

In the Matter Of:

IN RE PUBLIC HEARING - HB 111

PUBLIC HEARING

January 11, 2018

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BEFORE THE DEPARTMENT OF REVENUE

STATE OF ALASKA



In re:

Public Hearing - HB 111 Proposed
Regulations, Packet 2.

TRANSCRIPT OF PROCEEDINGS

Pages 1 - 44, inclusive
Thursday, January 11, 2018
9:00 A.M.

Taken at
REGULATORY COMMISSION OF ALASKA
701 West 8th Avenue, Suite 300
East Hearing Conference Room
Anchorage, Alaska

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A-P-P-E-A-R-A-N-C-E-S

For State of Alaska, Department of Revenue:

**John Larsen, Audit Master
Lennie Dees, Audit Master
550 West 7th Avenue, Suite 500
Anchorage, Alaska 99501
907/269-8436**

Also Present:

**Ken Alper, Department of Revenue
Brandon Brefczynski, AOGA
Marie Evans, ConocoPhillips
Colleen Glover, Department of Revenue
Michael Hurley, ConocoPhillips
Jon Iversen, Stoel Rives
Teri Kostka, ConocoPhillips
Kara Moriarty, AOGA
Nicole Reynolds, Department of Law
Jennifer Roberts, ConocoPhillips
Erin Ruebelmann, Department of Revenue
Jamie Volz, ConocoPhillips**

Present via Teleconference:

**Anna Anklam, Anadarko
Diane Colley, BP
Mary Gramling, Department of Law
Will Nebesky, Chevron**

Court Reporter:

**Gary Brooking, Registered Professional Reporter
PACIFIC RIM REPORTING
711 M Street, Suite 4
Anchorage, Alaska 99501**

1 ANCHORAGE, ALASKA; THURSDAY, JANUARY 11, 2018

2 9:07 A.M.

3 -o0o-

4 MR. LARSEN: Good morning everybody. It's a
5 little sparser crowd than we normally have, but it
6 looks like -- I don't know if we're going to get
7 anybody else in attendance here, so we will go ahead
8 and get started.

9 Today's date is Thursday, January 11th, 2018,
10 and the time is 9:07.

11 Welcome everyone to today's public hearing on
12 regulations proposed by the Alaska Department of
13 Revenue to implement Chapter 3, the Second Special
14 Session of the Legislature 2017, otherwise known as
15 HB 111.

16 The purpose of today's public hearing is to
17 receive input and comments from the public and other
18 interested parties regarding regulation changes
19 proposed in the Department's public notice dated
20 December 21, 2017.

21 In the public notice, the Department
22 identified numerous regulations as being proposed to
23 be either amended or added for the administration of
24 the Department's Oil and Gas Production Tax Program.

25 Today's public hearing is scheduled from

1 9:00 to 11:00 but may be extended, if necessary, to
2 accommodate those present before 10:00 who have not
3 had an opportunity to comment. And based on the
4 gathering here, I don't know that we will need to
5 extend it.

6 Prior to taking comments, there are some
7 administrative matters. In the event of a fire, the
8 fire exit is near this elevator, so out the door to
9 your left and the same -- the stairwell right next to
10 where you came up in the elevator is there.

11 The restrooms are out to the right, in the
12 first hallway to the right.

13 If you do have an electronic device, your
14 cell phone on, please turn it to mute.

15 Copies of the public notice and proposed
16 regulations are available near the sign-in sheets.
17 And if you haven't done so already, please sign in
18 before leaving.

19 Next I would like to go around the room and
20 have everyone introduce themselves and their
21 affiliations, and then on to the phone lines.

22 My name is John Larsen, and I'm with the
23 Alaska Department of Revenue.

24 MR. DEES: My name is Lennie Dees, Alaska
25 Department of Revenue.

1 MS. EVANS: Marie Evans, ConocoPhillips.

2 MS. VOLZ: Jamie Volz, ConocoPhillips.

3 MS. ROBERTS: Jennifer Roberts,

4 ConocoPhillips.

5 MS. KOSTKA: Teri Kostka, ConocoPhillips.

6 MR. HURLEY: Michael Hurley, ConocoPhillips.

7 MR. ALPER: Wrong side of the room here. Ken

8 Alper, Department of Revenue.

9 MR. BREFCZYNSKI: Brandon Brefczynski, Alaska

10 Oil and Gas Association.

11 MS. MORIARTY: Kara Moriarty, AOGA.

12 MR. IVERSEN: Jon Iversen, Stoel Rives.

13 MS. RUEBELMANN: Erin Ruebelmann, Department

14 of Revenue.

15 MS. GLOVER: Colleen Glover, Department of

16 Revenue.

17 MS. REYNOLDS: Nicole Reynolds, Department of

18 Law.

19 MR. LARSEN: And on the phone lines?

20 UNIDENTIFIED MALE: [Unintelligible] for

21 Chevron.

22 MR. NEBESKY: Will Nebesky, Chevron.

23 MS. COLLEY: Diane Colley, BP.

24 UNIDENTIFIED FEMALE: Anna Anklam, Anadarko.

25 MS. GRAMLING: Mary Gramling, Department of

1 Law.

2 MR. LARSEN: And anyone else on the phone
3 line?

4 Thank you. As previously stated, the
5 Department is holding this public hearing in order to
6 provide opportunity for the public and interested
7 parties to provide input and comment on the
8 Department's proposed regulations dated December 21,
9 2017.

10 Those proposed regulations deal primarily
11 with the treatment of carried-forward annual losses,
12 reasonably related exploration expenditures under
13 AS 43.55.165(s) and other conforming changes required
14 by the statutes.

15 After the close of the public comment period
16 on Friday, January 26, 2018, the Department will
17 either adopt the proposed regulation changes or other
18 provisions dealing with the same subject without
19 further notice or decide to take no action.

20 The language of the final regulations may be
21 different from that of the proposed regulations. If
22 you believe your interests may be affected, the
23 Department encourages you to submit any relevant
24 comments either here today or by the close of the
25 written comment period on Friday, January 26, 2018, at

1 4:00 p.m.

2 Written comments may be submitted to me, John
3 Larsen, by any of the following means: By e-mail to
4 JohnLarsen@Alaska.gov -- that's J-o-h-n, dot,
5 L-a-r-s-e-n at Alaska.gov -- via fax to 907/269-6644,
6 or hand delivered or mailed to 550 West 7th Avenue,
7 Suite 500, Anchorage, Alaska 99501.

8 All comments must be received by the close of
9 business Friday, January 26, 2018, at 4:00 p.m.

10 When making comments, please use the
11 microphones at the front of the table and give your
12 name and affiliation, if any. Please be sure the
13 microphone is activated, by observing the green light
14 on the stand.

15 The hearing is being transcribed, and copies
16 will be made available on the Department's website
17 after they have been received.

18 Please note that the hearing and all written
19 comments received will become part of the public
20 record and are available for public inspection.

21 For making comments and testimony, I'd like
22 to first begin here in Anchorage and then move to the
23 phone lines after that.

24 MS. MORIARTY: Go ahead, Marie.

25 MS. EVANS: Okay.

1 MS. MORIARTY: You get to go first today.

2 MS. EVANS: Marie Evans, Tax Counsel for
3 ConocoPhillips.

4 All right. I will try not to read too much,
5 but in order to make some sense of these
6 regulations -- they're a little bit cumbersome, so I
7 have written a lot of notes today.

8 So my comments are all, I think, on 217 for
9 the carried-forward annual loss regulations. And when
10 I looked back at what did the legislature intend or
11 discuss when they were creating the carried-forward
12 annual loss in place of the net operating loss tax
13 credit, there were about three points that came to
14 mind.

15 And the first was that the carried-forward
16 annual loss would be annual -- it was going to follow
17 the annual production tax calculation -- that if a
18 positive production tax value was calculated, then the
19 ring fencing wouldn't apply. It was only if a
20 negative production tax value resulted or was
21 calculated that a carried-forward annual loss would
22 be, quote, unquote, ring fenced.

23 And it's our understanding that the ring
24 fencing addressed a concern that was voiced by the
25 administration for a concern that the larger producers

1 on the North Slope would purchase small -- smaller
2 players/explorers for their losses, apply the losses
3 to the legacy production, and then not pursue or
4 develop what the little or smaller producer, slash,
5 explorer had found or thought was in the ground.

6 And the third kind of legislative intent
7 discussion point that we reflected on was the
8 application of the carried-forward annual loss was
9 purposefully unrestricted by the legislature. And we
10 see that specifically at AS 43.55.165(m) because the
11 legislature provided the taxpayer with an opportunity
12 to decide when to apply the loss as well as the amount
13 to apply.

14 And then of course we have the other part,
15 which, I think, in the 11th calendar year, the loss,
16 if not used, or whatever is remaining, starts to
17 diminish.

18 And I believe the reasoning behind allowing
19 the taxpayer to apply a portion or deciding when to
20 apply how much of a loss was to allow the taxpayer to
21 maximize their loss, because I don't think the
22 legislature could figure out all the different
23 taxpayer situations, and each taxpayer has different
24 individual characteristics. And so the taxpayer made
25 an investment either in low prices or without revenue.

1 And so the thought process behind allowing the
2 taxpayer the flexibility in determining when and how
3 much to apply was to let the individual taxpayers do
4 what's best for their situations.

5 So with those three legislative-intent points
6 in mind, I'm going to move to 15 AAC 55.217(d), which
7 is the first subsection I had a comment on regarding
8 the carried-forward annual losses.

9 And it ties to the legislative intent I
10 talked about at 43.55.165(m), which states: In a
11 calendar year, after application of a producer's lease
12 expenditures that are incurred that calendar year, the
13 producer may choose to apply all or a portion of a
14 carried-forward annual loss or carry an unused portion
15 forward. The Department may not require a producer to
16 apply all or a portion of the carried-forward annual
17 loss in a calendar year.

18 However, when I go to 15 AAC 55.217(d) -- and
19 bear with me, because I'm going to have to read
20 this -- (d) says: This subsection implements
21 AS 43.55.165(o)(1). A carried-forward annual loss
22 established under (b) of this subsection, referring to
23 217, may be deducted only in calculating the annual
24 production tax value for the same segment under
25 15 AAC 55.206, subsection (c), sub (1), for which the

1 carried-forward annual loss was established. A
2 carried-forward annual loss established for a segment
3 described in subsection (1), 15 AAC 55.206(c)(2)(A)
4 may be deducted only in calculating annual production
5 tax values for the following segments.

6 These sections continue on and require a
7 taxpayer that made a North Slope investment for oil,
8 and didn't have either production -- I'm going to use
9 an example here, as I read these regulations. And it
10 may be I -- let me back up so you have the right cite.

11 So it's 217(d)(1) and (d)(2). And so the
12 reference for both 217(d)(1) and (d)(2) is to the
13 existing 206(c)(2), which means the individual
14 explorer or small producer or new entrant did not have
15 any production, if they're under 206(c)(2).

16 However, these two sections are requiring
17 that taxpayer, as I read them, to go back and allocate
18 volumetrically their loss between gas used in state
19 and oil and other gas.

20 So you look at this language. And I'm going
21 to pick it up in the middle of the subsection. And it
22 says: By the producer from leases or properties that
23 include land North of 68 degrees North latitude during
24 the first calendar year that regular production of oil
25 commences or any -- from any of the leases or

1 properties.

2 So if I am reading this correctly, a taxpayer
3 could make North Slope investments for oil and not
4 have production in year one, two, three, or four, but
5 then say they have production in year five.

6 But that taxpayer would not be allowed to
7 apply the loss in year one, two, three or four unless
8 the taxpayer allocated a portion of those prior-year
9 losses to gas used in state based on their current
10 production.

11 And as we discussed, I already have a little
12 heartburn over the fact that we only -- many of us or
13 most of us only incur expenses to look for oil. The
14 gas is a byproduct. And so there's that.

15 But setting that aside and looking at just
16 what this legislature intended with House Bill 111, I
17 don't believe that years one, two, three, four, or
18 whatever they are, should then have to
19 backwards-allocate a part to gas used in state.

20 Now, maybe the taxpayer will luck out and not
21 have any gas used in state, and thereby have no
22 volumes to allocate to. But if they don't, I don't
23 think it was the intention of the legislature to have
24 someone who has spent several years investing to then
25 have to allocate, based on current-year production,

1 part of a prior-year loss.

2 Does that kind of make sense?

3 MR. LARSEN: Yes, Marie. I understand the
4 question. And I don't know -- I'll have to go out and
5 take a look at that. We will take that under
6 advisement. The statutes do require an allocation
7 between oil and gas used in state. And I don't know
8 that there's an alternative to that. But I will
9 certainly take a look at that language.

10 MS. EVANS: Well, I think -- I understand if
11 you're producing you have to do that.

12 MR. LARSEN: Right.

13 MS. EVANS: But here, this is someone who
14 hasn't been producing, because they're at 206(c)(2).
15 And I don't think, when they earned their losses, they
16 weren't producing.

17 MR. LARSEN: Okay.

18 MS. EVANS: And I'm reading this to say:
19 Before they can use their loss, they have to go back
20 and allocate to gas used in state using the
21 current-year volumes.

22 I can understand, okay, you're producing.
23 You're under 206(c)(1) now. You have to allocate
24 under (c)(1).

25 MR. LARSEN: Right.

1 MS. EVANS: But it seems a little odd that
2 we're going to have them go backwards.

3 MR. LARSEN: Okay.

4 MS. EVANS: And most likely this doesn't
5 apply to the company I represent. I just -- I can't
6 figure out why that would be appropriate, or if it
7 was -- this language is not easy to write.

8 MR. LARSEN: Yeah. And I guess just maybe
9 for the purposes of discussion and understanding, like
10 you say, there was no production when any of those
11 expenditures were incurred; but when production
12 begins, the oil and other gas and the gas used in
13 state, if there is any sold, are produced jointly at
14 that point in time. And so that's when the expense is
15 being taken, when -- after production begins. Because
16 like you say, during the exploration phase, during
17 development, there's no production going on, and so
18 there's no allocation of cost to either category at
19 that point.

20 So that's kind of the situation that exists,
21 that there's no production in those first four or five
22 years, for either oil or gas, or gas used in state,
23 and therefore no allocations can be done until the
24 production begins. And once it does begin, both --
25 like I say, the oil and other gas and the gas used in

1 state are being produced, and so that's when those
2 costs are allocated.

3 But I do understand your question, and we'll
4 take a look at that.

5 MS. EVANS: So I kind of thought a little bit
6 about that.

7 MR. LARSEN: Okay.

8 MS. EVANS: And so I can see, like, say in
9 the example I've been using, like, in year five say
10 they have another loss, but they actually have
11 production. I can see year five's loss having to be
12 allocated --

13 MR. LARSEN: Okay.

14 MS. EVANS: -- between -- based on
15 current-year production, assuming they have gas used
16 in state, they need to allocate.

17 MR. LARSEN: Right.

18 MS. EVANS: But then I thought about the
19 reverse situation where somebody is -- they have
20 production, so they're doing their production tax
21 value calculations for segments under (c)(1). And say
22 they come up with a loss, and so the loss is caused by
23 a new development.

24 So the new development doesn't have any
25 production, so is it going to then move to (c)(2)?

1 That's where I was trying to kind of apply it in the
2 reverse. And I didn't -- because it feels like what
3 this does is move between 206(c)(2) and (c)(1). And
4 so can someone who's in 206(c)(1) then have something
5 that is then falling under (c)(2), because it never
6 had any production, and might not for many, many years
7 of big development.

8 So that's kind of where I was -- you don't
9 have to answer me. But that's where I was, like,
10 trying to figure out why this was happening.

11 MR. LARSEN: Okay. And I will try to answer
12 that, Marie.

13 MS. EVANS: Okay.

14 MR. LARSEN: I think the answer is no,
15 because (c)(1) and (c)(2) are two completely different
16 situations. (c)(1) is for someone that is in
17 production --

18 MS. EVANS: Correct.

19 MR. LARSEN: -- right?

20 And then (c)(2), it says if a producer or
21 explorer does not produce any oil or gas from leases
22 in the properties in the state that include land North
23 of 68 degrees.

24 So I think the question about the property
25 that they're -- where the losses were incurred on is

1 not really relevant, because they are producing in the
2 state in other areas, as I understood the scenario.

3 And so I don't think that -- I would say that
4 as long as someone is producing in the state -- on the
5 North Slope -- excuse me -- and they incur lease
6 expenditures on a nonproducing property, they're still
7 subject to (c)(1).

8 MS. EVANS: Okay.

9 MR. LARSEN: Because (c)(1) -- or excuse me.
10 (c)(2). (c)(2) applies only to a producer that has no
11 producing properties in the state on the North Slope.

12 MS. EVANS: Okay. And so once they start
13 producing, they're going to be under (c)(1)?

14 MR. LARSEN: They're going to be under
15 (c)(1).

16 MS. EVANS: Okay.

17 MR. LARSEN: Yeah. So there's not that kind
18 of --

19 MS. EVANS: There's not the reverse
20 situation --

21 MR. LARSEN: Reverse.

22 MS. EVANS: -- that had crossed my mind.

23 MR. LARSEN: Yes.

24 MS. EVANS: Okay. Well, if you could just
25 look at whether it's really meant to be that they

1 allocate the prior-year losses before they start, that
2 would be good.

3 MR. LARSEN: Okay. And I have that down --

4 MS. EVANS: That down?

5 MR. LARSEN: -- as a question, Marie.

6 Thanks.

7 MS. EVANS: Okay. Moving on
8 15 AAC 55.217(e). This is the section which
9 implements AS 43.55.165(s), which has to do with
10 exploration expenditures when there is a net operating
11 loss. And I have to redo my vocabulary to say
12 carried-forward annual loss. It's not intuitive after
13 all these years.

14 Starting with 165(s) in the statute, I'm
15 going to just read it to ground myself.

16 In adopting a regulation that defines the
17 lease or property where a lease expenditure resulting
18 in a carried-forward annual loss is incurred for
19 purposes of (o) and (p) of this section, the
20 Department shall include an exploration lease
21 expenditure that is reasonably related to the lease or
22 property.

23 So looking at 15 AAC 55.217(e)(1), this
24 proposed regulation has what I would call a
25 geographical restriction as well as a time restriction

1 that I don't believe comport with the legislative
2 intent to continue to incentivize exploration. And
3 I'm confused on some of the timing.

4 So 15 AAC 55.217(e)(1) states: A lease
5 expenditure incurred by a producer to explore for oil
6 or gas deposits, large (A), within the land that later
7 becomes part or all of a lease or property of the
8 producer, or big (B), in the case of geological or
9 geophysical exploration, other than a stratigraphic
10 test well within 25 miles of land that later becomes
11 part or all of a lease or property of the producer is
12 reasonably related to that lease or property beginning
13 in the calendar year the land becomes part or all of
14 that lease or property.

15 My first observation is: Why 25 miles?

16 I could not figure out how 25 miles means
17 "reasonably related," because "reasonable" is, to me,
18 a measure of fair or sensible, and it really can't be
19 measured in miles.

20 And then when I look at AS 43.55.165(a)(2),
21 which defines lease expenditures, that part of the
22 statute specifically states that an activity does not
23 need to be physically located on, near or within the
24 premises of a lease or property within which oil or
25 gas deposits being explored for, developed or produced

1 is located, in order for the cost of the activity to
2 be upstream of the point of production of the oil or
3 gas.

4 So with this proposed regulation placing this
5 25-mile restriction, which is going to have to be
6 measured somehow, so we have to have a starting point
7 at some point, it seems to contradict the definition
8 of a lease expenditure. And I don't see how it's
9 going to incentivize exploration, which I think the
10 legislature still wants to do, incentivize.

11 So then I looked at the language that says --
12 that later becomes part -- the lease expenditure that
13 later becomes part or all of the lease or property of
14 the producer is reasonably related to that lease or
15 property beginning in the calendar year the land
16 becomes part or all of that lease or property.

17 So what I couldn't figure out with the timing
18 is if the taxpayer has a negative production tax
19 value, so it has a loss, would the costs for this
20 exploration be removed from that loss and then set
21 aside? And then maybe five years later, when the
22 lease becomes part of a unit, those exploration costs
23 are deemed reasonably related, so then do you deduct
24 them?

25 I couldn't figure out what the language was

1 saying when it says, beginning in that calendar year
2 that the land becomes part or all of the lease or
3 property, then it's reasonably related.

4 MR. LARSEN: Okay. There's a packet of
5 questions there, Marie.

6 MS. EVANS: I know. I know.

7 MR. LARSEN: So let me kind of try and walk
8 through them, and then whatever I left out, then we --

9 MS. EVANS: Okay.

10 MR. LARSEN: -- can try and come back and
11 cover that. The first question that I understand is
12 kind of the, like as you described, the geographic
13 limitation.

14 MS. EVANS: Correct.

15 MR. LARSEN: And this, to be clear, really
16 only applies to the seismic and the G & G type costs.

17 MS. EVANS: Okay.

18 MR. LARSEN: Okay. That's the intent of
19 paragraph -- in paragraph one, we're talking about
20 kind of the very beginning of the exploration phases,
21 the seismic and the G & G. And so at that point in
22 time, there really aren't leases of property. What
23 you're doing -- what an explorer is doing is trying to
24 identify potential prospects.

25 MS. EVANS: Correct.

1 MR. LARSEN: Okay. And so the reason for the
2 25 miles -- and from the discussion draft, that was, I
3 think, originally set at three miles.

4 MS. EVANS: Three, yeah.

5 MR. LARSEN: And what the Department is doing
6 is trying to give some meaning to subsection (s) that
7 says that the exploration costs must be reasonably
8 related to the lease or property where the
9 expenditures were incurred.

10 And there were -- the Department did receive
11 some comment that the entire North Slope is reasonably
12 related. And, in fact, that is how the current
13 regulations read, that if an exploration expenditure
14 is incurred, it's deducted against the entire segment.

15 But it was the Department's belief that the
16 "reasonably related" language was to put some type of
17 parameters around those expenditures. And I think you
18 alluded earlier that the legislature was concerned
19 with people buying losses, and a property must be
20 brought into production.

21 And so the Department was attempting to give
22 meaning to the statute to make sure that the
23 expenditures that are associated with the leases or
24 properties are properties that come into production.
25 Because a hundred percent of the exploration

1 expenditures would still be deductible if all of the
2 properties over which those expenditures were incurred
3 were brought into production.

4 But if they're not, then that's the
5 Department's understanding of what the legislative
6 intent was, is that the property must be brought into
7 production before those losses can be applied against
8 the production tax value for that property. And so
9 that's what I'm going to say as far as that.

10 Moving on to the second point that I think
11 you made, or what I'll -- for purposes of my
12 discussion, is the second point, that lease
13 expenditures do not necessarily incur -- need to be
14 incurred on a lease or property to be a lease
15 expenditure on the property.

16 And I would say what that's really in
17 reference to and -- within the span of our lifetimes,
18 the charge -- the way charges are deducted against a
19 property have evolved. You know, going back to
20 earlier times, there was a strict -- I would say a
21 fairly strict restriction that the lease expenditures
22 had to be incurred within the four corners of the
23 property.

24 But as technology grew and advanced, the
25 operators realized that there could be cost savings by

1 work that could be -- that is directly chargeable to a
2 lease or property but is not performed on the lease or
3 property.

4 MS. EVANS: Correct.

5 MR. LARSEN: Right? Correct. And --

6 MS. EVANS: Like all seismic analysis is not
7 done up north.

8 MR. LARSEN: Right. Right. The analysis --
9 and even some of the technical labor --

10 MS. EVANS: Correct.

11 MR. LARSEN: -- are not necessarily on the
12 lease or property. And so that's the intent. And I
13 think to try and take that language and apply that to
14 the G & G cost is outside the meaning of that language
15 there.

16 MS. EVANS: Okay. So when I read that,
17 I -- I mean, I understand we can understand it,
18 sitting here. What I'm more worried about later is
19 audits.

20 MR. LARSEN: Okay.

21 MS. EVANS: So we have -- you know, you drill
22 an exploration well. You have your core sent down to
23 Anchorage. The analysis has to be done down here. To
24 me, that's a lease expenditure.

25 MR. LARSEN: Sure. And (e) doesn't change

1 any of that. All (e) does is address the reasonably
2 related exploration expenditures, what's reasonably
3 related. And so like I say, (e)(1) deals with the
4 seismic and the G & G cost.

5 And then, for (e)(2), these would be costs
6 incurred after the -- we took a term from DNR, the
7 potential hydrocarbon accumulation --

8 MS. EVANS: Correct.

9 MR. LARSEN: -- and applied that into the
10 regulations here. And so the (e)(2) is after your
11 initial seismic exploration, but continues on with
12 other exploration costs for delineating the reservoir
13 and identifying the PA.

14 MS. EVANS: Okay.

15 MR. LARSEN: And then just to -- to
16 further -- then (e)(3) is for reasonably related
17 exploration expenditures related to drilling to expand
18 or delineate the reservoir.

19 (e)(4) is for leases or properties that are
20 not on state lands. But it doesn't change really
21 anything for (2) or (3), but (2) or (3) are recognized
22 that these are specifically for state lands and leases
23 or properties. But (4) recognizes that there may be
24 federal leases, private leases.

25 MS. EVANS: Right.

1 MR. LARSEN: And so that's to incorporate
2 those.

3 And then (5) is -- we included an example for
4 a stratigraphic test well. I don't know when the last
5 time a stratigraphic test well was drilled on the
6 North Slope.

7 My understanding is that is more often
8 incurred possibly even by a government agency or for
9 some type of a scientific purpose. I don't know
10 when's the last time a producer or explorer drilled a
11 stratigraphic test well, but that's not to say that
12 they wouldn't. And so this provides a specific
13 opportunity for those expenditures to be allowed if
14 that well led to a producing property.

15 MS. EVANS: Okay. So then the timing, the
16 beginning in the calendar year the land becomes
17 part --

18 MR. LARSEN: Oh, okay.

19 MS. EVANS: -- or all of that lease or
20 property, because the timing is also in, like, (e)(2)
21 and (e)(4). I didn't see any in (e)(3).

22 MR. LARSEN: Right. And that's precisely
23 because at (e)(3) the leases have been acquired. But
24 in (e)(1) and (2) and potentially, depending on time,
25 in (e)(4), it's in that predevelopment phase and

1 before the lease -- before the lease or property has
2 been purchased. And we're only talking about a
3 situation in which there's a loss incurred, right?

4 MS. EVANS: Right.

5 MR. LARSEN: Because if an existing producer
6 can't absorb all of the costs of the exploration, then
7 that can be deducted against their GVPP in determining
8 production tax value.

9 MS. EVANS: Yes. I hope to actually never
10 actually have to use any of these sections.

11 MR. LARSEN: We're with you on that, Marie.
12 We hope that you always have a positive production tax
13 value.

14 But the -- like I say, certainly in (1) and
15 in the early stages of (2), there are no leases or
16 properties that attach to -- that those lease
17 expenditures attach to. And so in the event of a
18 loss, that language provides that those lease
19 expenditures are associated with what becomes the
20 lease or property in the future to account for the
21 ring fencing that you mentioned earlier.

22 MS. EVANS: So this is, I think, part of my
23 confusion. So I have a loss, and part of that loss
24 is, say, related to something that's in production,
25 lease or property, in a unit.

1 Okay. So then I'm going to have perhaps some
2 of the loss created because of shooting seismic. So
3 beginning in the calendar year the land becomes part
4 or all of that lease, we're saying that the lease
5 expenditure is then incurred. Say, like it becomes --
6 say we get the lease five years later. So then it's a
7 lease expenditure, like, five years later?

8 So then do I start my, like, ten-year clock
9 when it becomes part of that -- the calendar year the
10 land becomes part or all of that lease or property?
11 That's where I'm trying to figure out where my -- how
12 my timing works.

13 MR. LARSEN: Marie, I'm not going to answer
14 that question right now.

15 MS. EVANS: That's okay. I told you this was
16 stuff that mostly came to me later.

17 MR. LARSEN: That's good. And to the extent
18 that I can, I'd like to try and address the questions
19 here. But on ones that we can't, then we'll take them
20 under advisement.

21 I think that's a great question. You know,
22 looking at the language of the statute, it says -- and
23 there's a couple situations depending on whether it
24 was production or not.

25 But it says beginning -- you know, under

1 (p)(1), 165(p)(1), beginning January 1 of the 11th
2 calendar year after the lease expenditure is carried
3 forward under (a)(3) of this section.

4 And so under (a)(3), (a)(3) is the year that
5 the lease expenditure -- or was a part of lease
6 expenditures that exceeded GVPP and was carried
7 forward.

8 And so my initial response is going to be
9 that it's from the year that that lease expenditure
10 was incurred, not from when the lease or property came
11 into being. Because that's my initial reading of the
12 statutes here. Because, like I say, it's based on
13 (a)(3). And if you look at (a)(3), it says lease
14 expenditures, you know, beginning -- excuse me --
15 165(a)(3), beginning with (3), lease expenditures
16 incurred in a previous calendar year that met the
17 requirements in 160(e) in which -- excuse me -- in the
18 year in which the lease expenditure was incurred.

19 And so I think that's the initial reading of
20 the statute, that it starts at the beginning of the
21 year that it was incurred. But that's a good
22 question, and I think we'll take a look at that.

23 MS. EVANS: Okay. And I actually just had --
24 I mean, I started with (e)(1), but that same language
25 is in (e)(2) and (e)(4) and that was the only other

1 comments I had on (e).

2 MR. LARSEN: Okay.

3 MS. EVANS: Okay. At 15 AAC 55.217(f), this
4 regulation or proposed regulation prohibits the
5 taxpayer from deducting a carried-forward annual loss
6 out of order. In other words, if you have a loss in
7 year one, two and three, you have to first deduct all
8 of the loss in year one before deducting all of the
9 loss in year two or part of the loss in year two.

10 And I understand, and especially because the
11 value of a loss begins to erode, that you would
12 actually -- it's inherent, kind of common sense that
13 you would first deduct year one, year two, year three.

14 My concern is, is that that wasn't really
15 what was behind the legislative intent in
16 43.55.165(m). So I was just going to point out that
17 that might not comport with the statute, because the
18 statute said that the producer may choose to apply all
19 or a portion of a carried-forward annual loss, or
20 carry any unused portion forward.

21 But the regulation is saying you have to do
22 it this way. So you can just take that under
23 consideration. I think the way the regulation is
24 written is kind of common sense that a taxpayer would
25 do that. But I think there was a little more

1 flexibility in the statute.

2 MR. LARSEN: Okay. And so just to be clear,
3 Marie, are you advising that, say, a lease expenditure
4 that was incurred in a fifth year would or should be
5 deducted before one in a prior year?

6 MS. EVANS: I'm just saying that if someone
7 wanted to do that, I think the statute gave them the
8 freedom to. I would question their ability to
9 understand that year five is going to expire after
10 year one. But to each their own.

11 MR. LARSEN: Yeah. No. And I understand the
12 question. And I --

13 MS. EVANS: It's not the way I would deduct
14 them but --

15 MR. LARSEN: I agree. And I think that part
16 of the intent of the regulation in this regard is
17 administratively. In order to be as efficient as
18 possible, I believe it makes much more sense to, you
19 know -- a party could have numerous projects over
20 numerous years, and to track each of those separately,
21 if they're being deducted piecemeal over time, I think
22 could be somewhat of an administrative nightmare. But
23 we will take a look at the statute and the language
24 there and see if it needs to be changed.

25 So let me -- okay.

1 MS. EVANS: I would not deduct them out of
2 order.

3 MR. LARSEN: Right.

4 MS. EVANS: And I did have flashbacks to when
5 we had the 43.55.023 credits that had to be cut back
6 or did half in one year and half the next year.

7 MR. LARSEN: Right.

8 MS. EVANS: I did have flashbacks when I read
9 that, but it was probably one of those nightmares to
10 track administratively. So I understood why it was
11 written that way. I was just pointing out it might be
12 not exactly what the statute said.

13 So moving on to 15 AAC 55.217(i), this one
14 states: If a producer acquires another producer or
15 explorer, the amount of the acquired entity's previous
16 unused carried-forward annual losses that may be used
17 may not exceed the value of consideration paid for the
18 acquisition multiplied by 2.86.

19 And curiosity simply got the better of me.
20 Why 2.86? I just couldn't figure out what the
21 acquisition value had to do with a carried-forward
22 loss. And then why 2.86? I actually joked: Why not
23 pi?

24 MR. LARSEN: Well, actually the 2.86
25 represents the tax benefit at 35 percent.

1 MS. EVANS: The tax benefit. How is that?
2 So you have a hundred-million-dollar loss, and then
3 you buy it -- I guess I will have to do the math,
4 because I can't do it mentally here.

5 MR. LARSEN: So if someone had a
6 hundred-million-dollar loss that was purchased for,
7 say, 500 million --

8 MS. EVANS: Okay.

9 MR. LARSEN: Okay? -- the Department's going
10 to say that you can't deduct -- the maximum that can
11 be deducted is the hundred-million-dollar loss.
12 Because, for one thing, the -- well, yeah.

13 MS. EVANS: I'll work on my math.

14 MR. LARSEN: Okay.

15 MS. EVANS: If I don't understand it, I will
16 write a comment.

17 MR. LARSEN: Okay.

18 MS. EVANS: 15 AAC 55.217(j), the last
19 sentence says: Upon receiving a written request from
20 the producer, the Department will request the Alaska
21 Oil and Gas Conservation Commission to determine
22 whether, and, if so, regular production of oil or gas
23 has commenced from lease or property.

24 And this regulation specifically pertains to
25 AS 43.55.165(o), which is the application of a

1 carried-forward annual loss, what we've been talking
2 about.

3 And I was just wondering. We don't have the
4 same language for the AOGCC and the GVR, so would it
5 be -- or maybe I missed it. But would it be helpful
6 to maybe also have it for the GVR?

7 MR. LARSEN: I think this is not restricted
8 to the carried-forward loss. And if that's the way
9 that's being read, Marie, I -- it was our -- it was
10 the Department intent that this language also include
11 a GVR request.

12 MS. EVANS: Oh, okay.

13 MR. LARSEN: I'll take another look. But I
14 don't see anything in the regulation that necessarily
15 restricts this to the carried-forward losses. But if
16 that's not true, then it was our intent that that --
17 it also include the GVR. And so if it's not, then
18 we'll go back and take a look at that.

19 MS. EVANS: Okay. I will also go back. I
20 probably -- I read -- I was reading about (o) in that
21 paragraph, but I will go back and look to make sure.

22 MR. LARSEN: Yeah.

23 MS. EVANS: Okay.

24 MS. GRAMLING: This is Mary. Sorry. Not to
25 cut you off, Marie, but I just wanted John to be

1 aware that -- I don't know who else is in the room,
2 but it's almost 10:00 o'clock, and so --

3 MS. EVANS: Oh.

4 MS. GRAMLING: -- I don't know how much more
5 presentation you've got, Marie. But, you know, if
6 there's other people in the room, I want to make sure
7 that they have the opportunity to comment and then --
8 I'm just concerned as where we are in time. I don't
9 want to, you know, cut your time or anything, Marie.
10 Maybe we could come back to it if there's a lot more.
11 I just want to make sure that we're not taking too
12 much time if there's other people that, you know, also
13 want to comment.

14 MR. LARSEN: Thanks, Mary.

15 And maybe let me just pause and ask: As far
16 as those on the teleconference, is there anybody on
17 the teleconference that wants to provide testimony at
18 the hearing here today? If so, could you just
19 identify yourselves now, because if Marie -- if we
20 could allow Marie to continue, that would be my
21 preference. But if it looks like we're going to run
22 into time constraints, then I'll certainly be aware of
23 that. But maybe just so my awareness -- if there's
24 anybody that wants to testify telephonically, could
25 you please identify yourself now, and I will make sure

1 that we do allow time for that to happen.

2 (Pause.)

3 MR. LARSEN: I'll take that as a no response.

4 Also, I spoke to Kara Moriarty briefly, and
5 it's my understanding that the AOGA presentation today
6 is probably going to be rather limited and will be
7 more complete in their written comments. Could --

8 MS. MORIARTY: That's correct.

9 MR. LARSEN: Kara's nodding her head in
10 agreement. So I think we'll go ahead and let Marie
11 continue here.

12 MS. EVANS: Yep. I really had mostly summary
13 stuff.

14 MR. LARSEN: Okay.

15 MS. EVANS: So I didn't have any other
16 specific sections in here. I did want to just advise
17 that the regulations are complex, and I hope that we
18 never have a loss. But I do think they're going to
19 require, due to their complexity, a lot of manual
20 calculations.

21 I don't believe that the legislature intended
22 to have the allocation to the gas in use -- the "gas
23 used in state" segment. And that I understand is the
24 way the statute is set up. I don't know that that was
25 understood, because I don't believe -- the "gas used

1 in state" segment, the way the math works, it's just
2 really easy to create a loss. And I don't -- and that
3 loss is very unlikely to be used unless your "gas used
4 in state" segment starts making a lot of revenues.

5 And I don't believe that this legislation was
6 passed with the intent of creating a small or smaller
7 but permanent tax increase, just because of the way
8 the math works for gas used in state.

9 I know you are implementing regulations, and
10 we have the structure we have, but that does concern
11 me a bit. I appreciate the "opt out" language that
12 was added into the draft, and that will at least
13 provide an opportunity, if you do have a loss, say, of
14 \$100 or a thousand dollars, that you don't have to go
15 through the complex mathematical calculations because
16 no matter what, depending on your size, you may just
17 opt to forgo, and I think that was a great addition.
18 So thank you.

19 What else did I have? And then as I said at
20 the beginning -- and I think this has more to do with
21 the complexity -- I really understood or we really
22 understood the "ring fencing" concept during the
23 discussions was to prevent the large producers from
24 purchasing explorers for their losses. And
25 irrespective of the merits of that policy goal, I

1 don't know that the complexity achieves that, and so I
2 would encourage the Department to reconsider that and
3 the policy goals of the legislature in light of the
4 complexity.

5 And that's really all I had.

6 MR. LARSEN: Thank you, Marie.

7 MS. EVANS: Thank you.

8 MR. LARSEN: Thanks, Marie. And, Marie, let
9 me just comment, if I can, on that, on the last
10 comment.

11 In looking at the language in 165(o), that a
12 carried-forward annual loss may only be applied to
13 determine the production tax value of oil or gas for a
14 category for which a separate annual production tax
15 value is required to be calculated under
16 AS 43.55.160(a) or (h), if the lease expenditure
17 resulting in that carried-forward annual loss was
18 incurred in the same category; and two, beginning in
19 the calendar year in which regular production in oil
20 or gas from the lease or property with a lease
21 expenditure resulting in the carried-forward annual
22 loss was incurred commences.

23 And so that's -- I think that really is the
24 "ring fencing" language there, and that's what
25 requires the allocation of those costs to those

1 properties.

2 I think that -- I don't want to say that the
3 formula is unnecessarily complex, but I think that
4 there is a necessary complexity in allocating those
5 expenditures to the lease or property where the loss
6 was incurred. And as we stated at the beginning, if
7 the producers' revenues can't absorb the losses, then
8 there's no allocation required.

9 MS. EVANS: Correct.

10 MR. LARSEN: And then in regards to the
11 calculations in 217(c), only one of those calculations
12 is going to apply during a year to a producer. In
13 other words, a calculation under (3)(A), (B) and (C)
14 is not -- annual, and the word being "and (C)," is not
15 going to be required. Only one of those calculations
16 is going to be required. And it's going to be based
17 on the -- what level of lease expenditures exceed the
18 gross value of the point of production.

19 And so the intent is such that if the -- the
20 intent is that -- and I think of both the statute and
21 the regulation, is that losses not be attributed to
22 producing properties unless a producing property
23 incurred those -- was responsible for a part of that
24 loss; but rather that, for example, if a producer has
25 producing properties that are able to absorb some but

1 not all of the loss, then only that portion of the
2 loss that remains will be attributable to the
3 nonproducing lease or property rather than, like, a
4 hundred percent of the loss.

5 MS. EVANS: Okay. Thank you.

6 MR. LARSEN: Yeah, you bet. Thanks.

7 So that's all we have from ConocoPhillips
8 today. Is there someone else that would like to
9 provide testimony?

10 MS. MORIARTY: Good morning. For the record,
11 my name is Kara Moriarty, and I'm the President and
12 CEO of the Alaska Oil and Gas Association.

13 John, as you mentioned during the portion
14 with ConocoPhillips, we, as AOGA, come between various
15 holiday calendars and other activities -- I have a
16 board meeting today -- and things of that nature. We
17 have not had a chance to rally the troops, if you
18 will, to see if we'll be providing any additional
19 comments beyond what we did on the discussion draft.

20 And so I anticipate -- we know that
21 January 26th is the deadline, and I have no doubt that
22 we will provide you with extensive comments based
23 on -- once we have a chance for all of us to sit down
24 and visit. That will probably happen sometime either
25 early or late next week.

1 So I apologize that we don't have our normal
2 type of oral comments during your public hearing
3 process like we normally do. It's just a function of
4 people's travel schedules and whatnot. But you can
5 expect a full set of AOGA comments by the 26th. And
6 they could be short, but at least we will have had a
7 chance to have got -- had everyone's input, because,
8 as I said, it's always a hundred percent consensus.

9 So I don't want to speculate, even based on
10 some initial conversations, and we will provide that
11 viewpoint on behalf of our membership by then.

12 MR. LARSEN: Thanks. Thanks, Kara. I
13 appreciate that, and I appreciate AOGA consolidating
14 the comments for us --

15 MS. MORIARTY: Again, no worries.

16 MR. LARSEN: -- putting that together.
17 Thanks.

18 Is there anyone else in the conference room
19 here today that would like to provide testimony or
20 comment?

21 Hearing none, I will go once again to the
22 phone lines and see if there's anybody on the
23 teleconference who would like to comment on anything
24 they have heard today or on the draft itself.

25 Hearing none, thank you everyone again for

1 your comments here today. A final reminder that the
2 public comment period closes at 4:00 p.m. Friday,
3 January 26, 2018.

4 The Department will either adopt the proposed
5 regulation changes or other provisions dealing with
6 the same subject without further notice or decide to
7 take no action.

8 Once again, comments may be delivered to me
9 by e-mail to John.Larsen@Alaska.gov, J-o-h-n, dot,
10 L-a-r-s-e-n at Alaska.gov, via fax to 907/269-6644, or
11 mailed or delivered to me at 550 West 7th Avenue,
12 Suite 500, Anchorage, Alaska 99501.

13 The comments will be accumulated and posted
14 online on the Tax Division's website at
15 www.tax.Alaska.gov. All comments will be considered
16 in the final drafting of the regulations proposed for
17 adoption by the Commissioner of Revenue. The language
18 of the final regulations may be different from that of
19 the proposed regulations; therefore, if you believe
20 your interests may be affected, you should comment
21 during the time allowed.

22 Please remember that all comments received
23 are public records and available for public
24 inspection.

25 Thank you again everyone here today for your

1 participation and interest in these matters. I said
2 that I would be here until 11:00, and so I think that
3 I will remain here and see if anybody shows up to make
4 comment. But the rest of you are free to go.

5 I think we'll pause in the proceeding and go
6 off the record for a while. And if anybody comes back
7 on, then we will take it up after that.

8 Thanks and good day.

9 (Off record.)

10 MR. LARSEN: This is John Larsen. We're back
11 on record. The time is 11:03. No one has showed up
12 to provide any additional testimony. This hearing is
13 now closed.

14 (Proceedings concluded at 11:03 a.m.)

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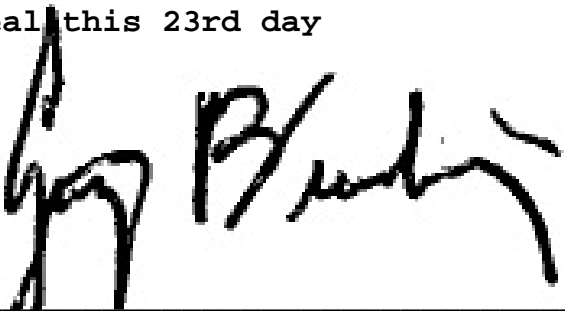
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CERTIFICATE

I, GARY BROOKING, Registered Professional Reporter and Notary Public in and for the State of Alaska, do hereby certify that the foregoing proceedings were taken before me at the time and place herein set forth; that the proceedings were reported stenographically by me and later transcribed by computer transcription; that the foregoing is a true record of the proceedings taken at that time; and that I am not a party to nor have I any interest in the outcome of the action herein contained.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my seal this 23rd day of January, 2018.



GARY BROOKING, RPR
My Commission Expires 6/28/2020

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