BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of:	)	
	)	
CHEVRON U.S.A. INC	)	OAH No. 10-0212-TAX
	)	
Exploration Tax Credits	)	

DECISION ON SUMMARY ADJUDICATION

I. Introduction.

In seeking exploration tax credits under AS 43.55.025, Chevron U.S.A. Inc. (Chevron) submitted some of the expenditures associated with particular exploration wells more than six months after the "completion date" for those wells as defined in Department of Revenue (department) regulations. The department disallowed the credits associated with those costs both initially and at informal conference. Chevron appealed.

In the appeal to this office, both Chevron and the department moved for summary adjudication regarding a central legal issue. The administrative law judge (ALJ) finds that the legal issue resolves the bulk of the appeal in the department's favor, but that it is not dispositive as to approximately ten percent of the claimed expenses at issue. At the department's request, the unresolved matters are remanded to the department for investigation and a new initial agency determination.

II. Background.

In a document dated July 13, 2010, the parties stipulated to a wide range of facts. The background facts below are drawn from that stipulation and its exhibits unless otherwise noted.

A. Entitlement to the Exploration Tax Credit

The exploration tax credit at issue in this case was an incentive to explorers created by the versions of AS 43.55.025 in effect in the late winter of 2008 and the late winter of 2009, the two periods during which the expenditures at issue were made. These versions of the exploration tax credit statute created, among other things, a credit against production tax for certain exploration wells. The credit could be 20, 30, or 40 percent of qualifying expenditures on those wells, depending on their location and on which version of the statute was in effect at the time.

In order to apply for the type of credit at issue, AS 43.55.025 provided then (and continues to provide today) that

> an explorer shall, in a form prescribed by the department and, except for a credit under (k) of this section, within six months of the completion of the exploration activity, claim the credit and submit information sufficient to demonstrate to the department's satisfaction that the claimed exploration expenditures qualify . . . .[1]

At the time, the department had an implementing regulation reading, in pertinent part, as follows:

> An explorer may request an alternative oil and gas exploration tax credit under AS 43.55.025 by filing an application with the department, no later than six months after the completion date of the exploration activity for which the tax credit is claimed.[2]

Finally—and of key importance to this case—"completion date" was defined as "for . . . an exploration well, the earliest of the dates drilling ceased on the well site, the well was abandoned, or the well was suspended . . . ."[3]

B. Qualifying Activity and Tax Filings

In 2006, Chevron began a multi-year exploration program on its White Hills prospect in the Brooks Range foothills. As finally executed, the program encompassed five explorations wells. The parties agree on their completion dates under the definition quoted above. They are shown in the following table:

Well	*Completed*
Smilodon 9-4-9	March 23, 2008
Mastodon 6-3-9	March 27, 2008
Panthera 28-6-9	April 11, 2008
Bluebuck 6-7-9	March 18, 2009
Muskoxen 36-7-8	March 22, 2009

[1] AS 43.55.025(f)(1). Subsection (k) involves a retrospective credit for seismic expenditures before 2003, and is not relevant to this case.
[2] 15 AAC 55.350(a) (2007 – 2009 version, Register 182).
[3] 15 AAC 55.900(b)(10).

Chevron filed ten claims for AS 43.55.025 exploration tax credits in connection with these five wells. They were submitted as follows:

Well	*Completed*	*Claim 1*	*Days After Completion*	*Claim 2*	*Days After Completion*
Smilodon 9-4-9	3/23/08	9/19/08	180	9/3/09	529
Mastodon 6-3-9	3/27/08	9/19/08	176	9/3/09	525
Panthera 28-6-9	4/11/08	9/19/08	161	9/3/09	510
Bluebuck 6-7-9	3/18/09	9/3/09	169	9/21/09	187
Muskoxen 36-7-8	3/22/09	9/3/09	165	9/21/09	183

The Department of Revenue issued exploration credit denial letters disallowing the second claims for the Smilodon, Mastodon, Panthera, and Bluebuck wells as untimely. The other six claims (including the second claim for the Muskoxen well) were deemed timely. Because the second claims were much smaller than the first, the effect of this determination was to deem about $42 million in credits timely, and to disallow as untimely $879,035 in credits. It is these four untimeliness determinations that Chevron challenges in the present appeal.

The amounts at issue in these four untimeliness determinations as to second submissions, broken out in more detail, were:

Well	*Expenses Claimed*	*Credit Percentage*	*Credit Claimed*
Smilodon 9-4-9	$679,591	30	$203,877
Mastodon 6-3-9	$550,481	40	$220,192
Panthera 28-6-9	$666,852	30	$200,056
Bluebuck 6-7-9	$849,700	30	$254,910

In each instance, the second submission occurred because, for one reason or another, some costs had not been assembled at the time the initial claim was submitted. For example, Chevron's September 3, 2009 claim for the Bluebuck well encompassed only costs "booked in Chevron's accounting system . . . through July 31, 2009," whereas the second claim brought in costs booked all the way up to the day before the second claim was submitted.[4]

It will be notable for Part III-C of the discussion below that the second submissions for Smilodon, Mastodon, and Panthera were sent in the same packet with initial submissions for the 2009 wells, Bluebuck and Muskoxen.[5]

The untimeliness determinations were upheld at informal conference. This appeal followed.

III. Discussion.

A. Standard of Review

The parties agree that the questions presented by their cross-motions are questions of law. The legislature has prescribed standards of review for such questions. As a general matter, the ALJ is to "resolve a question of law in the exercise of [his] independent judgment."[6] 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."[7]

These standards are 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.[8] The legal questions that arise in this case do bring with them a measure of deference to the department. The nature of that deference will be discussed in connection with the discrete legal question in B-1 below.

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4 *See* Div. Ex. D at 1.
5 *Id*.
6 AS 43.05.435(2).
7 AS 43.05.435(3).
8 *See State, Dep't of Revenue v. DynCorp and Subsidiaries*, 14 P.3d 981, 984 (Alaska 2000).

B. The Department Is Entitled to Summary Adjudication on the Disputed Legal Issue

1. Each well is an "exploration activity."

As noted above, explorers seeking the credit at issue in this case must claim the credit "within six months of the completion of the exploration activity" for which the credit is sought. The six-month window is set by statute, and the validity of the statute has not been questioned. The fundamental legal question the parties have advanced in this case is what should be regarded as the "exploration activity" whose "completion" *triggers* the running of the six months.

Chevron contends that the five wells were part of a unified exploration program, so that the "completion" date applicable to all expenditures, whenever they were incurred, was the operations ceased for last well in the program—that is, no sooner than the date the Muskoxen well was completed, or March 22, 2009. Under that approach, all of Chevron's submissions would be timely. The department, on the other hand, contends that each well is a separate "exploration activity" triggering a six-month period to claim expenses associated with that well.

The obstacle to Chevron's interpretation of the statute is the department's regulation at 15 AAC 55.900(b)(10). That regulation, as noted above, defined "completion date" as "for . . . an exploration well, the earliest of the dates drilling ceased on the well site, the well was abandoned, or the well was suspended . . . ." While the regulatory definition applied directly only to the department's time-limit regulation, 15 AAC 55.350(a), the latter regulation was no more than a repetition of the statutory time limit, and thus 15 AAC 55.900(b)(10) effectively functioned as an interpretive regulation codifying the department's interpretation of the statutory language, including its interpretation that a "completion date" triggering the six-month limit attaches every time drilling on that well ceases or the well is abandoned or suspended.

By means of this interpretive regulation, the department construed "exploration activity" narrowly. For an exploration program involving wells, each individual well was to be treated as an "exploration activity," with the six-month limit counted from the

"completion date" for each well. This interpretation is longstanding—dating back to the inception of the exploration tax credit program[9]—and it has been consistent.

The courts, and by extension, the Office of Administrative Hearings, are required to give "consideration and respect" to such a contemporaneous construction of a statute by the agency charged with its administration.[10] It is to be overruled only for "weighty reasons."[11]

Deference is especially appropriate where the interpretation has been longstanding,[12] which is the case here. It is also particularly called for where "the statute has been reenacted without change subsequent to the promulgation of the administrative regulation."[13] Since 15 AAC 55.900(b)(10) came into existence in early 2004, the underlying tax credit statute it construes was amended in 2004, 2005, 2006, and twice in 2007. On three of those occasions the amendments were pervasive. Nonetheless, the legislature did not disturb the department's approach to the six-month time limit.

Chevron has not offered weighty reasons that the department's interpretation should be abandoned in favor of a different one. It simply argues in a conclusory fashion that "exploration activity" is a broad term that plainly must encompass an exploration program as a whole. On the contrary, however, "exploration activity" is a vague and elastic phrase that could be applied to large or small components of an operation.

The very broad construction Chevron advocates is problematic. First, there is some tension between Chevron's approach and the fact that the legislature pegged the six-month deadline to "completion of the exploration *activity*" rather than to "completion of the exploration." Attaching the deadline to the end of an entire, multi-year regional program would be more consistent with the latter phrasing than the former. Moreover, Chevron's approach would create practical difficulties in administering the time limit. The White Hills program, for example, was effectively closed out in 2009,[14] but the company's plan called for operations until May of 2012.[15] Under Chevron's

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9 *See* Alaska Administrative Code, Reg. 168.

10 *Kelly v. Zamarello,* 486 P.2d 906, 910 (Alaska 1971) (quoting *Whaley v. State,* 438 P.2d 718 (Alaska 1968)).

11 *Id.*

12 *State, Dep't of Revenue v. Debenham Elec. Supply Co.*, 612 P.2d 1001, 1003 n. 6 (Alaska 1980).

13 *Id*.

14 Joint Stipulations of Fact, ¶ 7.

15 Lease/Unit Plan of Operations Application, item 5 (Att. C to Joint Stipulations of Fact).

interpretation, the explorer could control the triggering of the six-month deadline by saving a little work (perhaps something as minor as paperwork) to do in later years, spinning out the filing of a claim far beyond the completion of the major components of the program. It would be difficult for an auditor to know when the six months should really start to run.

The department's interpretation, on the other hand, creates a bright-line rule that is easy to administer. It also accords with the principle that exemptions from the general tax treatment, including tax credit provisions, are to be construed narrowly.[16]

The department's construction will be upheld.

2. The six-month limitation is a deadline.

Chevron also argues that "[t]he statute and regulations are silent as to the effect of the failure to identify exploration expenditures within six months."[17] This argument fails because no such provision is needed. The statute provides that [f]or a production tax credit under this section . . . an explorer *shall* . . . within six months of the completion of the exploration activity, claim the credit and submit information sufficient to demonstrate" the claim.[18] There is no provision for a tax credit if the explorer fails to follow this procedure and thus, if the procedure is not followed, no credit exists and the general tax provisions apply. There is no need for an additional provision divesting the taxpayer of the credit for "failure" to follow the procedure, because the credit does not exist in the first place if procedure is not followed.

If there were any doubt about this, the legislative history lays it to rest. When the "within six months" language was added to the bill that became AS 43.55.025, it was expressly explained that the language "narrows the timeframe and sets the timeframe for applying for the credit."[19]

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[16] For example, in *State, Department of Revenue v. OSG Bulk Ships, Inc.*, 961 P.2d 399, 409 (Alaska 1998), 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." *See also, 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).

[17] Memorandum in Support of Petitioner's Motion for Summary Adjudication, at 6.

[18] AS 43.55.025(f)(1) (italics added).

[19] Colloquy between Reps. Rokeburg and Kohring, House Special Committee on Oil and Gas, May 18, 2003.

3. The deadline is mandatory.

Chevron makes a brief argument that when the legislature said "shall . . . within six months," it was only making a suggestion. Chevron relies on *City of Yakutat v. Ryman,*[20] which held that some deadlines imposed on a taxing authority—in that case, the date by which to set a mill levy and mail out tax statements—can be directory rather than mandatory, so that a city is not left completely without revenue if it misses these dates. The practicalities of *Ryman* are far removed from the present situation, where a taxpayer is offered a credit if certain conditions, including a time limit, are met, but can simply pay at the regular rate if they are not. Moreover, the legislature did provide for time extensions in AS 43.55.025; the very next subparagraphs following the one at issue authorize the Department of Natural Resources to extend a 30-day deadline.[21] That the legislature included no such authorization with respect to the six-month limitation indicates that the deadline is mandatory.

4. 15 AAC 43.355 does not require issuance of credit certificates for expenditures submitted after the deadline.

In an even briefer argument, Chevron relies on 15 AAC 55.355(e), which provides:

> After the six-month application period in AS 43.55.025(f) has expired, the department will issue one or more production tax credit certificates for the qualified expenditures allowed under AS 43.55.025.

Chevron seems to contend that this regulation forces the department to issue certificates for all qualified expenditures, whenever they may be claimed. It does not. It requires certificates only for "qualified expenditures *allowed* under AS 43.55.025" [italics added]. Expenditures not claimed within the six-month span set by AS 43.55.025(f)(1) are not "allowed" under AS 43.55.025.

5. Chevron has not shown that the department has failed to follow the Administrative Procedure Act.

Lastly, Chevron argues that the department "was required to follow a formal rulemaking process before instituting a policy of denying exploration tax credits for

[20] 654 P.2d 785 (Alaska 1982).
[21] AS 43.55.025(f)(2)(B).

exploration well expenditures identified [more than] six months after individual well completion dates."[22] To the extent that the six-month deadline is set by regulation, the department appears to have followed the rulemaking procedure; the regulations appear in the Alaska Administrative Code, which creates a rebuttable presumption that they were duly adopted as printed there.[23] Chevron has not shown otherwise.

6. Matters Resolved.

The foregoing establishes that each well in an exploration program is a separate "exploration activity," and applications for a tax credit for expenses associated with each well must be submitted within six months of the "completion date" for that well, as "completion date" is defined in 15 AAC 55.900(b)(10).

C. The Legal Issue Does Not Resolve the Entirety of the Case

During the course of the motion practice to reach the above result, it appeared to the ALJ that some of the $624,125 in expenses that Chevron submitted on September 3, 2009 in connection with the Smilodon, Mastodon, and Panthera wells were incurred after the completion date of those wells. Moreover, according to Chevron's tax credit applications as originally submitted, these expenses related to "transitional activity"[24] leading to the second season's drilling at the Bluebuck and Muskoxen sites. This raised the question whether the expenses were simply associated with the wrong well in Chevron's combined September 3, 2009 application packet. The costs associated with transitioning exploration operations to new locations may be creditable in connection with the wells at the new locations. In response to a query from the ALJ, Chevron has indicated that it claims that $272,150 in costs associated with Smilodon, Mastodon, and Panthera in the September 3, 2009 application could also be associated with "the second season drilling program and the Muskoxen and Bluebuck exploration wells."[25]

If some or all of the $272,150 in costs were actually Muskoxen/Bluebuck costs but were simply associated with the wrong well in Chevron's packet, *it may still be appropriate to disallow them.* However, it would not be the six-month time limit that would disqualify them. Those expenditures would have been submitted within six

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22 Memorandum in Support of Petitioner's Motion for Summary Adjudication, at 9.
23 *See* AS 44.62.100, 110, 130; *cf.* Alaska R. Evid. 201.
24 *See, e.g.*, Div. Ex. F at 1.
25 E-mail submission, Feb. 24, 2011.

months of the completion date for the well with which they should have been associated. Rather, any disqualification would have to rest on some other procedural or substantive infirmity. The department's motion for summary adjudication rested only on the six-month time limit. Accordingly, the department's motion fully disposes of only the credits associated with $351,975 of the Smilodon/Masodon/Panthera costs submitted on September 3, 2009 or with the $849,700 in Bluebuck costs first submitted on September 21, 2009.

With respect to the $272,150 in costs not disposed of on summary adjudication, it would ordinarily be necessary to proceed to a hearing.[26] However, the department has instead requested that those costs "be remanded to the Department for investigation and an initial agency determination,"[27] since the department has never evaluated the misallocation issue, having thought the six-month time limit was wholly dispositive. This suggestion is sensible and will be followed.[28]

On remand, the department is not precluded from determining that the expenditures at issue cannot be associated with the Muskoxen or Bluebuck wells. No findings of fact have been made on appeal with respect to those expenditures.

IV. Conclusion and Order

Partial summary adjudication is granted to the department as set forth above.

This matter is remanded to the Department of Revenue to consider whether credits associated with the Bluebuck or Muskoxen well should be allowed in connection with the $272,150 in expenditures not encompassed by the summary adjudication.

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[26] The parties have never stipulated that this case can be resolved solely by motion or that it should be decided on written submissions. They simply agreed to a procedure for dispositive motions, and agreed that the case would "likely" be resolved that way. Thus, Chevron did not waive or otherwise fail to meet its burden of proof on this issue by omitting it from its own motion for summary adjudication. Chevron also did not waive or preclude the issue in the parties' fact stipulation. A careful review of that stipulation, including the two paragraphs (9 and 13) that the division has pointed to as particularly relevant, shows nothing inconsistent with an argument that costs misallocated among wells in the consolidated September 3, 2009 application could be reallocated to a different well.

[27] Response to Chevron's February 24, 2011 Submission, at 2.

[28] The ALJ perceives this remand to be to Chevron's advantage and has granted it on the assumption that it is unopposed. However, in the unusual procedural posture in which the issue arose, Chevron has not had an opportunity to comment on the remand. If the ALJ is mistaken and Chevron objects to remand, it may move for reconsideration as provided below.

Jurisdiction is not retained. Any new final agency determination will be appealable as a new case.

DATED this 19th day of May, 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 May 19, 2011, this document was mailed to the following: Andrew Zalewski, Senior Tax Counsel, Chevron U.S.A., Inc.; Tina Kobayashi, Chief Assistant Attorney General; Hollie Kovach, Tax Division, Department of Revenue.

By: *Signed*
Linda Schwass/Kim DeMoss