Alaska Oil and Gas Association

121 W. Fireweed Lane, Suite 207
Anchorage, Alaska 99503-2035
Phone: (907) 272-1481   Fax: (907) 279-8114
Email: moriarty@aoga.org

January 26, 2021

VIA EMAIL: john.larsen@alaska.gov

Mr. John Larsen, Audit Master
Tax Division, Alaska Dept. of Revenue
550 West 7th Avenue, Suite 500
Anchorage, AK 99501

Re: Proposed Regulations (December 23, 2020 Public Notice)

Dear Mr. Larsen:

The Alaska Oil and Gas Association ("AOGA") appreciates the opportunity to provide comments in response to the Department of Revenue's ("DOR") proposed regulations in Title 15. For nearly half a century, AOGA has been the trade association of the petroleum industry in Alaska, and our members actively continue to explore for, develop, produce, transport and refine oil and gas in the state. In keeping with our practice regarding tax matters, all our members have had the opportunity to review and contribute to these comments, and they have been approved without dissent.

Our comments concern proposed changes to regulations that DOR has proposed pursuant to the public notice dated December 23, 2020.

We note that several of the proposed changes would repeal regulations that are no longer operative and to make conforming changes concerning regulations that have been previously repealed. We appreciate DOR's efforts to repeal unnecessary regulations, reduce the sheer volume of regulations, and the addition of materiality thresholds to 15 AAC 55.520(f) to reduce cumbersome and costly reporting that adds little, if any, valuable information.

We request DOR does not implement the proposed changes to the regulations on field topping plants and the tariff for prevailing value because the proposed

changes conflict with statute and policy. We do not believe any urgency exists for the proposed changes to the field topping plants and the tariff used in calculating prevailing value. It is our request that DOR hold a public workshop allowing discussion on the proposed changes to 15 AAC 55.151(e), 15 AAC 55.163(a), and 15 AAC 55.171(o).

Our comments by specific provisions are below.

15 AAC 05.250(a)
The first concern with this proposed subsection is that the deletion of "under AS 43.55" would expand this regulation to make it apply to all Alaska taxes under Title 43 of the Alaska statutes. Given DOR's stated intent to allow certain sharing of operator information, one would assume that expanding this regulation to apply to taxes other than the AS 43.55 oil and gas production tax was unintentional. In any event, such an expansion would be ill-advised and beyond the scope of the public notice and would likely open a "can of worms" that DOR did not intend to open. Our additional comments are made assuming the proposed changes did not intend to remove AS 43.55. In other words, we are not able, at this time, to describe the implications if this regulation is expanded beyond production tax.

Second, the deletion of the language "is relevant to a sale, exchange, disposition, or netback valuation of oil or gas" expands the types of confidential documents allowed for release. This would include upstream capital and operating expenditures, often supported by: (i) commercially sensitive agreements (e.g., rig contracts); (ii) agreements that may include proprietary information (e.g., agreements with seismic contractors referencing areas of interest for exploration); or (iii) calculations (e.g., depreciation, depletion and amortization). In allowing the release of this information, DOR is treading into an additional realm of acute sensitivity. Among other issues, this raises third-party confidentiality concerns, as the party from which DOR seeks the information may be legally bound to protect and not disclose third-party confidential information.

Third, the current regulation would only allow release of information relating to a period that is at least one year before the release. This provision is deliberate — the sensitivity of information is heightened by its recency. The proposed regulation would delete the one-year limitation. Given the potentially highly sensitive information at issue, this is a step in the wrong direction. If anything, the limitation should be expanded to two years, and there would be no harm to DOR in doing so, given the six-year statute of limitations in AS 43.55.075 and the timing of audits and information requests within that time period. We recommend expanding the limitation to two years as it may also lessen resistance to providing the information and reduce the likelihood of appeals concerning its release.

Fourth, the term “taxpayer” is removed and replaced by “person.” AOGA disagrees with this change as the term “person” is much broader and taken in conjunction with the other proposed changes, it appears that a taxpayer’s contractors may be given notice that their information will be disclosed, which would open an entire realm of complications, delay, and potential appeals. AOGA does not recommend this change. At a minimum, the regulation should define “person” to be the owner of a working interest, an operator, or a taxpayer.

Finally, we are concerned that the timing provisions contemplated by this regulation will cause problems and generate protests that would otherwise not come to fruition. For instance, the 15-day notice period prior to disclosure may drive objections because it may be inadequate for internal deliberation by the person whose information is subject to disclosure. Likewise, the 10-day deadline to present arguments on appeal to the director in writing is simply too short for robust input, even for taxpayers familiar with the production tax regime, and it may not be possible to obtain internal approvals within the 10 days, which may itself force appeals. Further, those that are unfamiliar with Alaska’s tax laws, such as refineries buying oil and contractors providing rigs and support services, will likely be forced to file protective appeals, and written appeal arguments will likely not be well-articulated. We recommend that DOR allow 30 days for the notice period and should provide at least 30 days for a person to submit written arguments to the director.

15 AAC 55.151(e) and 15 AAC 55.163(a)

The proposed revisions to 15 AAC 55.151(e) and (f) provide that the tax would not apply to oil run through a field topping plant that (1) is used in operations; and (2) is not capable of being returned to the commingled stream (continuing down TAPS and being sold). We attempted to explain in our questions dated January 15, 2021 that currently, all oil run through a North Slope field topping plant until used on the lease or property is capable of being returned and blended back into the commingled production upstream of the point of production. Field topping plants on the North Slope heat and cool the crude stream to remove what is often referred to as Arctic Heating Fuel or Diesel No. 2. Therefore the oil, which is often stored in tankage, is, until actually used, capable of and sometimes is returned upstream to the commingled production stream. Thus, as proposed, the regulation would violate AS 43.55.020(e), which provides that oil or gas used in operation is not considered produced for production tax purposes.

DOR's answer to our question states the intention to clarify and reiterates the wording but fails to address the issue. All oil run through a field topping plant is capable of being returned until it is actually used. That is, the Arctic Heating Fuel when extracted from the crude oil and then later when placed in tankage at the topping units for use, is itself capable of being returned to the remainder of the stream. So, unless a working interest owner sells its take in-kind share to a third-party, all cuts of the oil run through the topping plant can be combined back together and returned upstream of the point of production until actually burned or placed down hole. Sometimes oil is diverted to the topping plant, the Arctic Heating Fuel tanks are filled, and the rest of the stream is diverted back. In this case, oil has run through the topping plant but it is capable of being returned to the commingled stream. As proposed, is DOR's intended result for this to be taxed at 120%?

Accordingly, we suggest that DOR does not implement this regulation. We request deleting that addition of "capable of being" in 15 AAC 55.163(a).

Finally, there is also a very specific problem with 15 AAC 55.151(e)(6)(A): the regulation would require that the product be used in production operations on "that" lease or property for the oil to be deemed not produced. This would violate AS 43.55.020(e), which requires that oil be used for operation of "a" lease or property to be considered not produced. It is well established that, unlike the state royalty lease-use exemption, AS 43.55.020(e) requires only that the oil be used for operation of a lease or property in the state. Accordingly, "that lease or property" in 15 AAC 55.151(e)(6)(A) needs to be changed to "a lease or property."

15 AAC 55.171(m)

The proposed change to the regulation calculating prevailing value removes Reuters and replaces it with Argus. As noted in the response by DOR to our questions dated January 15, 2021, Argus has two assessments published for Alaska North Slope crude. We recommend specifically identifying which assessment the taxpayer should use to avoid assumptions by a taxpayer that differ from the assessment DOR's auditors believe should be used, thereby leading to audit disputes.

Please see the attached example of more than one published assessment from Argus.

15 AAC 55.171(o)

The public notice states that the additional definition of "applicable publicly filed pipeline tariff" as "both the interstate and intrastate tariffs" for the calculation of prevailing value for oil has been added for clarity. As drafted, the definition does not accomplish this goal. Although this proposed regulation states the fact that interstate and intrastate tariffs do apply to the transportation of oil produced in Alaska, it does not clearly state that the “applicable” tariff for oil transported in interstate commerce is the interstate tariff, whereas the “applicable” tariff for oil transported in intrastate commerce is the intrastate tariff. We submitted a question to better understand what DOR is attempting to accomplish with this change.

Currently, audit approaches and theories differ on the application of the interstate and intrastate tariffs and those do not implement the statute or long-standing policy of DOR. DOR’s answer to our question states that the “proposed regulation refers to the tariff in effect at the point of sale by the producer of the oil or gas.” Nowhere is the “point of sale” found in the proposed regulation. Instead, the proposed regulation is attempting to define a phrase – the phrase being “applicable publicly filed pipeline tariff” – and it is proposing that this is both the interstate and intrastate tariff. The applicable tariff is not both tariffs. If the oil is sold on the West Coast, then the applicable tariff is the interstate rate. If the oil is sold in-state at a refinery then the applicable tariff is the intrastate rate, and the applicable tariff is not the lowest posted rate. Industry is seeing audit approaches where the lowest rate is improperly selected regardless of the oil destination. The regulation needs to clarify rather than add improper flexibility.

15 AAC 55.250(c)(5)
We appreciate the insertion of the word “from” to make it unquestionably clear that costs for demobilization of a rig, coiled tubing unit, or similar equipment and associated supplies “from” a drill site are eligible lease expenditures. The most reasonable interpretation of the current regulation would allow costs for demobilization from a drill site, but the addition of “from” removes the potential for dispute.

However, the proposed revision provides that demobilization does not include transportation “beyond the nearest significant road, rail, or harbor transportation hub.” The term “significant” is ambiguous in this context and is highly likely to lead to disputes as to whether any particular road, rail or harbor transportation hub is “significant.” In any event, the regulation currently in effect meets the policy objective of encouraging rig use in in the state (regardless of where the rig is transported in the state), while protecting the state’s fisc and discouraging removal of rigs from Alaska by providing that “demobilization does not include transportation out of the state.” The current limitation is adequate — the issue that has arisen over time is not driven by the language of the current regulation, but the addition of limitations by individual auditors that simply do not exist in the language of the regulation. DOR seems to by trying to crystallize those interpretations through the additional language. But from a policy perspective, it does not matter whether demobilization of a rig to another location in the state goes beyond any significant or insignificant transportation hub, so long as the same transportation costs are not claimed as “demobilization” by one party and “mobilization” by another. Indeed, the state should want rigs to be transported along – and past – significant transportation hubs to encourage exploration and development throughout Alaska, and the regulation should be designed accordingly.

15 AAC 55.260(a)(6)
At first blush, the change to expressly allow travel expenditures for contractors and the deletion of “to or from the site of vicinity of oil or gas exploration, development, or production operations” seem to be improvements. However, the costs are only allowed “when the expenses are incurred for purposes of performing labor activities allowed under [subsections (a)(3) and (a)(11)].” Subsections (a)(3) and (a)(11) limit labor costs for non-technical labor to costs for labor performed on the site or in the vicinity of operations. DOR has interpreted “site or vicinity” narrowly and without regard to the reality of modern oil and gas operations, such that costs for work that is not performed on the physical location of the actual lease or property have been disallowed. Unless DOR is going to change its interpretation (or amend 15 AAC 55.260(a)(3) and (11)) to recognize that much very valuable work is performed at a physical location other than the actual lease or property, DOR’s proposed change to 15 AAC 55.260(a)(6) is meaningless.

We note that we have previously sought DOR’s attention to a number of additional items that have not been addressed in this package of regulations. These areas for improvement include:

- Providing regulatory guidance regarding the exclusion from lease expenditures for unscheduled interruptions in production under AS 43.55.165(e)(19), including materiality thresholds
- Clarifying the application of AS 43.55.170 to major asset sales
- Aligning the application of 15 AAC 55.260 with modern industry practices in regard to labor charges
- Revisiting Advisory Bulletin 2017-01 regarding the North Slope minimum tax

We appreciate the opportunity to comment and recognize the value in DOR’s efforts to improve regulations and audit processes.

Please contact me if DOR has any questions or would like to meet to discuss these comments.

Sincerely,

ALASKA OIL AND GAS ASSOCIATION

Brooke Ivy
External Affairs Manager

Enclosure: Argus Americas Crude Examples

CC: Colleen Glover, Tax Division Director, Alaska Department of Revenue argusmedia.com

Argus *Americas Crude*

Crude market prices and analysis

Issue 20-126 | Wednesday 1 July 2020

OVERVIEW

- WTI crude futures rose as the US reported a large draw in domestic crude stockpiles. WTI Nymex August crude futures increased by 55¢/bl to settle at $39.82/bl. Ice September Brent rose by 76¢/bl to $42.03/bl. The September Brent-September WTI spread was $2.11/bl.

- Recent sour crude support against light sweet grades at the US Gulf coast is now appearing in the relationship between the Argus Sour Crude Index (ASCI) and the Argus AGS Marker, a new Midland-quality coastal crude assessment launched at the beginning of the July trade month.

- WTI fob Houston narrowed by 35¢/bl to October Ice Brent this session to an assessed range of possible trade at discounts between $1.55/bl and $1.15/bl, while Bakken fob Beaumont widened by nearly 10¢/bl to discounts circling $1.60/bl.

- Offers were due this session on Dominican Republic's Refidomsa tender to buy 500,000 bl of light sweet crude for 19-20 July delivery to the port of Punta Palenque.

IN THE NEWS

Infrastructure

- Phillips 66 Wood River reports flaring
- Phillips 66 Ponca City started FCC last week

ANNOUNCEMENT

New assessment for WTI at the US Gulf coast

Argus American GulfCoast Select (PA0030327) is a new price assessment reflecting standard Midland-quality WTI at the US Gulf coast that is now available in this report. Visit https://www.argusmedia.com/en/methodology/key-prices/argus-ags for more information.

KEY PRICES

All-day weighted average assessments	Diff to WTI	Diff to LLS	Price	±
				$/bl
LLS St James	+1.30		41.12	+0.45
WTI Cushing		-1.30	39.82	+0.55
WTI Midland	+0.04	-1.26	39.86	+0.64
WTI Houston	+0.91	-0.39	40.73	+0.52
Mars Clovelly	+1.05	-0.25	40.87	+0.46
WCS Hardisty	na		na	nc
WCS Cushing	-2.25	-3.39	37.73	+0.59
WCS Houston	-1.63	-2.77	38.35	+0.46

Forward curve: Locational spreads ($/bl)	WTI/Brent 4:30pm London	WTI/Brent 1:30pm Houston	LLS/Brent 1:30pm Houston
Sep	-2.14	-2.11	-0.91
Oct	-2.07	-2.02	-0.84
Nov	-2.06	-2.01	-0.77
1:30pm Houston	LLS/WTI	Mars/WTI	Mars/LLS
Aug	+1.30	+1.10	-0.20
Sep	+1.35	+1.00	-0.35
Oct	+1.38	+0.94	-0.44

Forward curve: Time spreads ($/bl) 1:30pm Houston	ICE Brent	CME WTI	LLS	Mars
Sep/Oct	-0.08	-0.17	-0.20	-0.11
Oct/Nov	-0.13	-0.14	-0.17	+0.01
Nov/Dec	-0.16	-0.11	-0.15	0.00

Forward curve: Outright prices ($/bl) 1:30pm Houston	LLS	WTI Midland	Mars
Aug	41.12	39.92	40.92
Sep	41.27	40.02	40.92
Oct	41.47	40.22	41.03

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This could indicate some alleviation of recent supply pressure at the US Gulf coast and lend support to waterborne prices.

Crude futures also drew support this session from a 1pc fall in total US crude stocks to 533.53mn bl in the week ended 26 June, from a record high 540.72mn bl set in the previous week.

US production was flat last week at 11mn b/d but may increase as domestic producers begin to restart previously shut-in wells this month.

US independent ConocoPhillips plans to restart some previously curtailed production in the continental US and Alaska with the expectation of improving oil demand, according to a company press release last session.

Separately, offers were due this session for Dominican Republican refiner Refidomsa's tender to buy a 500,000 bl cargo of Light Louisiana Sweet (LLS) or Nigerian Bonny Light crude for 18-20 July delivery to Punta Palenque, Dominican Republic.

LLS sold in the US Gulf coast physical pipeline market this session at premiums to WTI circling $1.30/bl, or roughly $1/bl under October Ice Brent. An estimated 30-60¢/bl cost to load crude at the dock would indicate waterborne LLS values around parity to WTI fob Houston.

But fob values at the US Gulf coast have been trending lower versus their respective pipeline benchmarks amid limited global crude demand during the ongoing Covid-19 pandemic.

WTI fob Houston was assessed at roughly parity to the WTI Houston pipeline index this session but has averaged a 15¢/bl discount since Friday's start to the August US trade month. Waterborne WTI also averaged a 15¢/bl discount to the pipeline benchmark throughout the July trade month, down from an average 12¢/bl premium during June trade.

In other news, crude output has resumed in eastern Libya for the first time since blockades paralyzed the country's oil sector in January and could lead to reduced demand for US light sweet crude in Europe.

The Mesla field — which was producing 60,000-80,000 b/d in the months before the shutdown — restarted last night, according to a field engineer. Mesla output is typically comingled with Sarir production and exported from the Marsa el-Hariga terminal.

Libya's production is not being exported yet, as a force majeure is still being maintained at the country's eastern export terminals.

Attempts to reopen eastern ports could be circumvented if the Libyan National Army (LNA) intercedes to take over the terminals. Maintenance work has been carried out at eastern Libyan fields during their shutdown, but a Libyan source warned that the prolonged disuse could hamper efforts to ramp up output.

Eastern fields could add as much as 600,000-750,000 b/d to Libyan production, which *Argus* estimates averaged just 80,000 b/d in May. Only the offshore Al Jurf and Bouri fields have been producing reliably throughout the blockades.

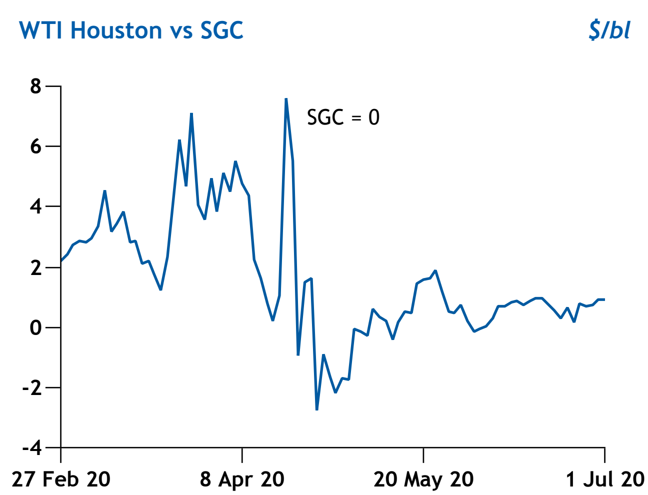
US west coast pipeline, 30 Jun			$/bl
	Basis	Diff to Ice Brent	Outright
Light postings avg	Aug	+0.87	42.02
Heavy postings avg	Aug	-3.80	37.35

US west coast waterborne				$/bl
	Timing	Basis	Diff low/high	Low/High
ANS del	Aug	CMA Nym	+3.58/+3.68	43.56-43.66
	Aug	CMA Ice	+1.45/+1.55	
ANS del concurrent	Aug	Aug WTI	+3.58/+3.68	43.40-43.50

ANS del USWC monthly volume-weighted average		$/bl
	Basis	Diff
May	Ice CMA	-1.24
Jun	Ice CMA	-11.92
Jul	Ice CMA	-3.30
Aug MTD	Ice CMA	+1.30

Assessment rationale

The ANS assessment against CMA Nymex WTI was adjusted to maintain the spread to CMA Ice Brent established when the grade last traded.



26 January 2021

Alaska Department of Revenue, Tax Division
Attn: John Larsen, Audit Master
550 West 7th Avenue, Suite 500
Anchorage, AK 99501

Re: Public notice of proposed changes on the administration of revenue laws and the Oil & Gas Production Tax, dated December 23, 2020

Dear Mr. Larsen,

Oil Search (Alaska), LLC would like to provide the Department of Revenue with the following comments in response to the Department's December 23, 2020 notice of proposed changes.

15 AAC 05.250(a). Use of confidential information in enforcement proceedings
The proposed change to this regulation seems overly broad. The stated purpose of this proposed change is to allow the sharing of operator information, however this limitation is not included in the proposed change. Instead, the proposed change deletes the reference to AS 43.55, that the information was obtained from another taxpayer and the type of information to be disclosed. These clarifications and limitations should be retained. Removing this language could be read to allow this regulation to apply to all tax types and all information. If so, what other types of confidential tax information does the Department intend to be covered by this regulation? If the intent is to share operator information, our recommendation is to retain the entire section proposed to be deleted and add any specific types of other information that the Department intends to disclose during an audit. With respect to the process to consider objections to disclosure set forth in the proposed regulation, given the sensitive nature of the information, the default should be that unless there is an affirmative decision that the information should be disclosed and the taxpayer's concerns are addressed, the information will not be disclosed.

15 AAC 05.171(o). Prevailing value for oil
Contrary to the identified purpose of the proposed change to this regulation, the change does not clarify the meaning of "applicable publicly filed pipeline tariff". Which pipeline tariff to use when calculating prevailing value has been the subject of public comment in the past, most recently in January 2018. The comments submitted then are still applicable today. The proposed change would add a new subsection to 15 AAC 05.171 that defines "applicable publicly filed pipeline tariff" to include both the interstate and intrastate tariffs. This language, however, does not recognize the reason two tariffs exist and the reality as to how North Slope oil is marketed, sold and transported. Our recommendation is that the regulation be amended to align the definition of "applicable publicly filed pipeline tariff" so the "applicable" tariff correspond to the final destination of the oil. Invariably this would be the interstate tariff, rather than the lowest tariff filed.

We appreciate the opportunity to provide comment and look forward to working with you in the future.

Warm regards,

Diane Colley

Diane Colley
Tax Manager
diane.colley@oilsearch.com