IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT AT ANCHORAGE

MUNICIPALITY OF ANCHORAGE d/b/a MUNICIPAL LIGHT & POWER, Appellant/Cross-Appellee, vs. STATE OF ALASKA, DEPARTMENT OF REVENUE, Appellee/Cross-Appellant.	Case No. 3AN-13-8916 CI

ORDER REGARDING ADMINISTRATIVE APPEAL

This administrative appeal involves the State of Alaska's taxation of natural gas production. The Municipality of Anchorage d/b/a Municipal Light and Power ("ML&P") is one of three entities that owns and produces gas in the Beluga River Unit gas field (the "BRU"). From 1996 through 1998, ML&P used a combination of BRU gas it produced as well as gas it purchased from the two other BRU owners under long-term gas supply contracts to generate power. ML&P also sold gas it produced to Enstar and Chugach Electric Association ("Chugach"). In general, a company that produces natural gas owes production taxes to the State.

ML&P alleges that, beginning in 1999, it began allocating the gas it was required to purchase from the two other BRU owners to fulfill the Enstar and Chugach contracts and began using the gas it produced for its own power

generation. ML&P argued to the State's Department of Revenue that it should not owe production taxes on the gas sold to Enstar and Chugach because it was only reselling the gas it bought from the other BRU owners. More controversially, ML&P also argued that it did not owe production taxes on the gas it produced and then used for its own purposes. ML&P's production tax liability would be significantly reduced under these theories. However, ML&P continued paying production taxes according to DOR's preferred valuation under protest. ML&P claims that it continued to allocate gas in this manner through 2005.

In 2004, the Supreme Court of Alaska vindicated ML&P's argument that gas ML&P produced and then used for its own power-generation needs was not taxable.[1] ML&P requested a refund from DOR. That refund would be approximately $4 million. DOR denied the request and ML&P appealed to the Office of Administrative Hearings. OAH upheld DOR's denial and ML&P again appeals. DOR has also filed a cross-appeal; primarily out of an "abundance of caution." The central question before the Court is whether there is substantial evidence in the record supporting OAH's finding that ML&P did not prove that it supplied purchased gas to Enstar and Chugach. The Court finds that substantial evidence supports OAH's decision and affirms.

Statement of Facts

I. ML&P and the BRU

ML&P is a municipal-owned power-generation utility providing power within a portion of the Municipality of Anchorage. OAH Dec. at 1. ML&P uses

[1] *State, Dep't of Revenue v. Municipality of Anchorage*, 104 P.3d 120 (Alaska 2004).

gas to generate the power it sells to its customers. *Id.* Various government agencies have oversight over ML&P and its operations. Of particular relevance to this suit are DOR, the Alaska Public Utilities Commission, the Department of Natural Resources, the federal Minerals Management Service, the Internal Revenue Service, and the Regulatory Commission of Alaska.[2]

In 1991, ML&P entered into three long-term gas supply contracts with the then-working interest owners of the BRU: Shell Western E&P, Inc. ("Shell"), ARCO Alaska, Inc. ("ARCO"),[3] and Chevron U.S.A., Inc. ("Chevron"). *Id.* at 5. ML&P agreed to purchase "gas in the amount of one-third (1/3) of ML&P's Total Gas Requirements . . ." from each company. *Id.*; *see also* R. at 515 (Shell Agmt. § V(a)). The agreements specifically provided that the purchased gas is "gas to be delivered to ML&P into the facilities of Enstar or Chugach Electric Association, Inc., at the current geographical location of the Beluga River Field or some other point(s) mutually agreeable to [the producing company] and ML&P." *See, e.g.*, R. at 516 (Shell Agmt. § V(c)). An exhibit to the original agreements provided that the gas would be delivered to ML&P at the "outlet side of [each producer's] meters at the Beluga River Field, and at such other locations as may be agreed upon by the parties . . ." *See, e.g.*, R. at 574 (Shell Agmt., Ex. D, ¶ 5). ML&P

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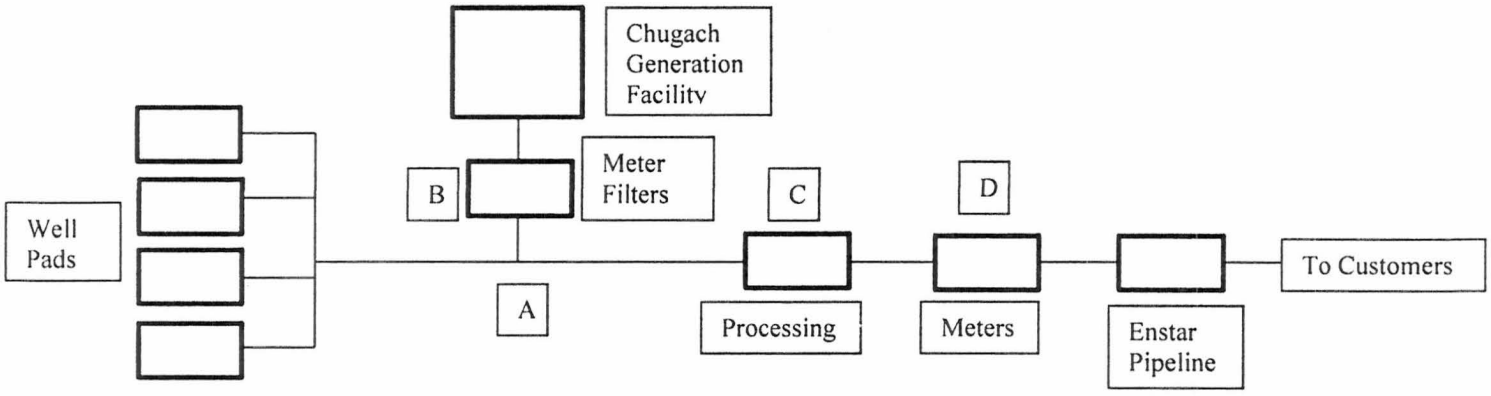
[2] These agencies are relevant to this case for different reasons, set out here briefly by way of background. DOR exercises taxing authority over ML&P and collected the 1999 through 2005 production taxes. The APUC was generally responsible for regulating public utilities. DNR is responsible for collecting state royalties from ML&P related to the gas it produces. MMS is similarly interested in obtaining any federal royalty payments, though it primarily operates through DNR. The IRS is responsible for determining the tax-exempt nature of the bonds ML&P issued in order to purchase its BRU interest. Finally, the RCA, which replaced the APUC, is responsible for setting utility tariffs in Alaska and approving any requested Cost of Power Adjustments sought by those utilities.

[3] ARCO was later replaced by Phillips and ConocoPhillips after that. These companies are referred to as "ARCO" throughout this memorandum for simplicity.

obtained title to the gas only after it passed the delivery point. *See, e.g.*, R. at 552 (SWEPI Agmt. § XI(c)). These agreements were all intended to last until December 31, 2005. *See, e.g.*, R. at 514 (Shell Agmt. § III(r) (Termination Date)).

The BRU layout was roughly depicted in the underlying administrative proceeding using the diagram reproduced below:



R. at 955. Gas can only flow in one direction from the well pads. Gas is collected from the well pads and then transmitted to the intersection marked as "A." At point A, the gas is either diverted to go to Chugach's facility or moves forward towards Enstar's pipeline. The gas is likely metered at point B (for gas to Chugach) or point D (for gas to the Enstar Pipeline). However, the testimony regarding meter locations and meter ownership was not clear and no detailed diagrams were included in the record.

While all three companies own the BRU gas, ARCO is in charge of the field's operations. ARCO produced several different kinds of statements concerning the field's operations. The first type is a statement known as an "offtake statement." *See, e.g.*, R. at 860. ARCO produced offtake statements to reflect the activity that occurred in a given month. *See* R. at 62-63. They were

subject to later revision as necessary. The offtake statements generally show the amount of gas produced from the field, to whom the gas was sold, the amount sold to each purchaser, and to which producer the sale was attributed. *See, e.g.*, R. at 861.

ARCO also created annual gas balancing settlement sheets. *See, e.g.*, R. at 1456. The parties' ownership of the BRU is governed, at least in part, by a gas balancing agreement. R. at 1384-97. This agreement governs how the parties deal with their relative production and how they determine what happens when one owner takes more than one-third of the production for the year.[4] The gas balancing settlement sheets describe the amount of gas taken from the BRU, to whom it was distributed, to which producer each distribution was attributed, and any overlift or underlift. *See, e.g.*, R. at 1457.

ARCO may have also created royalty reports required by various state regulations.[5] These would demonstrate where ARCO, and possibly the other BRU owners, actually sold their gas. The ALJ did not include any royalty statements in his determination and the Court does not have any such statements properly before it.

II. ML&P's Purchase of Shell's BRU Interest

In 1996, Shell sold its one-third interest in the BRU to ML&P. OAH Dec. at 5. In addition to gaining a one-third interest in the BRU gas, ML&P also assumed

[4] This is referred to as "overlift." Taking less than one-third of the year's production is "underlift." The records show ML&P as being consistently underlifted. As an underlifted party, ML&P could either attempt to claim the necessary capacity to bring it into parity with the other producers later in the life of the field (though with some limitations) or receive a balancing payment.

[5] There is some confusion in the record regarding the role the offtake statements played in royalty reporting.

gas supply contracts Shell had with other organizations, including Chugach and Enstar. OAH Dec. at 6.

The APUC vetted the sale, took prefiled testimony, and held hearings. *See, e.g.*, R. at 2021-2245. Chugach strongly objected to the sale because of ML&P's assumption of the Chugach-Shell gas supply contract. R. at 2038-39.[6] The evidence in front of the APUC discussed potential dangers to Chugach in detail as well as how ML&P intended to run its new gas ownership interest. During that hearing, there was some discussion of gas allocation. For example, one ML&P witness indicated that ML&P would continue to use ARCO and Chevron gas to power its generators. R. at 2202. Other ML&P witnesses stated that ML&P would reallocate the gas it received from ARCO and Chevron to supply the Enstar and Chugach contracts. R. at 2135, 2218.

This latter testimony came up in the context of ML&P's financing of the purchase. ML&P intended to use a mixture of equity and tax-exempt municipal bonds to purchase Shell's BRU interest. *See, e.g.*, R. at 1711-13, 2225, 2327. One condition for municipal bonds to be tax-exempt is that no more than ten percent of the bond amount can be used for private activity. R. at 2239. Thus, if ML&P used the bonds to buy one-third of the gas in the BRU,[7] no more than ten percent of that gas could be used for private activity. In the context of this deal, any gas ML&P produced and then sold to Chugach and Enstar would count

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[6] Chugach appears to have been concerned about having ML&P, which it viewed as a competitor, in control of a portion of its gas supply.

[7] The actual amount of ML&P's interest in the BRU financed by the bonds was less than one-third because ML&P also used a certain amount of equity in the deal. Using the equity-financed portion of ML&P's newly-acquired gas would not count towards exhausting the private activity allowance.

towards exhaustion of that allowance. Produced gas sold to Chugach and Enstar would be considered "bad use gas." R. at 957. Produced gas used for ML&P's own generation requirements would be considered "good use gas." *Id.*

The APUC eventually consented to ML&P's purchase of Shell's BRU interest following stipulations from the parties. The Municipality issued the necessary bonds and the sale went forward.

Shortly after consummating its Shell purchase, ML&P announced its intent to reallocate the gas it was purchasing from ARCO and Chevron to fulfill the Chugach and Enstar contracts. OAH Dec. at 6 (citing R. at 1417-19). ARCO agreed to the reallocation, but Chevron did not. *Id.* (citing R. at 1420-22). ML&P does not claim that it reallocated any gas in 1997 or 1998. *Id.*

In 2000, however, ML&P announced to Chevron and ARCO that it had reallocated all of the gas it purchased from them in 1999 to satisfy its obligations to Chugach and Enstar. *Id.* "This was a paper allocation; there was no physical routing or rerouting of gas associated with" the reallocation. *Id.* The record does not demonstrate that Chevron has ever taken action to prevent ML&P from reallocating gas.

III. The IRS Audit

The IRS later investigated whether ML&P had violated the private activity allowance. In a July 2003 letter, the IRS noted that it had reached a preliminary adverse determination ("PAD") finding that interest on the bonds would not be tax-exempt to the bondholders. R. at 1492. The IRS reviewed each of three series of bonds ML&P had issued and found that ML&P would go over the

permissible amount of private activity for the bonds used to finance the Shell purchase. R. at 1507.[8]

ML&P appealed the PAD. *See* R. at 1511-14. The IRS Appeals officer found that the PAD involved a certain amount of speculation regarding future events,[9] that no violation had yet occurred, and that ML&P's stated plans would not necessarily violate the tax-exempt regulations. R. at 1514. The IRS and ML&P entered into a closing agreement resolving the IRS audit without adverse consequences for ML&P or the bondholders. R. at 1521-24. That agreement specifically noted that the IRS will recognize any reallocation of purchased gas reflected in the gas balancing statements. R. at 1523. The agreement also notes, however that it "may not be cited or relied upon by any person or entity whatsoever as precedent in the disposition of any other case." *Id.*

IV. The MMS Audit

DNR, on MMS' behalf, also audited ML&P. This audit concerned ML&P's 2001 royalty payments. DNR alleged that ML&P had been reporting the volumes and valuations of the gas it took from the BRU inaccurately. R. at 2488. DNR argued that ML&P had failed to "report the correct volumes and values for its sales to [Enstar], [Chugach], and sales volumes to ML&P as a customer." *Id.* DNR found that ML&P "should only report the volume delivered to itself as reported by the [Offtake Statements] at the average price of its purchases from

[8] One of the bond series was issued to fund improvements to ML&P's electric systems. The IRS had some concern that the proceeds of those bonds were used to fund the equity portion of ML&P's payment to Shell. *See* R. at 1504-07.

[9] Part of this had to do with so-called "Period 3 gas", which was an additional 40 Bcf that Chugach had the right to attempt to purchase from ML&P under the supply contract ML&P assumed. Whether that would happen had not been determined at the time.

[ARCO] and Chevron." *Id.* DNR further claimed that ML&P "should have reported the MMS share of Beluga River gas for their sales to [Enstar and Chugach] at the value on the sales invoices." *Id.* Implicit in this conclusion was the finding that ML&P was selling produced, and not purchased, gas to Enstar and Chugach because ML&P would not owe royalties on gas it had not produced.

ML&P protested DNR's findings. R. at 2493-2500. The record does not contain any documentation of the audit's conclusion. DOR's witness claims that it is likely that DNR did not pursue the audit because DNR's proposed accounting method could have resulted in lower royalty payments. R. at 1695. The exact reason is unclear from the record.

V. ML&P's Refund Claim

In 2001, ML&P told DOR that it had been reallocating gas since 1999 and sought a refund of the production taxes it had paid on the gas provided to Chugach and Enstar. OAH Dec. at 7. DOR denied the claim. Through the end of 2005, ML&P continued to claim it had reallocated the gas it purchased and seek refunds from DOR. *Id.* The total amount of gas at issue from 1999 through 2005 is 32.5 million Mcf. 26.3 million Mcf went to Chugach and the remainder to Enstar. *Id.* ML&P's requirement contracts with ARCO and Chevron expired at the end of 2005, making reallocation after that point moot. *Id.*

DOR issued an Informal Conference Decision ("ICD") on ML&P's 1999-2005 refund claims on July 7, 2008. DOR formally denied the refund claims. DOR argued that:

> ML&P's allocation method is not supported by facts sufficient to allow the claim for refund. The allocation method, originally applied retroactively, is merely a mathematical reallocation that makes paper adjustments to reported volumes of gas. ML&P's paper allocation is not reflective of actual facts or events. The Beluga field operator statements or gas delivery arrangements did not change to reflect the allocation. ML&P has not shown that any change was made to its cost recovery requirements for RCA tariff filings.

R. at 4.

VI. The OAH Decision

ML&P appealed DOR's refund denial to OAH on August 5, 2008. R. at 1. OAH assigned the matter to Administrative Law Judge Christopher Kennedy. The parties submitted evidence to the ALJ through prefiled testimony and exhibits. *See, e.g.* R. at 43-937 (Prefiled Testimony of L. Dees on behalf of DOR and accompanying exhibits). The parties submitted both direct and responsive prefiled testimony. *See, e.g.*, R. at 1565-1657 (Prefiled Reply Testimony of Daniel B. Helmick and accompanying exhibits).

On December 23, 2009, and after submitting all of the prefiled testimony, the parties jointly moved for the ALJ to vacate the evidentiary hearing in the matter and establish a briefing schedule. R. at 2505-06. The ALJ did so and the parties completed their briefing on June 21, 2010. R. at 2657.[10] The ALJ held oral argument on December 20, 2010.

There the case rested until January 23, 2013 when the ALJ issued a Request for Supplemental Materials and, five days later, an Additional Request

[10] Not including errata and a notice of additional authority that were filed.

for Supplemental Materials. R. at 2736-37, 2739. Both parties responded to the ALJ's requests. *See, e.g.*, R. at 2972-3271. ML&P, however, objected to the ALJ's reliance on the supplemental responsive materials because the parties had agreed to resolve the case on the prefiled testimony. ML&P claimed that reliance on the supplemental materials without granting ML&P the chance to conduct discovery and cross-examination would violate its due process rights. R. at 2974.

Following the submission of the supplemental materials and a status conference with the parties, the ALJ released an early draft of his decision and invited feedback from the parties. R. at 3274. ML&P responded in part by claiming that it would be "inappropriate for OAH of its own motion to seek, consider, or base its decision in any way on evidence beyond the evidence that the parties have agreed must form the basis for OAH's decision" based largely on the fact that the parties had stipulated to try the case on the prefiled testimony. R. at 3288. DOR took the position that OAH could consider the supplemental materials without any additional proceedings or discovery. *See* R. at 3294, 3296.

The ALJ issued his final decision on May 22, 2013. After discussing certain background information, he specifically held that he would not consider any of the supplemental materials in rendering his final decision. OAH Dec. at 5. He then launched into his analysis of the case.

The ALJ noted that ML&P had the burden of proving its case by a preponderance of the evidence. *Id.* at 8 (citing AS 43.05.455(c)). He applied that standard in order to answer ML&P's formulation of the relevant question: do "'all

the facts and circumstances support ML&P's allocation of produced gas to its own use for generating electricity.'" *Id.* (citing R. at 2663 (Administrative Reply Brief of Municipality of Anchorage at 4)).

The ALJ first concluded that ML&P's contracts with ARCO and Chevron permitted ML&P to redirect the gas it purchased from them to someone else. *Id.* at 9. The ALJ then determined that, at least with respect to Chugach, it was physically possible for ML&P to have routed gas that it purchased from ARCO and Chevron to Chugach. *Id.* at 9-10.

The ALJ then turned to DOR's suggestion in the ICD that the nature of ML&P's reallocations as "paper allocations" undermined their validity. The ALJ found that paper allocations are the only possible type of allocation because the gas coming out of the BRU is all commingled. *Id.* at 10. ML&P's gas, Chevron's gas, and ARCO's gas do not flow through individual, traceable pipelines, but are all carried through the same equipment. The ALJ noted that "an allocation case like this one is not about tracing commingled molecules along a pipeline and finding out where they went." *Id.* at 11. Rather, "[a]ll ML&P must prove is that it owned sufficient quantities of the relevant types of gas at that location, that the allocation it proposes is a permissible one – not barred by contract or by law – and that it took all the relevant paper steps to make the allocation." *Id.* The ALJ's decision specifically held that "the paper trail of gas volumes is important" in a paper allocation situation. "Regulatory filings, contractual delivery points, and delivery records of particular volumes of gas may not casually be disregarded or left inconsistent with the desired allocation." *Id.*

A. ML&P's Allocation to Chugach

The ALJ then discussed whether ML&P had proven it had reallocated purchased gas to Chugach. The ALJ noted again that it was possible for ML&P to do so, but found that ML&P had not proven its case. *Id.* at 12-15. The ALJ found that there was no evidence that ML&P had actually taken delivery of purchased gas at Chugach's facility, such that ML&P could transfer that gas to Chugach. *Id.* at 13. He noted that there is a formal system for reporting the delivery of purchased gas, i.e. the gas ARCO or Chevron would have sold to ML&P at Chugach's facility. *Id.* at 12. ML&P, however, failed to file either its own sales point delivery reports or those of its BRU co-owners that would show ML&P taking delivery of any purchased gas at the Chugach facility. *Id.* at 13.

On the other hand, the ALJ found that there was evidence demonstrating that ML&P did not have any purchased gas to distribute to Chugach. The ALJ noted that the record contained seven months of offtake statements. *Id.*[11] These statements all showed "ML&P's purchased gas as delivered to ML&P at the ENSTAR pipeline" making it impossible for the gas to then be reallocated to Chugach because of Chugach's upstream location. *Id.* Moreover, the offtake statements showed that the gas delivered to Chugach was attributed to ML&P's production. The ALJ found that this was even the case after ML&P had announced its reallocation strategy. *Id.* at 14.

The ALJ rejected ML&P's claim that the offtake statements should not be attributed to ML&P because they were prepared by ARCO. The ALJ found that

[11] One monthly offtake statement for each tax year in question.

ARCO, as the operator, was acting as ML&P's agent insofar as it filed documents required under the State's royalty regulations. Moreover, ARCO was also one of the gas producers from whom ML&P was buying the gas it claimed it was reallocating and ARCO never indicated it was sending purchased gas to the Chugach plant. *Id.* On this evidence, the ALJ found that the record indicated that ML&P only took delivery of the purchased gas at the Enstar pipeline, making a reallocation to Chugach impossible. The ALJ further found that the offtake statements indicated that "ML&P's obligation to Chugach had apparently already been fulfilled through a sales point delivery of its own production at the Chugach meters." *Id.* The ALJ did not discuss the gas balancing statements in his analysis.

B. ML&P's Allocation to Enstar

The ALJ then turned to Enstar. *Id.* at 15-16. The ALJ began by noting that the offtake statements again indicated that ML&P's produced gas was being used to fulfill the Enstar contract. *Id.* at 15. The ALJ noted, however, that ML&P might be "taking delivery of all of its produced and purchased gas at the ENSTAR pipeline inlet, and then transporting that gas . . . down the pipeline to a later distribution point, where some would be delivered to ENSTAR as purchaser and some to ML&P's own generation facilities." *Id.*

The ALJ found, however, that it was physically impossible for ML&P to deliver purchased gas to ENSTAR. The ALJ noted that ML&P only took title to the purchased gas at "'the outlet side' of certain meters at the beginning of the pipeline." Enstar, however, was supposed to receive the gas it purchased from

ML&P at the inlet flanges of Enstar's meter station. *Id.* The ALJ assumed that the point where ML&P took title to its purchased gas was downstream of Enstar's inlet flanges and found there was no contrary evidence in the record. *Id.* at 15-16. He also specifically noted that he had requested evidence regarding the metering station layout, but that ML&P did not provide further information and objected to doing so. *Id.* at 16, n.69.

The ALJ concluded that the evidence regarding Enstar was "frustratingly ambiguous." *Id.* at 16. However, he found that the reallocation was inconsistent with the "formal indicia of gas ownership and allocation – the contracts and field records that show who owned gas at each point in the distribution cycle." *Id.* He noted: "[i]t may be that ML&P formed an intent to reallocate and even went so far as to obtain the permission of one important regulatory party, DNR, to proceed with doing so, but then failed to follow through to perfect the arrangement." *Id.* Based on these findings, the ALJ denied ML&P's appeal with respect to Enstar. ML&P now appeals to this Court.

Procedural History

ML&P filed its Notice of Appeal on August 19, 2013, followed by DOR's Cross-Notice on August 27, 2013. The Court received the OAH record on September 18, 2013. ML&P filed its initial brief on November 11, 2013 and DOR filed its response on January 22, 2014. ML&P filed its reply brief on March 11, 2014. DOR did not file a reply brief, despite asserting its own points on appeal.[12] On March 21, 2014, DOR filed a request for oral argument. The Court scheduled

[12] DOR did, however, file a notice of supplemental authority on July 10, 2014.

oral argument for July 15, 2014. Both parties appeared and participated in oral argument.

Standard of Review

The ALJ's findings of fact are reviewed under the substantial evidence test. *Williams v. State, Dep't of Revenue*, 938 P.2d 1065, 1069 (Alaska 1997). This standard is discussed further below. The ALJ's resolution of questions of law not involving agency expertise is subject to the substitution of judgment standard. *Id.* The substitution of judgment standard grants no deference to the ALJ's legal conclusions. *State, Dep't of Revenue v. Municipality of Anchorage*, 104 P.3d at 122 (Alaska 2004).

Discussion

There is substantial evidence in the record supporting the ALJ's conclusion that ML&P failed to prove that it used purchased gas to supply the Chugach and Enstar contracts.

The primary question on appeal is whether substantial evidence supports the ALJ's decision.[13] Answering this question primarily turns on the evidentiary standard. If there is substantial evidence supporting the ALJ's finding that ML&P supplied produced gas to Enstar and Chugach, then ML&P is not entitled to the tax refund it seeks here. Substantial evidence is

> 'such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.' *Keiner v. City of Anchorage*, 378 P.2d 406, 411 (Alaska 1963). We need only determine whether such

[13] Neither party has appealed the ALJ's decision to exclude the supplemental materials. Therefore, the Court has conducted its analysis using only the original evidentiary materials and has similarly excluded the supplemental materials from its analysis. While the Court may not have conducted these proceedings in this manner, and the ALJ appears to regret having done so himself, the Court will not engage in a de novo review of the excluded materials.

> evidence exists, and do not choose competing inferences. *Interior Paint Co. v. Rodgers*, 522 P.2d 164, 170 (Alaska 1974). We do not evaluate the strength of the evidence, but merely note its presence. *Matanuska-Susitna Borough v. Hammond*, 726 P.2d 166, 179 n.26 (Alaska 1986).

Handley v. State, Dep't of Revenue, 838 P.2d 1231, 1233 (Alaska 1992) (quotations and citations as noted). "'[W]hether the quantum of evidence is substantial is a legal question.'" *Williams*, 938 P.2d at 1069 (quoting *Fireman's Fund Am. Ins. Co. v. Gomes*, 544 P.2d 1013, 1015 n.6 (Alaska 1976)). An administrative decision will be upheld even in the face of conflicting evidence when supported by substantial evidence. *Id.* (citing *Summerville v. Denali Ctr.*, 811 P.2d 1047, 1051 (Alaska 1991)). The Court does not reweigh the evidence. *Id.* (citing *Miller v. ITT Arctic Services*, 577 P.2d 1044, 1049 (Alaska 1978)).

The main evidence on which the ALJ relied in finding that ML&P failed to prove that it had any purchased gas to allocate to Enstar and Chugach were the offtake statements prepared by ARCO, the BRU Operator. The statements purport to show how ARCO, as operator, distributed each working interest owner's produced gas. DOR initially introduced seven example offtake statements; each representing one month of each tax year in question. *See* R. at 860-66. The MMS audit letter, which implicitly rejected ML&P's preferred allocation, further indicates that, at least in 2001, the offtake statements did not allocate ML&P's purchased gas to Chugach. *See* R. at 2488. Although not cited by the ALJ, DOR also introduced in its rebuttal testimony a spreadsheet summarizing the distribution of "ML&P's purchased and produced gas as

indicated in the operator statements." R. at 1700 (Prefiled Responsive Testimony of L. Dees); R. at 2385-97 (DOR spreadsheet).[14] The spreadsheet indicates that the offtake statements consistently reported that ML&P's produced gas was used to satisfy ML&P's contractual obligations to Chugach and Enstar. *Compare, e.g.*, R. at 860 (April 1999 offtake statement) *with* R. at 87 (Prefiled Testimony of L. Dees).

A. Chugach

With respect to Chugach, ML&P challenges any reliance on the offtake statements. ML&P's Br. at 39-45. ML&P notes that the offtake statements cannot possibly demonstrate the actual distribution of each BRU owner's produced gas because it is impossible to attribute certain molecules of gas to individual producers. *Id.* at 40. ML&P also characterizes the offtake statements as preliminary reports subject to revision. *Id.* at 42.

ML&P notes that the information in the offtake statements is specifically contradicted by the gas balancing statements ARCO prepared annually. *Id.* at 42-43. ML&P further asserts that it had no obligation to use its gas in the manner reported by ARCO. *Id.* at 42. ML&P claims that its later report to ARCO regarding its allocation of gas should control whether it sent produced or purchased gas to Chugach and Enstar. *Id.* at 42-43.

DOR relies primarily on the offtake statements to demonstrate that ML&P used produced gas to satisfy its obligations to Chugach and Enstar. DOR's Br. at

[14] ML&P did not object to the inclusion of this spreadsheet in the record. Both parties submitted their copies of all of the relevant offtake statements in response to additional requests from the ALJ. However, the ALJ explicitly did not consider these statements because they were not part of the agreed-upon prefiled testimony.

27. DOR also points out that this conclusion is consistent with MMS' audit letter. *Id.* DOR argues that the gas balancing agreements "were simply ineffective examples of self-reporting, doing 'nothing to show ML&P's gas production was actually delivered as it claims.'" *Id.* at 31 (citing R. at 1689-90 (Prefiled Responsive Testimony of L. Dees)).

Neither party disagrees with the ALJ's discussion of the importance of written reports in a paper allocation case. The essential question is whether the offtake statements and MMS' audit letter represent substantial evidence supporting the ALJ's finding that ML&P failed to meet its burden to demonstrate that it used purchased gas to satisfy its Enstar and Chugach contracts. The gas balancing statements and ML&P's statements regarding its claimed allocations are the primary contrary evidence.

As discussed, however, an ALJ's findings may be supported by substantial evidence even where contrary evidence exists. That is the case here. The offtake statements, while not prepared by ML&P, were prepared by the BRU field operator. Those statements directly contradict ML&P's claimed allocation and represent a significant inconsistency surrounding the written documentation of ML&P's gas allocations. It is particularly notable that these statements were subject to revision and that, even though ML&P informed ARCO of its preferred allocation, nothing in the record considered indicates that ML&P ever had ARCO revise the offtake statements to show ML&P's preferred allocation in the offtake

statements themselves.[15] Instead, ML&P appears only to have provided ARCO with its preferred allocation on an annual basis to incorporate into the gas balancing statements.

It would appear reasonable to interpret the gas balancing statements as a year-end summary of the offtake statements, which might give them greater weight than the individual offtake statements. In such a scenario, one could argue that ML&P simply treated the reallocation in the gas balancing statements as a de facto revision of the offtake statements. This is not an unreasonable argument and the ALJ's failure to deal with this issue is troubling.

However, the ALJ's ultimate analysis was based on whether ML&P had met its burden to show that it used purchased gas to satisfy the Chugach and Enstar contracts. The ALJ specifically held that in a paper allocation case, the relevant documents cannot simply be discarded when inconsistent. Neither party has challenged that analytic framework. Here, the offtake statements support the ALJ's finding that ML&P had not proven that it used purchased gas to satisfy its contracts with Chugach and Enstar.[16]

It is important to note that this case does not present a situation where an unrelated, third-party's documents are used to undermine the gas owner's declared intent. In fact, this case would likely be resolved much differently had

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[15] One of the admitted offtake statements is even labeled "REVISED", which seems to indicate that ARCO would, in fact, issue new statements when it received additional information. R. at 863. There are no offtake statements reflecting the revisions that ML&P's self-reported gas balancing statement amounts would require.

[16] Favoring the gas balancing statements over the offtake statements would also be a reevaluation of contradictory evidence. The Court is not tasked with reweighing the evidence on appeal.

the evidence against ML&P's preferred allocation been internal Chevron documents. Chevron is a joint BRU owner, but is not acting on ML&P's behalf and ML&P does not appear to have a way to require Chevron to change how Chevron has internally allocated the gas it sells.

Here, however, the relevant documents are reports prepared by the *field operator*, not a third party acting on its own behalf. ARCO's reports are ARCO's determination, as field operator, of where it was allocating each company's BRU production. ML&P is correct in asserting that the idea that ARCO's reports reflect the actual transmission of individual gas molecules marked "ML&P", "ARCO", or "Chevron" is contrary to the nature of commingled transmission of gas. That, however, is why the paper fictions in which the parties engaged are so important. ARCO reported delivering ML&P's *produced* gas to Chugach. ARCO reported delivering ML&P's *purchased* gas to ML&P. Where it is the field operator preparing those paper fictions, they take on substantial weight.

ARCO's offtake statements do not support ML&P's claimed gas allocations. Instead, these statements fully support the ALJ's conclusion that ML&P had not met its burden of proving that it allocated purchased gas to its contracts with Chugach. The fact that there is contrary evidence in the record does not change that fact because substantial evidence may exist in the face of contrary evidence. The Court affirms the ALJ's findings regarding ML&P's allocation of gas to Chugach.

B. Enstar

The rationale discussed above also applies to ML&P's deliveries to Enstar. The offtake statements indicate that ML&P's produced gas was provided to Enstar. R. at 1698-99; *see e.g.*, R. at 861. For the reasons discussed above, The Court affirms the ALJ's conclusion regarding the gas allocation to Enstar.

One part of the ALJ's Enstar discussion bears further scrutiny however. The ALJ concluded that the terms of the contracts made it physically impossible for ML&P to provide purchased gas to Enstar. The ALJ based this on his belief that Enstar's purchases from ML&P occurred "at the inlet flanges of [ENSTAR's] meter station at the beginning of the ENSTAR pipeline." OAH Dec. at 15. The ALJ compared this to where he believed ML&P took delivery of its purchased gas: "the outlet side of certain meters at the beginning of the pipeline." *Id.* He assumed, due to a lack of evidence, that ML&P took delivery of its purchased gas downstream of where it would need to deliver gas to Enstar; making it impossible for ML&P's proposed allocation to occur.

The ALJ's conclusion regarding where ML&P took delivery, however, is not clearly supported by the evidence. ML&P took delivery of its purchased gas from "the outlet side of [Shell's/Chevron's/ARCO's] meters at the Beluga River Field . . ." R. at 574, 648, 722. The only diagram of the BRU layout indicates that there is a bank of meters in the BRU that appear *before* the Enstar pipeline. As these are the only meters indicated on the diagram between the well pads and the Enstar pipeline, it appears that the producers' meters are at that location. Moreover, ML&P was supposed to deliver gas to Enstar at the inlet flanges of

Enstar's central meter station. R. at 1311. That station appears to be located near Enstar's pipeline, which is located *after* the BRU meters. *See* R. at 955. This would all appear to indicate that it would be possible for ML&P to deliver purchased gas to Enstar. In fact, DOR's witness testified that it would not be physically impossible for ML&P to sell purchased gas to Enstar. R. at 1698.[17]

It may be that the ALJ was interpreting the field layout as he did because it was ML&P's burden to prove that the meters where it took delivery of purchased gas were located before the meters to which it would deliver gas to Enstar. If that is the case, it was not clearly explained in the ALJ's decision. Unless the ALJ's conclusions regarding where various delivery points were located was based in the fact that ML&P bore the burden in this case, the ALJ's assumptions regarding where certain delivery points were located and conclusions drawn from those assumptions are not supported in the record.

However, the ALJ's determination regarding ML&P's allocation of purchased gas to Enstar is still supported by substantial evidence; notwithstanding any potential error regarding delivery points. The ALJ found that the offtake statements demonstrated that ML&P had delivered produced gas to Enstar; leaving no reason for ML&P to then turn around and also provide Enstar with purchased gas. OAH Dec. at 16. That conclusion independently undermines ML&P's claimed allocation if supported by substantial evidence. For the reasons discussed above, the offtake statements provide substantial

[17] However, the Court gives this testimony little weight because it is not clear that DOR's witness was contemplating the exact location of the metering stations when discussing whether it would be possible for ML&P to deliver purchased gas to Enstar.

evidence in support of the ALJ's conclusions regarding ML&P's failure to meet its burden to prove that it used purchased gas to satisfy the Enstar and Chugach contracts. Therefore, the Court affirms the ALJ's findings regarding ML&P's use of produced gas to satisfy its obligation to Enstar.

C. Additional Arguments Regarding Gas Allocation

ML&P advances two other arguments in an attempt to undermine the ALJ's decision. They are discussed below. Neither of them alters the conclusions reached above.

1. The Importance of Royalty and Sales Point Delivery Statements

The ALJ briefly discusses the State's royalty reporting system which would include identification of sales point deliveries. OAH Dec. at 12-13. He appears to do so because the information in the royalty reports would indicate whether ARCO and Chevron were making sales point deliveries to ML&P at Chugach's plant such that ML&P could resell that gas to Chugach; instead of delivering the purchased gas to the Enstar pipeline downstream. *See id.*

The parties discuss this topic extensively, including what rules governed the reporting requirements, what information would be required, whether the offtake statements can be used for royalty reporting, and the fact that ML&P had declared its reallocation efforts to DNR such that DNR knew the offtake statements did not represent ML&P's actual allocations. ML&P's Br. at 35-36, 39; ML&P's Reply Br. at 3-6; DOR's Br. at 29-30. The record does not make clear whether the offtake statements were part of the royalty reports ARCO submitted

to DNR as field operator. The importance of this discussion in the ALJ's decision is that without royalty reports, the ALJ could not tell "whether [ARCO] or Chevron made any sales point deliveries to ML&P as a customer at point B. And one therefore cannot tell whether ML&P ever owned any purchased gas at point B that it could resell Chugach." OAH Dec. at 13.

No matter what the royalty reporting requirements were or what they would have shown, no one appears to have provided a copy of ML&P's, ARCO's, or Chevron's royalty statements. *Id.*[18] In light of the parties' failure to provide this information, the ALJ turned to the offtake statements. Nothing in the discussion of royalty reporting requirements changes the fact that neither party submitted royalty reports and the offtake statements and gas balancing statements were the only documents provided that purported to show how produced and purchased gas were distributed. Thus, the parties' arguments regarding reporting requirements do not affect the conclusions above and do not call for reversing the ALJ's decision.

2. Extraneous Information in the Offtake Statements

ML&P also argues that the offtake statements should not form the basis of the ALJ's decision because ARCO included information in the statements not required by the BRU owners' agreement. ML&P's Reply Br. at 5. This argument is unpersuasive. Whether ARCO was required to show how it was allegedly distributing the purchased and produced gas as field operator makes little

[18] These may have been included in the parties' response to the ALJ's request for supplemental information, but they are not properly before the Court here.

difference. ARCO was the field operator. ARCO's offtake statements indicate how ARCO claimed it was distributing the gas from the BRU. The fact that some of the information may not have been required under the gas balancing agreement does not render that information invalid or create less of an inconsistency in the paper record. This is not a basis for finding that the ALJ's decision was not supported by substantial evidence.

Conclusion

The Court affirms the ALJ in this administrative appeal.[19] The Court may not have resolved the issues in this case in the same manner had this been a case of first impression. The standard of review, however, is substantial evidence, and the record demonstrates that the ALJ's decision is supported by substantial evidence. This is all that is required. The Court cannot reweigh the evidence. The offtake statements uniformly indicate that ARCO, as field operator, delivered produced, not purchased, gas to Enstar and Chugach on ML&P's behalf. These statements support the ALJ's determination that ML&P failed to meets its burden to prove that it had used purchased gas to fulfill those contracts. Therefore, the Court affirms the ALJ's decision.

DATED at Anchorage, Alaska, this 25th day of August 2014.

[redacted]

MARK RINDNER
Superior Court Judge

I certify that on 8/26/14 a true and correct copy of this order was mailed to:

[redacted]

Administrative Assistant

[19] The Court does not discuss DOR's cross-appeal in light of this holding.