BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of	)	
	)	
COOK INLET REGION, INC.	)	
	)	OAH No. 16-1482-TAX
Oil and Gas Production Tax	)	
Tax Credit Certificate 2015-R14	)	

ORDER AND SUPPLEMENTAL DECISION UPON RECONSIDERATION

The Department of Revenue (DOR) filed a timely Motion for Reconsideration in this matter on December 31, 2018. After a response from Cook Inlet Region, Inc. (CIRI), reconsideration was granted on two issues in an order dated January 29, 2019.

DOR's motion for reconsideration was broad in scope, premised on the theory that this case had received inadequate attention from outgoing Administrative Law Judge Karen Loeffler, whose long-planned resignation became effective on the date the decision was issued. The impression that the central holdings in the case had not received Judge Loeffler's full attention was erroneous, and was addressed in a notice issued January 2, 2019. The scope of reconsideration ultimately granted by the January 29, 2019 order was very narrow, confined to a threshold legal issue the undersigned thought Judge Loeffler might have inadvertently skipped over, and to an alternative holding at the very end of the decision. No factual findings from the hearing itself were to be revisited. The parties provided supplemental briefing and the matter became ripe for a ruling on the merits on March 22, 2019.[1]

A. Reconsideration Was Improvidently Granted on the First Issue

The order of January 29, 2019 noted "an underlying, but unexplored, assumption [in Judge Loeffler's decision] that the tax credit [allowed by AS 43.55.023(a) and (b) in conjunction with AS 43.55.165(a)] must be construed to accommodate multiple purposes." It seemed possible that the statutes could have been construed to apply only to expenditures whose *primary*

[1] Under AS 43.05.465(e), the ruling on the merits should have been issued within 60 days thereafter. This deadline was overlooked and the deadline was tracked internally under AS 43.05.465(a). OAH apologizes for the oversight. Unlike the deadline in subsection (d) of the same statute, the period set by subsection (e) is not jurisdictional and its expiration does not deprive the tribunal of the power to act.

purpose was "explor[ing] for . . . oil or gas deposits." If that were so, Judge Loeffler's factual findings might not be sufficient to support granting a tax credit.

As CIRI explained in its lucid reconsideration brief, however, DOR had never advanced a primary purpose theory in the proceedings below[2] and, more crucially for our purposes here, had not argued for such a construction of the statute in its original motion for reconsideration. Alaska Statute 43.05.465(b) requires a party requesting reconsideration to state the "specific grounds" for reconsideration. DOR did set out "specific grounds" in its motion, but none of those stated grounds can reasonably be stretched to encompass an argument to interpret the statute to require the exploratory purpose to be the primary purpose, rather than merely a purpose, of the expenditure for which a credit is sought.

In particular, DOR presented an argument that "post-hoc rationalizations" to graft new purposes onto an investigative program, with no "temporal or objective connection between the exploration activity and the determination that the exploration was for oil or gas deposits," could not retroactively turn a non-qualifying expenditure into a qualifying one. I mistook this for a contention that only the primary purpose of an expenditure should be considered, but in fact it was a contention that only the *original* purpose (or purposes) should be considered.[3]

The answer to the argument DOR actually sought to make is simple enough. Judge Loeffler did not credit post-hoc rationalizations; instead, she found squarely that exploring for traditional gas and, to a lesser extent, for CBM, were among multiple *original* purposes for the seismic program.[4]

Because the first issue on which reconsideration was granted was not an issue on which reconsideration had been requested, the granting of reconsideration on this issue was improvident. The issue will not be taken up on the merits.

There is a corollary to the recognition that a primary-purpose-only construction of AS 43.55.023(a) & (b) and 43.55.165(a) cannot be taken up at this stage of the case. Such a construction of the statute (by future adjudication or, perhaps more appropriately, by future interpretive regulation), has not been foreclosed by Judge Loeffler's decision or by this supplement thereto.

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[2] *See* Department of Revenue's Opening Brief (April 12, 2018); Department of Revenue's Closing Arguments (Sept. 17, 2018).

[3] Motion at 5.

[4] Decision at 7-9. CBM is coal bed methane.

B. Part IV of the Decision Must Be Vacated

At the end of her decision, Judge Loeffler took up the question of whether gas that can only be extracted via underground coal gasification (UCG) falls within the term "gas deposits" in AS 43.55.165(a)(1). Revenue had taken the position that while UCG-derived gas, when it is produced, is indeed "gas" as that term in used in AS 43.55, the term "gas deposits" is a narrower term that encompasses only gas that has collected in a reservoir that can be produced with little or no processing. CIRI, on the other hand, argued that "gas" and "gas deposits" are essentially interchangeable terms in the statute.

Judge Loeffler did not have to reach this question. As she expressly noted in introduction to Part IV of her decision, once she found that CIRI was an explorer and that exploring for traditional gas and CBM were among the original purposes of the seismic program, the outcome of the case had been determined. Under the multiple-purposes interpretation of AS 43.55.023 and AS 43.55.165 that she and the parties were working from, it was unnecessary to go on to determine whether the objective of developing a UCG project would also qualify the seismic program for tax credits. She addressed the UCG issue as an alternative holding in deference to the efforts she felt the parties had devoted to it, noting that it "was central to much of the briefing and argument on appeal."[5] This part of the decision was added rather late and received less attention than the earlier sections. In its motion for reconsideration, DOR notes the lack of attention to several significant textual and contextual arguments for DOR's interpretation of "gas deposits," and notes the absence of any citation to genuine legislative history to support a contrary interpretation.

The brief analysis of the UCG issue is on pages 15-16 of the decision. The discussion begins by noting—I believe correctly—that the canon that tax relief provisions should be given a narrow construction applies to the analysis.[6] However, it is not clear from the ensuing paragraphs whether this canon affected the analysis.

The decision gives three reasons for choosing CIRI's broader construction. The first is that the informal conference decision contained an internally inconsistent statement on the UCG

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[5] Decision at 13.

[6] As this tribunal has noted previously, "[t]he rationale for cautious, narrow interpretation is especially strong where . . . the exceptional tax treatment at issue consists of transferable tax credits that function like a direct cash subsidy from the public fisc." *In re Renaissance Umiat, LLC,* OAH Case No. 10-0268-TAX, at 11 (Alaska Office of Administrative Hearings 2011) (published at https://aws.state.ak.us/OAH/Decision/Display?rec=4862).

issue. The second is that DOR, in one of its own regulations adopted in 2010, seems to have to used the term "gas" as an equivalent to, or shorthand for, "gas deposits."[7] Both of these are fair observations, and together they may denude DOR of whatever threads of deference it might claim to be entitled to on this issue. They do not, however, shed very much light on the underlying question of statutory interpretation.

The third reason given is legislative history. The decision notes that "[o]ne of the core purposes of the tax credits is to incentivize exploration for gas."[8] This is certainly true, but it is too broad of a truth to be useful as an aid to construction here.[9] The overall purposes of the incentive program would be amply met regardless of which interpretation we choose. The decision then states what seems to be the only real support for a broad interpretation, observing that "the legislature was very interested in CIRI's potential development of the unconventional gas resources through a UCG program."[10] The citation for this sentence is to "CIRI Opening Br. pp. 5-9 and legislative history described therein."[11]

The legislative interest in UCG discussed at pages 5-9 of CIRI's opening brief (or more precisely, beginning at the end of page 7) is not legislative history at all. It comes from a single "Overview" hearing about "Cook Inlet production" held by the Senate Resources Committee in October of 2011. The hearing was not about prospective legislation of any kind: in fact, Chairman Wagoner expressly stated that "this is not a hearing to talk about what we're going to

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[7] The mixing of terms is found in 15 AAC 55.250. Because the preamble of subsection (b) uses "only if" rather than "if" as a lead-in, the later use of "gas" rather than "gas deposits" in subsection (c) occurs in a context in which it does not directly broaden the scope of "lease expenditures" nor preclude that they may be otherwise limited by statutory language. Moreover, the use of the term "gas" in subsection (c) has the indicia of a drafting error rather than a deliberate choice; note that the term "gas deposits" appears in subsection (e) of the same regulation. To be sure of how this regulation should be analyzed, however, one would need to review the regulatory history—something that has not been done in this case.

[8] Decision at 16.

[9] This observation has been made before, likewise in the context of explorer tax credits:

> The fact that the legislature intended to encourage exploration does not mean that questions of statutory construction should be resolved in favor of the greatest possible subsidy for exploration. Just as it is plain that encouraging exploration was a goal, it is equally plain that the legislature intended to preserve some tax revenue and that it set out . . . to put sideboards around the tax credit.

In re ConocoPhillips Alaska, Inc., et al., Consolidated Appeal Concerning Kokoda #1 & #5, OAH Case No. 09-0018-TAX, at 14 (Alaska Office of Administrative Hearings 2009) (published at https://aws.state.ak.us/OAH/Decision/Display?rec=4859).

[10] *Id.*

[11] *Id.* n.64.

do in Juneau."[12] Yet more fundamentally, the phrase at issue in this case, "gas deposits," came into the statute five years before, in 2006.[13] Even if that phrase had been discussed in the 2011 overview hearing—and it was not—the discussion would be valueless as legislative history.[14]

The decision's alternative holding on UCG misconstrues an issue of legislative fact and is unconvincing as written. Since it is unnecessary to the outcome, the problematic portion of the decision will simply be vacated and there will be no holding on that issue.

C. Amended Decision

The decision in this case shall consist of the following portions of the Decision document dated November 30, 2019:

Part I less its final paragraph
Part II
Part III
Part V

There are no further reconsideration rights.

DATED June 27, 2019.

Signed
Christopher Kennedy
Administrative Law Judge – Tax

NOTICE

This order, together with the Decision distributed on November 30, 2018, is the hearing decision of the Office of Administrative Hearings under Alaska Statute 43.05.465(f)(2). The hearing decision will become the final administrative decision 60 days from the date of service of this order.[15]

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[12] Alaska Legislature, Senate Resources Standing Committee, Meeting at Kenai City Hall, Oct. 20, 2011 (recorded at http://www.akleg.gov/basis/Meeting/Detail?Meeting=SRES%202011-10-20%2009:10) (statement at 09:20:15 a.m.).

[13] § 25 ch. 2 TSSLA 2006. The phrase was originally in the preamble of AS 43.55.165(a), but in 2007 subsection (a) was reworked to set up more subparts, without altering the basic function of the phrase. § 58 ch. 1 SSSLA 2007.

[14] *See, e.g., State v. Alaska State Employees Ass'n/AFSCME Local 52*, 923 P.2d 18, 24 (Alaska 1996) (subsequent testimony about legislature's intentions irrelevant*); Department of Community & Reg. Affairs v. Sisters of Providence in Washington*, 752 P.2d 1012, 1015 (Alaska 1988) (after-the-fact letter from legislator irrelevant to determining legislative intent); *Alaska Public Empl. Ass'n v. State*, 525 P.2d 12, 16 (Alaska 1974) ("subsequent testimony of even the prime sponsor of a bill as to . . . the meaning of that bill should not be considered").

[15] AS 43.05.465(f)(2).

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.[16] 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 order.[17]

Judicial review of the hearing decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska Statute 43.05.480 within 30 days of the date the hearing decision becomes final.

[16] AS 43.05.470.
[17] AS 43.05.470(b).

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Oil and Gas Production Tax	)	
Tax Years Ended12/31/2010 – 12/31/2011	)	

DECISION

I. Introduction

Cook Inlet Region Inc. (CIRI) appeals the decision by the Department of Revenue Tax Division (DOR) disallowing CIRI's request for oil and gas production tax credits (tax credits) for expenditures it incurred in 2011 and 2012 in conducting a 2-D seismic exploration program (Seismic Program).

On December 29 ,2014, CIRI filed for $1,064,002 in tax credits for costs incurred in conducting a seismic exploration program on its lands on the west side of Cook Inlet. Upon review of the application, DOR denied the tax credits. CIRI requested an informal conference challenging the denial. In its informal conference decision (ICD) DOR affirmed the initial denial. The ICD analyzed whether use of a seismic program to obtain information in support of an Underground Coal Gasification Program (UCG) qualified as a capital expenditure under AS 43.55.023(a) and met the requirements for a lease expenditure under AS.55.165(a). The ICD affirmed DOR's initial decision that the Seismic Program costs were not incurred to explore for, develop or produce gas deposits as required under AS 43.55.165(a)(1)(B)(iii). The ICD found that CIRI's UCG project did not meet the definition of a "gas deposit" and denied the tax credits on that basis.

CIRI appealed. On appeal CIRI argues that the Seismic Program had multiple purposes and uses including for traditional gas and coal bed methane (CBM) – both purposes that DOR acknowledges would meet the requirements for exploration for gas deposits. CIRI also claims that the ICD incorrectly defined "gas deposits" to exclude UCG which, it argues, meets the definition of gas and therefore seismic work to explore development of a UCG program should qualify for tax credits.

DOR disputes CIRI's factual assertion that it had multiple purposes and uses for the Seismic Program and disputes that UCG exploration qualifies for tax credits since, DOR argues, UCG development is akin to coal mining, which is not eligible for tax credits. DOR also makes other arguments not addressed in the ICD. DOR claims that to the extent that CIRI established a purpose for the Seismic Program other than UCG, it would still not qualify for credits because in relation to other uses it does not meet the statutory definition of explorer.

The parties each filed prehearing briefing, and an evidentiary hearing was held on July 24, 2018. The sole witness at the hearing was Ethan Schutt, CIRI's former Senior Vice President of Land and Energy Development and the individual whom both parties agree was most familiar with the Seismic Program. The parties provided written closing arguments after the hearing, and the record closed on September 17, 2018.

Based on the record, testimony, exhibits and briefing, I find that CIRI has met the statutory requirements to qualify for oil and gas production tax credits for its Seismic Program. This conclusion is based on the factual finding that CIRI met its burden of proving that it had multiple purposes and uses for the Seismic Program. At least two of those purposes and uses – clarifying and delineating boundaries for tadeonal gas production and potential CBM development – constitute undisputed legal bases for eligibility for tax credits. In making this determination, I reject DOR's legal argument that CIRI does not qualify as an explorer as that term is defined in AS 43.55.900(7).

Having made this determination, the further legal issue of whether costs associated with UCG involve exploration for "gas deposits" is not essential to the final decision. However, I further find that CIRI's costs for the Seismic Program used to obtain information concerning the potential for UCG, although a closer question, would also qualify it for tax credits. DOR's decision to deny CIRI's requested credits for the expenditures on its Seismic Program is reversed.

II. Background

For the most part there are no disputes between the parties as to the background and facts relevant to most of the statutory requirements applicable to CIRI's application for tax credits. The one factual dispute, central to this appeal, involves whether CIRI's Seismic Program had multiple purposes and uses apart from its primary purpose to help CIRI understand the nature and scope of its coal resources in the area for a potential UCG program.

A. CIRI's Coal and Gas Resources

CIRI is one of the twelve Alaska Native regional corporations created by the Alaska Native Claims Settlement Act of 1971 (ANSCA). Through various federal laws, CIRI acquired approximately 750,000 acres of subsurface land in and around oil and gas producing regions on the Kenai Peninsula and the west side of Cook Inlet. Among those acquisitions were lands in the Beluga area on the west side of Cook inlet.[1]

The Cook Inlet Basin and the Beluga area contain well known and documented coal deposits as well as conventional oil and gas resources. While coal itself is a resource separate from oil and gas, almost all of the gas developed in the Cook Inlet Basin is sourced from coal.[2] The natural gas produced from Cook Inlet coal is primarily methane.[3] Methane migrates up from the source rock—coal—to a point where it gets trapped in commercial quantities in sandstone, where it is sealed by something that is not permeable and becomes trapped.[4] CBM also comes from coal. However, the methane is trapped in the pore that exist within coal and is extracted in a complicated process involving depressurizing the coal seam.[5] UCG is a complex process by which combustion is used to convert water in deeply buried coal into a useful energy product called syngas. Syngas is less energy rich than natural gas. UCG is a complicated set of chemical reactions that happen underground. It produces some methane that is native to the coal seam, but most of the energy resource is chemically created to become syngas.[6]

B. CIRI's UCG and Seismic Program

CIRI's subsurface lands in Cook Inlet contain low-rank coal, CBM and conventional oil and gas resources.[7] The low-rank coal is not "interesting" as a developable resource as it is too wet and too deep to be conventionally mined.[8] Therefore, CIRI turned to UCG as a possible resource project.[9]

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1 CIRI's Opening Brief p. 3 (citations omitted).
2 Transcript of Evidentiary Hearing (Tr.) at 65.
3 *Id*.
4 Tr. at 68.
5 Tr. at 69.
6 Tr. at 72-73.
7 *Id.* at 4. Record citations omitted.
8 Schutt Testimony Tr. 53and 97-98 (The Seismic Program was not shot with an eye toward mining coal as CIRI was aware of its coal resources and knew that the coal was buried too deeply and was too wet and heavy to be economically viable as a commercial product.)
9 *Id*. CIRI ultimately spent over 10 million dollars in an ultimately unsuccessful attempt to develop its UCG program.

CIRI formed a joint venture to explore the Cook Inlet Basin and evaluate possible UCG options. The joint venture needed information about the area's geology to assess the viability of UCG. To obtain this information, the joint venture drilled a number of boreholes and stratigraphic test wells in the Beluga coal fields. Those boreholes and wells were solely to study for potential for the UCG project. CIRI did not seek tax credits for the drilling phase of its UCG program.[10] After drilling the wells, a disagreement arose between CIRI and its joint venture partner concerning whether or not they should conduct a seismic survey. The joint venture partner believed they had sufficient information to proceed with the next step without seismic testing, and CIRI believed the program was necessary to better understand the subsurface resources in the Beluga area. CIRI went ahead with the Seismic Program over its joint venture partner's objections.[11]

As a result of the Seismic Program CIRI learned that previous maps had placed one of the major fault lines that provide important information concerning potential location for oil and gas exploration in the wrong location. Both parties acknowledge that CIRI's primary purpose in undertaking the Seismic Program was to determine the suitability of its lands for a UCG project.[12]

C. The ICD

In December 2014, CIRI filed an application for oil and gas tax credits requesting $1,064,002 in credits for costs incurred for the Seismic Program. CIRI claimed the costs qualified as lease expenditures under AS 43.55.165 and 43.55.023. After some back and forth concerning compliance with data submission requirements, DOR denied the credits, finding that the Seismic Program costs were not incurred to explore for, develop or produce oil or gas deposits.[13] CIRI requested an informal conference arguing that CIRI's seismic survey did qualify for tax credits noting that coal was the source of the potential gas that would be produced by the program and therefore the costs were incurred for exploration and development of "gas deposits" .[14] The ICD denied CIRI's appeal finding that CIRI's argument was contrary to the plain reading of the statute. Since the term "gas deposit" is not defined in AS 43.55, the ICD

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10 CIRI Opening Br. at 9-10.
11 *Id*.at 9-10 citing Schutt Depo. pp. 100-101, 155.
12 See CIRI Opening Br. at 1; DOR Opening Br. *passim*.
13 ICD at 5.
14 *Id*. CIRI also argued that the Seismic Program was commissioned for multiple purposes and uses. These claims were not addressed in the ICD.

looked to a treatise and adopted the definition of deposit as an "accumulation of oil, gas or other minerals capable of production."[15] In the next sentence, the ICD added,

> [i]t would be reasonable to conclude from the above definition of 'deposit', that the definition of 'gas deposit' would be 'an accumulation of gas capable of production.' This definition presumes that an accumulation of gas exists underground that would be capable of production with little or no processing. Under this definition, CIRI's coal resources do not qualify as gas deposits."[16]

On this basis, the ICD rejected CIRI's application finding that the UCG program did not constitute exploration for gas deposits. The ICD went on to note, "However, if the explorer subsequently produced gas that was taxable under the oil and gas production tax, then DOR would consider granting the credits."[17] CIRI argues that the ICD erred in its failure to address its claims of multiple purposes and uses and in its legal conclusion that UCG exploration does not qualify as exploration for "gas deposits".

III. CIRI Met its Burden of Proving its Seismic Program Qualified as Lease Expenditure Based on its Use for Multiple Purposes

A. Statutory Background

AS 43.55.023 permits a producer or explorer to receive tax credits for a qualified capital expenditure. Qualified capital expenditure is defined in §43.55.023(o)(1)(A) as "an expenditure that is a lease expenditure under as 43.55.165 and is (A) incurred for geological or geophysical exploration". AS 43.55.165(a) defines lease expenditures, stating, "[A] producer's lease expenditures for a calendar year are

> (1) costs…that are
>
> > (A) incurred by the producer during the calendar year after March 2006, to explore for, develop, or produce oil or gas deposits located within the producer's leases or properties in the state….; and
> >
> > (B) allowed by the department by regulation, based on the department's determination that the costs satisfy the following three requirements:
> >
> > > (i) the costs must be incurred upstream of the point of production of oil and gas;
> > >
> > > (ii) the costs must be ordinary and necessary costs of exploring for, developing, or producing, as applicable, oil or gas deposits; and

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15 ICD, quoting Williams and Meyers' *Manual of Oil and Gas Terms.*
16 ICD at 6.
17 *Id*.

(iii) the costs must be direct costs of exploring for, developing, or producing, as applicable, oil or gas deposits.

B. Standards of Review

Factual disputes on appeal are decided de novo. The taxpayer bears the burden of proof by a preponderance of the evidence on questions of fact.[18]

The central factual dispute at issue in this appeal is whether CIRI's sole purpose in commissioning its Seismic Program was to obtain information concerning the suitability of its lands for UCG development or whether the program served multiple purposes including providing information to promote, explore for, and develop traditional gas and promote exploration and development of CIRI's gas resources by other oil and gas companies interested in leasing CIRI lands including development of gas from potential CBM resources. DOR acknowledged at the hearing that CBM exploration (and, of course exploration for traditional gas resources) qualify for tax credits. DOR also acknowledged that this is an "all or nothing" issue.[19] Thus, if the costs for the Seismic Program include exploring for traditional gas and/or CBM in addition to its primary purpose of providing information for the UCG project, it would qualify for credits regardless of the legal determination whether exploration for UCG constitutes exploration for gas under the statute. CIRI bears the burden of proof on this issue.

C. CIRI Met Its Burden of Proving Multiple Purposes

Both before DOR and on appeal, CIRI acknowledged that the primary purpose of the Seismic Program "was to help CIRI better understand the nature and scope of its coal resources in the area for a potential UCG program."[20] However, CIRI also claims that is was also "keenly interested in using this data to help CIRI explore for develop and produce gas …and to promote exploration and development of CIRI's gas resources by oil and gas companies leasing CIRI lands. This included development of gas from its potential coal bed methane resource."[21]

The ICD focused only on the primary purpose of exploration for UCG in denying CIRI's request for tax credits and did not address CIRI's claim of multiple purposes. On appeal, DOR disputes that CIRI had multiple purposes. As to traditional gas, DOR does not dispute CIRI's factual assertion that the Seismic Program provided information to aid in traditional gas leasing

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18 AS 43.05.435(1) and AS 43.05.455(c).
19 See Tr. 207.
20 CIRI Opening Br. at 1.
21 *Id.*

by delineating the border of the UCG project and providing the data necessary to market CIRI lands for traditional gas development. Instead, DOR argues that the stated purpose would not qualify CIRI as an explorer as defined in AS 43.55.900(7).

As to CIRI's claim regarding CBM, DOR makes a credibility claim, arguing, "that CIRI never really considered pursuing CBM development" and further that CIRI's assertion of interest in CBM only arose after it filed for the credits and after the Department of Natural Resources started to ask "questions about costs incurred to explore coal deposits as support for an oil and gas tax credit."[22]

1. CIRI's Evidence Concerning Traditional Oil and Gas

CIRI has met its burden of proving that the costs of its Seismic Program were incurred, in part, for exploring for traditional oil and gas.[23] This finding is based, in large part, on the testimony of Ethan Schutt at the hearing and is supported by other corroborating evidence.

Mr. Schutt worked for CIRI for 13 years, spending most of his time as Senior Vice President of Land and Energy Development. In this position he oversaw CIRI's resource business and development which was primarily centered on the oil and gas within the Cook Inlet Basin.[24]

At the hearing, Mr. Schutt testified that the Seismic Program had two purposes. One, the primary purpose, was to support the UCG project. However, Mr. Schutt testified that the UCG project area was originally drawn as too large an area "with the intention of shrinking it down once we knew more so that we could open the rest for traditional resource development activities which, in this case, are oil and gas."[25] As Mr. Schutt explained, the Seismic Program provided new and very important information concerning the major faults that exist in the Beluga region – the Castle Mountain Fault and the Moquawakie Fault. The early seismic studies showed what was thought to be the location of the Moquawkie Fault as intersecting the Castle Mountain Fault on CIRI property. Mr. Schutt testified that in shooting the Seismic Program, they were trying to locate the precise orientation and alignment of the fault. It was important to figure out the location of the fault precisely

> so that we could make the area to the southeast of this fault available for traditional oil and gas exploration as – to lease. Because we – viewed it – and I

22 DOR Opening Br. at 5.
23 AS 43.55.165 (a)(1)(B) and 15 AAC.55.250(b) and (c)
24 Tr. 33-36.
25 Tr. at 52.

> viewed it, at the time, as the business principal as being prospective for traditional natural gas. And so, uh, we were very interested in figuring out where that was so that we could clear it up and get on with oil and gas exploration, uh, in that area.[26]

The information that the previous data was inaccurate, as Mr. Schutt explained, "has major implications for the, uh, the oil and gas prospectivity in the that particular area."[27] This is because companies seeking gas exploration relied on the theory that the two major fault systems intersected and the confluence of the two faults would create trapping structures for natural gas.[28]

Mr. Schutt testified that, prior to the Seismic Program, CIRI had been approached by Cook Inlet Energy repeatedly about leasing its land to the north of Cook Inlet's property for traditional gas development.[29] CIRI did not follow through with a leasing program because it did not believe it had sufficient data and could not say yes to the leasing until it had more data.[30] After the Program, when CIRI learned of the changed location for the Moquawkie Fault, CIRI did move forward to try to do conventional gas leasing based on the new data. It offered the data for a nominal licensing fee to Cook Inlet Energy and attempted to market it at the North American Prospect Expo, the largest seismic marketing conference in the United States.[31]

Further corroboration comes from CIRI's internal accounting. Because the UCG program was never developed, CIRI has written off all of the expenses related to the Program. However, CIRI from the beginning treated the Seismic Program on its books as a permanent capital investment.[32]

I find Mr. Schutt's testimony on this issue fully credible. His explanation that the Seismic Program was to be used, in part for this purpose, was corroborated by CIRI's actions in attempting to market the data for gas exploration.

2. CIRI's Evidence Concerning CBM

CIRI also argues that it incurred the costs for the Seismic Program, in small part, to explore for CBM. DOR does not dispute that CBM exploration would qualify for tax credits. Instead, DOR argues that CIRI's claim of such use is not credible because it arose only after the

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26 Tr. p. 54. See also Tr. pp. 176-177.
27 Tr. 36-37.
28 Tr. 44.
29 Tr. 45.
30 Tr. pp. 83-84.
31 Tr. 85-86,
32 Tr. 99-100.

credits were denied. As to the factual dispute, Mr. Schutt testified concerning the connection between CBM and the Seismic Survey. As he noted, he personally did not believe that CBM was economically viable for commercial development. However, he was willing to authorize the analysis of the data for this use because one of his subordinates pushed for it and it did not add significantly to costs to analyze the data for this purpose.[33] Moreover, CIRI used the Seismic Program to discover billions of standard cubic feet of CBM gas.[34] DOR's argument that this was an after the fact justification interposed in order to qualify for credits is not supported in the record and is based on speculation; it is therefore rejected.

3. DOR's Argument Against Tax Credits Based on Multiple Purposes

a. Traditional Gas

DOR does not challenge Mr. Schutt's testimony directly. It argues that because the program took place under a surface coal exploration permit it was, as a matter of law, in furtherance of a coal mining activity and thus not in furtherance of any exploration for oil and gas development.[35] Second, DOR claims that CIRI was not acting as an explorer as that term is defined in AS 43.55.900(7).[36] Neither argument was addressed in the ICD, and neither undermines the finding above.

In October 2011, CIRI submitted a request for a minor modification to its Surface Coal Exploration Permit E-1201. The request, submitted on its behalf by Jade North, LLC – a consulting firm – stated that the modification was "to give greater definition to the coal resource within CIRI's land and is consistent with the nature of the activity authorized under the original permit."[37] DOR argues that the fact that the program was conducted under a coal exploration permit is "absolutely relevant and critical to this Court's evaluation of the issue because it is direct evidence that DNR determined that CIRI's planned UCG project was a coal mining activity under Alaska Law, and the seismic survey was conducted to explore coal [sic] in furtherance of that coal mining activity."[38]

DOR's argument here suffers from two flaws. The first is that the conclusion does not follow from the stated premise. Even taking DOR's claim that DNR was making any

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33 Tr. 90-94, 163-165.
34 CIRI Reply Br. pp. 14 nt. 41-43 and Tr. pp. 94-95.
35 See DOR Closing Arg. pp. 8-11.
36 See DOR Closing Arg. pp. 12-13.
37 DOR Exh. E (Jade North Letter), DOR Opening Br. p.15.
38 DOR Closing Arg. p. 10.

determination concerning whether UCG constituted coal mining versus gas exploration for purposes of tax credits, it does not follow that the permit application request, or the issuance of the permit, calls into question CIRI's claim that it also intended and did use the seismic survey to delineate boundaries of the UCG program in support of its traditional gas exploration and leasing business.

There is no dispute between the parties that the Seismic Program was instituted as part of CIRI's UCG project. Mr. Schutt explained in his hearing testimony that UCG is something of a hybrid between mining and oil and gas as the drilling part of the project relates more to oil and gas than mining, but the regulatory regime puts it more into the mining classification. The regulatory regime required that the Seismic Program be permitted through the existing permit. Because the Program was connected to the UCG project, it was required to be permitted through the UCG project.[39] As Mr. Schutt noted, "the permitting does not define or limit the usefulness of the seismic data itself".[40]

CIRI and DOR dispute the relevance of the fact that the Seismic Program was permitted under a mining regulation. Here also CIRI has the better argument. DOR argues that DNR regulations classify UCG as a coal mining activity. Therefore, CIRI had to obtain a coal permit in order to explore for UCG and it could not have conducted the Seismic Program without first obtaining a coal exploration permit.[41] DOR dismisses CIRI's somewhat similar argument that, because the Alaska Oil and Gas Conservation Commission (AOGCC) asserted jurisdiction over its program, the Seismic Program related to traditional oil and gas. I find that both arguments carry little weight and provide little guidance as to the factual question whether CIRI's purpose included use of the Seismic Program for traditional oil and gas exploration.

Both UCG and CBM involve what is termed non-traditional gas. The Alaska statutory and regulatory scheme was written addressing more traditional differentiation between coal mining and gas exploration. For this reason alone, a company and the State of Alaska must, in essence, "fit a square peg in a round hole" when trying to permit and regulate activities related to activities such as UCG.[42]

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39 Tr. -. 79.
40 *Id*.
41 DOR Opening Br at 27-31, Closing Arg. pp. 9-10
42 Tr. 144-145. See also CIRI Opening Br. 22-24.

As to CIRI's claim regarding AOGCC jurisdiction, DOR is correct when it describes this assertion of jurisdiction as one relating to safety, with little bearing on the issue of tax credits. Almost all gas from Cook Inlet is derived from coal. CIRI notes that AOGCC asserted jurisdiction over CIRI's UCG program after CIRI had drilled certain stratigraphic wells. AOGCC then determined the wells were likely to have unexpected encounters of oil, gas or other hazardous substances and asserted jurisdiction.[43] AOGCC's jurisdiction relates to safety hazards and its concern with shallow gas is as a drilling hazard.[44] The fact that AOGCC asserted jurisdiction over part of CIRI's UCG program may support the claim that gas exists throughout the area covered by the Seismic Program, but does little to address the issue here regarding the purposes of CIRI's program. The same goes for DOR's argument regarding the modification to CIRI's DNR permit. Despite arguing that CIRI's action in using a modification of its coal permit as to basis to permit its seismic program is evidence that CIRI did not have a purpose related to oil and gas exploration, DOR suggests no alternative permitting process that would apply. Moreover, there is simply nothing in the permitting regime that suggests DNR was making any decision concerning whether CIRI's Seismic Program could qualify for tax credits as a capital expenditure and lease expense for gas exploration. The arguments of both parties are red herrings.

Thus, I find that CIRI had multiple purposes and uses for its Seismic Program, and therefore, its costs meet the criteria for exploring for gas contained in 43.55.165(a)(1). This finding, however, does not completely resolve the issue of whether the Seismic Program qualifies for tax credits. DOR argues that CIRI does not qualify as an "explorer" under AS 43.55.900(7) with regard to its claimed use of the Seismic Program for traditional gas.

D. CIRI Was an Explorer Under AS 43.55.900(7)

The statutes and regulations clearly and explicitly define the activity at issue here, a seismic survey, as a lease expenditure eligible for tax credits.[45] AS 43.55.900(7) provides: "'explorer' means a person, who, in exploring for new oil or gas reserves, incurs expenditures." 15 AAC 55.900(b)(13) requires that the "explorer" have an interest in the seismic work and 43.165(*l*)(1) defines "explore" to include "conducting geological or geophysical exploration."

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43 CIRI Opening Br. p. 14.

44 Tr. p. 120

Because there is no evidence that it has been articulated outside the context of this case, and indeed, even the ICD never addressed the argument raised by DOR on appeal that CIRI does not qualify as an explorer under AS 43.55.900(7), DOR's argument constitutes a "litigating position" to which no deference is owed.[46]

DOR argues CIRI "may have been acting as an 'explorer'…when it commissioned the seismic survey in furtherance of the UCG project, CIRI was no longer acting as an 'explorer' in its second role as a lessor and royalty interest owner."[47] DOR's argument is based on its characterization of CIRI's purpose in using the seismic data solely to market and/or lease the data and its lands to others who would then do the actual exploration.[48] CIRI's counter argument is supported by both the facts and a common sense interpretation of the clear wording of the statute.

The evidence shows that CIRI was not just marketing the data obtained from the survey, which, it acknowledges, would not constitute exploration.[49] CIRI commissioned, conducted and paid for the Seismic Program. In addition, CIRI used the data to identify lands that were prospective for natural gas and attempted to lease those lands to an interested party for further exploration. [50] Moreover, CIRI points out that it owned and still owns all of the subsurface to the land at issue.[51] Under these facts, CIRI clearly qualifies under the definition of explorer set forth in AS 43.55.900(7). [52]

DOR acknowledges that CIRI would meet the statutory definition of explorer with regard to its UCG purpose.[53] However, DOR claims CIRI loses its status as an explorer with regard to any purpose involving traditional gas activities because its use, in this regard, was only for

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46 *In re: Renaissance Umiat, LLC*, OAH Nos. 10-0268-TAX and 10-0131-TAX (consolidated), 2011 WL 7149743 *3 (2011), 43.05.435(2).

47 DOR Closing Arg. p. 12.

48 See DOR Opening Br. p. 11-14.

49 See CIRI Opening Br. at 27.

50 [cite to transcript cites and CIRI Opening Br. at 18.

51 Tr. pp.51-52. CIRI Closing Arg. pp. 11-15.

52 DOR also argued in its Opening Brief that CIRI was not a producer with respect to its gas business. That argument is not raised in the closing argument. To the extent that DOR is also relying on this position it too is rejected. Producer is defined in AS 43.55.900(21) as " an owner of an operating right, operating interest or working interest in a mineral in oil or gas." CIRI retained all of the rights and interests in the lands that it sought to lease. It is true that CIRI hoped to lease the lands for gas development, but at the time of seeking credits it was the owner of the operating interest in the properties at issue.

53 See DOR Closing Arg. p. 12.

marketing seismic data with the hope that a third party would lease the data or land.[54] This argument relies on a too narrow reading of the facts and the statute.

Since CIRI established that it commissioned the study, in some part, with the expectation of using the information for its oil and gas program, it has established the necessary qualifications to meet the definition of explorer. Nothing in the statutory definition suggests that a company is not an explorer if it uses its geophysical exploration to lease lands to a third party for further exploration and development. DOR's limiting interpretation would seem to require that the party that conducted the seismic survey must be the party that does other exploration activities such as drilling test wells or taking steps toward production. The statute does not contain this limitation. Nor would this narrow interpretation appear to serve the legislative purpose to encourage exploration of new gas resources. This conclusion establishes that CIRI has met all of the qualifications necessary to qualify for tax credits based on its traditional gas evidence alone. The same is true with regard to the CBM purpose.

DOR argues that under AS 43.55.165(a)(1)(A) to qualify for the tax credits CIRI must have had a plan to explore for CBM in the year that the costs were incurred. CIRI notes that this limitation does not appear in the statute and the interpretation put forward by DOR would contravene the purpose of the tax credit regime.[55] CIRI incurred the costs during the relevant calendar year. The purposes of the program included purposes that are undisputedly eligible under tax credits. Therefore, even without deciding whether UCG qualifies as gas exploration under the statutes, CIRI has met all of the criteria for qualifying lease expenditures.

IV. Whether UCG Meets the Definition of Gas Deposit Under AS 43.55.165(a)(1)(B)(iii).

Having found that CIRI had multiple purposes and uses for its Seismic Program, the issue of whether exploration for purposes of developing a UCG program qualifies as a lease expenditure for tax credits is not determinative of this appeal. However, as the issue was central to much of the briefing and argument on appeal it is addressed here as an alternative holding.

A. Background Regarding UCG

UCG requires a complicated set of chemical reactions that happen underground to convert buried coal into a useful energy product.[56]

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54 *Id*.
55 CIRI Closing Br. pp. 45.
56 Tr. 72-74.

The parties' dispute centers around AS 43.55.165(a)(1)(B) which sets forth the requirements for lease expenditures, and particularly subsection (iii) which provides: "the costs must be direct costs of exploring for, developing or producing, as applicable, or gas deposits." (emphasis added). The ICD found that UCG does not count as "gas deposits" because, it concluded, gas deposits mean gas that is capable of production with little or no processing."[57] CIRI argues that the term "gas deposits" simply means gas, that UCG clearly meets the accepted definition of gas and therefore exploration in connection with UCG meets all of the requirements as a lease expenditure. [58] DOR does not dispute that UCG fits the definition of gas but relies on the term "gas deposits" as meaning something different.

The legal issue is a close question as it requires examining the various intersecting and sometimes conflicting rules of statutory interpretation and standards of review. The confusion is compounded by inconsistencies in the statute and implementing regulation as well is within the ICD itself.

B. Standard of Review

The parties dispute the standard of review applicable to the interpretation of §165(a)(B)(iii). CIRI argues that questions of law and the application of law to facts are generally resolved in the exercise of independent judgment and that agency deference applies only where a question of law involves particularized agency expertise or where the agency's specialized knowledge and experience would be especially probative as to the meaning of a statute or regulation.[59] CIRI argues that the definition of gas deposits is not within agency expertise. Therefore, DOR is owed no deference. DOR argues that the legislature vested with DOR the authority to interpret the statutes and regulations involving lease expenditures, and therefore the administrative law judge is to defer to DOR unless its interpretation is not supported by a reasonable basis.[60] Because the dispute surrounds one sentence contained in the ICD, for which no reasons are given, and the interpretation in the ICD is inconsistent with a later interpretation contained within the opinion, the rule of deference does not apply here.[61]

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57 ICD p. 6.

58 See AS 43.55.900(8)(C) and 43.55.900(8)(B)(i), AS 43.55.900(9)(A)(i).

59 CIRI Opening Br., citing AS 43.05.435(2); *In re: Conoco Phillips Alaska, Inc*. OAH Nos. 09-10018-TAX and 09-0019-TAX (consolidated) at 5. (December 21, 2009); *State Dep't of Revenue v.DynCorp and Subsidiaries,* 14 P.3d 981, 984 (Alaska 2000).

60 DOR Opening Br. p. 6 citing *Renaissance Umiat*, *3, 43.05.435(2).

61 See *id*.

Two other potentially conflicting legal principles apply here. As a general rule ambiguity in tax statutes are resolved in favor of the taxpayer. However, the opposite rule applies to provisions, such as the one at issue here, creating exemptions for the general tax treatment which are to be narrowly construed against the taxpayer.[62] As to this potential conflict the latter rule applies, and the exemption is to be narrowly construed.[63]

C. Analysis

Having determined that the exemption should be narrowly construed, looking to DOR's statements, the statute and regulations and comparing legislative history to resolve the disputed interpretation of "gas deposits" results in a conclusion that exploration for UCG does qualify as a lease expenditure as exploration for gas deposits for three reasons.

1. The ICD's Inconsistent Positions

The ICD found that CIRI was not entitled to credits for the Seismic Program because the term "gas deposits" requires an accumulation of gas that exists underground "that would be capable of production with little or no processing "and "[u]nder this definition CIRI's coal resources to not qualify as gas deposits." However, the ICD just a few paragraphs later states: "However, if the explorer subsequently produced gas that was taxable under the oil and gas production tax, then DOR would consider granting the credits." These two statements provide conflicting views on the interpretation of the requirements listed in AS 43.55.165(a)(1)(B)(iii) even within the same decision. For a cost of exploration to qualify as a lease expenditure it must only be for exploration for gas; there is no requirement that gas actually be produced. Similarly, stating that exploration for UCG (through costs associated with a geophysical survey such as the Seismic Program) would qualify for tax credits if gas was produced certainly implies, if not explicitly acknowledges, that costs of exploring in aid of developing a program to produce gas by this method does qualify as costs expended to explore for gas deposits.

2. DOR's Interpretation of the Statute Conflicts with Its Implementing Regulation

AS 43.55.165(a)(B)(iii) uses the term "gas deposits" providing the central basis for DOR's rejection of UCG exploration costs. However, 15 AAC 55.250 sets forth the regulatory standards for lease expenditures other than overhead and states:

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62 *Renaissance Umiat* at *3.

63 See *id* at n.29 and cases cited therein.

(b) Costs incurred after June 30, 2007, satisfy the requirements established in AS 43.55.165(a)(1)(B), …only if they are

(1) direct charges under 15 AAC 55.260 incurred for an activity or purpose described in (c) of this section; and..

(c) the activities or purposes referred to in (a) and (b) of this section are

(1) conducting a geological or geophysical survey to explore for oil or gas.

Thus, while the relevant statute refers to exploring for gas deposits, the regulation refers only to exploring for gas. This difference between the statute and regulation supports CIRI's argument that the terms gas and gas deposit are used interchangeably within the regulatory regime and are not meant to make a narrowing distinction as to eligible costs.

3. *Legislative History*

Finally, because of the ambiguity created by the statutes and regulations, and DOR's own conflicting position, it is helpful to look at legislative history. As CIRI points out the legislative history supports the allowance of tax credits here. One of the core purposes of the tax credits is to incentivize exploration for gas. And the legislature was very interested in CIRI's potential development of the unconventional gas resources through a UCG program.[64]

V. Conclusion

CIRI's Seismic Program met all of the requirements for tax credits under AS 43.55.023(a) and (b). For all of the above reasons, DOR's decision to deny CIRI's application for tax credits for the costs associated with its 2011 and 2012 Seismic Survey is reversed.

Dated November 30, 2018.

Signed
Karen L. Loeffler
Administrative Law Judge

[64] See CIRI Opening Br. pp.5-9 and legislative history described therein.

NOTICE

This is the hearing decision of the Administrative Law Judge under Alaska Statute 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.[65]

A party may request reconsideration in accordance with Alaska Statute 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.[66] 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.[67]

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska Statute 43.05.480 within 30 days of the date this decision becomes final.[68]

[This document has been modified to conform to the technical standards for publication. Names may have been changed to protect privacy.]

65 AS 43.05.465(f)(1).
66 AS 43.05.470.
67 AS 43.05.470(b).
68 AS 43.05.465 sets out the timelines for when this decision will become final.