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

CERTIFIED TRANSCRIPT

In re:

Public Hearing - HB 111 Proposed Regulations, Packet 2.
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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

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
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ANCHORAGE, ALASKA; THURSDAY, JANUARY 11, 2018
9:07 A.M.
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MR. LARSEN: Good morning everybody. It's a little sparser crowd than we normally have, but it looks like -- I don't know if we're going to get anybody else in attendance here, so we will go ahead and get started.

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

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

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

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

Today's public hearing is scheduled from

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

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

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

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

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

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

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

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

MS. EVANS: Marie Evans, ConocoPhillips.

MS. VOLZ: Jamie Volz, ConocoPhillips.

MS. ROBERTS: Jennifer Roberts, ConocoPhillips.

MS. KOSTKA: Teri Kostka, ConocoPhillips.

MR. HURLEY: Michael Hurley, ConocoPhillips.

MR. ALPER: Wrong side of the room here. Ken Alper, Department of Revenue.

MR. BREFCZYNSKI: Brandon Brefczynski, Alaska Oil and Gas Association.

MS. MORIARTY: Kara Moriarty, AOGA.

MR. IVERSEN: Jon Iversen, Stoel Rives.

MS. RUEBELMANN: Erin Ruebelmann, Department of Revenue.

MS. GLOVER: Colleen Glover, Department of Revenue.

MS. REYNOLDS: Nicole Reynolds, Department of Law.

MR. LARSEN: And on the phone lines?

UNIDENTIFIED MALE: [Unintelligible] for Chevron.

MR. NEBESKY: Will Nebesky, Chevron.

MS. COLLEY: Diane Colley, BP.

UNIDENTIFIED FEMALE: Anna Anklam, Anadarko.

MS. GRAMLING: Mary Gramling, Department of

Law.

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

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

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

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

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

4:00 p.m.

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

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

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

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

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

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

MS. MORIARTY: Go ahead, Marie.

MS. EVANS: Okay.

MS. MORIARTY: You get to go first today.

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

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

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

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

And it's our understanding that the ring fencing addressed a concern that was voiced by the administration for a concern that the larger producers on the North Slope would purchase small -- smaller players/explorers for their losses, apply the losses to the legacy production, and then not pursue or develop what the little or smaller producer, slash, explorer had found or thought was in the ground.

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

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

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

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

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

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

However, when I go to 15 AAC 55.217(d) -- and bear with me, because I'm going to have to read this -- (d) says: This subsection implements AS 43.55.165(o)(1). A carried-forward annual loss established under (b) of this subsection, referring to 217, may be deducted only in calculating the annual production tax value for the same segment under 15 AAC 55.206, subsection (c), sub (1), for which the carried-forward annual loss was established. A carried-forward annual loss established for a segment described in subsection (1), 15 AAC 55.206(c)(2)(A) may be deducted only in calculating annual production tax values for the following segments.

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

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

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

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

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

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

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

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

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

Does that kind of make sense?

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

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

MR. LARSEN: Right.

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

MR. LARSEN: Okay.

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

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

MR. LARSEN: Right.

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

MR. LARSEN: Okay.

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

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

So that's kind of the situation that exists, that there's no production in those first four or five years, for either oil or gas, or gas used in state, and therefore no allocations can be done until the production begins. And once it does begin, both -- like I say, the oil and other gas and the gas used in state are being produced, and so that's when those costs are allocated.

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

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

MR. LARSEN: Okay.

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

MR. LARSEN: Okay.

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

MR. LARSEN: Right.

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

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

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

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

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

MS. EVANS: Okay.

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

MS. EVANS: Correct.

MR. LARSEN: -- right?

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

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

not really relevant, because they are producing in the state in other areas, as I understood the scenario.
And so I don't think that -- I would say that as long as someone is producing in the state -- on the North Slope -- excuse me -- and they incur lease expenditures on a nonproducing property, they're still subject to (c)(1).
MS. EVANS: Okay.
MR. LARSEN: Because (c)(1) -- or excuse me. (c)(2). (c)(2) applies only to a producer that has no producing properties in the state on the North Slope.
MS. EVANS: Okay. And so once they start producing, they're going to be under (c)(1)?
MR. LARSEN: They're going to be under (c)(1).
MS. EVANS: Okay.
MR. LARSEN: Yeah. So there's not that kind of --
MS. EVANS: There's not the reverse situation --
MR. LARSEN: Reverse.
MS. EVANS: -- that had crossed my mind.
MR. LARSEN: Yes.
MS. EVANS: Okay. Well, if you could just look at whether it's really meant to be that they

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

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

MS. EVANS: That down?

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

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

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

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

So looking at 15 AAC 55.217(e)(1), this proposed regulation has what I would call a geographical restriction as well as a time restriction that I don't believe comport with the legislative intent to continue to incentivize exploration. And I'm confused on some of the timing.

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

My first observation is: Why 25 miles?

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

And then when I look at AS 43.55.165(a)(2), which defines lease expenditures, that part of the statute specifically states that an activity does not need to be physically located on, near or within the premises of a lease or property within which oil or gas deposits being explored for, developed or produced is located, in order for the cost of the activity to be upstream of the point of production of the oil or gas.

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

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

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

I couldn't figure out what the language was saying when it says, beginning in that calendar year that the land becomes part or all of the lease or property, then it's reasonably related.

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

MS. EVANS: I know. I know.

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

MS. EVANS: Okay.

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

MS. EVANS: Correct.

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

MS. EVANS: Okay.

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

MS. EVANS: Correct.

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

MS. EVANS: Three, yeah.

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

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

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

And so the Department was attempting to give meaning to the statute to make sure that the expenditures that are associated with the leases or properties are properties that come into production. Because a hundred percent of the exploration expenditures would still be deductible if all of the properties over which those expenditures were incurred were brought into production.

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

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

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

But as technology grew and advanced, the operators realized that there could be cost savings by work that could be -- that is directly chargeable to a lease or property but is not performed on the lease or property.

MS. EVANS: Correct.

MR. LARSEN: Right? Correct. And --

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

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

MS. EVANS: Correct.

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

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

MR. LARSEN: Okay.

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

MR. LARSEN: Sure. And (e) doesn't change any of that. All (e) does is address the reasonably related exploration expenditures, what's reasonably related. And so like I say, (e)(1) deals with the seismic and the G & G cost.

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

MS. EVANS: Correct.

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

MS. EVANS: Okay.

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

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

MS. EVANS: Right.

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

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

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

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

MR. LARSEN: Oh, okay.

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

MR. LARSEN: Right. And that's precisely because at (e)(3) the leases have been acquired. But in (e)(1) and (2) and potentially, depending on time, in (e)(4), it's in that predevelopment phase and before the lease -- before the lease or property has been purchased. And we're only talking about a situation in which there's a loss incurred, right?

MS. EVANS: Right.

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

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

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

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

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

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

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

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

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

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

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

But it says beginning -- you know, under (p)(1), 165(p)(1), beginning January 1 of the 11th calendar year after the lease expenditure is carried forward under (a)(3) of this section.

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

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

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

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

MR. LARSEN: Okay.

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

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

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

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

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

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

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

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

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

So let me -- okay.

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

MR. LARSEN: Right.

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

MR. LARSEN: Right.

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

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

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

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

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

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

MS. EVANS: Okay.

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

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

MR. LARSEN: Okay.

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

MR. LARSEN: Okay.

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

And this regulation specifically pertains to AS 43.55.165(o), which is the application of a carried-forward annual loss, what we've been talking about.

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

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

MS. EVANS: Oh, okay.

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

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

MR. LARSEN: Yeah.

MS. EVANS: Okay.

MS. GRAMLING: This is Mary. Sorry. Not to cut you off, Marie, but I just wanted John to be aware that -- I don't know who else is in the room, but it's almost 10:00 o'clock, and so --

MS. EVANS: Oh.

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

MR. LARSEN: Thanks, Mary.

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

(Pause.)

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

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

MS. MORIARTY: That's correct.

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

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

MR. LARSEN: Okay.

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

I don't believe that the legislature intended to have the allocation to the gas in use -- the "gas used in state" segment. And that I understand is the way the statute is set up. I don't know that that was understood, because I don't believe -- the "gas used in state" segment, the way the math works, it's just really easy to create a loss. And I don't -- and that loss is very unlikely to be used unless your "gas used in state" segment starts making a lot of revenues.

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

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

What else did I have? And then as I said at the beginning -- and I think this has more to do with the complexity -- I really understood or we really understood the "ring fencing" concept during the discussions was to prevent the large producers from purchasing explorers for their losses. And irrespective of the merits of that policy goal, I don't know that the complexity achieves that, and so I would encourage the Department to reconsider that and the policy goals of the legislature in light of the complexity.

And that's really all I had.

MR. LARSEN: Thank you, Marie.

MS. EVANS: Thank you.

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

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

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

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

MS. EVANS: Correct.

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

And so the intent is such that if the -- the intent is that -- and I think of both the statute and the regulation, is that losses not be attributed to producing properties unless a producing property incurred those -- was responsible for a part of that loss; but rather that, for example, if a producer has producing properties that are able to absorb some but not all of the loss, then only that portion of the loss that remains will be attributable to the nonproducing lease or property rather than, like, a hundred percent of the loss.

MS. EVANS: Okay. Thank you.

MR. LARSEN: Yeah, you bet. Thanks.

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

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

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

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

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

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

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

MS. MORIARTY: Again, no worries.

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

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

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

Hearing none, thank you everyone again for your comments here today. A final reminder that the public comment period closes at 4:00 p.m. Friday, January 26, 2018.

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

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

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

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

Thank you again everyone here today for your participation and interest in these matters. I said that I would be here until 11:00, and so I think that I will remain here and see if anybody shows up to make comment. But the rest of you are free to go.

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

Thanks and good day.

(Off record.)

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

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

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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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