BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of	)	
	)	
ConocoPhillips Alaska, Inc. and	)	
Pioneer Natural Resources Alaska, Inc.	)	
	)	
Appeal of Adjustment to Storms 3D Seismic	)	OAH No. 09-0140-TAX
	)	
Exploration Tax Credit Claim 2005	)	

DECISION ON SUMMARY ADJUDICATION

I. Introduction

ConocoPhillips Alaska, Inc., for itself and Pioneer Natural Resources Alaska, Inc., appealed a Department of Revenue informal conference decision (ICD) regarding 2005 exploration tax credit for the Storms 3D Seismic project. The single issue raised concerns the expenditure allowed by the department in the credit calculation for Pioneer's proportionate share of diesel fuel. The same legal issue has been resolved by another case which has the force of legal precedent under AS 43.05.475(a). ConocoPhillips has not established that the prior precedent should be overruled as erroneous.

Accordingly, the department's decision is affirmed. ConocoPhillips' request for an additional $87,199 in exploration tax credit is denied.

II. Facts

ConocoPhillips takes diesel fuel in-kind, as a working interest owner of the Prudhoe Bay Unit and the Kuparuk River Unit, and sells it through Colville, Inc., a non-affiliate North Slope bulk fuel distributor.[1] Colville purchases the fuel from ConocoPhillips and resells it to ConocoPhillips or sells it to other customers. Colville resells fuel to ConocoPhillips at the same price for which it purchased the fuel, plus a transportation charge, or an administrative fee if Colville does not transport the fuel.

ConocoPhillips and Pioneer jointly owned the Storms 3D Seismic exploration project, each owning 50%. ConocoPhillips was the operator. For this project, ConocoPhillips took diesel fuel from the topping plants at the Prudhoe Bay Unit and the Kuparuk River Unit.

As operator of the project, ConocoPhillips filed an application for exploration tax credit under AS 43.55.025 in 2006, for itself and on behalf of Pioneer. The application claimed

[1] Unless otherwise indicated, the "Facts" are taken from the parties' June 4, 2010 Stipulation of Facts and the May 19, 2010 Affidavit of John R. Daly.

qualifying expenditures of more than 7.6 million dollars and sought a 40% tax credit. Based on an audit, in 2007 the department disallowed $250,781 of the diesel expenditures claimed. ConocoPhillips appealed to informal conference.

As a result of the informal conference process, the department increased the allowed diesel fuel expenditures to $185,185. The department determined that the auditor had erred in allowing just the actual net costs paid by ConocoPhillips (topping plant processing fees and differentials paid to Colville) without any value for the crude oil feedstock ConocoPhillips supplied.[2] The diesel fuel expenditure allowance was increased to capture the feedstock value.[3] The audit's disallowance of "the base fuel purchase price originally paid by Colville and subsequently paid back to Colville" was upheld.[4] ConocoPhillips' argument that "its purchase of fuel from Colville was a third party transaction and that the full price paid represents its actual cost" was rejected. The ICD reasoned that the full cost ConocoPhillips paid to Colville was "not a true measure of the cost incurred."[5]

The ICD upheld the auditor's disallowance of what was, in effect, an explorer-to-explorer markup resulting when Colville invoiced amounts that included the base fuel price, not just the topping plant processing fee and transportation differentials or administrative fee.

Following informal conference, ConocoPhillips continued to dispute $87,199 of the remaining disallowed amount (claimed on behalf of Pioneer) and filed a formal appeal on March 9, 2009.[6] At the parties' request, the appeal was diverted for alternative dispute resolution, so that they could attempt to resolve the matter after consideration of an anticipated decision in another tax appeal—the Kokoda appeal—raising the same legal issue.[7] After the decision in the Kokoda appeal was issued, the parties could not agree to a resolution. They stipulated to a schedule for briefing on cross motions for summary adjudication, and entered into a stipulation of facts to supplement the existing record. ConocoPhillips also filed an affidavit from the Colville fuel manager and an excerpt from the audit narrative.

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2 February 9, 2009 ICD at 9-10 (attached as Exhibit 1 to ConocoPhillips' March 9, 2009 Notice of Appeal from Informal Conference).

3 *Id*. at 10-11.

4 *Id*.

5 *Id*. at 10.

6 The only issue remaining after informal conference concerns credit for diesel fuel paid for by Pioneer. March 9, 2009 Notice of Appeal from Informal Conference Decision at 2.

7 *See* March 26, 2009 Order Diverting Appeal for Alternative Dispute Resolution (allowing for parties to attempt a resolution after issuance of a decision in consolidated cases before another judge raising the same legal issue); January 15, 2010 Order Extending Alternative Dispute Resolution.

III. Discussion

In administrative adjudications, the right to be heard does not require development of facts through an evidentiary hearing when no factual dispute exists, but rather the disputed issue can be decided as a matter of law.[8] Instead, the matter can be resolved through summary adjudication. Summary adjudication in an administrative proceeding uses the same standard as summary judgment in court: if the material facts are undisputed, they are applied to the relevant law and the resulting legal conclusions determine the outcome. Only if the parties genuinely dispute a material fact (not legal conclusion) is it necessary to hold an evidentiary hearing.[9]

ConocoPhillips and the department have stipulated to facts they consider material to resolution of the purely legal issue in this appeal and the record supplies the remaining material facts through the ICD, audit narrative excerpt and affidavit. Summary adjudication, therefore, is appropriate here.

A. Standard of Review for Legal Issue

The standards for decision set out in AS 43.05.435 apply to this appeal.[10] Under those standards, the administrative law judge exercises independent judgment to resolve questions of law and affords deference to the department's determination only "as to a matter for which discretion is legally vested in the Department of Revenue[.]"[11] If discretion is legally vested in the department, deference is appropriate only if the determination is supported by a reasonable basis.[12] When deference is appropriate, the department's interpretation of a tax statute through its regulations should not be overruled without good reason.[13] Here, the department has asserted that deference is due to its interpretation. ConocoPhillips disagrees.

Which of the two standards of review applies to the legal question raised by this appeal, however, need not be decided here. The same interpretation question was resolved in a prior case—the Kokoda appeal—in a decision upholding the department's interpretation without

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8 *See Smith v. Dep't of Revenue*, 790 P.2d 1352, 1353 (Alaska 1990).

9 A fact is not "material" unless it would make a difference to the outcome. *Whaley v. State*, 438 P.2d 718, 720 (Alaska 1968).

10 This appeal is within the original jurisdiction of the Office of Administrative Hearings under AS 43.05.405.

11 AS 43.05.435(2)&(3).

12 AS 43.05.435(3).

13 *See In Re ConocoPhillips Alaska, Inc.*, (Consolidated Appeal Concerning Kokoda #1 & #5) OAH Nos. 09-0018-TAX & 09-0019-TAX at 6 (Alaska Office of Administrative Hearings 2009) (quoting prior authority stating that "a statutory construction adopted by those responsible for administering a statute should not be overruled in the absence of weighty reasons").

applying a deferential standard of review.[14] Thus, whether deference is afforded to the department's interpretation or not, the result is the same, unless the Kokoda decision should be overruled.

B. The Kokoda Decision Should Not Be Overruled.

This tribunal (the office of administrative hearings) previously declined to rule in the Kokoda appeal

> that it is error to interpret "cost" in former AS 43.55.025 to mean the cost that the operator incurred in procuring a particular good or services for the project, and not to recognize as a "cost" a premium or markup that one explorer has charged to another.[15]

The Kokoda decision upheld the "department's conservative interpretation of the word 'cost' in the tax credit statute[,]" explaining that the interpretation comports with the rule "that tax credit provisions 'are narrowly construed against the taxpayer'."[16] The Kokoda decision's ruling on this legal question has not been reversed; thus, it "has the force of legal precedent" unless overruled.[17]

1. Legal precedents are not overruled absent error or changed conditions.

Under the doctrine of *stare decisis*, previous rulings on legal questions can be supplanted by new ones when the interest in stability yields to the need to adapt to changes, as well as when necessary to correct errors.[18] The Alaska Supreme Court has stated:

> We will overrule a decision only when convinced: (1) "that the rule was originally erroneous or is no longer sound because of changed conditions," and (2) "that more good than harm would result from a departure from precedent."[19]

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[14] *Id*. at 7 (declining to apply a deferential standard of review because the department had not asserted that deference was due, except in "a single oblique sentence" in a reply brief filed too late in the process to allow the taxpayer a reasonable opportunity to react).

In the present appeal, the department advocated for application of the deferential standard of review and the parties briefed that question much more thoroughly. It is unnecessary to reach the issue of whether the independent judgment standard used in the Kokoda appeal is the proper standard, since the judge in that appeal affirmed the department's interpretation of "cost" using that non-deferential standard. The undersigned, therefore, declines to give what would, in effect, be an advisory opinion on the applicable standard of review, but this does not prejudge which standard of review applies in tax credit appeals not governed by the Kokoda precedent.

[15] *In Re ConocoPhillips Alaska, Inc.*, (Consolidated Appeal Concerning Kokoda #1 & #5) OAH Nos. 09-0018-TAX & 09-0019-TAX at 18.

[16] *Id*. at 17-18, quoting *State, Dep't of Revenue v. OSG Bulk Ships, Inc*., 961 P.2d 399 (Alaska 1998).

[17] AS 43.05.475(a), stating that "[a]s to questions of law, a final administrative decision issued under AS 43.05.405 – 43.05.499, unless reversed or overruled, has the force of legal precedent."

[18] *Pratt & Whitney Canada, Inc. v. Sheehan*, 852 P.2d 1173, 1175 (Alaska 1993).

[19] *State v. Carlin*, 249 P.3d 752, 757-758 (Alaska 2011), quoting *Pratt & Whitney Canada supra*.

One example of changed conditions that warranted overruling a precedent was found in an amendment of Alaska's constitution to give greater rights to the victims of crime, consistent with the evolution of victims' rights in the criminal justice process across the country over four decades.[20]

Nothing remotely like that exists here. Indeed, the parties have pointed to no changed conditions occurring between the 2004/2005 diesel fuel expenditures at issue here and the early-2005 expenditures for exploration projects covered in the Kokoda appeal. That the present appeal concerns seismic project expenditures, whereas the Kokoda appeal concerned well drilling expenditures, does not constitute changed conditions. As illustrated below, the same statute governed tax credits for exploration well and seismic project expenditures, and the variation within the pertinent subsections of the implementing regulation does not affect the interpretation of "cost."

Since changed conditions have not been shown, the Kokoda decision would have to be erroneous to be overruled.

2. The Kokoda ruling was not erroneous.

The Kokoda ruling and this appeal both rest on an oil and gas exploration incentive tax credit created in 2003 by former AS 43.55.025. Under that statute an explorer could receive a credit against production taxes of 20 or 40 percent of its qualified exploration expenditures incurred between July 1, 2003, and June 30, 2007.[21] Expenditures could be for seismic or geophysical exploration costs not connected to a specific well, or for specified types of expenditures for certain activities associated with an exploration well.[22]

If multiple explorers held interests in a well or seismic exploration project, each explorer was entitled to "claim an amount of credit that is proportional to the explorer's cost incurred[.]"[23] The credit claim had to be made "in a form prescribed by the department and within six months of the completion of the exploration activity."[24] The production tax credit certificate issued by the department was transferable.[25]

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[20] *Id*. at 758-759 (overruling prior precedent under which criminal convictions were abated *ab initio* when the defendant died while an appeal was pending).

[21] AS 43.55.025(a) & (b), as amended through 2005. For a copy, s*ee* DOR Exh. A to the Department's May 21, 2010 Motion for Summary Adjudication.

[22] AS 43.55.025(b).

[23] AS 43.55.025(f)(3).

[24] AS 43.55.025(f)(1).

[25] AS 43.55.025(g).

Qualified exploration expenditures generally were "the reasonably required direct costs for work performed on a particular exploration well or seismic or geophysical exploration project" during the July 1, 2003 to June 30, 2007 period.[26] For seismic exploration projects in particular, qualified expenditures included "goods, services, and materials," with the cost being calculated at the contract rate, if provided under a third-party contract, or the actual costs incurred "if provided in whole or in part by an explorer."[27] For exploration wells, the regulation also used the word "cost" or "costs" in various well drilling contexts—for instance, the cost of mobilizing drill rigs or transporting equipment.[28] Though the exploration well subsection of the regulation did not contain a complete parallel to the "goods, services and materials" provision for seismic projects, it provided for cost calculations based on explorer-owned equipment and equipment acquired under third-party contracts.[29] Thus, both subsections contemplated that exploration expenditures might be calculated based on third-party contracts or on the explorer's own costs.

The Kokoda decision dealt with diesel fuel costs for an exploration well project, but the fuel acquisition arrangement was the same as for the seismic project in this appeal. Though the Kokoda decision was not construing "cost" specifically under the regulation's subsection on qualified expenditures for seismic projects, it was construing the word as used in same regulation. Nothing about the text of the regulation as a whole suggests multiple meanings for the word "cost." Moreover, the statute (AS 43.55.025) implemented through the department's regulation distinguishes between well and seismic projects in some details pertaining to eligibility for tax credit, but not as to how qualified expenditures for goods such as fuel should be calculated.

In short, the Kokoda decision is an apt precedent for this appeal, notwithstanding the fact that this appeal concerns a seismic project, not exploration well drilling. The diesel fuel for both operations was obtained in the same way, including the same explorer-to-explorer markup applied to the non-operator's proportionate share of the fuel.

The Kokoda decision's ruling that the department did not err by interpreting "cost" to mean the cost the operator incurred, exclusive of any premium or markup one explorer charged

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[26] 15 AAC 55.230(a). For a copy of this regulation, which was enacted in 2004 and repealed in 2007, s*ee* DOR Exh. B at 3-6, attached to the Department's May 21, 2010 Motion for Summary Adjudication.

[27] 15 AAC 55.230(c)(4)(A)&(B).

[28] 15 AAC 55.230(b)(4)(A) & (5).

[29] 15 AAC 55.230(b)(4)(B)(i)-(ii) & (5)(A)&(B).

to another, is not erroneous. Such an interpretation is consistent with the rule of construction that tax credits, as a form of exemption, are narrowly construed against the taxpayer.

This is not a question of which expenditures count as deductible business expenses. The statute and regulation at issue here granted the explorers transferrable tax credits above and beyond any deduction for which they might have qualified under any then-applicable corporate income or production tax regimes. The tax credits could even be sold, making them a valuable asset to an explorer who had little or no production tax liability of its own against which to apply the credits. Reading "cost" to exclude explorer-to-explorer markups or premiums prevents an artificial inflation of the qualified expenditures relative to the actual "reasonably required direct costs" (15 AAC 55.230(a)) the operator needed to make to conduct the seismic project. This is consistent with the narrow-construction-against-the-taxpayer rule, and with the statutory aim to incentivizing exploration, not marketing of goods between explorers.

IV. Conclusion

The Kokoda decision governs the resolution of this appeal. That decision was not erroneous. The decision is not overruled. The department's informal conference decision not to further increase the tax credit for diesel fuel expenditures, therefore, is affirmed.

DATED this 2nd day of March, 2012.

By: *Signed*
Terry L. Thurbon
Chief Administrative Law Judge

NOTICE

This is the decision of the Administrative Law Judge under AS 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.[30]

A party may request reconsideration in accordance with AS 43.05.465(b) within 30 days of the date of service of this decision.

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.[31] A party may file a motion for a protective

[30] AS 43.05.465(f)(1).
[31] AS 43.05.470.

order, showing good cause why specific information in the record should remain confidential, within 30 days of the date of service of this decision.[32]

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with AS 43.05.480 within 30 days after the date on which this decision becomes final.[33]

Certificate of Service

The undersigned certifies that on March 2, 2012, this decision was distributed by **U.S. MAIL** with courtesy copies by **EMAIL** to the following: Marie Evans, counsel for ConocoPhillips Alaska, Inc.; Susan Pollard, Assistant Attorney General.

Signed
Neil Roberts

[This document has been modified to conform to the technical standards for publication.]

[32] AS 43.05.470(b).
[33] AS 43.05.465 set out the timelines for the decision becoming final.