BEFORE THE STATE ASSESSMENT REVIEW BOARD
STATE OF ALASKA

In the Matter of	)	OAH No. 11-0154-TAX
	)	OAH No. 12-0091-TAX
PIONEER NATURAL RESOURCES USA INC.	)	OAH No. 16-0423-TAX
	)	Appeal of Revenue Decisions
Oil & Gas Property Tax (AS 43.56)	)	Nos. 11-56-03/11-56-10/
2007-09; 2011-2013 Assessment Years	)	12-56-05/13-56-03

CERTIFICATE OF DETERMINATION

The State Assessment Review Board (Board) convened on May 17 and 19, 2016, to hear and deliberate on the AS 43.56 appeals of the assessment of oil production and pipeline property owned by Pioneer Natural Resources USA Inc. (Pioneer) during tax years 2007, 2008, 2009, 2011, 2012 and 2013.[1] The Board certifies that the value of Pioneer's oil production and pipeline property on the lien dates applicable to these appeals as follows:

- January 1, 2007: $93,182,983
- January 1, 2008: $359,570,039
- January 1, 2009: $399,115,429
- January 1, 2011: $396,742,061
- January 1, 2012: $421,499,904
- January 1, 2013: $420,533,171

I. Introduction

The subjects of this appeal are the division's Revenue Decision numbers 11-56-03, 11-56-10, 12-56-05, and 13-56-03. The parties positions in these appeals is summarized as follows:

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[1] Chair Steve Van Sant, and members James I. Mosley, Bernard Washington, and Bill Roberts heard the appeal, constituting a quorum as required by AS 43.56.130(b). Administrative Law Judges Neil Slotnick and Cheryl Mandala from the Office of Administrative Hearings assisted the Chair. Under AS 44.64.020(6) and 44.64.030(b), the Office of Administrative Hearings provides administrative law judges to advise the Board at the request of the Commissioner of Revenue.

Year	Assessment	North Slope	Pioneer
2007	$87,708,113[2]	205,209,770	35,825,474
2008	$353,938,960[3]	481,949,137	186,416,098
2009	$393,484,350[4]	538,448,18,	212,089,803
2011	$391,224,130[5]	627,078,750	216,196,355
2012	$416,193,530[6]	677,566,630	238,795,937
2013	$415,192,510[7]	720,903,310	245,355,827

Under AS 43.56.130(f), the Board cannot adjust the division's assessed valuation unless the evidence in the record shows that this valuation is unequal, excessive, improper, or otherwise contrary to the standards set out in AS 43.56. The Board finds that neither Pioneer nor the North Slope has met its burden of proof. The only adjustment to the assessment is an adjustment to correct an inadvertent underassessment of approximately $5 million. This underassessment was due to spreadsheet error caused by an erroneous sorting procedure. All three parties agreed that this error should be corrected.

A. Description of the Property

Pioneer's Oooguruk development is located on Beaufort Sea in the Colville River area northwest of the Kuparuk River Unit. Oooguruk is in the North Slope Borough. Pioneer began construction on Oooguruk in 2006, and first oil was produced in 2008. The project includes a five-acre artificial island.[8] The island houses wells and production facilities. A subsea flowline connects the island to the Oooguruk Tie-in Pad, an onshore facility that houses production

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2 Division Exhibit mm. The number reported here is based on property in the North Slope Borough.
3 Division Exhibit mm. The number reported here is based on property in the North Slope Borough.
4 Division Exhibit mm. The number reported here is based on property in the North Slope Borough.
5 Division Exhibit oo. The number reported here is based on property in the North Slope Borough.
6 Division Exhibit pp. The number reported here is based on property in the North Slope Borough.
7 Division Exhibit qq. The number reported here is based on property in the North Slope Borough.
8 *See* PNC-0148 at 1.

facilities and electrical generation equipment.[9]

B. Parties Appealing

The parties to the appeal are Pioneer Natural Resources USA, Inc., the North Slope Borough, and the Tax Division of the Alaska Department of Revenue.[10]

C. Consolidation and Coordination of Appeals

Pioneer's and the North Slope's appeals of Revenue Decision Nos. 11-56-03,11-56-10,12-56-05, and 13-56-03 were consolidated.[11]

II. Facts

In 2007, Pioneer Natural Resources, USA, Inc., began drilling wells from a five-acre artificial island it had constructed in the Beaufort Sea. The division issued initial assessments of Oooguruk's value for 2007, 2008, and 2009. These initial assessments were set aside as the division conducted an audit. On December 16, 2010, the division issued a Notice of Supplementary and Amended Assessment for 2007-09. In general, the division assessed the project at full and true value based on actual cost of the project, except that intangible drilling expenses were excluded from value because those costs are exempted from taxation under AS 43.56.060(f). Intangible development expenses, however, were included in assessed value.

Pioneer appealed the assessment, arguing that because the division had incorrectly distinguished between drilling and development, the assessment wrongfully taxed exempt intangible drilling expenses. Under the Department of Revenue's administrative regulations in effect at that time, however, the department itself would hear appeals regarding issues that concern taxability of an asset under AS 43.56. Because the issue in this case was more appropriately decided by the department's process, the parties stipulated to dismiss the appeal before the Board. The Board remanded the appeal for proceedings before the department under 15 AAC 05.001-05.050.[12] During its informal conference process, a division informal conference officer disagreed with the approach taken by the assessor, and reduced the assessment.

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9 *See* PNC—0148 at 3.

10 The Owners were represented by F. Steven Mahoney and Ryan Fitzpatrick. Assistant Attorneys General Katherine Swanson and Martin Schultz represented the Tax Division. The North Slope Borough was represented Jessica Dillon and Molly Brown.

11 *See* Pre-Hearing Order issued April 18, 2016.

12 *Id.* at 217. The Board dismissed the case and remanded it back to the division. *Id.* at 216.

Both Pioneer and North Slope appealed the informal conference decision to a formal hearing. A hearing was held before the Office of Administrative Hearings on the informal conference decision. After a lengthy discovery and hearing process, a decision was issued and adopted by the Commissioner's designee. The decision ruled on the distinction between drilling and development, and remanded the case to the division for a new assessment. While the issue was on remand, however, the Alaska Supreme Court invalidated the regulation under which "taxability" issues were determined by the department.[13] Instead, all issues raised in an appeal of an assessment were to be heard by the Board. This decision nullified both the preliminary decision of the Commissioner and the informal conference decision. As a result, the assessment issued by the assessor was back on appeal, now before the Board for the 2016 appeal cycle.

During the interim while the audit, assessment, and appeal for 2007-09 were pending, the division had issued new assessments for tax years 2010-13. (The division continued to assess the Oooguruk project after 2013, but effective January 1, 2014, Pioneer sold Oooguruk, and for purposes of this appeal, was no longer the taxpayer of record.) All years except 2010 were appealed. Those appeals were stayed, pending the results of the appeal of 2007-09 on the issue of the taxability of intangible development costs. After the Supreme Court ruling in *Valdez,* however, tax years 2011-13 also came before the Board during the 2016 property tax appeals cycle.

The 2016 hearings before the Board were bifurcated between taxability and valuation. A preliminary hearing was held on April 5, 2016, to address the taxability of intangible drilling expenses in this and other currently pending AS 43.56 appeals. Because the issue was common in all of the pending 2016 property appeals (involving three taxpayers, each with multiple years at issue), the taxability issue was consolidated for one joint hearing.

The taxability issue involved construing Alaska law exempting intangible drilling expenses from being included in the taxable value of oil and gas pipeline and production property.[14] The Department of Revenue has adopted a regulation defining "intangible drilling expenses" for

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[13] *City of Valdez v. State,* No. S-15840, 2016 WL 1719372, at *5 (Alaska Apr. 29, 2016) ("revenue's interpretation of 'assessment' through its regulation is not consistent with the text of AS 43.56."); *see also* Order, *City of Valdez v. State of Alaska*, Supreme Ct. No. S-15840 (Alaska, January 29, 2016).

[14] AS 43.56.060(f).

purposes of this exemption.[15]

The taxpayers in the 2016 taxability appeal argued that the state intangible drilling expense exemption mirrors the federal income tax provision on intangible drilling and development costs.[16] Their reading of Alaska law is broader than the one followed by the division. The taxpayers asserted that the assessor erred in including intangible "development" expenses in the assessments.

On April 12, 2016, the Board upheld the division's determination that the state exemption under AS 43.56.060 and 15 AAC 56.120 incorporated federal income tax law only to the extent that federal income tax law referenced intangible drilling costs. The Board concurred with the division that the state exemption did not incorporate federal income tax law with respect to intangible development expenses. The decision did not, however, address which activities are included or excluded from the regulation's definitions of nontaxable "intangible drilling expenses" versus taxable "intangible development expenses." The April 12, 2016, decision is incorporated by reference and made part of this decision.

III. Discussion

An oil-and-gas project in Alaska is subject to the state oil-and-gas property tax imposed under AS 43.56. In general, during the construction phase of a project, the taxable value of an oil-and-gas project is determined by the actual cost of the project.[17] For tax years after construction, property committed to the production of oil or gas is valued based on "replacement cost less depreciation based on the economic life of proven reserves."[18]

The determination of actual or replacement cost for assessment purposes excludes "intangible drilling expenses."[19] Intangible drilling expenses are those intangible expenses incurred or accrued in preparing to drill a well, such as, "clearing ground, draining, road making, surveying, and geological works," and actually "drilling wells."[20] But "intangible drilling

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15 15 AAC 56.120.
16 *See* 26 U.S.C. 263(c); 26 C.F.R. § 1.612-4(a).
17 AS 43.56.060(d).
18 AS 43.56.060(d)(2).
19 AS 43.56.060(f); Division Exhibit aa at 12.
20 AS 43.56.210(4); 15 AAC 56.120.

expenses" do not include "intangible development expenses."[21] Nor do they include expenditures "that are properly allocable to the cost of depreciable property ordinarily considered to have a salvage value."[22]

In this appeal, both North Slope and Pioneer have asserted that the assessment is in error. In particular, both parties focus on the treatment of intangible drilling expenses. We begin this discussion with North Slope's arguments.

A. Has the North Slope established that the division erred?

1. Does 15 AAC 56.120 require that intangible completion costs be included in the well model used to value the RCN for a project?

We begin our analysis with a discussion of tax years 2011-13. For these years, the division assessed the project under the replacement cost new less depreciation (RCNLD) appraisal approach, using a model for calculating the cost of drilling a well, and then adding in the cost of production equipment.

The North Slope Borough has urged the Board to reject the tax division's application of the Department's regulation defining intangible drilling expenses, 15 AA 56.120. In the North Slope's view, the division has failed to distinguish between "drilling" and "development." North Slope points out that the Board's April decision recognized that, unlike the federal income tax option to expense, in state property tax law, intangible development expenses are not included in the exemption. North Slope asserts that the division has drawn the line between "drilling" and "development" in the wrong place.

North Slope's engineering experts testified that drilling stops when the hole has reached what is commonly called "casing point." At this depth, the bit no longer is grinding and the hole has reached final depth. The operator must make the decision about whether to complete the hole for production, complete it as a reinjection well, or abandon it as a dry hole.

If the well is completed as a production well, the operator will undertake additional steps before oil begins to flow. These steps are called "completion." Completion will include installation of the production tubing, hardware that goes into the well (called the "jewelry"), and the "Christmas tree" (the valve assembly that sits on the wellhead). Because completion occurs

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[21] 15 AAC 56.120(c)(1).
[22] 15 AAC 56.120(c)(3).

after casing point, the North Slope concludes that intangible completion costs are taxable costs of development, not nontaxable intangible drilling expenses.

The division's well model, however, does not include intangible completion expenses as part of the taxable costs for valuing the replacement cost new of a well. Instead, this model includes intangible costs only for installation of production property after the Christmas tree. Downhole intangible costs are valued as drilling costs, not development costs. This version of the well model has been in place since at least 2002.

In arguing against including completion costs in the exemption, the North Slope urges that the term "drilling" should be narrowly construed. The North Slopes believes that completion costs could not be considered drilling costs under the regulation. Both as a matter of common sense, and as matter of expert opinion, the North Slope would limit drilling to activity that involves deepening the hole.

The North Slope also presents a textual argument, pointing out that the state regulation defining intangible drilling expenses, 15 AAC 56.120, contains many of the same terms as the federal regulation defining intangible drilling and development costs, 26 C.F.R. § 1.612-4(a). The state regulation, however, omits the phrase "expenditures made by an operator for . . . the preparation of wells for the production of oil or gas," which is included in the federal regulation.[23] To North Slope, this omission is crucial: it identifies that the break point between drilling and development is at the moment drilling stops and preparation for production begins. Thus, because of the omission of this key phrase, the North Slope considers 15 AAC 56.120 to require that development begin at casing point.

The North Slope has calculated a per-foot cost of the intangible completion costs for purposes of using a well model to value the replacement cost for projects. It determined, based on 2016 data, that the cost per foot for intangible completion costs was $197.22.[24] It asserts that the Board should amend the assessment for 2011-13 by including this value in the replacement cost new less depreciation calculation.

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23 *Compare* 26 C.F.R. § 1.612-4(a) *with* 15 AAC 56.120(b). The state regulation also omits expenditures for "shooting and cleaning" the wells, which the North Slope believes further supports its argument because these terms also denote completion activity.

24 The support for this number was provided in a different taxpayer's appeal by North Slope expert Rick Baggot. It is cross-referenced here for completeness purposes.

If this were simply a matter of first impression, the North Slope's arguments might well be persuasive. Their experts have established that casing point could be a reasonable place to draw the line between drilling and development. Further, the omission of terms could be significant when construing this regulation, if the Board were applying the regulation without reference to the division's historical interpretation and application of the well model.

The terms "drilling" and "development," however, are not precise. Indeed, North Slope's own experts, when trying to find a cut-off point for drilling that they could use for purposes of valuing the costs included in a well, recognized that some imprecision was necessary. The imprecision that they noted was that an operator might have to resume drilling after having already set the production liner if trouble occurred. Although installation of the production liner is a completion cost, and it occurs after casing point has been reached, the North Slope elected to treat installation of the production liner as nontaxable as if it were a drilling cost, rather than a completion or development cost. That way, it could pick a consistent moment in time and still ensure that all drilling costs (including trouble costs for redrilling) are exempted.[25] Although the Board recognizes that the North Slope merely was doing this for convenience, recognizing that as a tax administrator it could give the tax payer a break, from the Board's point of view, if North Slope can extend the line past casing point, then the division should also be able to do so.

Thus, even if "casing point" and "drilling" are precise terms to an engineer, "drilling" and "development" are not precise terms to a tax administrator. A tax administrator could reasonably determine that the activities that the legislature intended to incentivize by this tax exemption included all pre-oil activities. Under this approach, the division could reasonably determine that the best fit for the term "drilling" might be "downhole activity" or "activity before first oil." These activities generally involve use of the drill rig even if they do not necessarily involve use of a bit to deepen the hole, so lumping pre-oil activities in with drilling is not unreasonable.

As for the North Slope's textual argument regarding the terms omitted from the regulation, that argument does not compel the result that completion costs *must* be taxed. If the department had intended to compel the taxation of completion costs, the department would have stated in its regulation that completion costs are taxable development costs. Similarly, the department could

25 Bishop testimony.

have specified that casing point was the operable moment in time after which all activity in the well is development. The omission of the terms "completion" and "casing point" from the regulation means that the division has discretion to determine where drilling stops and development begins based on the most reasonable application for purposes of administering the tax exemption.

The division has made this determination by adopting a well model that does not begin taxing intangible costs until production begins.[26] The Board's role in this matter is to defer to the assessor's determination unless the appellant has proven that the assessment is excessive, unequal, or improper. Here, the Board has no reason to second-guess the division's determination that the exemption to tax established in AS 43.56.060(f) should be administered by exempting completion costs from taxation.

Before leaving the issue of the well model, however, the Board will provide the following additional guidance. First, with regard to intangible expenses, the Board offers the following four observations:

- Nothing in this decision should be interpreted to mean that the Board has made a decision regarding where drilling ends and development begins. All that the Board is holding here is that the North Slope has not met its burden of proving that the division erred by using an event that occurs after casing point to distinguish between drilling and development.
- The Board appreciates the assessor's testimony that trying to distinguish between drilling and development is a difficult issue. The Board understands that some gray issues remain, and that the assessor is committed to working on defining this distinction with greater precision than exists now. Indeed, the Board was never clear whether the division's approach is to define development to mean "all costs after first oil" or to define drilling to mean "all down-hole costs." These two definitions would result in different identification of taxable costs. Having more

[26] The North Slope argues that the division's approach nullifies the distinction between federal law and state law by making all development costs nontaxable. As will be seen in the discussion of the taxpayer's arguments, however, the division does not exempt facilities costs that the federal law would consider IDC because the division considers those expenses to be development expenses.

precision and certainty would be beneficial to the division, the taxpayer, and the municipality. The Board would encourage the division to adopt language in its regulations that clarifies the distinction between drilling and development.

- In that regard, the Board does not agree with the argument put forth by at least one of the taxpayers during the 2016 proceedings that hydraulic fracturing (commonly called "fracking") is equivalent to drilling. Although no party has proved that the division erred by exempting intangible fracking costs from taxation for these developments, if the line between drilling and development is drawn at first oil, then fracking would almost always be on the taxable side of the line. Again, the purpose of this observation is to encourage additional clarity, certainty, and precision in identifying taxable and nontaxable costs in the well model.
- Finally, and most important, the Board would encourage stratification of the well model among projects. Here, for example, this project (and the other projects at issue in the 2016 proceedings) was a state-of-the-art, technical, and expensive project. Although the Board understands that the well-model RCNLD must always be an approximation, the Board has concerns about valuing the RCNLD for this project using a single well model that is designed to value every well in the state.

The second observation relating to the well model follows directly from the Board's observation that stratifying the well model to arrive at a more reliable RCNLD would be an appropriate approach. Here, the North Slope has put forward evidence that the *tangible* costs included in the RCNLD through the well model are low. This is particularly true for projects that, like this one, are state-of-the-art projects, using higher-cost jewelry and other hardware than legacy projects.[27]

Yet, adding stratification to the well model must be done carefully. The point is not to have a sliding scale with multiple complex data points. The point is to have a very limited number of stair steps that recognize significant differences among projects. To do this would require

[27] There was question among the board members as to the value of the tangibles in the well model, including whether the jewelry (subsurface valves, electric submersible pumps (ESPs), safety valves, gas-lift valves, control lines, etc.) were being recognized and valued. The Board would recommend that the division review its procedure in picking up all down hole equipment and other tangible costs.

analysis of multiple projects that fit into the "more complex" stratum, and a reliable way to identify the cost for this stratum that can be used to estimate a reasonably accurate RCN for like projects.

Here, the North Slope has done a credible analysis of the tangible costs of this project for the purpose of evaluating the accuracy of the RCN generated by use of the well model. Its expert calculated that for tax year 2013, the tangible costs for this project was $127.84 per foot. He contrasted that amount to the division's well model, which, he testified, used $112.44 for tax year 2013. In the view of North Slope's expert, however, this represented "very little difference."[28] He did not recommend that the Board adopt his calculation for the purpose of amending the well model.[29] Moreover, for purposes of an RCN, the price structure for a well model should be based on multiple projects for multiple years. Given the North Slope's recommendation, and given that the only evidence of an alternative tangible cost structure is for one year for one project, the Board will not amend the division's well model to account for the higher tangible costs of this project over the costs included in the well model.

2. Does 15 AAC 56.120 require that intangible completion costs be included in the actual cost used to value a project under construction?

We turn next to tax years 2007-09, the years for which the Oooguruk project was under construction. For these years, the division did not use its well model to value the replacement costs of the project. Instead, as required under statute, the division valued the project based on the actual costs less intangible drilling expenses. Just as it did in its well model, when assessing the project, the division considered intangible completion costs to be exempted as intangible drilling expenses.

Using the same arguments that it used to advocate taxation of intangible completion costs when discussing the RCNLD and the well model, the North Slope argues that completion costs must be included in the valuation for 2007-09 based on actual costs. In presenting its case, the North Slope extensively analyzed costs, authorizations for expenditure (AFEs), and drilling logs, in order to distinguish intangible costs from tangible costs during these years.

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28 Baggot testimony.

29 Mr. Baggot did, however, strongly urge the Board to amend the well model to include additional *intangible* costs. As explained above, the Board will defer to the division's decision on which intangible costs to exempt from taxation.

For the same reasons that the Board did not accept the North Slope's argument that intangible completion costs must be taxed when using the well model, the Board is not persuaded that the division erred in its exemption of intangible completion costs from taxable value during the actual cost years. As explained above, the division has discretion under the regulation to apply exemption to completion costs.[30] Indeed, because the approach to assessing property should be equal, the Board's decision on how to apply the well model necessarily compels its decision on how to value the actual well costs during construction. Therefore, the Board will not overrule the division's approach to exempting intangible completion costs from assessed value.

North Slope also argued extensively that the division erroneously exempted many taxable items that were included on one of Pioneer's AFEs (AFE 10762).[31] This AFE was a "non-well" AFE, which meant that it was for expenses other than activities or items that actually went into the well itself. The largest expense on this AFE was coded to "platforms and inland water drilling facilities." Because the North Slope interpreted this to mean that these item were all facilities, the North Slope concluded that the expenses in this code were taxable under 15 AAC 56.120(c). For the other items in the AFE, the North Slope determined that some were taxable, some were exempt, and some were allocable.

Pioneer's accounting manager, however, explained that the coding to the platforms account for expenses related to the island was an acceptable accounting practice.[32] The division explained that it treated development costs as taxable and that it exempted "only the intangible costs specific to the actual activity of preparing to drill and drilling."[33] Nothing in the North Slope's presentation on AFE 10672 indicates that the assessor was confused by the coding and therefore failed to follow his standard procedure for determining which expenses were exempt.

The parties do agree, however, that a sorting error was made regarding AFE 10762 at some point during the assessment process. All three parties recommend that the Board adjust the

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30 The North Slope frequently cited to the preliminary decision in the now-void taxability appeal in OAH No. 13-1161-TAX. That decision held that intangible completion costs were taxable under the regulation. That preliminary decision, however, was based on an appeal from an informal conference decision that had overturned the assessor. The standard of review in that decision was different than it is here, and the well model was not under review. Moreover, that decision is not binding or even precedential in these proceedings.

31 Cross testimony.

32 Lee testimony.

33 Greeley testimony.

assessment to correct for this error. The Board will adjust the assessments using the adjustment calculated by the taxpayer as follows:

Year	2007	2008	2009	2011	2012	2013
Correction[34]	5,474,870	5,631,079	5,631,079	5,517,931	5,306,374	5,340,661

3. Has the North Slope proven that the division erred in its selection of end of life for purposes of applying age/life depreciation?

As explained above, after the construction phase, property committed to the production of oil or gas is valued based on "replacement cost less depreciation based on the economic life of proven reserves."[35] Here, this method of valuation applies to the Oooguruk project for tax years 2011-13. (For the earlier years, 2007-09, the project was valued on an actual-cost basis under AS 43.56.060(d)(1).) The North Slope, however, does not agree with the division's application of depreciation to the Oooguruk project.

This Board and the courts have spent considerable time in previous cases discussing the issues raised by the terms "economic life" and "proven reserves." These terms have resulted in applying age-life straight-line depreciation to oil and gas property that is being valued under a RCNLD methodology. In order to determine age-life depreciation, the division must first determine when the field will cease producing oil.[36] In general, this determination is made on the basis of the economics of the field—when it costs more to produce a marginal barrel of oil than the revenue that will be generated for that barrel, production will cease.

To determine when the Oooguruk field would cease production, the division used its estimate for when the Trans-Alaska Pipeline System (TAPS) would no longer be economically viable. For the years at issue in this appeal, the division's methodology resulted in a determination that production in Oooguruk would cease in 2034.[37]

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34 *See* PNC-0149.

35 AS 43.56.060(d)(2).

36 *State, Dep't of Revenue v. BP Pipelines (Alaska) Inc.*, 354 P.3d 1053, 1058 n.19 (Alaska 2015) ("In the economic age-life method, total depreciation is estimated by calculating the ratio of the effective age of the property to its economic life expectancy and applying this ratio to the property's total cost" (quoting Appraisal Inst., THE APPRAISAL OF REAL ESTATE 410, 420 (13th ed.2008))); *BP Pipelines (Alaska) Inc. v. State, Dep't of Revenue*, 325 P.3d 478, 494 (Alaska 2014), *reh'g denied* (May 12, 2014) ("Both the Department of Revenue and the superior court took into account projections for declining throughput in determining economic life.").

37 Greely testimony; Division Exhibit hhh.

The North Slope does not accept the division's estimate. The North Slope's expert, Dudley Platt, offers a different estimate. He bases his analysis on the estimates of recoverable reserves provided by the industry to outside sources, including regulatory agencies and the media. He then predicts the end of life, based on assumptions that production will follow a typical decline curve, operation expenses will gradually decline, and prices will increase over time. Mr. Platt testified that "Oooguruk will likely be able to produce economically 5,000 barrels a day."[38] His report states that the best estimate for end of field life in Oooguruk will be 2052 in 2011, and 2055 in 2012-13.[39]

Pioneer's expert Shaun Hoolahan presented evidence that over the last several years Mr. Platt's estimates have been overly optimistic. He described his preferred methodology for estimating end of field life, which involves, among other factors, predicting the percent of water recovered and then determining end of life based on water-handling capacity. He was not able to use this methodology for Oooguruk, however, because of a lack of data. Instead, he used an alternative analysis that he called "reservoir simulation." His estimates for end of life were 2032 in 2011, 2033 in 2012, and 2044 in 2013. Mr. Hoolahan concluded that these estimates were not materially different from the division's estimates, and asked the board to affirm the division.

Estimating end-of-life for an oil field is problematical. In the past, this Board and the courts have been generally open to Mr. Platt's methodology, and critical of Mr. Hoolahan's approach. Yet, the data presented by Mr. Hoolahan is credible. As to the division's approach, the Board has concerns about estimating the shut-in date for TAPS (which has been a very controversial subject in previous proceedings) rather than using a field-specific analysis.

Here, however, the evidence supporting the division's estimate is stronger than the evidence opposing it. Mr. Platt's expert report acknowledges that the general reported field life for Oooguruk has been roughly 20 to 30 years.[40] These reports are more consistent with the division's and Pioneer's estimates than with the North Slope's. Given these reports, and Mr. Hoolahan's testimony, the division's end-of-field-life estimates are reasonable. Therefore, the division's

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38 Platt testimony.

39 NSB-Pioneer-GV at 3.

40 NSB-Joint Qa at, e.g., 12 (referencing media reports for 2013 that "[i]t is expected the field to [sic] remain economic for at least 25 years."); *id.* at 15 (giving production estimates "over a 20 to 30 year project life").

depreciation calculations are affirmed.

B. Has Pioneer established that the division erred by not excluding additional costs Pioneer characterizes as intangible drilling expenses?

Like North Slope, Pioneer asserts that the division erred in its determination of which expenses qualify as nontaxable intangible drilling expenses. Pioneer, however, believes that the division was too stingy in its allocation of expenses to the category of exempt intangible drilling expenses.

The assessor testified that, consistent with "many years of DOR policy and practice," the only intangible drilling expenses that are excluded from AS 43.56 property taxation are those "*specific to the actual activity of preparing to drill and drilling wells*."[41] Pioneer contends that the division's assessments should have allowed a range of more than $50,000,000 (in 2007) per year to more than $170,000,000 per year in additional deductions for intangible drilling expenses.[42]

The Alaska Supreme Court has explained, however that "[a]a taxpayer claiming a tax exemption has the burden of showing that the property is eligible for the exemption. Furthermore, the courts must narrowly construe statutes granting such exemptions."[43] For the reasons that follow, Pioneer did not meet its burden of proving that the division erred in its interpretation of the 15 AAC 56.120 exemption for Oooguruk.

The assessor's affidavit and testimony summarizes his approach to the scope of the intangible drilling expense exemption. He includes "intangible expenses associated with gravel installation and construction only for wells"; "intangible expenses associated with drilling"; and "intangible expenses associated with well completion."[44] Additionally, "a portion of general overhead costs can be allocated to intangible drilling expenses if appropriate," but he cautions that "this is a delicate exercise [and] should be approached with caution, because some overhead costs may already be in the costs book to the drilling AFEs."[45]

The assessor does not, however, accept the taxpayers' broad arguments that all "costs

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41 Ex. a, p. 5 (emphasis in original).
42 PNC-0149.
43 *Greater Anchorage Area Borough v. Sisters of Charity of House of Providence,* 553 P.2d 467, 469 (Alaska 1976).
44 Exhibit a at 10.
45 Exhibit a at 9.

associated with gravel and gravel installation and construction," "costs associated with drilling except for tangible tubulars and jewelry," "costs associated with completion except for tangible tubulars and jewelry" are also intangible drilling expenses.[46]

Pioneer takes an aggressive view of intangible drilling expenses and what it means for an expenditure or an item to be "incident and necessary to drilling wells" under 15 AAC 56.120.[47] As explained above, however, the division has discretion to determine whether and how intangible expenses are allocated between drilling activity and longer-term activity over the life of the development.

On appeal, Pioneer asserts that it was entitled to additional intangible drilling expense deductions for project management expenses, as well as for the intangible expenses and gravel costs incurred in construction of most of the island.[48] Pioneer's arguments in this regard relate to its assertion that "drilling expenses" mean all expenses that the federal government categorizes as "IDC." The department's regulation, however, clearly states that development expenses are not exempt.[49] And under 15 AAC 56.120(c)(3)(B), even intangible expenses that may be related to drilling are not exempt if they are "properly allocable to the cost of depreciable property ordinarily considered to have a salvage value." The division's interpretation of the regulation to give the division the discretion to allocate overhead costs or gravel costs among drilling and development is reasonable.

Indeed, Pioneer admits that the division has discretion under the regulation to allocate gravel, overhead, management, and engineering expenses. Its own assessment includes an allocation of these costs. Pioneer's only argument here is that it disagrees with the division's exercise of discretion. Pioneer, however, has produced no evidence that the assessor erred in his allocation of drilling-related expenses in these categories to intangible drilling expenses.

Relatedly, Pioneer's expansive view of intangible drilling expenses also seeks to exempt costs implicated in development or production beyond "the actual activity of preparing to drill and

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46 Exhibit a at 10; Exhibit c, Exhibit d.
47 *See* PNC-0150.
48 Pioneer Prehearing brief at 5-7.
49 15 AAC 56.120(c).

drilling wells."[50] In addition to the claims discussed above, these arguments include the intangible expenses relating to control facilities, power systems, and communications facilities for Oooguruk.[51] These expenses relate to development/production activities at Oooguruk, and are not "drilling expenses" as the division has interpreted that term in the regulation. The division has interpreted the intangible drilling expenses exemption as covering only those intangible expenses "*specific to the actual activity of preparing to drill and drilling wells*."[52] Again, Pioneer did not prove that the Assessor abused his discretion in apportioning costs attributable to intangible drilling expenses versus development or production expenses.

Lastly, a number of the costs Pioneer claims are excluded from the intangible drilling expenses definition under 15 AAC 56.120(c)(3)(B). That section expressly excludes from "intangible drilling expenses" those expenditures "that are properly allocable to the cost of depreciable property ordinarily considered to have a salvage value." The North Slope's expert in forensic accounting, Loretta Cross, identified numerous types of depreciable property on the Oooguruk Island and testified that, as a basic principle of oil and gas accounting, intangible expenses on those items are properly allocable to the cost of the depreciable property.[53] The specific items claimed by Pioneer and that the Board finds to be excluded from the definition of intangible drilling expenses by 15 AAC 56.120(c)(3)(B) include the construction and installation of well bay and interconnect modules; power systems; on-shore and off-shore control facilities; communication facilities; piperacks; the flowline; and the pump house.[54] For these items, Pioneer seeks to recover intangible expenses (such as labor, hauling and repairs) associated with the item. But each of the items listed is depreciable property ordinarily considered to have salvage value.[55] The costs associated with it therefore fall outside the scope of the exemption for intangible drilling expenses.

Pioneer's reliance on 15 AAC 56.120(b)(3) to support an exemption for these items is not persuasive. Although that section defines intangible drilling expenses to include expenditures

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[50] Exhibit a at 5.
[51] Pioneer prehearing brief, pp. 5-12.
[52] Exhibit a at 5 (emphasis in original).
[53] Cross testimony.
[54] Pioneer prehearing brief at 7-13; Exhibit PNC-0149.
[55] Cross testimony.

incident and necessary to "construction of derricks, tanks, pipelines and other physical structures necessary to drilling wells," the testimony established that these are generally temporary structures erected as a prelude to drilling operations.[56] This reading harmonizes (b)(3) with (c)(3)(B), the provision excluding expenditures "that are properly allocable to the cost of depreciable property ordinarily considered to have a salvage value."

In short, Pioneer did not come forward with sufficient evidence to establish that the assessor's treatment of any of the items identified was improper or excessive, and so did not meet its burden of proving that the assessor erroneously applied 15 AAC 56.120. The division is entitled to deference in its assessment, and the Board believes that deference is warranted here.

IV. Conclusion

Applying the standard of review in AS 43.56.130(f), the Board certifies that the value of Pioneer's oil production and pipeline property in the North Slope Borough on the lien dates applicable to these appeals is as follows:

- January 1, 2007: $93,182,983
- January 1, 2008: $359,570,039
- January 1, 2009: $399,115,429
- January 1, 2011: $396,742,061
- January 1, 2012: $421,499,904
- January 1, 2013: $420,533,171

Under AS 43.56.130(g), I, on behalf of, and as Chair of, the State Assessment Review Board, certify to the Department of Revenue, State of Alaska, that the Board has made its determination as stated in this Certificate of Determination.

DATED this 27th day of May, 2016.

Signed
Steve Van Sant, Chair
State Assessment Review Board

[56] Kelley testimony.

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska Rule of Appellate Procedure 602(a)(2) within 30 days after the date of this decision.

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