Tennessee Gas agreed to a buy out of its remaining future obligations under the contract, and Tesoro received yet another large payment from Tennessee Gas. The payment was \$51.8 million in income plus the right to recover severance taxes of \$8.2 million, in return for its cancellation of the remainder of the take-or-pay contract.¹⁴² This settlement was in addition to the \$64 million in income from the sale of the C – F units of the BWF in 1996.

Dr. Smith explained Tesoro’s active involvement in managing the primary risks associated with the BWF and E&P.¹⁴³ Dr. Smith explained that the three primary risks E&P’s ownership of its interest in the BWF presented were market risk, such as volatile pricing interfering with predictable cash flow, geological risk, such as unexpected disruptions because the company has misjudged where the gas is located or how much of the gas can be recovered, and operator risk, such as operator mistakes leading to higher costs or reservoir damage.¹⁴⁴ Tesoro dealt with the market risk by hedging some of its production through decisions made by a

¹³⁶ DOR 16 (Agreed Stipulation of Facts), Nos. 182, 184.

¹³⁷ DOR 16 (Agreed Stipulation of Facts at Nos. 175, 184).

¹³⁸ 5/13/08 Hearing Tr. at 79-80 (Michael D. Kotowski).

¹³⁹ DOR 16 (Agreed Stipulation of Facts), No. 178.

¹⁴⁰ *Id.* at No. 179.

¹⁴¹ *Id.* at Nos. 181-82.

¹⁴² *Id.* at Nos. 183-84.

¹⁴³ DOR 359 (Smith Report) at 107-15; 5/14/08 Hearing Tr. at 65-72 (Dr. James L. Smith).

committee that included both E&P employees and top management from the parent.¹⁴⁵ Tesoro dealt with geological risk by making sure that it had the best geological and geophysical knowledge of the area in which drilling would occur, as well as trying to diversify its holdings in subsequent years so that it was not so dependent on a single field.¹⁴⁶ Tesoro dealt with operator risk by relinquishing the day-to-day production operator responsibilities to Coastal on the basis of information that Coastal could drill the wells more efficiently.¹⁴⁷

A. Income from Bob West Field Apportionable

Tesoro argues that the Division should not have included the Bob West Field joint ventures in a single unitary business with R&M because Tesoro's lack of control over the joint ventures precluded functional integration, centralization of management, and economies of scale. Tesoro, however, maintained contractual control over the location of wells to be drilled because Tesoro correctly believed that it had a much greater understanding of the geology of the BWF. E&P and TPC's executive management team were also closely involved in the hedging decisions that added to the profits E&P made on that field.¹⁴⁸ Dr. Smith explained the importance of these hedging activities, in which not only Mr. Van Kleef and CEO Bruce Smith were closely involved, but also the TPC board in the case of long-term hedging commitments:¹⁴⁹

Now, this was, as you heard Mr. Van Kleef say, this was -- this was big-time. The gas business, you have to understand, is not about producing gas. It's about making money. You don't make money by producing gas; you make money by selling gas. A lot of companies have gone bankrupt producing gas or oil that cost them more than they could sell it for. And that's always a danger in an industry like gas and oil where your product is highly volatile. I mean, any study will show you that gas and oil are the two most volatile commodities. If you measure volatility as I do, and I have my students do, that's absolutely true.^[150]

Finally, Tesoro was actively involved in the Tennessee Gas litigation. The Division showed that Tesoro actively managed its interest in the BWF. The Division correctly apportioned the income that Tesoro received from its interests in BWF, including income from

¹⁴⁴ 5/14/08 Hearing Tr. at 66-68 (Dr. James L. Smith).

¹⁴⁵ 5/13/08 Hearing Tr. at 62-64 (William Van Kleef); Van Kleef Deposition at 145-46; 5/14/08 Hearing Tr. at 68 (Dr. James L. Smith).

¹⁴⁶ 5/14/08 Hearing Tr. at 69-71 (Dr. James L. Smith); 5/13/08 Hearing Tr. at 90-91 (Michael D. Kotowski).

¹⁴⁷ 5/14/08 Hearing Tr. at 71 (Dr. James L. Smith); 5/13/08 Hearing Tr. at 83-84 (Michael D. Kotowski).

¹⁴⁸ 5/13/08 Hearing Tr. at 61-66 (William Van Kleef).

¹⁴⁹ Flowers Deposition at 26-32; Van Kleef Deposition at 131-32, 139-46; Oliver Deposition at 99-101; 5/13/08 Hearing Tr. at 64-65 (William Van Kleef).

¹⁵⁰ 5/13/08 Hearing Tr. at 227 (Dr. James L. Smith).

the sale of the C – F units and from resolution of disputes with Tennessee Gas as to the single unitary business that included Tesoro’s R&M segment in Alaska.

B. Income from Bob West Field was Business Income

Tesoro argues that the BWF income should be excluded from its apportionable income base because this income is not properly characterized as “business income” under the statutory test.

“Business income” under AS 43.19.010 Article IV(1)(a), includes:

Income arising from transactions and activity in the regular course of taxpayer’s trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations.

“Business income” and nonbusiness income are further defined by regulation.15 AAC 19.011 provides:

Business and nonbusiness income - application of definitions

(a) The following subsections in this section are rules for determining whether particular income is business or nonbusiness income.

(b) Rents from Real and Tangible Personal Property. Rental income from real and tangible personal property is business income if the property with respect to which the rental income was received is used in the taxpayer's trade or business or is incidental to it and, therefore, is includable in the property factor under 15 AAC 19.141 and 15 AAC 19.151.

(c) Gains or Losses From Sales of Assets. Gains or losses from the sale, exchange, or other disposition of real or tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business. However, if that property was used for the production of nonbusiness income or otherwise was removed from the property factor before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income. See 15 AAC 19.141 and 15 AAC 19.151.

(d) Interest. Interest income is business income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible is related to or incidental to those trade or business operations.

(e) Dividends. Dividends are business income where the stock with respect to which the dividends are received arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the stock is related to or incidental to those trade or business operations.

(f) Patent and Copyright Royalties. Patent and copyright royalties are business income where the patent or copyright with respect to which the royalties were received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the patent or copyright is related to or incidental to those trade or business operations.

Tesoro used its interest in the C – F units in its business to generate income. The escrow income Tesoro received from the Tennessee Gas litigation was income that Tesoro was owed from prior gas sales. Income from the buyout of the future obligations under the Tennessee Gas contract was effectively the reduction of future income to a present lump sum. All of these assets, when owned by Tesoro, were used its business. The dispositions of these assets were transactions in the regular course of Tesoro's business. The Division correctly included this income in Tesoro's apportionable base.

C. Sales Apportionment Factor

Tesoro also argues that even if Tesoro, including its E&P and R&M segments, is unitary, the Division made errors in its sales factor calculation for tax years 1995 and 1996. Tesoro argues that the Division's calculation of Tesoro's 1995 and 1996 sales factor unjustifiably excluded approximately \$128 million of E&P's out-of-state gross revenues from the sales factor denominator, resulting in a higher amount of income being apportioned to Alaska.

Tesoro points out that while the Division included litigation settlement from the Tennessee Gas in the sales factor denominator, but the buyout proceeds from the sale of C, D, and E units of the Bob West Field were not included.¹⁵¹ The Tennessee Gas litigation settlement were the escrowed amounts, that is the difference between what Tennessee Gas had Tesoro paid for the gas and the contract price they were ultimately ordered to pay. The buyout proceeds were the payment Tennessee Gas made for the rest of the revenue stream at the contract price if the contract had gone to conclusion.

The Division excluded Tesoro's income from the sale of its interest in the C, D, and E units of the Bob West Field the buyout proceeds from the sales factor, but included all of the income from the Bob West Field, including that which resulted from the litigation and unit sale, as "business income" subject to tax in Alaska. The fact that all of this income was apportionable

¹⁵¹ DOR 4 (Informal Conference Decision), pages 55-61.

does not mean that it has to be included in the sale factor. As Ms. Wilson pointed out in her testimony, income that is apportionable can be excluded from the sales factor.¹⁵²

The Division relied on Alaska Regulation 15 AAC 19.302(a) in excluding sale of the BWF C, D, and E units.¹⁵³ Tesoro argues these were not the types of sale that are covered by the exclusions in 15 AAC 19.302.

15 AAC 19.261 sets out the income that should be included in the denominator of the sales factor:

The denominator of the sales factor must include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business, except receipts excluded under 15 AAC 19.302.

The exclusion that the Division argues covers the proceeds from the sale of the BWF C, D, and E units is set out in 15 AAC 19.302(a), which provides:

(a) Where substantial amounts of gross receipts arise from an incidental or occasional sale of a fixed asset used in the regular course of the taxpayer's trade or business, those gross receipts must be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.

Substantial amounts of gross receipts from the incidental or occasional sale of a fixed asset, such as the sale of the BWF C, D, and E units, are excluded in order to limit wide swings in the sales factor from one year to the next from unique events that do not reflect the taxpayer's usual level of business activity. Tesoro's interest in the BWF C, D, and E units was a fixed asset used in the regular course of its business. The Division therefore correctly excluded the income from the sale of the BWF C, D, and E units from the sales factor in accordance with 15 AAC 19.302(a).

In contrast, the Division's exclusion of Tesoro's income from the payment Tennessee Gas made for its liability for purchasing the projected gas production from those units at the contract price was not in accordance with 15 AAC 19.302. This payment could not be characterized as even a partial sale of a fixed asset, excludable under 15 AAC 19.302(a) because Tesoro was still able to sell the gas from those units. Instead, the Division relied on Alaska Regulation 15 AAC 19.302(d) in excluding the buyout payment.¹⁵⁴ 15 AAC 19.302(d) provides:

Where business income from intangible property cannot readily be attributed to any particular income-producing activity of the taxpayer that income cannot be assigned to the numerator of the sales factor for any state and must be excluded from the denominator of the sales factor. For example, where business income in the form of

¹⁵² Testimony of Robynn Wilson, Tr. May 12, 2008 169:15- 170:20.

¹⁵³ DOR 4 (Informal Conference Decision) pages 56-59.

¹⁵⁴ DOR 4 (Informal Conference Decision) pages 60-61.

dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures or government securities results from the mere holding of the intangible personal property by the taxpayer, those dividends and that interest must be excluded from the denominator of the sales factor.

Tesoro's contract rights, which were disposed of Tennessee Gas litigation, were excluded by Division under this regulation because Tesoro failed to show that the income from the buyout could be readily attributable to a particular income-producing activity.¹⁵⁵ Under cross examination at the hearing, the Division's auditor Robynn Wilson, provided the following additional explanation of her understanding of the justification for the exclusion:

My understanding, the way UDITPA was developed, there was a focus on property and payroll, and the market states an objection to that, and that's kind of how the sales factor evolved and got in there. An apportionment factor is a measure of activity. You could just as easily, in addition to property and payroll, you could just as easily pick some other measure of activity, such as number of employees in a various jurisdictions. That would be a measure. It so happened that they picked sales. And so the problem with that is, I think, some folks have said, well, that means if there's any income in an apportionable base, then that income has to be in a sales factor, but our view is that that's not -- the view here is for the market state. In the case of the escrowed amounts, those sales had already happened. At the time of the contract buyout, they had not. What they're trying to do there if you do include them in the factor is you're trying to apportion current year income with other-year factors, factors that aren't sort of real, they're not sales that have occurred. So that kind of misstates, I think, the sales factor. That's our view of it. I understand not everyone agrees.^[156]

The problem with the Division's justification for the exclusion is that the income from the buyout can be readily attributed to Tesoro's income from a particular producing activity, namely, the development of the portions of the Bob West Field that were subject to the contract. The economically recoverable reserves that resulted from this development increased the value of Tesoro's contract rights and led to the buyout. The Division may be correct that the result is in conflict with some of the theory supporting the development of the apportionment factors in UDITPA, the sales factor in particular. The Division is correct that including the buyout income would tend to distort the sales factor. The buyout income was unusually large and was qualitatively distinct from the income producing activities that Tesoro usually engaged in during a typical year to produce its income in Texas, but the buyout income is simply not covered by any of the exclusions in 15 AAC 19.302, which uses a limited list of exclusions that are more narrowly drawn than the basis for the Division's exclusion of this income. This contract right

¹⁵⁵ DOR 4 (Informal Conference Decision) page 61.

¹⁵⁶ Testimony of Robynn Wilson, Tr. May 12, 2008 169:15- 170:20.

could not be characterized as a fixed asset. Tesoro's development of the fields covered by the contract created the income from the buyout, and to a degree, Tesoro's aggressive litigation of its rights under the contract was an ongoing source of a large portion of its income during the audit period.

The Division's position that this income was for liabilities for contract obligations that, but for the settlement, would not have been due until future tax years, again merely raises the issue of conflict with the theory supporting the development of the apportionment factors in UDITPA, rather than conflict with the specific language setting out the limited exclusions within 15 AAC 19.302. The buyout proceeds did not result from the mere holding of Tesoro's contract rights, and the regulation does not exclude income that results from the reduction of the value of future rights to their present worth. The buyout proceeds were income from the sale of intangible personal property that should have been included in the sales factor in accordance with 15 AAC 19.301(b)(4).¹⁵⁷

VI. Taxes Paid to Bolivia

Taxpayers who claim a federal tax credit for their foreign taxes have an incentive to characterize foreign taxes paid as "income taxes" under federal law because only foreign "income taxes" are credited under federal law. Taxpayers have the opposite incentive when filing Alaska tax returns because foreign income taxes are not deductible and do not result in a credit. However, the definitions of what constitutes a "foreign income tax" for the purpose of the federal tax credit and the nondeductibility provisions under Alaska law are not the same.¹⁵⁸

The Division added back to Tesoro's adjustable base income \$9.8 million that Tesoro paid to the Bolivian government in 1995, 1996 and 1997 and reported as foreign income taxes on its U.S. federal income returns. Tesoro argues that the Division incorrectly included the \$9.8 million in Tesoro's apportionable income because these payments did not constitute taxes based on or measured by net income.¹⁵⁹

¹⁵⁷ Once found to be applicable to the particular situation, the regulations should control. *See Appeal of Fluor Corporation*, 1995 WL 799363 *4 (Cal. State. Bd. of Equalization).

¹⁵⁸ *See* the Alaska Supreme Courts discussion of taxpayer incentives regarding foreign income tax in *Gulf Oil Corp. v. State, Dept. of Revenue*, 755 P.2d 372, 379-380 (Alaska 1988).

¹⁵⁹ The Division agreed not to include taxes paid by Tesoro to the Bolivian government beginning in November of 1997, because the Division determined that these taxes, paid under the Bolivian government's new hydrocarbon law were a severance rather than an income tax." DOR 4 (Informal Conference Decision) page 67, Tr. DOR 00040068.

Tesoro and the Division provided documents indicating that Tesoro was required to pay the cash wellhead value, adjusted for certain expenses, of 30% of net production to the Bolivian government.¹⁶⁰ The documents indicate that YPF, an agent of the Bolivian government, withheld 30% of Tesoro's share of production in order to make payments to the government in accordance with Bolivia's General Law of Hydrocarbons.¹⁶¹ However, the Division points out that section 14.5 of the Operations Contract between Tesoro and YPF obligates YPF to provide Tesoro with receipts showing the actual amount paid in taxes by YPF on Tesoro's behalf. Tesoro did not provide these receipts.

Tesoro asserts the 30% of production withheld by the government was not adjusted for transportation and conditioning costs or other expenses, but was instead a flat, constant 30% payment of production Tesoro was required to make to the government. The Division responded that Tesoro had only provided internal reports regarding monthly amounts of gas withheld rather than documentation showing the amounts that Tesoro actually paid to the Bolivian government in the form of worksheets, tax forms, or similar documentation, with calculations showing that what Tesoro paid was measured on the basis of a flat percentage of the total gross production.

AS 43.20.072 provides in pertinent part:

Oil and gas producers and pipelines.

(a) All business income of a taxpayer engaged in the production of oil or gas from a lease or property in this state or engaged in the transportation of oil or gas by pipeline in this state shall be apportioned to this state in accordance with AS 43.19 (Multistate Tax Compact) as modified by this section.

(b) A taxpayer's business income to be apportioned under this section to the state shall be the federal taxable income of the taxpayer's consolidated business for the tax period, except that

(1) taxes based on or measured by net income that are deducted in the determination of the federal taxable income shall be added back; . . .

Tesoro asserts that the Division based its decision on Tesoro's failure to produce adequate documentation to demonstrate that these payments to the Bolivian government were based upon gross production rather than net income, but this is only partly correct. The Division based its conclusion not only on the limited documentation provided by Tesoro, but also on a careful review of Tesoro's contract obligations and the relevant Bolivian tax law.¹⁶² Tesoro asserted

¹⁶⁰ Tesoro Bolivia Monthly Production Records, Tr. TES 096. Tesoro Bolivia Monthly Production Records, Tr. TES 0960052, 0960133, 0960182, Bolivia Block XVIII Operations Contract, Tr. TES 0980038 cl. 14.4.

¹⁶¹ Bolivia Block XVIII Operations Contract, Tr. TES 0980037 cl. 14.1.

¹⁶² DOR 4 (Informal Conference Decision) pages 62-68, Tr. DOR 00040063-69.

that it paid 30% of its gross production in kind to the Bolivian government but Tesoro did not show by a preponderance of the evidence that the Division's findings regarding how the taxes were calculated were incorrect.

The Division determined that because these taxes were required to be paid as the cash value of thirty percent of production at wellhead prices, the taxes were based on real prices and market conditions, and the taxes therefore met the requirement that such taxes be based on "actual revenues." The Division also determined that the tax allowed for the deduction of expenses, because the wellhead price calculations were required to include reductions for transportation, conditioning costs, and "other factors which could intervene in the composition of these prices," The Division therefore concluded that the taxes were based on net revenues, and that Tesoro was not allowed a deduction from its apportionable income for these taxes.¹⁶³

Tesoro argues that the adjustments to calculations of the wellhead price are not deductions for expenses, but rather reflects inherent qualities of the produced product that govern its value. In short, Tesoro is arguing that the tax was based on net value rather than net income. Tesoro characterizes what it paid as a tax of 30% of its gross production in kind to the Bolivian government. It would be more accurate, however, to characterize the tax as the net cash value of 30% of Tesoro's net¹⁶⁴ wellhead production.

A tax that is based on a net cash value of a percentage of net production is a tax that is based on net income. The Division analyzes the issue in this way: The fact that the cash value of production is a market value means that the cash value is a measure of the income from the taxpayer's production, and because the tax allows some deductions from the market value for expenses of production, the tax is based on net income.¹⁶⁵ The amount of the tax Tesoro paid was dependent both on the net amount of production and the net value of the product, which is simply another way of calculating a net income from production.

A tax based on actual revenues, where expenses are deductible, is a tax based on net income.¹⁶⁶ While it is possible that these taxes were assessed in a manner that was not based on income or that did not allow any deductions for expenses, Tesoro failed to meet its burden of

¹⁶³ DOR 4 (Informal Conference Decision) pages 66-67, Tr. DOR 00040067-68.

¹⁶⁴ Gas that was flared off or used in production was not included in the calculation.

¹⁶⁵ DOR 4 (Informal Conference Decision) pages 66-67, Tr. DOR 00040067-68.

¹⁶⁶ *Gulf Oil Corp. v. State, Dept. of Revenue*, 755 P.2d 372, 378 (Alaska 1988).

proof to show that it was ultimately required to pay these taxes in a way that was inconsistent with the Division's analysis of the Bolivian tax and inconsistent with the conclusion that it was a tax based on net income. Based on the preponderance of the evidence in the record, the Bolivian tax was a tax based on net income.

VII. Penalties and interest

In its post hearing briefing, Tesoro argues that the negligence and failure-to-pay penalty assessed by the Division should be abated.¹⁶⁷ The Division incorrectly implied that its assessment of the negligence penalty is discretionary and could only be overturned if there was no rational basis for the assessment. The Division does not have any discretion to assess the penalty, however, unless the requirements for the additional penalty are met. A taxpayer may therefore have the penalty overturned if the preponderance of the evidence in the record does not show that the deficiency was due to at least negligence. Abatement for the negligence penalty therefore merely requires showing that the late filing or payment was not due to the taxpayer's negligence. The Alaska Regulation for this penalty provides:

15 AAC 05.220. Additional penalty for negligence or intentional disregard

- (a) A negligence-or-intentional-disregard penalty will, in the department's discretion, be assessed in addition to a penalty for failure to file, failure to pay, or civil fraud.
- (b) If it is determined by the department that a tax deficiency or part of a tax deficiency is due to negligence or intentional disregard of a law or a regulation without intent to defraud, then a penalty of five percent will be assessed and collected. The penalty is computed on the total amount of the tax deficiency, even if the determination relates to only a part of the deficiency.
- (c) Negligence is the failure to do something which a prudent and reasonable person, guided by those considerations which ordinarily regulate the conduct of human affairs, would do; it is also doing something which a prudent and reasonable person would not do.
- (d) Intentional disregard of a law or a regulation without intent to defraud is the failure to comply with governing laws and regulations when the taxpayer has knowledge of the pertinent laws and regulations and does not have specific intent to evade the payment of tax. An error or honest difference of opinion does not constitute intentional disregard.
- (e) Negligence or intentional disregard may be demonstrated by any relevant evidence, including but not limited to the following:

¹⁶⁷ Tesoro appears to have waived any challenge to the Division's assessment of interest as only the issue of the negligence penalty was raised in Tesoro's post hearing briefing, although Failure-to-Pay penalties were again raised in Tesoro's response brief. However, to the extent that this issue was not waived, I find that interest was appropriately assessed for the reasons set forth in the Division's briefing.

- (1) the taxpayer has substantially deviated from the statutes or regulations in reporting income or claiming deductions after being advised by the department of the proper methods of reporting;
- (2) the taxpayer has failed to keep adequate records;
- (3) the taxpayer has exaggerated deductions unsubstantiated by facts; or the taxpayer has not justified an understatement of income.

The evidence in the record shows that the Division's determination that Tesoro's deficiency was due to at least negligence was correct. This was a situation where the taxpayer should have timely paid disputed taxes under protest to avoid a negligence penalty. Tesoro's position in this case is very aggressive. This position was not necessarily taken in bad faith. It is understandable that Tesoro should devote significant resources to attempt to limit the added Alaska tax liability that resulted from its acquisition of KPL. However, a reasonably prudent taxpayer in Tesoro's position wishing to avoid interest and penalties would have ascertained the Division's position regarding the impact of that acquisition, or determined its tax liability based on the non-aggressive position of the legal effect of its acquisition of KPL, and timely under protest paid its full disputed tax liability consistent with that position.

Tesoro filed Alaska corporate income tax returns from 1969 through its original 1994 tax return as a single unitary business under AS 43.20.073.¹⁶⁸ Tesoro purchased KPL in March of 1995, which changed Tesoro's Alaska tax status, making it subject to AS 43.20.072.¹⁶⁹ On its original 1995 tax return, Tesoro filed as if E&P and Marine Services were unitary with R&M, but filed claiming that KPL was the only company that was subject to AS 43.20.072.¹⁷⁰ This claim allowed Tesoro to receive preferable tax treatment of intangible drilling costs.¹⁷¹ Auditor Robynn Wilson notified Tesoro that the Division did not agree with this claim in April of 1997.¹⁷² The Tesoro representatives Ms. Wilson dealt with indicated they were aware that the position that KPL was the only company that was subject to AS 43.20.072 was problematic.¹⁷³

A 1994 Tesoro internal memo shows Tesoro's was aware that prior to the purchase of KPL that the purchase would make Tesoro subject to AS 43.20.072, with a higher Alaska tax

¹⁶⁸ 5/10/08 Hearing Tr. at 178, 180-81 (Robynn Wilson).

¹⁶⁹ 5/10/08 Hearing Tr. at 180-81 (Robynn Wilson).

¹⁷⁰ 5/10/08 Hearing Tr. at 182-86 (Robynn Wilson).

¹⁷¹ See DOR 756 (1994 John Moore memo) at 4-5 (acknowledging the difference in treatment).

¹⁷² 5/10/08 Hearing Tr. at 191-95 (Robynn Wilson).

¹⁷³ 5/10/08 Hearing Tr. at 192 (Robynn Wilson); 5/12/08 Hearing Tr. at 4, 6, 224-25, 234-35, 285-86 (Robynn Wilson, Joe Faifer; John Moore).

liability.¹⁷⁴ Tesoro explored several ways to limit this additional Alaska tax liability.¹⁷⁵ At the hearing, John C. Moore, Tesoro's Tax manager, who was ultimately responsible for all taxes related to Tesoro from 1992 to sometime in 1998, was asked about the series of memos he prepared on a monthly basis in 1994 and 1995 regarding activities of Tesoro's tax department. In one of these memos, Mr. Moore explained Tesoro's plan to claim that the Tennessee litigation proceeds were entirely allocable to the State of Texas, and that this claim would be "very aggressive" for Tesoro's Alaska and California filings.¹⁷⁶ At the hearing, Mr. Moore admitted that by "aggressive" he had meant it was likely that an Alaska auditor would propose an adjustment as a result of this claim.¹⁷⁷

In 1996 and 1997, Tesoro also filed as if Tesoro's refinery and related business in Alaska were subject to taxation under AS 43.20.073, with E&P and Marine Services in same unitary group as R&M. Tesoro again claimed that KPL was the only Alaska subsidiary subject to AS 43.20.072.¹⁷⁸ In 1996, Tesoro excluded the Victory Finance and Financial Services Holding Company from the unitary group reporting income on its Alaska 1996 tax returns, taking the position that the Tennessee litigation proceeds and contract buyout were income of Victory Finance Company entirely allocable to the State of Delaware and not taxable by Alaska, California or Texas.¹⁷⁹

The Division's October 1998 audit for 1994–1995 concluded that Tesoro should have included income from the sale of the BWF Units C – F as part of its the worldwide income, that was apportionable to Alaska.¹⁸⁰ Tesoro requested an informal conference to the 1994–1995 assessment. It was during the informal conference process Tesoro first argued to the Division that Tesoro was not a single unitary business.¹⁸¹

Tesoro had filed its original 1998 tax return claiming that KPL and the rest of the R&M companies were two different unitary groups, and that these two groups were separate from the

¹⁷⁴ DOR 756 (1994 John Moore memo).

¹⁷⁵ 5/15/08 Hearing Tr. at 56-59. (Professor Pomp), DOR 763 (6/17/97 memo from Deloitte & Touche to John Moore), 5/12/08 Hearing Tr. at 226-27, 229-30 (John Moore), DOR 842 (Pomp Report) at 5. 5/8/08 Hearing Tr. at 163-64. (John Sherburne).

¹⁷⁶ DOR 766 (1997 Tax Study) at 16-18; 5/12/08 Hearing Tr. At 211& 221-222 (John Moore).

¹⁷⁷ DOR 766 (1997 Tax Study) at 16-18; 5/12/08 Hearing Tr. At 224 (John Moore).

¹⁷⁸ 5/10/08 Hearing Tr. at 201-02, 205-08 (Robynn Wilson).

¹⁷⁹ See 5/10/08 Hearing Tr. at 201-04; 5/12/08 Hearing Tr. at 60-61 (Robynn Wilson).

¹⁸⁰ 5/12/08 Hearing Tr. at 14-16 (Robynn Wilson).

¹⁸¹ 5/12/08 Hearing Tr. at 18-19 & 26 (Robynn Wilson).

rest of Tesoro. In its original 1998 tax return Tesoro again claimed that only KPL was subject to AS 43.20.072.¹⁸²

Income from Tesoro's business segments located outside Alaska was not included on its 1998 Alaska tax return.¹⁸³ On its 1998 California tax return, Tesoro claimed that its business segments were different unitary groups. This claim eventually led to a California Franchise Tax Board audit finding that Tesoro's business segments were not unitary for tax years 1996-1998.¹⁸⁴

The Division concluded in its audit that Tesoro's business segments were a single unitary business assessment for 1996-1998 tax years.¹⁸⁵ The Division also concluded that Tesoro should have included its 1996 income from the Tennessee Gas contract and the subsequent contract buyout to its worldwide apportionable income tax base.¹⁸⁶

The Division issued an addendum to its 1994-1995 assessment concluding that Tesoro was also a single unitary business during 1994 and 1995.¹⁸⁷ Tesoro's appeals for all five tax years were addressed the informal conference decision, issued January 8, 2005, which is the subject of this appeal.¹⁸⁸

Six months after the informal conference decision was issued, Tesoro filed amended tax returns covering the audit period. On its 1994-1998 amended returns, Tesoro claimed that during the audit period R&M, including KPL were one rather than two unitary businesses, but this unitary business was the only unitary business that Tesoro conducted in Alaska.¹⁸⁹

This is not the filing history of a reasonably prudent taxpayer attempting to avoid the penalties that result from deficiencies. Rather, it is the filing history of a taxpayer taking very aggressive filing positions. A reasonable taxpayer taking these positions would expect to pay interest and penalties on any deficiency that would result from the Division's anticipated adjustments unless the taxpayer avoided the deficiency either by paying under protest or ultimately prevailing in defending its filing positions.

The California Franchise Tax Board audit finding for tax years 1996-1998 that Tesoro's business segments were not unitary provides no more support for Tesoro's position that the

¹⁸² 5/12/08 Hearing 19-20(Robynn Wilson).

¹⁸³ 5/12/08 Hearing 19-20(Robynn Wilson).

¹⁸⁴ DOR 846.

¹⁸⁵ 5/12/08 Hearing Tr. at 37-39 (Robynn Wilson); DOR 3 (1996-98 audit narrative).

¹⁸⁶ 5/12/08 Hearing Tr. at 48 (Robynn Wilson).

¹⁸⁷ 5/12/08 Hearing Tr. at 37-39 (Robynn Wilson).

¹⁸⁸ 5/12/08 Hearing Tr. at 56 (Robynn Wilson).

Division should not have assessed a negligence penalty than the finding does for Tesoro's Alaska tax liability.¹⁹⁰ Professor Pomp's analysis of the weight that should be given to that audit finding, and the other evidence in the record the aggressive of Tesoro's position, show that a reasonably prudent taxpayer would have concluded that the better part of valor called for paying Alaska taxes as a unitary business under protest.¹⁹¹ The California Franchise Tax Board audit finding was probably influenced in part on a cost benefit decision by the California auditor not to pick an expensive fight with a taxpayer over a complex tax issue. The finding did not show it was reasonable for Tesoro to expect that it would ultimately prevail with such an aggressive position on the unitary issue in Alaska.

Tesoro simply failed to provide persuasive evidence that a prudent and reasonable person in Tesoro's position, guided by those considerations which ordinarily regulate the conduct of human affairs, and wishing to avoid a penalty, would not have avoided a deficiency by timely paying the disputed taxes under protest.

Similarly, Tesoro's argument that the Failure-to-Pay penalties should be abated also fails because of the aggressiveness of Tesoro's positions and its filing history. Tesoro argues that there was reasonable cause for the deficiencies because AS 43.20.072 is unconstitutional, and because Tesoro's in-house tax professionals consulted with an outside accounting firm, which signed Tesoro's returns.

The failure-to-pay penalties under Alaska Statute 43.05.220(a) must be added unless there was reasonable cause for the failure to pay and file. The definition of "reasonable cause" is found in Alaska Regulation 15 AAC 05.200, which provides:

Reasonable cause for delay

(a) The civil penalty under AS 43.05.220 will not be imposed if the taxpayer shows reasonable cause for delay in filing the return or paying the tax.

(b) A taxpayer who wishes to avoid the penalty established by AS 43.05.220 for failure to file a tax return or pay a tax must make an affirmative showing of all facts alleged as a reasonable cause for her or her failure to file the return or pay the tax on time in a written statement containing a declaration that it is made under penalty of perjury. The statement should be filed with the return or filed with the Department of Revenue as soon as possible thereafter. In determining whether the delinquency was due to reasonable cause and not to willful neglect, the department will apply the administrative and judicial interpretations of Internal Revenue Code § 6651 and the Treasury Regulation

¹⁸⁹ 5/12/08 Hearing Tr. at 56 (Robynn Wilson). 5/8/08 Hearing Tr. at 126 (emphasis added).

¹⁹⁰ See DOR 846. The Narrative Report on the finding was last modified on June 30, 2004.

¹⁹¹ Testimony of Richard Pomp, Tr. May 15, 2008 74:4-12.

§ 301.6651-1(c).

(c) Circumstances which may constitute reasonable cause under AS 43.05.220 include, but are not limited to, the following:

(1) war, riot, rebellion, act of God or other disaster which rendered it impossible to make the filing or payment or which made delay unavoidable in making the filing or payment; or

(2) acts or omissions by a third party which were beyond the control of the person making the filing or payment and which made delay unavoidable in making the filing or payment; or

(3) the person took in good faith all steps and precautions reasonably necessary to ensure the timeliness of the filing or payment.

As discussed in the order granting partial summary adjudication, AS 43.20.072 is not unconstitutional because it provides taxpayers and the Division with the option of using a different methodology in order to avoid an unconstitutional result. The Division granted section 18 relief on its own initiative. Tesoro's deficiency is not the result of Tesoro having timely petitioned for section 18 relief and having had appropriate relief delayed or denied by the Division. Rather, Tesoro's deficiency is the result of Tesoro's failure to timely pay its full tax liability in accordance with Alaska law.

Furthermore, Tesoro has not shown how the outside accounting firm's involvement in Tesoro's filings could be reasonable cause for the deficiency. Reliance on the advice of an accountant or an attorney on a matter of tax law may be reasonable cause for a late tax payment only when the advice was on an issue of tax law that a person who is not a tax professional could not ascertain himself without special training or effort.¹⁹² Tesoro had its own, in house, tax professionals who were involved in its filings during the audit period. Persuading, an outside accounting firm to go along with a very aggressive position is not reasonable cause for a deficiency. As indicated above in the discussion with the negligence penalty, one reasonable step that a taxpayer can take in order to avoid a deficiency when taking an aggressive position is to pay the taxpayer's full liability under protest in accordance with what would be a filing that was unlikely to result in an adjustment.

VIII. Conclusion

Tesoro failed to show that the Division's determination that Tesoro was unitary during the audit period was incorrect. The assessment including interest and penalties is affirmed,

¹⁹² U.S. v. Boyle, 469 U.S. 241, 251.

except for the Division's failure to include the Tesoro's proceeds from the buyout in the Tennessee Gas litigation in the sales factor denominator.

IX. Order

The Division will recalculate Tesoro's tax liability, interest and penalties to conform to the conclusions in this decision.

DATED this 22nd day of April 2009.

By: Signed
Mark T. Handley
Administrative Law Judge

NOTICE

1. This is the hearing decision of the Administrative Law Judge under Alaska Statute 43.05.465(a). Unless reconsideration is ordered, this decision will become the final administrative decision 60 days from the date of service of this decision.¹⁹³
2. A party may request reconsideration in accordance with Alaska Statute 43.05.465(b) within 30 days of the date of service of this decision.
3. When the decision becomes final, the decision and the record in this appeal become public records unless the Administrative Law Judge has issued a protective order requiring that specified parts of the record be kept confidential.¹⁹⁴
4. A party may file a motion for a protective order, showing good cause why specific information in the record should remain confidential, within 30 days of the date of service of this decision.¹⁹⁵
5. Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska Statute 43.05.480 within 30 days of the date of this decision becomes final.¹⁹⁶

¹⁹³ Alaska Statute 43.05.465(f)(1).

¹⁹⁴ Alaska Statute 43.05.470.

¹⁹⁵ Alaska Statute 43.05.470(b).

¹⁹⁶ Alaska Statute 43.05.465 sets out the timelines for when this decision will become final.