BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of RENAISSANCE UMIAT, LLC Oil & Gas Production Tax Credit Certificates 2008-A67, 2008-B67, 2008-A44, 2008-B44	OAH No. 10-0268-TAX
In the Matter of RENAISSANCE UMIAT, LLC Oil & Gas Production Tax Credit Certificates 2008-P25, 2008-A26, 2008-B26 2009-A14, 2009-B-14	OAH No. 10-0131-TAX (Consolidated)

DECISION

I. INTRODUCTION

Renaissance Umiat, LLC ("Renaissance") conducted an oil and gas exploration program in the winter season of 2007-2008 near Umiat, Alaska. Renaissance sought tax credits for a variety of expenditures connected with this program. Some of the expenditures were disallowed, and this led to three appeals to the Office of Administrative Hearings with partially overlapping issues, designated 10-0027-TAX, 10-0131-TAX, and 10-0268-TAX. By agreement, these appeals were consolidated for briefing and argument, with all filings collected under case 10-0027-TAX. The parties also agreed that the cases should be "tried on the agreed administrative record."[1]

On May 13, 2011, after the cases were fully briefed and argued, the parties reported a settlement of all of the issues originally joined in case 10-0027-TAX, which had the effect of settling the parallel issues in the other two cases. The parties indicated that the "Doyon issues"—the disallowance of payments to Doyon Drilling, Inc., that were among the issues in cases 10-0131-TAX and 10-0268-TAX—had not been settled. The parties later moved for dismissal of case 10-0027-TAX, and the dismissal was entered by order dated June 21, 2011.

[1] Scheduling Order (April 19, 2010).

This decision addresses the "Doyon issues" that remained pending after the partial settlement. To prevail on these issues, Renaissance had the burden of showing that the Department of Revenue erred in disallowing the payments to Doyon Drilling for purposes of calculating a carry-forward annual loss under AS 43.55.023(b) or a "qualified capital expenditure" under AS 43.55.023(a), and for purposes of the partial tax credits under those two statutory provisions. This decision concludes that Renaissance has failed to carry that burden

II. FACTS

The parties have not stipulated to a set of facts in this case; instead, they have agreed that the case is to be "tried" upon the written agency record.[2] There are no direct factual disagreements between the parties, but they do differ somewhat as to factual inferences to be drawn from the underlying circumstances.

As originally planned, Renaissance's 2007-2008 Umiat program consisted of a 115-square-mile seismic survey and a drilling program of multiple wells.[3] In preparation for this program, on September 20, 2007 Renaissance contracted with Doyon Drilling, Inc. to supply and operate its Arctic Wolf drilling rig.[4] The contract set a "Standard Operating Rate" of $43,000 per day.[5] It provided that "[i]n the event the rig operates less than 120 days, the Standard Operating Rate shall apply for 120 days."[6]

As the program unfolded, seismic results suggested that the drilling program should be conducted in a different manner than originally envisioned, and Renaissance decided to defer all drilling to the next winter season.[7] On February 5, 2008, Renaissance notified Doyon that it would not be using the Arctic Wolf rig that year and gave notice "to terminate the contract."[8] There is no evidence that the Arctic Wolf rig was ever used in the Umiat program, even in subsequent years.

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[2] Notwithstanding this stipulation, Renaissance submitted an affidavit from one of its vice presidents, Mark Landt, with its opening brief. The affidavit functions mainly to place some of the events in a broader context. The administrative law judge deems Renaissance's submission of the Landt Affidavit to be an implicit motion to add that item to the trial record and, after reviewing the division's objection at footnote 46 of its responsive brief, exercises his discretion to admit the affidavit in the interest of deciding this case on as coherent a factual record as possible.

[3] Record 27:81, 131:112, 131:68. In this case, the record as a whole consists of three separately assembled and numbered records. Record citations in this decision consist of a pair of numbers separated by a colon. The first number is the OAH case number corresponding to the individual case record being cited ("27" for 10-0027-TAX, "131" for 10-0131-TAX, and "268" for 10-0268-TAX). The second number is the page number within that record.

[4] Record 268:358 and following.

[5] Record 268:367, 404.

[6] Record 268:367.

[7] Record 268:413.

[8] *Id.*

Under the terms of the contract, Renaissance nonetheless owed Doyon a substantial sum for tying up the rig.[9] The Doyon contract had complicated and potentially ambiguous terms relating to the full amount owing if the rig was not used, but it was clear that—under any interpretation—a decision to defer drilling to the following year made as late as February 5 would leave Renaissance obligated to pay 120 days at the Standard Operating Rate for the current season.[10] 120 days at $43,000 adds up to $5,160,000. That is the amount Doyon initially demanded,[11] and that is essentially the amount Doyon and Renaissance agreed to by way of settlement, subtracting a small amount for interest earned on certain escrowed funds.[12] With the possible exclusion of the fee discussed in the next two paragraphs, the total amount Renaissance paid for access to the Arctic Wolf rig in the 2007-2008 drilling season was $5,153,799.86.[13] Renaissance claims this amount as a qualified lease expenditure, and it will be discussed in part III-C below.

In addition to the day rate charges for the drilling rig, Renaissance has claimed as a qualified lease expenditure a payment of $450,000 to Doyon for an "annual training and startup fee." There is not much information in the record about the nature of this fee and the services it covered, but it seems to have related in part to training for Doyon personnel associated with the rig. It is referenced briefly in Exhibit C of the Doyon contract as a fee that will be "invoiced" at some point.[14]

The record does not establish whether this fee was paid as an amount over and above the $5,153,799.86 discussed previously. The fee was invoiced,[15] but notes on the invoice suggest that Renaissance did not pay it with new money, instead paying it from the escrow account set up to secure the payment of the basic Standard Operating Rate.[16] Other documents[17] suggest that Renaissance was nonetheless given credit for the full original contents of the escrow—that is, the

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[9] *See* Record 268:380 (indicating that the reason for the liquidated damages provisions in the contract was "lost opportunity to market the rig elsewhere").

[10] This result would be dictated either by Section 10.2(b) (although that section arguably did not apply) or by Section 4.2. Record 268:367, 380.

[11] Record 131:185-186.

[12] *See* Record 131:184.

[13] *See id.* This is the total of $3,259,990 in escrow payments and a final payment of $1,893,799.86.

[14] Record 268:405.

[15] Record 131:174.

[16] The essential purpose of the escrow is inferred from Section 5.2 of the contract, which established that the escrow would be in exactly the amount corresponding to 120 days at the Standard Operating Rate. However, it was permissible to draw on escrowed funds for other invoices, provided a minimum balance was maintained in the escrow account. Record 268:370.

[17] Record 131:185-186.

total of all deposits Renaissance ever made to the escrow, or $3,259,990—as an offset against the $5,160,000 that Doyon demanded for 120 days at the Standard Operating Rate. The banking records that have been submitted do not support a separate payment of $450,000 over and above the $5,153,799.86 that has been documented.[18]

At informal conference, the Department of Revenue concluded that no payments to Doyon qualified as lease expenditures and therefore none of the payments could form the basis for tax credits under AS 43.55.023(a) or (b).[19]

III. DISCUSION

A. Standard of Review

Factual issues in a case such as this one are evaluated on a new record and are therefore decided de novo, with the taxpayer bearing the burden of proof by a preponderance of the evidence.[20] The primary questions to be resolved in this case are questions of law, however. The legislature has prescribed a pair of standards of review for such questions. As a general matter, the administrative law judge (ALJ) is to "resolve a question of law in the exercise of [his] independent judgment."[21] At the same time, the ALJ must "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."[22] This pair of standards is intended to track the normal approach to review taken by appellate courts, including the deference owed to the agency on certain matters of statutory or regulatory interpretation.[23]

As will be seen, the legal questions in this case involve interpreting Department of Revenue regulations. For such questions, regardless of whether agency expertise is implicated, the reasonable basis review standard applies to the agency's "interpretation of its own regulations . . . unless plainly erroneous or inconsistent with the regulation."[24] In the present case, that deference is constrained by the fact that the department seems to have overlooked

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18 *See* Record 268:410-412. It is possible that there are other banking records that do support such a payment, but they do not appear to be in the record.

19 At audit, the department had inadvertently allowed the portion of the total daily rate payments to Doyon that were not accounted for by escrow deposits ($1,893,799.86). The informal conference decision corrected this oversight and treated all daily rate payments consistently, disallowing all. *See* Record 131:14 at n.16.

20 AS 43.05.455(c).

21 AS 43.05.435(2).

22 AS 43.05.435(3).

23 *See State, Dep't of Revenue v. DynCorp and Subsidiaries,* 14 P.3d 981, 984 (Alaska 2000).

24 *Lake & Peninsula Borough v. Local Boundary Comm'n*, 885 P.2d 1059, 1062 & n.11 (Alaska 1994) (quoting prior authority); *see also Lakloey, Inc. v. University of Alaska*, 157 P.3d 1041, 1045 (Alaska 2007).

some of the key issues of interpretation at the informal conference level, so that there is not always a reasoned decision on the issue to which one could defer.

B. Narrow Construction of Tax Relief Provisions

Although there is a general principle that ambiguities in tax statutes are to be resolved in favor of the taxpayer,[25] the opposite rule applies with provisions creating exceptions or exemptions from the general tax treatment.[26] This rule covers tax credit provisions. Thus, in *State, Department of Revenue v. OSG Bulk Ships, Inc.,*[27] the Alaska Supreme Court upheld a narrow construction of a tax credit statute on the basis that it was "consistent with the following canon of construction: Exemptions are narrowly construed against the taxpayer."[28] This canon of strict construction applies to all types of taxes, including—most relevant for the instant case—oil and gas production taxes.[29]

C. Tax Credit for Drill Rig Payments

The largest dollar amount in dispute involves the $5,153,799.86 in payments to Doyon to fulfill the contractual obligation to pay for 120 days at the Standard Operating Rate for the Arctic Wolf drilling rig, regardless of whether the rig was used. Renaissance claimed this amount as a "lease expenditure" for purposes of calculating a carry-forward annual loss under AS 43.55.023(b) (Case 10-0131-TAX) and as a "qualified capital expenditure" under AS 43.55.023(a) (Case 10-0268-TAX). Such "lease expenditures" and "qualified capital expenditures" give rise to partial tax credits under those two statutory provisions.

In order to be a "qualified capital expenditure" under AS 43.55.023(a) or a "lease expenditure" usable under AS 43.55.023(b), an expenditure has to be a "lease expenditure" under AS 43.55.165.[30] It is undisputed that the Doyon payment would have to come under subparagraph (a)(1) of section 165, which encompasses costs incurred "to explore for . . . oil or gas" that are "*allowed by the department by regulation,* based on the department's determination

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25 *Union Oil Co. of Cal. v. Dep't of Revenue*, 560 P.2d 21, 25 (Alaska 1977).

26 E.g., 3A N. Singer, Statutes and Statutory Construction § 66.09 (5th ed. 1992); *Green Constr. Co. v. State, Dep't of Revenue,* 674 P.2d 260, 266 (Alaska 1983).

27 961 P.2d 399 (Alaska 1998).

28 *Id.* at 409.

29 *E.g., Pledger v. Ethyl Corp.,* 771 S.W.2d 24, 25 (Ark. 1989) (in context of oil severance tax, "[a]ny tax exemption provision must be strictly construed against exemption, and to doubt is to deny the exemption."); *Secretary of Dep't of Revenue & Taxation v. Texas Gas Expl. Corp.,* 506 So. 2d 528, 530 (La. App. 1987); *Eagerton v. Terra Resources, Inc.,* 426 So. 2d 807, 808 (Ala. 1982); *Phillips Petroleum Co. v. Oklahoma Tax Comm'n,* 542 P.2d 1303, 1305 (Okla. 1975).

30 This connection is part of the wording of AS 43.55.023(b). For AS 43.55.023(a), the connection is found in AS 43.55.023(*l*).

that the costs satisfy" various requirements, including requirements that they be "ordinary and necessary costs of exploring" and also "direct costs of exploring."[31]

Since the costs must be "allowed by the department by regulation" in order to qualify under the statute, one must next turn to the applicable regulations. The department adopted regulations to address eligibility of these costs in 2010, with retroactive application back to the tax years at issue in this case. The retroactivity of these regulations (a retroactivity expressly authorized by the Legislature when it enacted large-scale revisions of the tax structure, many of them retroactive or effective immediately, in December of 2007[32]) is not at issue in this case. The validity of the regulations is also not at issue.[33]

By regulation, unless it falls within certain statutory exclusions that have no application here, a cost qualifies as a "lease expenditure" if it is both:

- incurred for an activity or purpose listed in 15 AAC 55.250(c) and
- a "direct charge" as that term is defined in 15 AAC 55.260.[34]

The department contends that the rental payments for the Arctic Wolf rig meet neither criterion. Renaissance contends that they meet both. The criteria will be addressed one at a time.

1. Activity or Purpose

In one of its informal conference decisions (ICDs), the department held that "the payment at issue was not used for an activity described in 15 AAC 55.250(c)."[35] The department seemed to rely on the determination that the payment was not within the scope of section 250(c) as part of its reason for disqualifying the expense.

The trouble with this reasoning is that it overlooks a dimension of the department's own regulation. 15 AAC 55.250(c) encompasses "activities *or purposes*." Thus, if an expense is for the purpose of accomplishing one of the listed items, whether successful or not, it is covered by section 250(c). One of the listed items is "designing, drilling, testing, logging, completing, operating, maintaining, repairing, or suspending [an exploration well]."[36] Thus, even if the payment to Doyon did not actually pay for drilling and related operations, if it was for that

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31 AS 43.55.165(a)(1)(B) (italics added).
32 *See* ch 1§ 72 SSSLA 2007.
33 Colloquy between ALJ and counsel for Renaissance, Feb. 17, 2011.
34 15 AAC 55.250(b)(1).
35 Informal Conference Decision (ICD) of May 13, 2010 (now Case 10-0268-TAX) at 3, 4. The ICD of Feb. 22, 2010 (now Case 10-0131-TAX) did not have a parallel finding and did not expressly disallow this expenditure on the basis of 15 AAC 55.250(c).
36 15 AAC 55.250(c)(4) and (6).

purpose, it falls within the ambit of 15 AAC 55.250(c).

Deference to the department's interpretation of its own regulation does not come into play here. By referencing only the "activity" dimension of 15 AAC 55.250(c), the ICD was not interpreting the regulation; it was overlooking part of the regulation.

In its briefing in this case, the department argues that the Doyon obligation was not even for the "purpose" of drilling and associated activities. It characterizes the $5,153,799.86 as a "fee paid for breach or to have a contractor walk away from performing any work at all [having] nothing to do with 'designing,' 'drilling,' 'preparing,' 'surveying,' 'testing,' or 'maintaining' anything."[37]

This argument is factually at odds with the best interpretation of the evidence in this case. Renaissance incurred the obligation to pay Doyon for 120 days of usage when it signed the contract with Doyon in September of 2007.[38] The $5,153,799.86 obligation, far from having "nothing to do" with drilling, was incurred precisely for the purpose of making drilling possible several months later. This is an allowable purpose under 15 AAC 55.250(c)(6).

2. <u>Direct Charge</u>

The second regulatory criterion that must be satisfied to qualify as a "lease expenditure" is that the expenditure be a "direct charge" as defined in 15 AAC 55.260. Both informal conference decisions under review in this appeal found that the $5,153,799.86 was not a "direct charge."[39]

15 AAC 55.260(a) is an exclusive list of the 21 types of expenditure that will be considered "direct charges" and therefore be counted as lease expenditures under AS 43.55.165.

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[37] Department of Revenue's Responsive Brief (Sept. 30, 2010) at 25.

[38] Under a literal reading of the contract, the obligation to pay for 120 days at the Standard Operating Rate was mature and inescapable as soon as the contract was signed, and that is the basis for the finding in the text.

There has been some suggestion in this case that Renaissance might have avoided some of the cost by cancelling the rig earlier. It is true that, had Renaissance sought to walk away from the arrangement prior to the "commencement date" as defined in Section 2.2, one could imagine an argument that Renaissance's obligation would be limited to a lesser sum calculated under Section 10.2(a) of the contract. However, the Section 10.2(a) damages provision was literally written so as to apply only in the event of a termination for a cause such as destruction of the rig or insolvency of Doyon, as outlined in Section 10.1. Making the Section 10.2(a) damages provision applicable to an early cancellation for ordinary operational reasons would entail some extrinsic evidence as to the parties' intent, and there is no such evidence in this case, leaving the literal terms of the contract as the only basis for a factual finding on this point. Moreover, liability under Section 10.2(a) would have been very substantial once the escrow was funded, so that even if Section 10.2(a) applied, any cancellation after mid-December of 2007 would have left Renaissance on the hook for at least the majority of the $5,153,799.86 that was ultimately paid. *See* Record 268:363, 370, 379, 380.

[39] ICD of May 13, 2010 (now Case 10-0268-TAX) at 4; ICD of Feb. 22, 2010 (now Case 10-0131-TAX) at 14.

Renaissance contends that the $5,153,799.86 qualified as a direct charge under subdivision (11).

15 AAC 55.260(a)(11) is a provision with difficult wording. It brings into the definition of "direct charges" the costs

> paid to a third party for contract services, utilities, or use of a facility equipment, or infrastructure provided by the third party and used in oil or gas exploration, development, or production operations, or used in support of those operations, or for use of a system [for communications or field automation] provided by the third party; for purposes of this paragraph,
>
> (A) contract services
>
> (i) do not include work in tax, legal, or accounting matters, or matters involving a dispute before a government agency;
>
> (ii) are limited to services the labor costs of which, under (3) of this subsection, would be allowable as direct charges if the operator's employees performed the services;
>
> (B) support facilities, equipment, and infrastructure are limited to the categories described in 15 AAC 55.250(c)(16)[.]

Before embarking on interpretation of this regulation, one should start by acknowledging that it contains a drafting error. This error occurred in the adoption process when the text acquired the phrase "use of a facility equipment, or infrastructure." The error is that there should undoubtedly be a comma between "facility" and "equipment," for three reasons. First, "facilities, equipment, and infrastructure" appears as three separate items, separated by appropriate commas, in subparagraph (B) of the same provision, and versions of the same formulation appear at numerous other locations in 15 AAC 55.250-260,[40] whereas "facility equipment" or "facilities equipment" (as a unitary item with no comma) is not a phrase used elsewhere. Second, before the word "infrastructure" was added, the public comment draft of this regulation contained the phrase "equipment and facilities provided by third-parties,"[41] which indicates that facilities and equipment were viewed as two separate things and facilities was not intended to be a modifier of equipment. Third, "a facility equipment" is an incorrect phrase grammatically, since the singular article "a" (or "an") cannot be used with the collective noun "equipment."

In briefing to this tribunal, both parties have focused on whether the Doyon contract qualifies as "contract services," with Renaissance arguing that it is by being for "contract

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[40] *See, e.g.,* 15 AAC 55.250(c)(12); 15 AAC 55.250(c)(16); 15 AAC 55.260(a)(3) (A)(iv).

[41] The draft referred to is the Dec. 24, 2008 public comment draft, found at http://www.tax.alaska.gov/programs/documentviewer/viewer.aspx?398 .

services" that the Doyon expenditures meet the regulatory threshold[42] and the department arguing that it is by failing to fit the mold of "contract services" that they fail to qualify.[43] As the department reasons:

> Subsection (a)(11) allows a tax credit for "costs paid to a third party for contract services" but only if they are actually "*used* in oil or gas exploration, development or production." Doyon provided no contract services that were actually "used" in exploration or production. [44]

The trouble with this reasoning is that it simply assumes, with no analysis or discussion, that the phrase "used in oil or gas exploration, development, or production" applies to "contract services." It reads subparagraph (a)(11) *as though* it were written this way:

> costs paid to a third party for contract services, utilities, or use of a facility[,] equipment, or infrastructure provided by the third party, that are used in oil or gas exploration, development, or production operations . . .

A somewhat more natural reading of the immediate portion of the language the parties have focused on would be that "use of a facility[,] equipment, or infrastructure provided by the third party and used in oil or gas exploration, development, or production operations" is a single phrase, with "and used in . . ." carrying back only to modify the facility, equipment, or infrastructure being used. These facilities, equipment, and infrastructure have to meet two requirements—they have to be "provided by" the third party and they have to be "used in" the industry.[45]

To carry the phrase "used in" back further runs counter to the "rule of the last antecedent," under which "qualifying words, phrases and clauses are to be applied to the words or phrases immediately preceding and are not to be construed as extending to or including others more remote."[46] This is a canon of statutory and regulatory[47] construction best illustrated by an example. In a California case, a court had to construe a law that defined a certain term as "any action which may lead to dismissal, demotion, suspension, reduction in salary, written reprimand, or transfer for purposes of punishment." The court applied this canon to determine that the limitation "for purposes of punishment" applied only to "transfer" and not, for example,

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[42] Renaissance Umiat, LLC's Opening Brief at 22.

[43] Department of Revenue's Responsive Brief at 21.

[44] *Id.* In quoting the regulation, the department has inadvertently omitted a comma.

[45] The facilities, equipment, and infrastructure being talked about seem to be things like camps, labs, and medical facilities. *See* 15 AAC 55.260(a)(11)(B) and 15 AAC 55.250(c)(16)(A).

[46] *White v. County of Sacramento,* 646 P.2d 191, 193 (Cal. 1982).

[47] Principles of statutory interpretation carry over to the interpretation of regulations. *State Dep't of Highways v. Green,* 586 P.2d 595, 603 n.24 (Alaska 1978).

to a "reduction in salary."[48] It noted that the result would be different had there been a comma before "for purposes of punishment,"[49] for there is a "comma exception" to the last antecedent rule, whereby "the presence of a comma before the qualifying phrase is evidence that the qualifier is intended to apply to all antecedents instead of only the immediately preceding one."[50] But in the example given—and in the language we are construing here—no comma precedes the qualifying phrase.

The "rule of the last antecedent" has been restated and applied recently by appellate courts in Alaska.[51] It is not an absolute rule, however, but rather a guide where the context does not compel otherwise[52] or where there are no indicia of contrary intention.[53]

In 15 AAC 55 there are indeed some indicia of contrary intention, but they require a broader focus than the first few lines of subparagraph 55.260(a)(11). Most significantly, 15 AAC 55.260(a)(11)(A)(ii) limits "contract services" to "services the labor costs of which, under (3) of this subsection, would be allowable as direct charges if the operator's employees performed the services." Moving to 15 AAC 55.260(a)(3), one finds that if Renaissance's own employees were assigned to the drilling, their labor costs would not qualify for the tax credit unless they were "on the site or in the vicinity" of the exploration activity or "in transit to or from the site or vicinity."[54] Their wages would not be covered if they were simply waiting in readiness in hotel rooms in Anchorage or in dormitories at Prudhoe Bay. Since there is no evidence that the Doyon employees assigned to the contract work were ever deployed at all, they would not meet the criterion set by 15 AAC 55.260(a)(3). More broadly, the requirement that

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[48] *White,* 646 P.2d at 193.

[49] *Id.*

[50] *In re Sehome Park Care Center, Inc.,* 903 P.2d 443, 447 (Wash 1995).

[51] *Weimer v. Continental Car & Truck, LLC,* 237 P.3d 610, 614-5 (Alaska 2010); *Whiting v. State,* 191 P.3d 1016, 1022 (Alaska App. 2008).

[52] *See Braaten v. State,* 705 P.2d 1311, 1321-2 (Alaska App. 1985). In that case the context did compel otherwise, as the modifying phrase (which was not separated from either of its potential antecedents by any punctuation at all) had to be applied to both antecedents because without it neither could stand alone as an independent standard. This case is different: the antecedent to which the department seeks to apply the phrase is far removed and separated by punctuation, and it does not need this modifier to function as an independent standard because it is bounded by the purpose limitation in 15 AAC 55.250 and the further limitations in 15 AAC 55.260(a)(11)(A).

[53] *E.g., Barnhart v. Thomas,* 540 U.S. 20, 26 (2003) (rule "can assuredly be overcome by other indicia of meaning"); *American Fed'n of Gov't Employees, AFL-CIO Local 2152 v. Principi,* 464 F.3d 1049, 1055-6 (9th Cir. 2006) (looking to broader context and legislative history).

[54] The exceptions to this requirement would be if they were (1) on the site of a communications or field automation system they were operating (15 AAC 55.260(a)(3)(A)(iii)); (2) on the site for construction, transportation, repair, or maintenance of certain equipment other than a well (15 AAC 55.260(a)(3)(A)(iv)); or (3) working out specific technical or design problems (15 AAC 55.260(a)(3)(B)). No evidence in this case brings the Doyon employees into the scope of any of these exceptions.

contract workers be in transit or at the site is an indication that qualification for contract services was indeed intended to depend on whether those services were actually rendered—in other words, whether they were "used in" the operation.

A similar indication of intent is found by looking at a closely related provision, 15 AAC 55.260(a)(14). That subdivision of the 21-item list of allowable costs specifically enumerates "standby costs paid to a third party drilling rig contractor, and incurred . . . to secure a rig for drilling," but then allows those costs only "if the rig is actually used for the operation for which it was secured." Renaissance maintains stoutly that this provision does not apply to the Doyon services because the rig was never on "standby."[55] Renaissance may be right about this; Williams & Meyers defines standby rig time as a period "when drilling is temporarily held in abeyance pending agreement . . . on such a matter as whether to continue drilling, etc.,"[56] and mobilization of the Arctic Wolf rig never seems to have progressed far enough for it to be on standby in that sense. Nonetheless, the limitation in (a)(14) is instructive, indicating that the overall thrust of 15 AAC 55.260 was to allow charges for the downtime of teams and equipment actually used in the operation, but to rule out charges incurred merely to have teams and equipment available even though never used at all. It would be anomalous if (a)(14) excluded charges for an idle rig that was deployed to the site but then never actually put to use, and yet (a)(11) allowed all charges for a rig that was never even deployed at all.

Concluding that 15 AAC 55.260(a)(11) should be construed to encompass contract services only if they are actually used in operations comports with the principle, mentioned above, that provisions creating exceptions or exemptions from the general tax treatment are to be interpreted narrowly. The rationale for cautious, narrow interpretation is especially strong where—as in the present case—the exceptional tax treatment at issue consists of transferable tax credits that function like a direct cash subsidy from the public fisc.[57]

Accordingly, the best reading of the regulation is that it does not encompass the $5,153,799.86 paid to Doyon to secure the Arctic Wolf rig. The payment therefore satisfies only one of the two regulatory criteria to be a "lease expenditure" under AS 43.55.165: it satisfies the

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55 Renaissance Umiat, LLC's Reply Brief at 10 n.4.

56 Williams & Meyers, *Oil and Gas Terms* (7th ed. 1987).

57 In this decision, the canon of narrow construction is applied solely to the Revenue regulation that must be satisfied in order for an expenditure to qualify. Because the validity of the regulation has been conceded, it is not necessary to construe the underlying statute. Moreover, this decision should not be read to suggest that the exclusion of payments to secure items that ultimately remain unused, as reflected in 15 AAC 55.260(a)(11) and (14), was a regulatory choice compelled by the statute.

15 AAC 55.250 purpose/activity requirement, but not the 15 AAC 55.260 direct charge requirement. Since it is not a "lease expenditure" under AS 43.55.165, the expenditure is neither a "qualified capital expenditure" under AS 43.55.023(a) nor a "lease expenditure" usable under AS 43.55.023(b).

In reaching the above conclusion, the administrative law judge has not relied on deference to the agency to tip the balance. This might be a case where deference would play a role if, for example, the department had recognized the fact that its regulatory language from 15 AAC 55.260(a)(11) that it sought to rely on at the appeal level implies an opposite result, but articulated a broader rationale or policy for placing a slightly counterintuitive interpretation on the language. In this instance, however, the department's informal conference decisions failed to address whether the Doyon expenditures might be for "contract services" under 15 AAC 55.260(a)(11); one ICD never cited or addressed the regulation at all in this context,[58] and the other did not address the "contract services" part of the regulation.[59] The department did not identify the "contract services" aspect of 15 AAC 55.260(a)(11) as central until the appeal stage, formulating its view on this only as a litigation position. A mere litigation position ordinarily commands little or no deference.[60] Further, in formulating its litigation position the department did not appreciate that "used in oil or gas exploration, development, or production" might not modify "contract services," and hence it offered no reasoning on this question. If deference is appropriate, however, it strengthens the conclusion reached above.

D. Tax Credit for "Annual Training and Startup Fee"

In addition to the rental charges for the drill rig, Renaissance claimed as a qualified lease expenditure a payment of $450,000 to Doyon for an "annual training and startup fee." As noted at the end of the Facts section above, this fee seems to have related in part to training for Doyon personnel associated with the rig.

Renaissance included the training and startup fee in the scope of its appeal letters initiating cases 10-0131-TAX and 10-0268-TAX. When it filed its opening brief, however, it omitted any argument about this fee.[61] It also omitted the fee from its bulleted list of the items for which it was requesting credit in the conclusion of that brief.[62] There was no mention of the

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[58] ICD of Feb. 22, 2010 (now Case 10-0131-TAX) at 14.
[59] ICD of May 13, 2010 (now Case 10-0268-TAX) at 4.
[60] *See, e.g., Totemoff v. State,* 905 P.2d 954, 967-8 (Alaska 1995).
[61] The fee is mentioned twice in the factual summary on pages 12-14 of the brief, but there is no argument.
[62] Renaissance Umiat, LLC's Opening Brief at 30.

fee in Renaissance's reply brief, and the fee was again omitted from the list of items requested in the conclusion of that brief.[63] At oral argument, Renaissance again made no allusion to the $450,000 fee in its main argument. The sole argument Renaissance offered about this fee was during its rebuttal oral argument—after the department's briefing and argument opportunities had been entirely exhausted.

Under these circumstances, the issue should fairly be deemed to be waived. In any event, Renaissance has failed to meet its burden of showing that the department's disallowance of this cost was legally mistaken. Renaissance has made no effort to explain the regulatory route to support allowance of the fee, nor to point to evidence that would show that the fee fell within the scope of that regulatory path.[64]

Finally, and perhaps most fundamentally, as discussed in the final paragraph of the Facts section, it is not clear that this fee was paid at all as an amount over and above the sum paid to cover the obligation for 120 days at $43,000 per day. That sum was $5,153,799.86 (120 x $43,000, less a small credit for interest), and the record before the ALJ documents only $5,153,799.86 in total outlays to Doyon. If Renaissance in fact paid Doyon only a grand total of $5,153,799.86, it would seem that the $450,000 fee was effectively credited against the daily rental charge for the rig, and this could be viewed as tantamount to having the fee waived or refunded. It is impossible for the ALJ to get to the bottom of this issue without briefing and, in providing none, Renaissance fails to meet its burden to establish the factual predicate for its claim.

IV. CONCLUSION

Renaissance Umiat, LLC has not shown that the Department of Revenue erred in disallowing all payments to Doyon Drilling, Inc. in the challenged portions of the Informal Conference Decisions. Insofar as the appeals have not previously been settled, the Informal

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[63] Renaissance Umiat, LLC's Reply Brief at 14.

[64] To be allowed, the fee would perhaps have to be brought within the scope of 15 AAC 55.260(a)(4) as a bona fide charge for training of employees whose duties are described in 15 AAC 55.260(a)(3)(A). If so, the record seems entirely inadequate to establish the necessary prerequisites.

Conference Decisions of May 13, 2010 (appealed in Case 10-0268-TAX) and Feb. 22, 2010 (appealed in Case 10-0131-TAX) are affirmed.

DATED this 29th day of November, 2011.

By: *Signed*
Christopher Kennedy
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.

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. 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.

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.

Certificate of Service: The undersigned certifies that on the 29th day of November, 2011, a true and correct copy of this document was mailed to the following: David Mayberry, counsel for Renaissance Umiat, LLC; Steven DeVries, AAG. A courtesy copy was provided to Hollie Kovach, Chief of Appeals, Tax Division.

By: *Signed*
Kimberly DeMoss/Jessica Ezzell

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