November 29, 1996

The Honorable Wilson L. Condon, Commissioner
Alaska Department of Revenue
P. O. Box 110400
Juneau, Alaska 99811-0400

Re: Oil and Gas Production Tax Statutes; Proposed Regulation Changes; and Compromised FGSO Tax Assessments
A.G. file no: 663-97-0210
1996 Op. Att=y Gen. No. 5

Dear Commissioner Condon:

You have submitted to me a detailed memorandum containing your draft decisions on several production tax issues regarding North Slope gas. The memorandum explains your interpretations of various production tax statutes and then applies those statutes to several uses of gas on the North Slope. As a result, you propose several changes in the Department of Revenue's regulations and the compromise of taxes assessed against several taxpayers on Prudhoe Bay fuel gas that is subject to the Fuel Gas Supply Option ("FGSO") contained in Section 30.008 of the Prudhoe Bay Unit Operating Agreement. In accordance with our respective statutory responsibilities, you have asked me to review your interpretation of the production tax statutes, comment on the substance of the regulatory changes you propose,[1] and approve your decision to compromise the FGSO tax assessments. This memorandum responds to your request.

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[1] The written statement of approval or disapproval of each regulation required by AS 44.62.060 will be separately prepared in accordance with the normal practices of our respective

I. INTRODUCTION

Your memorandum presents a thorough analysis of how and when North Slope gas is "produced" for production tax purposes pursuant to AS 43.55.900(7), and of whether certain "produced gas" that is used in production operations or for repressuring by North Slope producers is exempt from production tax pursuant to AS 43.55.020(e). As a practitioner of oil and gas law for many years before becoming the Commissioner of Revenue, you bring an unusually high level of expertise to these issues that is reflected in the analysis in your memorandum.

Of all the decisions in your memorandum, the one that has drawn the most attention within each of our departments is your decision to compromise the pending tax assessments on FGSO gas. If I approve your decision exempting most FGSO gas from tax, the pending tax assessments against two producers will be substantially reduced. The other decisions in your memorandum involve less potential tax revenues than the FGSO claims, but also resolve important questions about the tax consequences of present and future transfers and uses of North Slope gas. My department has spent a considerable amount of time examining these issues.

As described in your memorandum, our departments have exchanged information on these gas issues for over a year. We have met informally with the taxpayers affected most by these decisions and have given them an opportunity to explain their positions. We have had frequent discussions about these issues and I have reviewed various drafts of your memorandum. I have reviewed the final draft of your memorandum carefully and have consulted with members of my staff

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offices. I consider my current responsibility to be the preliminary one imposed by AS 44.62.060(b): "[T]he Department of Law shall advise the agencies on legal matters relevant to the adoption of regulations and may advise the agencies on the need for and the policy involved in particular regulations."

and outside counsel in preparing this response. I have also independently analyzed the legal issues and have drawn my own conclusions about how the relevant production tax statutes should be interpreted.

For the reasons set forth below, I find that you have reasonably interpreted the pertinent production tax statutes, have raised valid policy considerations in support of your interpretations, and have appropriately applied the statutes to several uses of North Slope gas. I therefore approve your proposed FGSO decision and support your regulatory changes.

1. ROLE OF THE DEPARTMENT OF LAW IN COMPROMISING A TAX

Before addressing the substance of your decisions, I must first determine the level of review that I should apply to those decisions. Because your FGSO decision involves compromising a tax claim, I have a statutory obligation to either approve or disapprove the decision. *See* AS 43.05.070. Your proposed regulatory changes require similar approval. *See* AS 44.62.060. My office has not previously determined the appropriate standard of review for proposed tax compromises. I have considered this issue and conclude that the Attorney General should approve a tax compromise proposed by the Commissioner of Revenue when such a compromise is reasonable in light of the relevant circumstances.

1. The Relationship between the Attorney General and the Commissioner of Revenue Generally

AS 44.23.020(b)(1) and AS 43.05.010(13) and (14) require that the Commissioner of Revenue and the Attorney General work together to collect all revenue due the State. Both officials are statutorily required to take all "necessary and proper" action to collect state revenue. AS 44.23.020(b)(1); AS 43.05.010(15).

The Commissioner's responsibilities to "take all steps necessary and proper to enforce" the tax laws (AS 43.05.010(15)) and to hold "investigations necessary for the administration" of the tax laws (AS 43.05.010(8)) require the Commissioner, in the first instance, to determine whether taxpayers have paid the appropriate amount of tax. If the Commissioner determines that additional taxes are owed and an action is necessary to collect, the Commissioner must ask the Attorney General to institute the action. *See* AS 43.05.010(14). If the Attorney General agrees that a collection action is "necessary and proper," he must institute the action. *See* AS 44.23.020(b)(1).

If the taxpayer appeals the Department of Revenue's assessment of a tax to either an informal conference or a formal hearing (AS 43.05.240), the Alaska Statutes do not specifically require the participation of the Attorney General in the appeal, although, as a matter of sound policy, assistant attorneys general are typically involved at all stages of administrative appeals.

2. The Attorney General's Specific Statutory Responsibility in Compromising a Tax

AS 43.05.070 provides that:

> **Compromise of tax or penalty.** (a) If in the opinion of the department there is doubt as to the liability of the taxpayer for or the collectibility of a tax, license fee, or excise tax, the department, with the approval of the attorney general, may compromise the tax.
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> (b) The department, with the approval of the attorney general, may, for cause shown, compromise a penalty accruing under the state tax, license, or excise tax laws.

In short, when the Department of Revenue believes that the liability of the taxpayer or the collectibility of a tax is in doubt, the Department can compromise the tax if the Attorney General approves the compromise. Determining what action constitutes a compromise requiring Attorney

General approval has been a topic of controversy between our departments in the past and was the subject of a formal opinion issued by General Baily in 1990.[2] It is unnecessary for me to elaborate on this point because your request correctly presupposes the applicability of AS 43.05.070 to your proposed compromise of the pending tax assessments on FGSO gas.

c. The Standard to Be Applied by the Attorney General When Reviewing a Proposed Compromise of a Tax or Penalty

My office has never formally delineated the standards for reviewing a tax compromise proposed by the Commissioner, although General Baily's opinion referred to above provides some insight:

> [T]he very predicate of a compromise under AS 43.05.070 is that there be "doubt as to the liability of the taxpayer" . . . ; without at least the possibility that an appeal will find an error in the assessment, a compromise would not be permissible. The requirement of attorney general approval is undoubtedly intended to protect the public fisc by helping to ensure, *inter alia*, that the department does not, in the guise of "correcting" an assessment, give up a tax claim unnecessarily by misjudging the degree of "doubt" as to the taxpayer's liability.

1990 Op. Att'y Gen., No. 1, at 13 (Dec. 3, 1990).

General Baily continues:

> While that review [of a Department-recommended settlement] should not be an occasion to "second guess" the Department of Revenue, it should consist of an informed analysis of the settlement and compromise.

1990 Op. Att'y Gen. No. 1 at 14, n.12.

This statement, together with the explanation of the reason that Attorney General approval is required, indicates that the Attorney General will review the Commissioner's proposed

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[2] 1990 Op. Att'y Gen., No. 1 (Dec. 3, 1990).

action to ensure that no errors were made, to check that the Commissioner has not misperceived the doubt as to the taxpayer's liability, and to ensure that the proposed resolution is reasonable in light of the degree of doubt that is perceived.

What the Baily opinion does not explain is what sort of "informed analysis of the settlement and compromise" is required. I am persuaded that it is not appropriate to articulate a static standard of review for the Attorney General's review of a department recommendation to compromise a tax assessment. Each individual compromise will vary in many salient factors, including the degree to which the compromise involves questions of law, policy, and fact; the effect on the public interest (including the dollar amount at issue and the effect on future tax collection); and the level of analysis which the Department has applied in arriving at its recommendation. The presence or absence of these factors will determine whether the Attorney General's review should be more independent or more deferential.

Insofar as the Commissioner's recommendation for compromise rests on policy, facts, or expertise in applying tax codes, the Attorney General's review of the recommendation should be more deferential; the inquiry will be whether the Commissioner's recommendation is reasonable.[3]

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[3] This approach is consistent with that taken in exercising approval authority in the adoption of agency regulations. Alaska Statute 44.62.060(b) requires a written statement of approval or disapproval of proposed regulations in order to determine, among other things, "its legality, constitutionality, and consistency with other regulations."

> The Department's *Civil Manual* provides in pertinent part:
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> > If a provision is questionable, but the question is too close to call with reasonable certainty, *and* there is reasonable justification for the provision and a reasonable, substantial argument could ethically be made in its defense, we should accord the agency a presumption of validity and not lightly overturn its policy judgment.

See, e.g., Gulf Oil Corp. v. State, 755 P.2d 372, 379-80 & n.19 (Alaska 1988) (applying rational basis standard of review to policy matter). Insofar as the Commissioner's recommendation is based on legal concepts, such as canons of statutory construction, the Attorney General should exercise independent judgment in determining whether the compromise is in the public interest.[4] *See, e.g., National Bank of Alaska v. State, Dep't of Revenue*, 642 P.2d 811, 815 (Alaska 1982) (court applied its independent judgment in upholding department's decision regarding a business license fee deficiency). Mixed questions of fact and law present a middle ground. Although the courts will generally defer to an agency's decision on such mixed questions, the Attorney General plays a more central role in determining the initial interpretation of law and should not be too deferential on such questions.

As a practical matter, most recommendations for compromise will be the result of a collaborative effort between the Departments of Revenue and Law. The present case illustrates this concept. Here, you and your staff have spent many hours considering mixed questions of fact and law. You have been advised on the law by several assistant attorneys general, and you have heard

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See Civil Manual, § 3.0.1.A.5(6) at 22.

[4] This case also illustrates the advantages of a "flexible" standard of review. In the normal case, I would consider analysis of legislative history to be a legal matter, and would exercise my independent judgment in reviewing the Commissioner's conclusions based on his analysis of legislative history. However, as the current Commissioner of Revenue, you are extraordinarily well versed in the legislative history of the tax statutes in question. It would be foolish to adhere to judicial notions of standard of review and independently review a matter on which you possess special expertise merely because the matter could technically be classed as "legal" rather than "policy." Because we are both members of the executive branch, I believe that I can choose to defer to you on this legal question without compromising my duty to protect the public interest. *See Public Defender Agency v. Superior Court*, 534 P.2d 947, 950 (Alaska 1975). Conversely, in the future, the Attorney General may well exercise independent judgment on policy or factual matters where necessary to protect the public interest.

debate on the issues from several private attorneys and taxpayer representatives. In these cases, deferential review of the recommendation will usually be in order.

In sum, the Attorney General has authority to disapprove the Commissioner's recommendation for settlement. But, this authority should be exercised with caution and prudence. When reviewing the Commissioner's recommendation, the Attorney General should consider all salient factors that went into the recommendation, giving deference to the Commissioner where deference is due. I apply that analysis here.

2. THE POINT OF PRODUCTION FOR NORTH SLOPE GAS

In Section II of your memorandum you examine the point of assessment (the point of production) for the production tax. Because all gas produced on the North Slope is recovered from or in association with oil, you focus on AS 43.55.900(7)(B) and apply your interpretation of this statute to various North Slope facilities. I have reviewed this section of your memorandum to determine whether you have reasonably interpreted AS 43.55.900(7)(B).

Alaska Statute 43.55.900(7)(B) provides:

> "gross value at the point of production" means . . .
>
> (B) for gas recovered from or in association with oil, the value of the gas at the point where it is accurately metered or measured after separation from the oil; for gas run through a gas processing plant, the gross value at the point of production is the full consideration received by the producer if sold in an arm's length transaction or, in the absence of an arm's length transaction, is the sum of the value of the liquids extracted from the gas at the plant and the value of the residue gas, less a reasonable allowance for processing the gas at the plant and for transporting the gas to the plant from the premises upon which the oil production operation is conducted.

You interpret this provision as establishing the following criteria for the point of production for associated gas: (1) separation of gas from oil; and (2) accurate metering or measuring of the gas. I agree that these are the only statutory criteria for identifying the point of production for associated gas. I further agree that by stating that the point of production is the meter where the "sales stream" of gas meets the "conditions for purposes of sale," the current regulation interpreting that statute, 15 AAC 55.900(a)(6)(B), is ambiguous and should be revised. Alaska Statute 43.55.900(7)(A) imposes a "pipeline quality" requirement on the point of production for oil, and the drafters of the statute may have considered imposing a similar requirement on the point of production for gas. But, because the "plain language" of the statute does not impose a pipeline quality requirement with respect to gas, and because the history of the statute is equivocal at best, we should not interpret the statute to impose such a requirement.[5] I support your revision of the applicable regulation.

As you demonstrate, the application of AS 43.55.900(7)(B) to the actual operations on the North Slope since 1977 can be quite complicated, and requires a thorough understanding of the various production facilities. I have reviewed your discussion of these issues with care, and I am satisfied that your application of the statute to the North Slope facilities is based on a thorough understanding and careful analysis of the facts and is a reasonable application of the law to those facts.

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[5] Although the Alaska Supreme Court has rejected the "plain meaning" rule as an exclusionary rule, the court still gives "unambiguous statutory language its ordinary and common meaning." *City of Dillingham v. CH2M Hill Northwest*, 873 P.2d 1271, 1276 (Alaska 1994). "The plainer the meaning of the statute, the more persuasive any legislative history to the contrary must be." *Id.; see also Borg-Warner v. AVCO Corp.*, 850 P.2d 628, 633 n.12 (Alaska 1993) ("The plainer the language of the statute, the more convincing contrary evidence must be.").

Your analysis of the point of production for North Slope gas also reveals the need for a workable definition of the term "gas processing plant." The statutory scheme clearly anticipates that the point of production must be upstream of a gas processing plant. Our departments have jointly developed a process-based definition of gas processing, and I am persuaded that such a definition is appropriate. I, of course, leave the final approval of the exact language of any regulatory change to my department's regulations attorney in accordance with AS 44.62.060(b).

3. THE PRODUCTION TAX EXEMPTION FOR GAS

In Section III of your memorandum, you analyze AS 43.55.020(e), propose several regulatory changes consistent with your interpretation of that statute, and apply your interpretation to several uses of North Slope gas. I agree with your interpretation and application of AS 43.55.020(e) and support your proposed regulatory changes.

a. AS 43.55.020(e) Exempts from Taxation Gas Used in the Operation of a Lease or Property in Drilling for or Producing Oil or Gas, and Gas Used in the Operation of a Lease or Property for Repressuring

AS 43.55.020(e) exempts from taxation "gas used in the operation of a lease or property in drilling for or producing oil or gas, or for repressuring." The current regulations of your department apply the exemption differently for gas used in production than for gas used for repressuring, apparently on the grounds that the phrase "a lease or property" applies to production uses but not repressuring. You conclude that this distinction is not supported by the statute. Although your conclusion represents a significant shift in your department's regulatory interpretation of AS 43.55.020(e), I agree with your analysis and support your conclusion.

For gas produced prior to January 1, 1995, the current regulations provide:

> For valuation purposes, production of gas does not include gas
>
> (1) used. . . in production operations on *the* lease or property;
>
> * * *
>
> (3) injected into a reservoir in the course of operations in the *same field*[6] for purposes of repressuring or conservation.

15 AAC 55.150(d) (emphasis added).

> For gas produced on or after January 1, 1995, the regulations provide:
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> For valuation purposes, production of gas does not include gas
>
> (1) used . . . in production operations on *the same* lease or property; or
>
> * * *
>
> (3) injected into a reservoir in the course of operations in the *same area*[7] for purposes of repressuring or conservation, including enhanced recovery.

15 AAC 55.151(e) (emphasis added).

Thus, under the current regulations, gas used for repressuring is exempt if used in the same field (before January 1, 1995) or area (on or after January 1, 1995), while gas used in production operations is only exempt if used on the same lease or property.

I agree with you that the better reading of the statute is that it exempts (1) gas used in the operation of a lease or property in drilling for or producing oil or gas, or (2) gas used in the operation of a lease or property for repressuring. This interpretation is the most natural reading of

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[6] "Field" is defined as "that part of an area underlain by one or more overlapping, contiguous, or superimposed pools, including Prudhoe Bay Field or Middle Ground Shoal Field in the state." 15 AAC 55.900(b)(2).

[7] "Area" is defined as "a geographic region or geologic province, including the Cook Inlet basin or the North Slope of the state." 15 AAC 55.900(b)(1).

the statutory language. The phrase "a lease or property" modifies, and to some extent limits, both tax-exempt uses of gas.

Indeed, a contrary reading could lead to absurd results. As you recognize, the current regulatory position also interprets "*a* lease or property" as meaning "*the* lease or property" or "*the same* lease or property." As discussed below, I believe that this regulatory gloss on the statutory language is inappropriate. I am aware that one of the reasons for reading "a" as "the" was to avoid the obviously absurd result of allowing the exemption to apply to remote uses, such as the operation of out-of-state production facilities. Although that particular result can be avoided in a way that is more consistent with the language of the statute, avoiding absurd results is an appropriate consideration in statutory construction. *See Sherman v. Holiday Constr. Co.*, 435 P.2d 16, 19 (Alaska 1967). The phrase "in the operation of a lease or property" provides the only statutory limitation on the permissible scope of the tax-exempt uses of gas. If that phrase is read as referring only to production uses, then the use of gas for repressuring would bear no statutory limitation.

For these reasons, I agree that AS 43.55.020(e) exempts from taxation gas used in the operation of a lease or property in drilling for or producing oil or gas, and gas used in the operation of a lease or property for repressuring.[8]

b. The Phrase "a Lease or Property" in AS 43.55.020(e) Does Not Mean "the Same Lease or Property"

[8] The inclusion of the words “therefrom” and “thereon” in the original version of what is now AS 43.55.020(e) also supports my conclusion that both production and repressuring uses reference the phrase “a lease or property.” *See* Ch. 7, ESLA 1955. Although I conclude that these words were mere surplusage and were properly deleted when the statute was codified, both words did cross-reference “any lease or premises,” indicating that “any lease or premises” relates to both production and repressuring uses.

The current "production" use regulation, 15 AAC 55.151(e)(1), interprets "a lease or property" in AS 43.55.020(e) to mean "the same lease or property." This interpretation became effective January 1, 1995. The regulation that applies to gas produced before 1995 interprets "a lease or property" to mean "the lease or property." I read the change, effective January 1, 1995, from "the" to "the same" as being a clarification of the earlier definition, and not a substantive change. Consequently, your department has a longstanding regulatory interpretation (of AS 43.55.020(e)) that gas used for fuel in production operations must be used on the same lease or property in order to be tax exempt. Nevertheless, I agree with you that the statute does not support this interpretation.

Members of my own department hold differing views on this subject. But, after a thorough review of the arguments in favor of each interpretation, I am convinced that a court would more likely read AS 43.55.020(e) literally: "a" does not mean "the." The contrary arguments are simply not compelling enough to overcome the plain meaning of the statute. *See Borg-Warner*, 850 P.2d at 633 n.12 ("The plainer the language of the statute, the more convincing contrary evidence must be.").

Essentially four arguments have been expressed in favor of interpreting "a lease or property" as meaning "the same lease or property": (1) that this interpretation avoids the absurd result of allowing gas used at distant production facilities to be exempt from tax in Alaska; (2) that the inclusion (and later non-substantive deletion) of the words "therefrom" and "thereon" in the original version of AS 43.55.020 reflect a legislative intent to limit exempt uses to the same lease or property; (3) that this interpretation best comports with the presumption that tax exemptions should be narrowly construed; and (4) that this interpretation of the statute is longstanding and has

been accepted by the taxpayers in different contexts. Your memorandum effectively refutes each of these arguments, and I agree with your analysis.

As set forth above, the analysis of the statute must begin with the words of the statute. Because the ordinary and common meaning of "a lease or property" appears clear and unambiguous, any argument that "a" means "the" bears a heavy burden on Alaska's sliding scale of statutory interpretation. *See Anchorage Sch. Dist. v. Hale*, 857 P.2d 1186, 1189 (Alaska 1993) ("In interpreting a statute, this court's 'approach involves a 'sliding scale,' such that the plainer the language, the more convincing must be evidence contrary to the plain meaning.'") (quoting *In re E.A.O.*, 816 P.2d 1352, 1357 n.8 (Alaska 1991)).

First, although the court will not adopt an interpretation that leads to an absurd result, *see Sherman v. Holiday Constr. Co.*, 435 P.2d at 19 (Alaska 1967), a literal interpretation of AS 43.55.020(e) does not inexorably lead to an absurd result. The Department of Revenue's current limitation on the exemption for gas used in repressuring to gas used in "the same area" avoids the absurd results this department and the Department of Revenue fear without stretching the plain meaning of the statute. *See* 15 AAC 55.150(d)(3); 15 AAC 55.151(e)(3).[9] A similar limitation could just as easily be applied to gas used in production operations to avoid absurd results.

Moreover, as your analysis of the history of AS 43.55.020(e) demonstrates, the language of the statute has never limited the exemption to the same lease or property. As originally enacted, the statute exempted gas:

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[9] In your proposed revisions to the regulations, gas would have to be used for an exempt purpose “in the State of Alaska” in order to benefit from the exemption. This interpretation also avoids the feared absurd results and is consistent with the statute.

> used in the operation of **any** lease or premises in the drilling for or production of oil or gas therefrom, or for repressuring thereon.

Ch. 7, ESLA 1955.

> When the Alaska Statutes were first codified, AS 43.55.020(e) exempted gas:
>
> used in the operation of **a** lease or premises in drilling for or producing oil or gas, or for repressuring.

AS 43.55.0020(e) (1962).[10]

In the codified section, "any" is changed to "a" and the words "therefrom" and "thereon" are deleted. The committee responsible for the 1962 codification of Alaska's statutes was not authorized to make substantive changes. *See Employment Security Comm'n v. Wilson*, 461 P.2d 425, 428 (Alaska 1969). The codified statute must be interpreted consistently with its prior version. *Id.*

On review of the 1962 changes in light of the instructions to the drafters of the codified law, I agree with you that the change from "any" to "a" reflected a simple choice of the more appropriate indefinite, singular article. The key consideration is that "a" and "any" are indefinite articles. "The" is a definite article. If the drafters of the 1962 codification had chosen to replace "any" with "the," they would have changed the meaning of the statute by replacing an indefinite article with a definite article. Since originally enacted in 1955, the Alaska exemption statute has exempted gas used in production or for repressuring on any lease or property, and not just the lease or property from which the gas was itself originally produced.

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[10] The current version of AS 43.55.020(e) exempts gas “used in the operation of a lease or property in drilling for or producing oil or gas, or for repressuring.” For purposes of this analysis, the change from “premises” to “property” is not significant.

In this regard I note that the exemption provision of Oklahoma's tax statutes, which have long been considered a source of some of Alaska's tax statutes, differs significantly from AS 43.55.020(e). As enacted in 1933, Oklahoma's exemption statute provided:

> Casinghead gas when produced and utilized in any manner, except when used in the operation of *the lease or premises* in the production of oil or gas therefrom, or for repressuring thereon, shall be considered for the purpose of this Act, as to the amount utilized, as casinghead gas actually produced or saved.

1933 Okla. Sess. Laws, ch. 103, ' 1, now codified without relevant changes at 68 O.S. ' 1009(e)(2) (emphasis added).

If the Alaska legislature had, in fact, adopted Oklahoma's exemption statute and had affirmatively changed "the lease or premises" to "any lease or premises," this would be a strong indication that the legislature had intended to grant a more expansive exemption than that allowed in Oklahoma. *See, e.g., Borg-Warner Corp.*, 850 P.2d at 633 (deletion of specific language is an indication that the legislature rejected that language); *Arabie v. State*, 699 P.2d 890, 895 (Alaska App. 1985) (relying on fact that "in adopting the current Alaska statute, the legislature considered and rejected statutory language of the New York penal code which specifically embodies the interpretation proposed by the state" in rejecting state's interpretation). The Department of Revenue does not have authority to adopt by regulation language specifically rejected by the legislature.

This is not to say, however, that there is any indication in the legislative history that the 1955 territorial legislature specifically considered and rejected "*the* lease or premises." We do not know with certainty whether the legislature adopted Oklahoma's exemption statute, and changed "the" to "any," or adopted North Dakota's exemption statute, which exempted gas used on "any lease

or premises."[11] 1953 N.D. Laws, ch. 339, § 5, now codified without relevant changes at NDCC § 57-51-05 (1993). Although it is more likely that the legislature adopted North Dakota's exemption statute, I do not need to answer this historical question. It is sufficient to recognize that, had the legislature adopted Oklahoma's statutes directly, this one change would indicate legislative intent to expand the exemption. *Compare City of Nome v. Catholic Bishop*, 707 P.2d 870, 882-83 (Alaska 1985) (stating that statutory amendment changing "the residence of *the* pastor" to "the residence of *a* bishop" indicated that the legislature desired a broader exemption).

Second, I do not find that the inclusion of the words "therefrom" and "thereon" in the original version of AS 43.55.020(e) or the subsequent non-substantive deletion of these words indicates an intent to limit the exemption to use on the property from which the gas was produced. The words "therefrom" and "thereon" in ESLA 1955, Ch. 7, merely recognize the fact that oil and gas are produced *from* a lease or premises, and that repressuring takes place *on* a lease or premises. These words do not restrict the place of use to the place of production. Both words were properly deleted in 1962 as surplusage.[12]

Third, I recognize that the regulatory limitation of the exemption to production uses on the same lease or property does adopt a narrow interpretation of the statute that is arguably consistent with the principle of statutory construction that statutes granting tax exemptions should

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[11] I recognize that North Dakota interprets the phrase “any lease or premises” to mean “the lease,” N.D. Admin. Code § 81-09-02-16 (1989), but I do not find this interpretation persuasive. Their administrative interpretation that “any” means “the” has not been tested and, in my view, is not well-founded.

[12] In this regard, I find the Oklahoma Legislature’s deletion of these same terms thirty years later to be instructive, though I would not accord that action significant weight in statutory interpretation.

be narrowly construed. *See City of Nome*, 707 P.2d at 879; *Sisters of Providence v. Municipality of Anchorage*, 672 P.2d 446, 447 (Alaska 1983). However, because "the canon of strict construction 'is an aid to, not a substitute for, statutory interpretation, the interpretation must still be a reasonable one.'" *City of Nome*, 707 P.2d at 879 (quoting *Sisters of Providence*, 672 P.2d at 447). Although the exemption statute at issue here should be narrowly construed, the interpretation must be reasonable in light of the words of the statute.[13]

The policy in favor of construing exemptions statutes narrowly in order to provide a broad base of taxation does not allow me to ignore the words of the statute. If the legislature had intended a narrower gas use exemption it could have provided for one, but it did not. The legislature chose the indefinite article "any," which is very broad, rather than the definite article "the," which is much more narrow. It is also reasonable to conclude that the legislature's adoption of a broadly stated tax exemption for gas was intended to further the purpose of the exemption statute, *i.e.*, to encourage the tax-exempt use of gas (a less valuable substance) to increase the production of oil (a more valuable substance).

Finally, I have considered the fact that the Department of Revenue's interpretation of AS 43.55.020(e) as requiring that production uses occur on "the lease or property" or "the same lease or property" is longstanding. Alaska's courts do accord some deference to longstanding administrative interpretations of statutes. *See, e.g.*, *National Bank of Alaska v. State, Department of Revenue*, 642 P.2d 811, 815 (Alaska 1982) ("[E]ven under the independent judgment standard this

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[13] In *Sisters of Providence*, the court recognizes that it could not allow policy considerations to control over the plain language of the statute: "The exemption statute involved in this case is clear and unambiguous. . . . If there are policies to be implemented by granting an exemption under these circumstances, then it must be done by the legislature." 672 P.2d at 452.

court has noted that the court should give some weight to what the agency has done, especially where the agency interpretation is longstanding."). However, the court has also stated that "it will not defer to an agency interpretation that conflicts with the plain meaning of the statute. A lengthy existence of a regulation does not bestow validity on it." *Fairbanks North Star Borough School Dist. v. NEA-Alaska, Inc.*, 817 P.2d 923, 926 and n. 4 (Alaska 1991). I think it is unlikely that a court will accord too much weight to the regulatory interpretation in light of the conflict between the regulation and statute.

In addition, the weight given an agency interpretation of a statute is reduced when the agency interpretation is inconsistent. *See Totemoff v. State*, 905 P.2d 954, 968 (Alaska 1995) ("if agency interpretation is neither consistent nor longstanding, the degree of deference it deserves is substantially diminished"); *Underwater Construction, Inc. v. Shirley*, 884 P.2d 150, 153 n.11 (Alaska 1994) (inconsistent interpretations of statute meant that there was no longstanding interpretation worthy of deference). In the present case, the Department of Revenue's interpretation of "a lease or premises" for purposes of applying the exemption to gas used in production is inconsistent with the allowance of the exemption for repressuring uses in the same "field" or "area." *See* 15 AAC 55.150(d)(3) and 15 AAC 55.151(e)(3).

Based on my independent review of the statute, the legislative history, and the arguments presented in favor of each interpretation, I agree that the regulatory restriction of the exemption for gas used in production operations to "the" or "the same" lease property cannot stand.

c. Application of Your Interpretation of AS 43.55.020(e)

You propose to express your interpretation of AS 43.55.020(e) by modifying 15 AAC 55.150(d) and 15 AAC 55.151(e) to provide:

15 AAC 55.150(d)[14]

For valuation purposes, production of gas does not include gas

(1) used or unavoidably lost in production operations on a lease or property in the State of Alaska by the producer;

* * *

(3) injected by the producer into a reservoir on a lease or property in the State of Alaska in the course of operations for purposes of repressuring or conservation, including enhanced recovery;

(4) sold or otherwise transferred to another producer of oil or gas for use in a manner described in subsection (1) or (3) of this section in the State of Alaska, provided that

(A) the producer of the gas obtains and provides to the Department on a monthly basis a Certificate of Exempt Use from the purchaser or transferee; and

(B) the gas is actually used in a manner described in subsection (1) or (3) of this section.

15 AAC 55.151(e)

For valuation purposes, production of gas does not include gas

(1) used or unavoidably lost in production operations on a lease or property in the State of Alaska by the producer;

* * *

[14] I reserve the question of the necessity and propriety of revising this regulation (applicable to gas produced before January 1, 1995) for my staff to review as part of the pending regulation project.

> (3) injected by the producer into a reservoir on a lease or property in the State of Alaska in the course of operations for purposes of repressuring or conservation, including enhanced recovery;
>
> * * *
>
> (6) sold or otherwise transferred to another producer of oil or gas for use in a manner described in subsection (1) or (3) of this section in the State of Alaska, provided that
>
> > (A) the producer of the gas obtains and provides to the Department on a monthly basis a Certificate of Exempt Use from the purchaser or transferee; and
> >
> > (B) the gas is actually used in a manner described in subsection (1) or (3) of this section.

I agree that these changes in the existing regulations are appropriate. Below, I examine each of the scenarios you discuss and conclude that applying your interpretation of AS 43.55.020(e) (as described in your proposed regulatory changes) to these facts yields a reasonable result.

i. Gas from Satellite Reservoirs Injected into a Common Reservoir

A current and reportedly an increasingly common practice of the North Slope producers is to send well fluid from the so-called satellite reservoirs to production and processing facilities constructed in conjunction with some of the larger North Slope reservoirs. This practice has obvious economic efficiencies for the producers. However, this practice does pose a potential tax issue. The residue gas leaving the production and processing facilities is generally not reinjected for repressuring purposes in the reservoir from which it was produced. Instead, the gas from the satellite reservoirs is generally injected for repressuring into the reservoir associated with the production and processing facilities. Is this gas subject to tax?

You conclude that this gas is tax exempt under AS 43.55.020(e) and the current version of 15 AAC 55.151(e). I agree.

The gas in question is used for repressuring and is therefore used for a tax-exempt purpose under AS 43.55.020(e). The only issue is whether the transfer from one reservoir to another removes the gas from the scope of the exemption statute. The current regulations concerning repressuring, which you and I agree represent a reasonable interpretation of AS 43.55.020(e), allow this gas to remain tax exempt because it is reinjected in the same "area." 15 AAC 55.151(e). Also, this gas is obviously exempt under the broader version of 15 AAC 55.151(e) that you propose. As you point out, exempting this gas from tax avoids the administrative inconvenience created when some of the gas in the reservoir has been taxed, and furthers the overall purpose of the exemption statute by allowing the producers to use gas for repressuring where it will help produce the most oil. For these reasons, I agree with your decision that such gas is tax exempt. Your decision, as well as the regulation supporting it, are based on reasonable interpretations of AS 43.55.020(e).

ii. Injection of Prudhoe Bay NGLs into Kuparuk

A similar tax issue arises due to the current transfer of Prudhoe Bay NGLs to Kuparuk for injection into the Kuparuk reservoir as part of the Kuparuk large-scale enhanced oil recovery (LSEOR) project. As you point out, most of the Kuparuk producers own enough Prudhoe Bay NGLs to simply transfer some of their Prudhoe Bay NGLs to Kuparuk as an intra-company transfer. The one exception is Union. They have no Prudhoe Bay NGLs and therefore purchase NGLs from BP. Are these NGLs subject to tax?

You conclude that the NGLs that are sent to Kuparuk as part of intra-company transfers are clearly tax exempt under AS 43.55.020(e) and the current version of 15 AAC 55.151(e). I agree. You further conclude that, because of the broad language of AS 43.55.020(e), even the NGLs that BP sells to Union for use in the LSEOR project are tax exempt. You have tailored your revisions to 15 AAC 55.150(d) and 15 AAC 55.151(e) to express your interpretation of AS 43.55.020(e) that a sale of the gas (in this case NGLS) to another company for a tax-exempt use does not prevent the producer of the gas from getting the benefit of the exemption. Although I view this as a closer question, I agree with your conclusion.

As you note, members of my department have questioned whether the tax exemption provided by AS 43.55.020(e) is limited to a taxpayer who both produces *and* uses the gas (or NGLs) for a tax-exempt purpose. If this argument is correct, a taxpayer who produces gas and sells it to another taxpayer for what would otherwise be an exempt use (production or repressuring) cannot benefit from the exemption. Thus, although NGLs produced by BP are used by Union for repressuring and enhanced oil recovery in the same area, *see* 15 AAC 55.151(e)(3), the NGLs would be taxable to BP because BP used them for sale, not for repressuring. This is an intriguing argument, and I have given it careful consideration. Ultimately, however, I believe that the courts are more likely to apply the exemption to all gas used for an exempt purpose, regardless of any change in ownership between production and use. In reaching this conclusion, I have relied on both my own independent interpretation of the statute and on your discussion of the policy considerations in favor of not taxing this gas.

1. Statutory Analysis

AS 43.55.016 imposes a tax on "produced" gas. Specifically, it levies upon the producer of gas a tax for all gas produced from each lease or property in the state, less any gas the ownership or right to which is exempt from taxation. AS 43.55.016(a).

AS 43.55.020(e) exempts some gas from tax by deeming it not to be "produced." It provides, in full:

> Gas produced in excess of that needed for safety purposes, except gas used in the operation of a lease or property in drilling for or producing oil or gas, or for repressuring, is considered, for the purpose of AS 43.55.011 -- 43.55.150 and in the amount used, as gas produced from a lease or property. Gas flared beyond the amount authorized for safety by the Alaska Oil and Gas Conservation Commission under AS 31.05 is considered as gas produced, except that it is subject to a penalty equal to the tax computed under AS 43.55.016 per 1,000 cubic feet of gas for the month in which the gas was flared.

AS 43.55.020(e).

It has been suggested to me that because AS 43.55.016 imposes the tax on the producer, and because the activities set forth in AS 43.55.020(e) are typically performed by a producer, the exemption statute can be read as limited to situations where the producer of the gas personally uses the gas for a tax-exempt purpose.

My analysis of the statute begins with its words. AS 43.55.020(e) does not expressly limit the exemption to use by the producer. The language of the statute only requires that the gas be used "in the operation of a lease or property in drilling for or producing oil or gas, or for repressuring." The statute does not on its face require the tax-exempt repressuring and production uses be performed by a producer who produces the gas. Some of the provisions of the statute, however, do anticipate use by the producer. For example, no one other than the producer of the gas

would, under normal circumstances, have reason to flare the gas. Reading "by the producer" into the statute following "gas flared" probably does not change the meaning of the statute. However, as your discussion of BP's sale of NGLs to Union illustrates, other exempt uses, such as use for repressuring, can occur away from the place of original production and by another producer.

In the absence of any express statutory language limiting the exemption to the same producer, this argument is only viable if it is supported by convincing contrary evidence in the legislative history, the general structure of the tax statutes, the principle of statutory construction that tax exemption statutes are read narrowly, or strong policy considerations.[15] I do not find this contrary evidence to be present in this case. I encourage and appreciate the efforts of members of my department to question proposed interpretations of the tax statutes in an effort to make sure that I fulfill my obligation to take "all necessary and proper actions in the name of the state for the collection of revenue." In this particular situation, however, I agree with the interpretation of AS 43.55.020(e) that the plain language of the statute, as interpreted in accordance with the standards set forth above, exempts gas used for repressuring or production regardless of the identity of the user.

2. Alaska Supreme Court Decisions

The Alaska Supreme Court has, in the somewhat analogous area of property tax exemptions, examined the actual use of property by a non-owner in determining whether to allow a tax exemption for property "used exclusively for nonprofit . . . hospital . . . purposes." *See, e.g.,*

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[15] In interpreting statutes, the Alaska Supreme Court has looked to legislative history, *see CH2M Hill Northwest*, 873 P.2d at 1274 n. 5; *Borg-Warner*, 850 P.2d at 633-34, related statutes, *see Borg-Warner*, 850 P.2d at 633-34, rules of statutory construction, *see City of Nome* 707 P.2d at 879, and, consistent policy considerations, *see Saunders Properties v. Anchorage*, 846 P.2d 135, 138 (Alaska 1993).

Greater Anchorage Area Borough v. Sisters of Charity, 553 P.2d 467, 471 (Alaska 1976) (holding that "when the property in question is used even in part by non-exempt parties for their private business purposes, there can be no exemption"). In light of this decision, and other Alaska Supreme Court decisions addressing Alaska's "exclusive use" property tax exemption, it is unlikely that the courts would read an owner/producer requirement into AS 43.55.020(e) in the absence of explicit language to that effect.

The Alaska Constitution provides that: "All, or any portion of, property used exclusively for non-profit religious, charitable, cemetery, or educational purposes, as defined by law, shall be exempt from taxation." Alaska Const. art. IX, § 4. Pursuant to this provision, AS 29.45.030(a)(3) provides that "property used exclusively for nonprofit religious, charitable, cemetery, hospital, or educational purposes" is exempt from general taxation.[16]

In *Sisters of Charity*, the taxpayer claimed that a property it leased to doctors with hospital staff privileges at Providence Hospital was tax exempt, despite the actual use of the property as office space for doctors in private practice. The taxpayer asked the court to consider "the owner's use, rather than the actual use" in applying the exemption. 553 P.2d at 470. The court rejected this suggestion, because it would extend the exemption to everything owned and used by an exempt organization. *Id.* The court held that "when the property in question is used even in part by non-exempt parties for their private business purposes, there can be no exemption." *Sisters of Charity* establishes that "use," as employed in Alaska's tax statutes, may, at least in some cases, include use by someone other than the owner.

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[16] Prior to the 1985 revisions, this provision was found at AS 29.53.020.

In *Sisters of Providence v. Municipality of Anchorage*, 672 P.2d 446 (Alaska 1983), the court considered the application of the exemption to property leased to the hospital by a private, for-profit corporation, and used by the hospital for hospital purposes. The court held that because the owner of the property used it for a non-exempt purpose (making a profit), the property was not used exclusively for exempt purposes. 672 P.2d at 449-52. At first glance, *Sisters of Providence* may seem to support the argument that a producer's sale of gas removes the gas from the exemption. However, there is a critical distinction between AS 29.45.030(a)(3) and AS 43.55.020(e): the property tax exemption in AS 29.45.030(a)(3) is only available when the property is "used *exclusively"* for an exempt purpose. In contrast, AS 43.55.020(e) does not require that the exempt use be the exclusive use of the gas. So long as the gas is used for an exempt purpose, the gas is exempt notwithstanding the fact that it is also used for other incidental purposes.

(3) Other Relevant Decisions

Our interpretation of AS 43.55.202(e) is consistent with the cases interpreting statutes that do not require exclusive use. In *Sisters of Providence*, the Alaska Supreme Court explicitly distinguished *Cleveland State University v. Perk*, 268 N.E.2d 577 (Ohio 1971), on the grounds that it did not require exclusive use. The statute in *Cleveland State University* provided that "public colleges and academies and all buildings connected therewith, and all buildings connected with public institutions of learning, not used with a view to profit, shall be exempt from taxation."[17]

[17] The Ohio Supreme Court had previously held that the "not used with a view to profit" language did not apply to "buildings connected" with public colleges. *See Denison University v. Board of Tax Appeals*, 205 N.E.2d 896 (Ohio 1968); *see also Bexley Village, Ltd. v. Limbach*, 588 N.E.2d 246, 247 (Ohio App. 1990) ("[P]ublic colleges and academies and all buildings connected therewith are exempt regardless of whether the property is used with a view toward profit.").

268 N.E.2d at 579. Cleveland State leased temporary buildings from a for-profit corporation for use as faculty offices and classrooms. The court held that because the buildings were "connected" with the university, they were exempt, notwithstanding the lessor's use of the buildings for making a profit.

As you note, several cases have addressed the question of whether an ownership requirement should be read into property tax exemption statutes based on "use." *See Ross v. City of Long Beach*, 148 P.2d 649 (Cal. 1944);[18] *Montana Deaconess Hospital v. Cascade County*, 521 P.2d 203 (Mont. 1974). In both of these cases, the taxing authority claimed that a tax exemption based on the use of a property could not be claimed unless the user was also the owner. This is similar to the current argument that the use exemption provided by AS 43.55.020(e) cannot be claimed unless the user is also the producer. Both the California and the Montana courts refused to read an ownership requirement into the statutes. The California Supreme Court stated their position concisely:

> The fact that [the framers of the constitution] ignored "ownership," and made "use" the test of exemption, shows clearly that they recognized the essential distinction between the two, and established the later rather than the former as the basis of exemption.

Ross, 148 P.2d at 653.

In *Cascade County*, the Montana Supreme Court relied on *Ross* and further observed that the legislature knew how to make ownership a requirement for an exemption, as other exemptions were based on ownership. *See* 521 P.2d at 205.

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[18] *Ross* was criticized by the Alaska Supreme Court in *Sisters of Providence* for focusing on the ownership issue while failing to analyze the exclusive use issue. 672 P.2d at 450. Although this criticism is valid, it does not affect the persuasiveness of *Ross*'s discussion of the ownership issue.

In AS 43.55.020(e), the Alaska legislature exempted gas based on its use. The statute does not require that this use be by the producer or the owner, and I must conclude that "[t]o insert these suggested words into this statute would give to it an added meaning not to be found in the plain and unambiguous language of the statute." *Cascade County*, 521 P.2d at 205. Alaska Statute 43.55.016 exempts gas that is owned by the state or federal government from taxation. Had the legislature intended to make the AS 43.55.020(e) exemption contingent on both ownership and use, they clearly knew how to do so. In the absence of any other evidence of legislative intent regarding AS 43.55.020(e), the existence of an exemption based on ownership elsewhere in the statute is the only relevant indication of legislative intent, and it undercuts the argument that an ownership or producer requirement should be read into the statute.

1. Policy Considerations

I am also persuaded that interpreting AS 43.55.020(e) as exempting from taxation gas used in production operations or for repressuring without regard to whether the producer of the gas is also the user of the gas for an exempt purpose is consistent with the policies underlying this exemption. I agree that it is logical to conclude that the purpose of exempting gas used in production operations or for repressuring is to encourage producers to produce more oil. In the present example, NGLs sold by BP to Union are used by Union to repressure and enhance oil recovery from the Kuparuk reservoir. This allows Union to produce more oil from Kuparuk and thereby increase state revenues and further the goals of the exemption.

You have also pointed out that taxing NGLs that BP sells to Union for use in the LSEOR project would impose an enormous administrative burden on your department. As you note,

when the Prudhoe Bay NGLs are injected into the Kuparuk reservoir, they blend with hydrocarbons that have not been taxed. As the Prudhoe Bay NGLs cycle through the Kuparuk reservoir, there is no way to determine with any precision how much will be produced and sold with Kuparuk oil, how much will be produced and sold with Kuparuk NGLs (should they sell Kuparuk NGLs in the future), and how much will remain in the reservoir. The administrative difficulties involved in estimating these amounts and in making sure they are not taxed twice would be severe.[19]

For the reasons set forth above, I support your decision that the Prudhoe Bay NGLs BP sells to Union for injection at Kuparuk as part of the LSEOR project are exempt from tax.

iii. Production Use of FGSO Gas

The use/sale argument discussed above in relationship to the sale of Prudhoe Bay NGLs to Kuparuk has also been raised in relationship to FGSO gas. The Department of Revenue has issued assessments against several taxpayers based on the transfer of gas among Prudhoe Bay producers pursuant to the Prudhoe Bay Fuel Gas Supply Option ("FGSO"). Based on your interpretation of AS 43.55.020(e) and your thorough review of the actual operation of the FGSO, you conclude that the majority of FGSO gas is exempt from taxation because it is used for production purposes,[20] and that the terms of the FGSO do not remove this gas from the scope of the exemption.

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[19] In an extremely close case, where there is interpretive flexibility, such administrative policy considerations would strongly influence my interpretation. *See* 2A Norman J. Singer, *Sutherland Statutory Construction*, § 45.12 at 61 (5th ed. 1992) (noting that "an interpretation that would overtax enforcement machinery is disfavored as unreasonable"). But this is not an extremely close case, and these administrative policy considerations, while valid, do not form the basis for my decision.

[20] Some FGSO gas is used for post-production purposes. This gas is without question subject to taxation under AS 43.55.016.

You propose that the assessments be amended to reflect that FGSO gas used in production operations is exempt. As you recognize, amendment of assessments in this way constitutes a "compromise" of the assessed taxes within the meaning of AS 43.05.070, and therefore requires my approval. Alaska Statute 43.55.020(e) exempts from taxation gas "used in the operation of a lease or property in drilling for or producing oil or gas, or for repressuring." FGSO gas used in production operations on the Prudhoe Bay Unit is therefore exempt unless some attribute of the FGSO removes the gas from the exemption.

The Department of Revenue issued assessments for tax on FGSO gas on the theory that the Prudhoe Bay Oil Rim Participating Area and the Prudhoe Bay Gas Cap Participating Area are not the same lease or property, and that as a result gas produced from one and used on the other is not exempt. This theory is based on the interpretations of AS 43.55.020(e) contained in prior and existing gas exemption regulations. *See* 15 AAC 55.150(d)(1) (1981); 15 AAC 55.150(d)(1) (1994); 15 AAC 55.151(e)(1) (1994) (exempting gas used in production operations on "the" or "the same" lease or property). As discussed above, however, I agree with you that these regulations do not reflect the proper interpretation of the statute. The statute does not require that gas be used on the same lease or property from which it was produced in order to benefit from the exemption. Even if the Oil Rim Participating Area and the Gas Cap Participating Area are separate leases or properties,[21] gas transferred from one to the other should not, by virtue of the transfer, lose the exemption.

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[21] In your memorandum, you argue that the Oil Rim Participating Area and the Gas Cap Participating Area are in fact part of the same lease or property, as “lease or property” is defined in AS 43.55.900(9). Although I agree with you that AS 43.55.020(e) exempts gas used for exempt purposes even if used on a different lease or property, and therefore need not reach the question, I

The argument is that FGSO gas is subject to taxation because it is sold by its producer before it is used, and is therefore used by its producer for a non-exempt purpose. As you explain, it is arguable that FGSO gas is even sold. Although Judge Carpeneti ruled that a portion of the FGSO gas was sold in the ANS Royalty Litigation, it is a close question. Assuming for purposes of my decision that some FGSO gas is sold, however, I nevertheless conclude that a sale does not subject otherwise exempt gas to taxation. For the same reason that I determined that BP's sale of NGLs to Union for purposes of repressuring does not exclude those NGLs from the exemption, I conclude that the "sale" of FGSO gas would not remove it from the exemption. The statute does not limit the exemption to uses by the initial producer/owner of the gas, nor does it provide that the exemption is lost if the gas is first sold.[22] I am convinced that the Alaska courts would not read these restrictions into the statute.

For these reasons, I approve your proposed compromise of the tax assessments on FGSO gas to limit the assessments to FGSO gas used in post-production operations. FGSO gas used in production operations is tax-exempt under AS 43.55.020(a).

Sincerely yours,

Bruce M. Botelho
Attorney General

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am persuaded by your discussion of the separate lease or property issue. The Oil Rim Participating Area and the Gas Cap Participating Area may be characterized as being the same property pursuant to 26 U.S.C. § 614(b)(3)(A)(I) (1974), and are therefore part of the same lease or property as defined by AS 43.55.900(9).

[22] As the table on pages 56-57 of your memorandum illustrates, several states do explicitly provide that gas which is sold for an otherwise exempt purpose is not exempt.