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IN THE SUPREME COURT FOR THE STATE OF ALASKA

STATE OF ALASKA, DEPARTMENT OF NATURAL RESOURCES, Appellant, vs. EXXONMOBIL CORPORATION, OPERATOR OF THE POINT THOMSON UNIT; BP EXPLORATION (ALASKA) INC.; CHEVRON U.S.A. INC.; CONOCOPHILLIPS ALASKA, INC., Appellees.	**Supreme Court Case No. S-13730** Trial Court Case No. 3AN-06-13751 CI (Consolidated Appeals) Case No. 3AN-06-13760 CI Case No. 3AN-06-13773 CI Case No. 3AN-06-13799 CI Case No. 3AN-07-04634 CI Case No. 3AN-07-04620 CI Case No. 3AN-07-04621 CI

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BRIEF OF APPELLANT STATE OF ALASKA, DEPARTMENT OF NATURAL RESOURCES

REVIEW ON PETITION FROM THE SUPERIOR COURT
FOR THE STATE OF ALASKA, THIRD JUDICIAL DISTRICT
THE HONORABLE SHARON GLEASON, SUPERIOR COURT JUDGE

Filed in the Supreme Court of the
State of Alaska, this 10th day of May,
2011.

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CONSTITUTIONAL PROVISIONS

ALASKA CONST., art. VIII, § 1

§ 1. Statement of Policy

It is the policy of the State to encourage the settlement of its land and the development of its resources by making them available for maximum use consistent with the public interest.

ALASKA CONST., art. VIII, § 2

§ 2. General Authority

The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for the maximum benefit of its people.

STATUTES

AS 31.05.110(a)

Unitization and unitized operation of pools and integration of interests by agreement

(a) To prevent, or to assist in preventing waste, to insure a greater ultimate recovery of oil and gas, and to protect the correlative rights of persons owning interests in the tracts of land affected, these persons may validly integrate their interests to provide for the unitized management, development, and operation of such tracts of land as a unit. Where, however, they have not agreed to integrate their interests, the commission, upon proper petition, after notice and hearing, has jurisdiction, power and authority, and it is its duty to make and enforce orders and do the things necessary or proper to carry out the purposes of this section.

AS 38.05.005

Division of lands

The commissioner shall control and supervise the division of lands created and established under the Department of Natural Resources. The director has administrative powers and other delegated duties, as prescribed by law or regulation

AS 38.05.020

Authority and duties of the commissioner

(a) The commissioner shall supervise the administration of the division of lands.

(b) The commissioner may

(1) establish reasonable procedures and adopt reasonable regulations necessary to carry out this chapter and, whenever necessary, issue directives or orders to the director to carry out specific functions and duties; regulations adopted by the commissioner shall be adopted under AS 44.62 (Administrative Procedure Act); orders by the commissioner classifying land, issued after January 3, 1959, are not required to be adopted under AS 44.62 (Administrative Procedure Act);

(2) enter into agreements considered necessary to carry out the purposes of this chapter, including agreements with federal and state agencies;

(3) review any order or action of the director;

(4) exercise the powers and do the acts necessary to carry out the provisions and objectives of this chapter;

(5) notwithstanding the provisions of any other section of this chapter, grant an extension of the time within which payments due on any exploration license, lease, or sale of state land, minerals, or materials may be made, including payment of rental and royalties, on a finding that compliance with the requirements is or was prevented by reason of war, riots, or acts of God;

(6) classify tracts for agricultural uses;

(7) after consulting with the Board of Agriculture and Conservation (AS 03.09.010), waive, postpone, or otherwise modify the development requirements of a contract for the sale of agricultural land if

(A) the land is inaccessible by road; or

(B) transportation, marketing, and development costs render the required development uneconomic;

(8) reconvey or relinquish land or an interest in land to the federal government if

(A) the land is described in an amended application for an allotment under 43 U.S.C. 1617; and

(B) the reconveyance or relinquishment is

(i) for the purposes provided in 43 U.S.C. 1617; and

(ii) in the best interests of the state;

(9) lead and coordinate all matters relating to the state's review and authorization of resource development projects;

(10) exercise the powers and do the acts necessary to carry out the provisions and objectives of AS 43.90 that relate to this chapter

AS 38.05.180(a)

Oil and gas and gas only leasing

(a) The legislature finds that

(1) the people of Alaska have an interest in the development of the state's oil and gas resources to

(A) maximize the economic and physical recovery of the resources;

(B) maximize competition among parties seeking to explore and develop the resources;

(C) maximize use of Alaska's human resources in the development of the resources;

(2) it is in the best interests of the state

(A) to encourage an assessment of its oil and gas resources and to allow the maximum flexibility in the methods of issuing leases to

(i) recognize the many varied geographical regions of the state and the different costs of exploring for oil and gas in these regions;

(ii) minimize the adverse impact of exploration, development, production, and transportation activity; and

(B) to offer acreage for oil and gas leases or for gas only leases, specifically including

(i) state acreage that has been the subject of a best interest finding at annual areawide lease sales; and

(ii) land in areas that, under (d) of this section, may be leased without having been included in the leasing program prepared and submitted under (b) of this section

AS 38.05.180(m)

Oil and gas and gas only leasing

(m) An oil and gas lease or a gas only lease must cover a reasonably compact area not exceeding 5,760 acres, and may be for a maximum period of 10 years, except that the commissioner may issue a lease for a period not less than five years upon a finding that it is in the best interests of the state. An oil and gas lease shall be automatically extended if and for so long thereafter as oil or gas is produced in paying quantities from the lease or if the lease is committed to a unit approved by the commissioner, and a gas only lease shall be automatically extended if and for so long thereafter as gas is produced in paying quantities from the lease or if the lease is committed to a unit approved by the commissioner. A lease issued under this section covering land on which there is a well capable of producing oil or gas in paying quantities does not expire because the lessee fails to produce oil or gas unless the lessee is allowed reasonable time to place the well on a producing status. Upon extension, the commissioner may increase lease rentals so long as the increased rental rate does not exceed 150 percent of the rate for the preceding year. If drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, including such operations as redrilling, sidetracking, or other means necessary to reach the originally proposed bottom hole location, the lease continues in effect until 90 days after drilling has ceased and for so long thereafter as oil or gas is produced in paying quantities. An oil and gas lease or a gas only lease issued under this section which is subject to termination by reason of cessation of production does not terminate if, within 60 days after production ceases, reworking or drilling operations are commenced on the land under lease and are thereafter conducted with reasonable diligence during the period of nonproduction.

AS 38.05.180(p)

Oil and gas and gas only leasing

(p) To conserve the natural resources of all or a part of an oil or gas pool, field, or like area, the lessees and their representatives may unite with each other, or jointly or separately with others, in collectively adopting or operating under a cooperative or a unit plan of development or operation of the pool, field, or like area, or a part of it, when determined and certified by the commissioner to be necessary or advisable in the public interest. The commissioner may, with the consent of the holders of leases involved, establish, change, or revoke drilling, producing, and royalty requirements of the leases and adopt regulations with reference to the leases, with like consent on the part of the lessees, in connection with the institution and operation of a cooperative or unit plan as the commissioner determines necessary or proper to secure the proper protection of the public interest. The commissioner may not reduce royalty on leases in connection with a cooperative or unit plan except as provided in (j) of this section. The commissioner may require a lease issued under this section to contain a provision requiring the lessee to operate under a reasonable cooperative or unit plan, and may prescribe a plan under which the lessee must operate. The plan must adequately protect all parties in interest, including the state

AS 38.05.180(q)

Oil and gas and gas only leasing

(q) A plan authorized by (p) of this section, which includes land owned by the state, may contain a provision vesting the commissioner, or a person, committee, or state agency, with authority to modify from time to time the rate of prospecting and development and the quantity and rate of production under the plan. All leases operated under a plan approved or prescribed by the commissioner are excepted in determining holdings or control under AS 38.05.140. The provisions of this section concerning cooperative or unit plans are in addition to and do not affect AS 31.05.

AS 38.05.180(t)

Oil and gas and gas only leasing

(t) The commissioner may prescribe conditions and approve, on conditions, drilling, or development contracts made by one or more lessees of oil or gas leases, with one or more persons, when, in the discretion of the commissioner, the conservation of natural resources or the public convenience or necessity requires it or the interests of the state are best served. All leases operated under approved drilling or development contracts and interests under them, are excepted in determining holding or control under AS 38.05.140.

The commissioner may not reduce royalty on a lease or leases that are subject to a drilling or development contract except as provided in (j) of this section.

AS 44.37.020

Duties of department with respect to natural resources

(a) The Department of Natural Resources shall administer the state program for the conservation and development of natural resources, including forests, parks, and recreational areas, land, water, agriculture, soil conservation, and minerals including petroleum and natural gas, but excluding commercial fisheries, sport fish, game, and fur-bearing animals in their natural state.

(b) The Department of Natural Resources shall administer and maintain a recording system established under the laws of this state.

REGULATIONS

11 AAC 83.190

Extension by commitment to an approved unit.

If, on or before the expiration date of the primary term of a lease, the lease is committed to a unit agreement approved by the state, the lease will be extended for so long as it remains subject to the unit agreement

11 AAC 83.303

Criteria.

(a) The commissioner will approve a proposed unit agreement for state oil and gas leases if he makes a written finding that the agreement is necessary or advisable to protect the public interest considering the provisions of AS 38.05.180(p) and this section. The commissioner will approve a proposed unit agreement upon a written finding that it will

(1) promote conservation of all natural resources, including all or part of an oil or gas pool, field, or like area;

(2) promote the prevention of economic and physical waste; and

(3) provide for the protection of all parties of interest, including the state.

(b) In evaluating the above criteria, the commissioner will consider

(1) the environmental costs and benefits of unitized exploration or development;

(2) the geological and engineering characteristics of the potential hydrocarbon accumulation or reservoir proposed for unitization;

(3) prior exploration activities in the proposed unit area;

(4) the applicant's plans for exploration or development of the unit area;

(5) the economic costs and benefits to the state; and

(6) any other relevant factors, including measures to mitigate impacts identified above, the commissioner determines necessary or advisable to protect the public interest.

(c) The commissioner will consider the criteria in (a) and (b) of this section when evaluating each requested authorization or approval under 11 AAC 83.301 - 11 AAC 83.395, including

(1) an approval of a unit agreement;

(2) an extension or amendment of a unit agreement;

(3) a plan or amendment of a plan of exploration, development or operations;

(4) a participating area; or

(5) a proposed or revised production or cost allocation formula

11 AAC 83.343

Unit plan of development.

(a) A unit plan of development must be filed for approval as an exhibit to the unit agreement if a participating area is proposed for the unit area under 11 AAC 83.351, or when a reservoir has become sufficiently delineated so that a prudent operator would initiate development activities in that reservoir. All development operations must be conducted under an approved plan of development. A unit plan of development must contain sufficient information for the commissioner to determine whether the plan is consistent with the provisions of 11 AAC 83.303. The plan must include a description of the proposed development activities based on data reasonably available at the time the

plan is submitted for approval as well as plans for the exploration or delineation of any land in the unit not included in a participating area. The plan must include, to the extent available information exists

(1) long-range proposed development activities for the unit, including plans to delineate all underlying oil or gas reservoirs, bring the reservoirs into production, and maintain and enhance production once established;

(2) plans for the exploration or delineation of any land in the unit not included in a participating area;

(3) details of the proposed operations for at least one year following submission of the plan; and

(4) the surface location of proposed facilities, drill pads, roads, docks, causeways, material sites, base camps, waste disposal sites, water supplies, airstrips, and any other operation or facility necessary for unit operations.

(b) The commissioner will approve the unit plan of development if it complies with the provisions of 11 AAC 83.303. If the proposed unit plan of development is disapproved, the commissioner will, in his discretion, propose modifications which, if accepted by the unit operator, would qualify the plan for approval.

(c) The unit plan of development must be updated and submitted to the commissioner for approval at least 90 days before the expiration date of the previously approved plan, as set out in that plan. The update must describe the extent to which the requirements of the previously approved plan were achieved; if actual operations deviated from or did not comply with the previously approved plan, an explanation of the deviation or noncompliance must be included in the update. The commissioner will approve the updated unit plan of development if it complies with the provisions of 11 AAC 83.303. If the proposed update of a unit plan of development is disapproved, the commissioner will, in his discretion, propose modifications which, if accepted by the unit operator, would qualify the plan for approval. Within 10 days after receipt of an updated unit plan of development, the commissioner will inform the unit operator as to whether the proposed unit plan of development is complete. After the commissioner has determined that an updated unit plan of development is complete as submitted, or as modified by the unit operator following the commissioner's suggestions, the commissioner will have an additional 60 days in which to approve or disapprove the plan; if no action is taken by the commissioner, the update of the unit plan of development is approved.

(d) The unit operator shall submit an annual report to the commissioner describing the operations conducted under the unit plan of development during the preceding year.

(e) The unit operator may, with the approval of the commissioner, amend an approved plan of development

11 AAC 83.374

Default.

(a) Failure to comply with any of the terms of an approved unit agreement, including any plans of exploration, development, or operations which are a part of the unit agreement, is a default under the unit agreement.

(b) The commissioner will give notice to the unit operator and defaulting party (if other than the unit operator) of the default. The notice will state the nature of the default and include a demand to cure the default by a specific date, which in the case of failure to pay rentals or royalties will be a date determined by the commissioner and in the case of any other default will be a date not less than 90 days after the date of the commissioner's notice of default.

(c) If a default occurs with respect to a unit in which there is no well capable of producing oil or gas in paying quantities and the default is not cured by the date indicated in the demand, the commissioner will, in his discretion, and after giving the unit operator and defaulting party (if other than the unit operator) reasonable notice and opportunity to be heard, terminate the unit agreement by mailing notice of the termination to the unit operator and defaulting party. Termination is effective upon mailing the notice.

(d) If a default occurs with respect to a unit in which there is a well capable of producing oil or gas in paying quantities and the default is not cured by the date indicated in the demand, the commissioner will, in his discretion, seek to terminate the unit agreement by judicial proceedings.

11 AAC 83.316

Unit approval.

(a) Within 60 days after the close of the public comment period required by 11 AAC 83.311, the commissioner will issue a written decision approving or disapproving the unit agreement, in which he states the basis for his decision after considering the provisions of 11 AAC 83.303.

(b) If the commissioner determines that the provisions of 11 AAC 83.303 are not met, the commissioner will, in his discretion, propose modifications which, if accepted by the parties to the proposed unit agreement, would qualify the agreement for approval.

(c) No unit will be approved unless parties to the unit agreement hold sufficient interest in the unit area to give reasonably effective control of operations and at least one lease or portion of a lease in the unit area is a state lease.

11 AAC 88.185(27) (1974)

(27) "unit agreement" means an agreement or plan of development and operation for the recovery of oil and gas from a pool, field or like area, or any part of one, as a single consolidated unit without regard to separate ownerships, and for the allocation of costs and benefits on a basis as defined in the agreement or plan; "unit agreement" also includes "cooperative agreement" unless the context clearly requires the more restricted meaning.

11 AAC 83.315 (1974)

Rates of Prospecting And Production

The director may require that that any unit agreement contain a provision vesting authority in the director or other person, committee, or agency as may be designated in the agreement and satisfactory to the director, to alter or modify from time to time the rate of prospecting and development and the quantity and rate of production under the agreement.

20 AAC 25.526

Conduct of operations.

An operator shall carry on all operations and maintain the property at all times in a safe and skillful manner in accordance with good oil field engineering practices and having due regard for the preservation and conservation of the property and protection of freshwater.

20 AAC 25.200

Production equipment.

(a) Surface production equipment must be installed to control, separate, clean, gather, and carry to the point of custody transfer or other disposition in a safe manner all produced

oil, gas, and water. All equipment must be installed, operated, and maintained in accordance with good oil field engineering practices.

(b) All equipment must be designed and protected to ensure reliable operation under the range of weather conditions expected for the specific location.

(c) Wellhead equipment must include appropriate gauges and valves installed on the tubing, casing-tubing annulus and casing-casing annuli to show surface pressures and to control the well flow for the range of conditions expected. Other alternatives will, in the commission's discretion, be approved for subsea completions.

(d) All producing wells capable of unassisted flow must be completed with downhole production equipment consisting of suitable tubing and a packer that effectively isolate the tubing-casing annulus from fluids being produced, unless the commission specifically approves production through the annulus to increase flow rate without jeopardizing ultimate recovery from the well.

20 AAC 25.270

Initial reservoir properties.

(a) The operator shall determine the initial reservoir pressure in each new pool before regular production. The results must be reported to the commission on a Reservoir Pressure Report (Form 10-412).

(b) The operator shall obtain fluid samples from each new pool at the time of discovery or before regular production and determine

(1) the crude oil composition assay;

(2) pressure, volume, and temperature properties of the crude oil; and

(3) the solution or non-associated gas composition assay.

(c) Sampling and analysis must be conducted and reported in accordance with good oil field engineering practices. Reports must be submitted to the commission within 45 days following the completion of the determinations required in (b) of this section.

(d) The operator shall determine within three months after discovery of each new oil pool the original solution gas-oil ratio by a well test conducted in a manner approved by the

commission. The operator shall report the results on the Well Status Report and Gas-Oil Ratio Tests (Form 10-409) within 45 days after the test.

20 AAC 25.235

Gas disposition.

(a) For each production facility the operator shall compile and report monthly gas disposition and acquisition on the Facility Report of Produced Gas Disposition (Form 10-422). If a facility's production comes from multiple pools, the operator shall allocate production between each producing pool as a percentage of the total volume of gas that the facility handled for the month. The operator shall report gas acquisition or disposition by category, as follows:

(1) gas sold;

(2) gas reinjected;

(3) gas flared or vented;

(4) gas used for lease operations other than flaring or venting;

(5) natural gas liquids (NGLs) produced;

(6) gas purchased;

(7) gas transferred;

(8) other.

(b) Any release, burning, or escape into the air of gas other than incidental de minimis venting as authorized under (d)(4) of this section must be reported as flared or vented on the Facility Report of Produced Gas Disposition (Form 10-422). The operator shall submit a written supplement for any flaring or venting incident exceeding one hour. The supplement must describe why the gas was flared or vented, list the beginning and ending time of the flaring or venting, report the volume of gas flared or vented, and describe actions taken to comply with (c) of this section.

(c) The operator shall take action in accordance with good oil field engineering practices and conservation purposes to minimize the volume of gas released, burned, or permitted to escape into the air.

(d) Gas released, burned, or permitted to escape into the air constitutes waste, except that

(1) flaring or venting gas for a period not exceeding one hour as the result of an emergency or operational upset is authorized for safety;

(2) flaring or venting gas for a period not exceeding one hour as the result of a planned lease operation is authorized for safety;

(3) flaring pilot or purge gas to test or fuel the safety flare system is authorized for safety;

(4) de minimis venting of gas incidental to normal oil field operations is authorized;

(5) within 90 days after receipt of the report required under (b) of this section, the commission will, in its discretion, authorize the flaring or venting of gas for a period exceeding one hour

(A) if the flaring or venting is necessary for facility operations, repairs, upgrades, or testing procedures;

(B) if an emergency that threatens life or property requires the flaring or venting, unless failure to operate in a safe and skillful manner causes the emergency; or

(C) if the flaring or venting is necessary to prevent loss of ultimate recovery;

(6) upon application, the commission will, in its discretion, authorize the flaring or venting of gas for purposes of testing a well before regular production.

(e) Notwithstanding an authorization under (d) of this section, the commission will, in its discretion, review flaring or venting of gas and classify as waste any volume of gas flared or vented in violation of (c) of this section.

(f) Notwithstanding conservation orders that the commission issued before 1/1/95, this section applies to flaring or venting of gas that occurs on or after 1/1/95.

I. JURISDICTIONAL STATEMENT

On January 11, 2010, Superior Court Judge Sharon Gleason issued a Decision After Remand addressing issues raised on appeal by ExxonMobil Corporation, BP Exploration (Alaska), Inc., Chevron U.S.A., Inc., and ConocoPhillips Alaska, Inc. (Lessees) from a decision by the State of Alaska, Department of Natural Resources (DNR) Commissioner terminating the Point Thomson Unit on the North Slope of Alaska.[1] The superior court's Decision After Remand reversed the DNR Commissioner's termination decision. DNR filed a Petition for Review pursuant to Appellate Rule 402, which the Court granted on May 29, 2010.

II. INTRODUCTION AND SUMMARY OF ARGUMENT

Alaska is a resource development state.[2] The Alaska economy is largely dependent on resource extraction and a substantial majority of the State's revenue is derived from oil and gas production and development.[3] The drafters of the Alaska Constitution knew that the State's future would hinge on resource development, which is why the Alaska Constitution provides that the State must encourage the development of its resources by making them "available for maximum use consistent with the public

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[1] Exc. 765-93, 658-761.

[2] ALASKA CONST., art. VIII, § 1 ("It is the policy of the State to encourage the settlement of its land and the development of its resources by making them available for maximum use consistent with the public interest.").

[3] State of Alaska, Dep't of Revenue, *Alaska Tax Division 2010 Annual Report* at Executive Summary, p. 4, at http://www.tax.alaska.gov/programs/documentviewer/viewer.aspx?2283f.

interest,"[4] and requires the legislature to "provide for the utilization, development, and conservation of all natural resources belonging to the State . . . for the maximum benefit of its people."[5] To fulfill this purpose, the legislature has delegated to DNR the enormous responsibility of managing Alaska's oil and gas resources.[6]

This case involves one of the most important resource development disputes in the history of Alaska and centers on an issue that was at the forefront of the minds of the Alaska Constitution's drafters: oil companies coming to Alaska, discovering massive resources, and then deciding to stall development. Alaska's congressional delegate, Bob Bartlett, in a speech to the constitutional convention, stated:

> This moment will be a critical one in Alaska's future history. Development must not be confused with exploitation at this time. The financial welfare of the future state and the well being of its present and unborn citizens depend upon the wise administration and oversight of these developmental activities. Two very real dangers are present. The first, and most obvious, danger is that of exploitation under the thin disguise of development. The taking of Alaska's mineral resources without leaving some reasonable return for the support of Alaska governmental services and the use of all the people of Alaska will mean a betrayal in the administration of the people's wealth. The second danger is that outside interests, determined to stifle any

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4 ALASKA CONST., art. VIII, § 1.

5 ALASKA CONST., art. VIII, § 2.

6 *See, e.g.*, AS 38.05.020 ("The [DNR Commissioner] shall supervise the administration of the division of lands . . . [and] exercise the powers and do the acts necessary to carry out the provisions of this chapter"); AS 38.05.180 (oil and gas and gas-only leases effectuate interests of Alaskans in the development of the state's oil and gas resources and the DNR Commissioner manages the leasing process); AS 44.37.020 (DNR shall administer oil and gas resources for development); *see also Kachemak Bay Conservation Soc'y v. State,* 6 P.3d 270, 276 (Alaska 2000) ("[T]he legislature delegated to DNR much of its authority to ensure that such leasing of state land or interests in land is consistent with the public interest.").

> development in Alaska which might compete with their activities elsewhere, will attempt to acquire great areas of Alaska's public lands in order NOT to develop them until such time as, in their omnipotence and the pursuance of their own interests, they see fit. If large areas of Alaska's patrimony are turned over to such corporations the people of Alaska may be even more the losers than if the lands had been exploited.[7]

The history of Point Thomson is a manifestation of Bartlett's fears. The Point Thomson Unit (the Unit) is one of the largest proven but undeveloped oil and gas fields in Alaska.[8] The Unit contains approximately eight trillion cubic feet of gas, hundreds of millions of barrels of gas liquids, and hundreds of millions of barrels of oil.[9] In the words of Lessees, the Unit contains "world class hydrocarbon resources."[10] The first Point Thomson leases, in the heart of the reservoir, were acquired in 1965.[11] Oil was discovered in 1975.[12] The Point Thomson Unit was formed in 1977.[13] By the early 1980s, massive quantities of oil, liquid gas condensates, and natural gas were discovered.[14] Yet, although the State offers oil and gas leases on state lands and forms

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7 Vic Fischer, *Alaska's Constitutional Convention* 131 (1975) (quoting E.L. "Bob" Bartlett, Address to the Delegates of the Alaska Constitutional Convention, November 8, 1955).

8 Exc. 493.

9 Exc. 386-87, 375-76.

10 Exc. 339.

11 Exc. 1, 6.

12 Exc. 193; R. 21013, 30069.

13 Exc. 17.

14 Exc. 193, 386-87, 375-76.

units for the express purpose of timely production,[15] Point Thomson's vast known "world class" resources, after four decades, have never been put into production.

The fundamental issue in this appeal is that the superior court's ruling reversing unit termination misinterpreted the text of the Point Thomson Unit Agreement in a way that entirely undermines DNR's ability to carry out its constitutional mandate to protect the public interest by ensuring timely production of state resources. If allowed to stand, the court's ruling limits, if not eviscerates, DNR's power to require timely development of state recourses and eliminates its power to seek the return of state lands after decades of non-development.

DNR's primary tool for managing units in the public interest is reviewing and approving plans of development (POD). The Point Thomson Unit Agreement (Unit Agreement) expressly requires Lessees to periodically submit PODs for DNR review and approval that shall be "as complete and adequate as [DNR] may determine to be necessary for timely development and proper conservation . . . ."[16] In 2006, after decades of unsuccessful efforts to induce Unit production, DNR rejected a POD that only called for "studies," placed the Unit in default, explained that the Unit would terminate if

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[15] *See* AS 38.05.180(m), (p); *see also White v. State, Dep't of Natural Res.*, Op No. 0811, *8 (Alaska March 6, 1996) (unpublished opinion) ("The purpose of [oil and gas] leases is to encourage production, not speculation by lessees who make the nominal lease payments and hold the leases without any real intention of conducting operations on them. The State's real interest is in the receipt of royalties.") [R. 12520-28]; *see generally* 6 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW § 901, at 3 (2010).

[16] Exc. 156.

Lessees did not cure the default, and requested a POD that committed to production.[17] Lessees refused to abide by DNR's request and instead submitted a revised POD that did not commit to production.[18] DNR rejected this revised POD and terminated the Unit.[19] Unit termination was the culmination of over thirty years of DNR frustration with Lessees' refusal to commit to produce the millions of barrels of known liquid hydrocarbon reserves in the Unit.[20]

Lessees initially appealed DNR's termination decision to the superior court, and Judge Gleason concluded in her Decision on Appeal that: (1) DNR's POD review process under Section 10 of the Point Thomson Unit Agreement was subject to DNR discretion; (2) DNR was within its discretion to reject Lessees' POD; and (3) DNR could administratively terminate the Unit.[21] The court held, however, that DNR had not provided sufficient notice to Lessees that it was considering Unit termination as a remedy for Lessees' failure to submit an acceptable POD.[22] The court remanded to DNR for a determination of the proper remedy.[23]

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17 Exc. 499-518.

18 Exc. 325-333.

19 Exc. 500.

20 Exc. 375.

21 Exc. 555-60, 567.

22 Exc. 577.

23 *Id.*

On remand to DNR, Lessees submitted another POD as a remedy.[24] DNR rejected this remedy as inconsistent with the public interest in light of this particular Unit's 30-year history of non-development and broken commitments. DNR again terminated the Unit.[25] Lessees appealed and the superior court reversed, holding in its Decision After Remand that even though DNR was within its discretion to reject Lessees' proposed POD initially, DNR's only remedy was to invoke a separate section of the Unit Agreement unrelated to the POD process, Section 21, which provides that DNR may order Lessees to change the rate of prospecting and development only if consistent with good and diligent oil and gas practices.[26] The court also held that DNR violated due process by continuing to rely on the advice of counsel who represented DNR in the previous appeal and by appointing as hearing officer in the remand proceeding a DNR representative who sat at counsel table during oral argument in the previous appeal.[27] DNR petitioned for review and this Court granted the petition.

DNR was correct in not invoking Section 21 of the Unit Agreement on remand. The superior court's conclusion that DNR *must* invoke the "burden" of Section 21 if it is dissatisfied with a POD submitted under Section 10 undermines DNR's ability to achieve its constitutional and statutory mandates—to advance development of the resources in a manner that protects the public interest. The court erred, in other words, by ruling that

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24 Exc. 773, 602-21.

25 Exc. 774, 734.

26 Exc. 766, 785, 129.

27 Exc. 791.

the standard of Section 21 should supersede the statutory and regulatory criteria mandating that PODs be reviewed with respect to the broader public interest.

The superior court also erred because its reading of Section 21 and Section 10 is contrary to the text of both sections and reflects a fundamental misunderstanding of the purposes of each. Section 10 provides DNR broad discretion to review and approve PODs, which must be "as complete and adequate as [DNR] may determine to be necessary for timely development and proper conservation . . . ."[28] Section 21, on the other hand, grants DNR a *power* it may invoke, at its discretion, to mandate that Lessees undertake specific development activities, but only if consistent with "good and diligent practices." Holding that DNR's only remedy when it rejects a POD is to invoke Section 21 fails to harmonize these sections because Section 21's standard limits DNR discretion in a way that Section 10 expressly does not. As the parties' past conduct demonstrates, DNR's disapproval of a POD does *not* trigger Section 21 proceedings. The court's interpretation is also inconsistent with the statutes and regulations that are an implicit part of the Unit Agreement because, under the superior court's decision, Section 21 would supplant DNR's ability to manage a unit in the public interest according to mandatory statutory and regulatory criteria.

The superior court's conclusion that DNR violated due process by relying on the advice of counsel who represented DNR in the previous appeal, and by appointing a DNR employee as hearing officer, was based on a fundamental misreading of this Court's

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[28] Exc. 44-55, 156-57.

decision in *In re Robson.*[29] *Robson* prohibits attorneys who appear before an agency decision-maker from subsequently assisting the same decision-maker in rendering a decision in the same proceeding.[30] The facts of *Robson* make clear that it does not apply to agency attorneys who advise an agency decision-maker but do not appear before the agency, advocate a particular outcome, or otherwise participate in the agency proceeding.[31] Thus, *Robson* does not prohibit attorneys who defend a decision-maker's decision on appeal from advising the same decision-maker on remand. Likewise, *Robson* does not prohibit agency employees from assisting an agency commissioner as a hearing officer, which is what occurred in this case.[32] The court's due process decision purports to add procedural safeguards that add no value to DNR proceedings and that place an onerous burden on DNR and other administrative agencies.

Given these errors, DNR respectfully requests that this Court remand this case to the superior court with instructions to review the substance of the Commissioner's Unit termination decision, applying the correct interpretation of the Unit Agreement and affirming that DNR's reliance on counsel and staff did not violate Lessees' due process rights.

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29 575 P.2d 771 (Alaska 1978).

30 575 P.2d 791, 774 (Alaska 1978).

31 *See* 575 P.2d 771, 773-74 (Alaska 1978).

32 *Id.*

III. ISSUES PRESENTED FOR REVIEW

1. Whether DNR was correct in concluding that Section 21 of the Unit Agreement did not apply to its remand analysis and the superior court erred when it held that the only remedy available to DNR upon rejection of Lessees' proposed remedy for failure to submit an acceptable Plan of Development under Section 10 was to initiate a proceeding under Section 21, considering that this interpretation of Section 21: (a) subverts the Alaska Constitution and state law by undermining DNR's ability to manage state lands in the public interest and ensure that lessees of state land timely develop state resources; and (b) is contrary to the text of the Unit Agreement and the statutes and regulations that are part of the Unit Agreement?

2.

Stricken per court order dated 6/24/11

3. Whether Department of Law attorneys and private outside counsel and DNR personnel violated Lessees' right to due process when, consistent with longstanding practice, they advised DNR on issues related to Point Thomson administrative proceedings, represented DNR in the superior court appeal, and counseled DNR during the proceedings after remand, even though Lessees were not prevented from presenting

evidence to the Commissioner, there is no evidence of prejudice, and the Commissioner provided a detailed written explanation of the rationale for his decisions?

IV. STATEMENT OF THE CASE

A. Under the Alaska Constitution, DNR is Obligated to Protect and Manage State Resources to Maximize Development in a Manner that Protects the Public Interest

The superior court's interpretation of the Unit Agreement significantly undermines DNR's ability to protect the public interest. DNR has the responsibility to manage the State's oil and gas resources for the public.[33] Alaska's natural resources belong to the State, which controls them as trustee for all Alaskans.[34] The Alaska Constitution provides that the State has the policy of encouraging the development of its resources by making them "available for maximum use consistent with the public interest,"[35] and requires the legislature to "provide for the utilization, development, and conservation of all natural resources belonging to the State . . . for the maximum benefit of its people."[36] The legislature has delegated primary responsibility for managing Alaska's oil and gas resources to the DNR Commissioner.[37]

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[33] *See supra* n.4.

[34] *Shepherd v. State, Dep't of Fish and Game*, 897 P.2d 33, 40 (Alaska 1995) (citing ALASKA CONST., art. VIII, § 2).

[35] ALASKA CONST., art. VIII, § 1.

[36] ALASKA CONST., art. VIII, § 2.

[37] *See supra* n.4.

B. The Point Thomson Unit and its Relation to Oil and Gas Leasing and Unitization Under Alaska Law

This case arises out of DNR's efforts to protect the public interest by insisting that Lessees submit a POD that committed to develop the Unit or face Unit termination. The Point Thomson Unit is an oil and gas unit on Alaska's North Slope containing untapped reserves of natural gas, gas condensates, and oil, including at least eight trillion cubic feet of gas, hundreds of millions of barrels of gas liquids, and hundreds of millions of barrels of oil.[38] Lessees first began acquiring the leases that now make up the Point Thomson Unit in 1965.[39] Oil was discovered in 1975, the Unit was formed in 1977, and significant amounts of gas and gas condensates were discovered soon thereafter.[40] The Unit is in relative proximity to infrastructure that connects with the Trans-Alaska Pipeline,[41] which could bring the known oil and gas condensates in the Unit to market if the Unit were developed.[42]

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[38] Exc. 386-87, 375-76, R. 30069.

[39] *See, e.g.*, Exc. 1-10. Appellees (ExxonMobil, BP Exploration (Alaska) Inc., Chevron U.S.A., Inc., and ConocoPhillips Alaska, Inc.) are the primary lessees of the PTU; there are other lessees who are not parties to the appeal.

[40] Exc. 38-57, 193.

[41] Exc. 488. The Unit's western boundary is approximately three miles east of the Badami Unit. Badami is connected to the Trans-Alaska Pipeline System (TAPS) and is 30 miles east of the Prudhoe Bay Unit. Exc. 376.

[42] For this reason, DNR has rejected Lessees' position that the Unit cannot be developed absent a natural gas pipeline from the North Slope. *See, e.g.*, Exc. 375. Further, if Lessees were permitted to produce only the natural gas reserves from the Unit, much of these liquid hydrocarbons would be permanently lost in the process. Exc. 376.

The oil and gas in the Unit is owned by the State of Alaska,[43] leased to Lessees, and managed by the DNR. DNR approved the creation of the Unit in 1977 as consistent with the public interest and entered into the Unit Agreement with Lessees.[44] DNR and lessees of state oil and gas leases form oil and gas units to provide for joint development of two or more oil and gas leases to facilitate efficient production.[45] Oil and gas resources are typically found in subsurface reservoirs with physical boundaries that are unrelated to the surface boundaries of the leases.[46] As a result, unitization—the aggregation of multiple leases into a single production unit—is commonly used to ensure efficient development of oil and gas reservoirs, and to avoid the waste and confusion that would come from different operators attempting to produce from common reservoirs.[47] Because unitization extends the primary terms of the unitized leases, DNR will not

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[43] Exc. 148-49; Alaska Statehood Act, Pub. L. No. 85-508, July 7, 1958 (as amended through Dec. 10, 2004), § 6(i); AS 38.05.005, *et seq.*

[44] Exc. 38-57. In 2005, the Unit consisted of 106,200.55 acres and 45 state oil and gas leases. Exc. 376.

[45] The agreement that governs in this proceeding is the Point Thomson Unit Agreement. Exc. 147-70; AS 38.05.180(p); 11 AAC 83.303. In 1977, DNR regulations provided: "(27) 'unit agreement' means an agreement or plan of development and operation for the recovery of oil and gas from a pool, field or like area, or any part of one, as a single consolidated unit without regard to separate ownerships, and for the allocation of costs and benefits on a basis as defined in the agreement or plan; 'unit agreement' also includes 'cooperative agreement' unless the context clearly requires the more restricted meaning" 11 AAC 88.185(27) (1974); *ConocoPhillips Alaska, Inc. et al. v. State, Dep't of Natural Res.*, 109 P.3d 914, 917 n.16 (Alaska 2005), *reh'g denied* ("Unit agreements . . . are organizational schemes approved by the [DNR] to efficiently extract oil from a common reservoir that is the subject of multiple leases.").

[46] 6 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW § 901, at 3 (2010).

[47] *Id.*

approve the formation or continuation of a unit until it has determined that unitization is "in the public interest."[48]

Oil and gas leases do not last in perpetuity. Rather, they are for limited duration and, as a general matter, will not extend past their initial terms unless there is production from the lease.[49] In Alaska, state leases are issued for "primary terms" of five to ten years, after which leases automatically expire, unless the lease is in production or other conditions are met.[50] A non-producing lease, however, will not automatically expire at the end of its primary term if the lease has been "unitized," meaning that DNR has authorized the inclusion of a lease in a unit.[51] Unitization is thus advantageous to lessees

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[48] AS 38.05.180(p); 11 AAC 83.316(a); 11 AAC 83.303(a).

[49] *See Gottstein v. State v. Dep't of Natural Res.*, 223 P.3d 609, 611 n.1 (Alaska 2010) ("The following summarizes conditions under which the lessee could have extended the primary term or entered a secondary term: (a) oil or gas being produced in paying quantities from the lease area; (b) the lease being committed to and remaining in a state-approved unit agreement; (c)(1) commencing drilling by the end of the primary term and continuing drilling with reasonable diligence (well completion clause); (c)(2) commencing diligent drilling or reworking operations within six months of production cessation (temporary cessation of production clause); (d) failing to produce oil or gas in an area that could produce in paying quantities if the state gave no notice requiring production; (e) the state suspending operations or production in the lease area; or (f) failing to produce or to perform specific actions because of an unanticipated natural cause (force majeure clause).").

[50] AS 38.05.180(m); *see also* Exc. 1, 165-66.

[51] A non-producing lease will also extend beyond its primary term if one of the lease's savings clauses is applicable, such as demonstrating there is a well capable of producing in paying quantities on the lease or if drilling operations are being conducted on the lease. 11 AAC 83.135, 11 AAC 83.125. This means that Lessees would not lose all of the leases in the Unit if the unit were terminated. They are now conducting drilling operations on two such leases, ADLs 47559 and 47571. These leases would survive unit

because the unitized leases are extended past their primary term simply by inclusion in a unit, even if lessees are not producing from the leases.[52] The central purpose of leasing state lands is identical to the purpose of forming units: to encourage production.[53] To that end, and to protect the public interest when leases are indefinitely extended by unitization, state law requires unit lessees to periodically submit PODs for DNR review and approval.[54] Unit lessees may operate only pursuant to approved PODs.[55] This POD submission process, set forth in Section 10 of the Unit Agreement, is the cornerstone of DNR's unit management authority, and expressly grants DNR the discretion and authority to require a POD that is "as complete and adequate as the Director may determine to be necessary for timely development and proper conservation of the oil and gas resources of the unitized area . . . ."[56] Section 10 is consistent with the statute in effect in 1977 when DNR formed the Unit.[57]

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termination so long as drilling or production operations were being conducted. AS 38.05.180(m); *see also* Exc. 1-10.

[52] *See* AS 38.05.180(m); 11 AAC 83.190.

[53] *Accord White v. State, Dep't of Natural Res.,* Op No. 0811 *8 (Alaska March 6, 1996 (unpublished opinion) ("The purpose of [oil and gas] leases is to encourage production, not speculation by lessees who make the nominal lease payments to hold the leases without any real intention of conducting operations on them. The State's real interest is in the receipt of royalties."). R. 12520-28. This principle was reflected in the original Point Thomson Unit Agreement, as well as in the most recent version of the Unit Agreement. Exc. 38, 148. *See also* Exc. 536.

[54] Exc. 156-57; AS 38.05.180(p); 11 AAC 83.303, .343.

[55] AS 38.05.180(p); 11 AAC 83.343.

[56] Exc. 156.

[57] *See* AS 38.05.180(m) (1977), currently found at AS 38.05.180(p). Exc. 44-45, 139, 454.

C. Early Unit Plans of Development, Unit Expansions Prior to the 2005 Unit Default, and Initial Unit Termination

Over the Unit's three decades of existence, Lessees submitted 22 PODs and DNR approved 19 PODs.[58] However, the approval process was consistently characterized by Lessees' reluctance to develop the Unit or to produce reserves that had been discovered decades earlier.[59] Despite the Unit's massive known reserves, Lessees have not placed the Unit into production after thirty years.[60]

PODs 1 through 5 focused on exploration wells and unit studies.[61] Lessees represented that they would pipe oil, if discovered, to Prudhoe Bay.[62] In 1982, DNR reluctantly approved the 6th POD, which proposed environmental studies but no drilling or development.[63]

In the 7th POD, submitted in 1983, Lessees noted that they had spent more than $700 million on lease acquisition and drilling, that the 12 wells drilled in the area

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[58] DNR never approved the 12th POD. Exc. 145-46, 171-78. DNR rejected the 15th POD and the 22nd POD. Exc. 186-88, 395. DNR came very close to rejecting the 21st POD. Exc. 312-24.

[59] Indeed, while Lessees expended $800 million on Point Thomson by 2005, $700 million of that amount was spent by the early 1980s, meaning Lessees made minimal investment in Point Thomson for over two decades. Exc. 120-23, 595.

[60] *See supra* n.7.

[61] Exc. 487-88, 80-110.

[62] Exc. 69-79, 80-83, 101-04, 108-10.

[63] "[T]he department feels that the activities proposed for the time period covered by the Sixth Plan of Further Development and Operation do not significantly contribute to the further delineation and understanding of the reservoir(s) and unit area as required by in 11 AAC 83.343(a)(1), and in the unit agreement." Exc. 120-22, 111-19.

had sufficiently established the "area and potential commerciality of the field," but that further development should not occur until there was a gas pipeline or other "feasible transportation system for the gas."[64] Lessees accordingly asked for an additional five-year study period.[65] DNR approved the 7th POD for the period from January 1984 through December 1988. During the same time period, Lessees and DNR were negotiating to expand the Unit in return for drilling additional wells and commencing production by 1995.[66] DNR agreed to expansion of the Unit but Lessees ultimately refused to meet these drilling and production commitments.[67]

In PODs 8 through 22, covering a period from 1988 to 2005, Lessees continued to insist that they could not develop the Unit for a multitude of reasons, including economics, the need for more studies, and the lack of a market for Unit hydrocarbons,[68] despite the fact that the Unit is in relatively close proximity to TAPS and contains millions of barrels of liquid hydrocarbons that can be shipped through TAPS.[69] Though DNR pressed Lessees to drill additional exploration wells and develop the Unit's known massive liquid hydrocarbon reserves, they resisted and the agency became increasingly

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64 Exc. 120-22.

65 *Id.*

66 Exc. 123, 140-41, 134-37.

67 Exc. 133.

68 This period lasted from 1988 through 2005. Exc. 179-83, 171-73, 296-301, 142.

69 *See supra* n.38.

frustrated with the lack of Unit production.[70] This frustration resulted in DNR's rejection of the 15th proposed POD in 1997 and rejection of Lessees' 1998 application to expand the Unit with additional leases because, both times, Lessees failed to adequately address Unit development.[71] Nonetheless, DNR approved PODs during this era because Lessees insisted the limited work commitments in the PODs would adequately position the Unit for future production.[72]

In 2001, Lessees sought to expand the Unit a third time to add 12 more leases to the Unit (the "Expansion Leases"), increasing the Unit from approximately 76,000 to 116,000 acres.[73] The Expansion Leases were close to the end of their primary terms and, in order to avoid lease expiration, Lessees had to unitize or drill them.[74] DNR initially rejected the expansion due to Lessees' persistent lack of development, but later agreed to the expansion when Lessees committed to drill one exploration well by 2006 and seven development wells by 2008, and to put the Unit into production by 2008.[75] If the work was not done, the Expansion Leases would contract out of the Unit and Lessees would be required to pay the State millions of dollars for lost lease bid opportunities.[76]

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70 Exc. 185, 189-91.

71 Exc. 186-88, 250.

72 Exc. 184-85, 286-87, 292-95, 302-05, 143-46.

73 Exc. 378, 245-72, 227-39.

74 *See* AS 38.05.180.

75 Exc. 247-72.

76 Exc. 205-06.

The 2001 expansion commitments induced DNR to approve PODs from 2001-2004.[77] But Lessees did not follow through.[78] They did not drill any of the promised wells.[79]

In 2004, DNR conditionally approved the 21st POD.[80] In his decision, DNR Director Myers incorporated the 2001 expansion commitments to drill seven production wells and required that the 22nd POD "contain specific plans for development drilling within the [Unit]."[81] The Commissioner upheld these requirements on appeal, [82] and Lessees did not appeal the Commissioner's decision to the superior court. Thus, the requirement in the 21st POD that the 22nd POD must contain specific development drilling plans became final.

D. The 22nd POD, Unit Default, and Procedural History Leading to Lessees' Appeals

1. Initial Unit Termination and the First Superior Court Appeal

Lessees submitted their proposed 22nd POD on August 31, 2005.[83] In the 22nd POD, Lessees stated that Unit development was not economic, they could not find a

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77 Exc. 286, 201-10.

78 Exc. 288-89, 279.

79 Exc. 225-26, 288-89, 277-85, 257, 429, 578.

80 Exc. 302-05.

81 *Id.*, Exc. 221.

82 Exc. 318-19, 322-24. The decision was appealed to the Commissioner who affirmed it, including incorporation of the 2001 expansion drilling commitments into the POD. Exc. 312-24.

83 Exc. 375.

viable way to develop the Unit, the Unit would probably never be developed without a North Slope gas line and tax and royalty concessions, and more studies were needed.[84] The new POD did not address the drilling required by the 21st POD.[85] The Director of Oil and Gas (Director) offered to approve a 22nd POD that included a commitment to drill an exploratory well intended to resolve uncertainties that Lessees relied on as a barrier to development, but Lessees declined to revise their POD to accommodate the Director's request.[86]

The Director responded to Lessees' refusal by rejecting the proposed 22nd POD as inadequate in light of Lessees' decades-old refusal to develop known hydrocarbon reserves, placing the Unit in default, and explaining to Lessees that failure to cure this default by submitting a modified 22nd POD that committed to production could result in Unit termination.[87] The Director's decision considered the applicable POD statute[88] and regulations,[89] and relied on Section 10's provisions requiring the Unit Operator to "submit for the approval of the Director a plan for an additional specified period for the development and operation of the unitized land" and providing that such plan shall be "as complete and adequate as the Director may determine to be necessary for timely

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84 Exc. 325-33.

85 *Id.*

86 Exc. 381-83, 357-59.

87 Exc. 385-86, 389-96, 543.

88 AS 38.05.180(p).

89 11 AAC 83.343 sets forth POD requirements. 11 AAC 83.303 contains the decision criteria for POD approval. Exc. 383-85.

development and proper conservation of the oil and gas resources of the unitized area."[90] In short, after four decades, 22 PODs, and not one drop of hydrocarbons actually produced, DNR finally put the unit into default.

Lessees appealed to Commissioner Menge, who extended the deadline to submit a modified 22nd POD by approximately one year.[91] Ultimately, in 2006, Lessees submitted a modified POD as their proposed cure for Unit default.[92] They also submitted two appeal briefs and hundreds of pages of supporting documents, but did not request a hearing.[93] Contrary to DNR's express instructions, Lessees' proposed cure did not include a commitment to develop the Unit.[94] In 2006, Commissioner Menge affirmed the Director's Unit default decision, rejected the modified 22nd POD offered as a cure, and decided that Unit termination was in the public interest.[95] Acting Commissioner Rutherford granted Lessees' request for reconsideration.[96] She ultimately affirmed Commissioner Menge's decision, including Unit termination.[97]

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90 Exc. 156.

91 Exc. 519-20.

92 Exc. 412-28.

93 Exc. 479-89.

94 Exc. 412-28. Lessees conditioned unit development on a hypothetical future gas line, and refused to drill an exploratory well, stating it "cannot be justified at this time." Exc. 374-96, 350-73, 337-39, 347-49.

95 Exc. 499-518.

96 Exc. 519-31.

97 *Id.*

Lessees appealed the Commissioners' decisions to superior court.[98] The superior court held that DNR's review of PODs under Section 10 was subject to DNR's discretion and that DNR was within its discretion to reject the revised 22nd POD.[99] The court further held that DNR had the authority to terminate the Unit administratively, but that the agency had failed to give adequate notice of potential Unit termination, thereby denying due process to Lessees.[100] The court remanded the matter to DNR to hold a hearing on the proper remedy for failure to submit an acceptable POD.[101]

2. The Remand Proceedings and the Second Superior Court Appeal

On remand, DNR applied its regulatory procedures[102] and went to unusual lengths to ensure that Lessees were on notice of the remedies DNR was considering for Lessees' failure to cure the 2005 default.[103] Commissioner Irwin promptly gave Lessees notice that he was considering the remedy of unit termination and invited briefing regarding alternative remedies.[104] He specifically asked Lessees to provide him with assurances that they would follow through with any proposed unit development.[105]

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98 Exc. 550.

99 Exc. 555-60.

100 Exc. 555-58, 562-76, 580.

101 Exc. 580.

102 11 AAC 02.010-.900.

103 Exc. 772, 581-82.

104 Exc. 581-82.

105 Exc. 591.

Lessees requested a hearing and submitted a proposed 23rd POD as their remedy for the failure to cure the default with the modified 22nd POD.[106] Commissioner Irwin granted the request for an evidentiary hearing so Lessees could present witnesses and argument on the appropriate remedy, but he denied their request for an adversarial proceeding.[107] The evidentiary hearing began on March 3, 2008.[108] Lessees submitted, and the Commissioner considered, 256 exhibits.[109] Lessees presented fourteen witnesses, totaling thirty hours of testimony.[110] Six additional witnesses provided testimony through affidavits.[111] The hearing was a unilateral, non-adversarial presentation to the Commissioner – no DNR employees or affiliates presented a case against accepting the new POD as a remedy for default.[112]

Commissioner Irwin selected Nanette Thompson, then a DNR employee and a former Chair of the Regulatory Commission of Alaska, as hearing officer.[113] She administered status conferences and the evidentiary hearings that Commissioner Irwin presided over.[114] Acting as a representative of DNR and not as an attorney, Ms.

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106 Exc. 583-88, 602-21.

107 Exc. 590.

108 Exc. 589.

109 Exc. 597-601.

110 Exc. 663.

111 Exc. 663-69.

112 *See* Exc. 590-91.

113 Exc. 590.

114 *See, e.g.*, February 27, 2008 Transcript [Tr.] at 3-59; March 3-7, 2008 Tr. at 64-1054.

Thompson had attended an oral argument in 2007 in one of Lessees' superior court Unit appeals.[115] Commissioner Irwin also continued to consult with DNR's counsel, some of whom had advised DNR in issuing its initial termination decision in 2005, and all of whom had represented DNR in Lessees' first appeal before the superior court.[116]

After the hearing, Lessees filed lengthy post-hearing briefs.[117] On April 22, 2008, the Commissioner issued a decision terminating the Unit based on the following grounds: (1) the Unit history showed a pattern of "broken development commitments, recalcitrance and repeated efforts to delay rather than bring the substantial hydrocarbon resources" of the Unit to market; (2) Lessees would not complete the 23rd POD or continue to expand Unit production when it was completed; (3) Lessees failed to offer assurances; and (4) Lessees insisted that Unit management authority be transferred from DNR to the court.[118] The Commissioner also analyzed the proposed remedy under 11 AAC 83.303, which sets forth the criteria DNR must consider when deciding whether to approve a unit or a POD.[119] The main criterion is the public interest.[120] Commissioner Irwin found that the proposed remedy did not further the public interest.[121] The Commissioner granted

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115 April 17, 2007 Tr. at Page 3, lines 7 – 9.

116 Exc. 773-74.

117 Exc. 625-57.

118 Exc. 658-734.

119 Exc. 694-723.

120 *Id.*

121 Exc. 715-16, 734.

Lessees' request for reconsideration and issued a twenty-five page written decision affirming the termination in May 2008.[122]

Lessees again appealed the Commissioner's decision, arguing that Commissioner Irwin should not have acted as a decision maker, that Commissioner Irwin's consultation with agency counsel was a due process violation because agency counsel had defended DNR in the previous appeal, and that it was error for Ms. Thompson to act as a hearing officer.[123] Lessees' appeal to superior court also relied heavily on Section 21, a Unit Agreement provision unrelated to the POD process that gives DNR the discretionary power to order a change in the rate of prospecting, development, or production, but only if consistent with good and diligent oil and gas practices.[124] Section 21 also requires DNR to give notice and an opportunity for a hearing.[125]

Lessees argued that DNR could not terminate the Unit simply because Lessees had offered a POD that DNR found to be deficient.[126] They contended that if DNR was dissatisfied with a POD offered by Lessees, DNR must invoke Section 21 and prove in an adversarial proceeding before an independent decision maker that Lessees were required to do more than was proposed in the 23rd POD.[127]

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122 Exc. 737-61.

123 Exc. 788. Lessees made other due process arguments, but Judge Gleason found them moot. Exc. 788, 793.

124 Exc. 166-65.

125 *Id.*

126 Exc. 775.

127 Exc. 775, 778.

On January 11, 2010, the superior court reversed DNR's Unit termination, holding that DNR's only remedy for Lessees' failure to submit an acceptable POD under Section 10 was to invoke Section 21, and thus DNR should have held a Section 21 proceeding on remand.[128] The court rejected Lessees' argument that Commissioner Irwin could not act as a decision maker and reaffirmed its previous finding that "DNR does have the authority to administratively adjudicate disputes related to the [Unit Agreement]."[129] However, relying on *In re Robson*,[130] the court agreed with Lessees that DNR should not have consulted with its lawyers who participated in the previous appeal, and that Ms. Thompson should not have acted as a hearing officer.[131]

On February 5, 2010, DNR filed a Petition for Review of the court's January 11 decision.[132] The Court granted the Petition on May 28, 2010.[133]

V. STANDARD OF REVIEW

Because the superior court acted as an intermediate court of appeal, this Court owes "no deference . . . to the lower court's decision," but, rather, "independently scrutinize[s] directly the merits of the administrative determination."[134]

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128 Exc. 787.

129 Exc. 789 (citing Decision on Appeal at 20).

130 575 P.2d 771 (Alaska 1978).

131 Exc. 791-93.

132 Exc. 794-808, 810-24.

133 Exc. 827-28.

134 *Tesoro Alaska Petroleum Co. v. Kenai Pipe Line Co.*, 746 P.2d 896, 903 (Alaska 1987).

With respect to DNR's determination that Section 21 did not apply to Lessees' proposed remedy, this Court should apply the rational basis standard. The rational basis standard is used where questions of law involve agency expertise or where the agency's specialized knowledge and experience would be particularly probative as to the meaning of a statute.[135] Lessees will likely argue that DNR's Section 21 conclusions involved pure questions of contract law and thus the independent judgment standard applies. The Unit Agreement, however, is not just any contract. It is a contract executed by the Unit Lessees and approved by DNR if the agency finds unitization is in the public interest.[136] DNR is charged with managing state lands in the public interest, a mandate that is part of the statutes and regulations that are incorporated into the Unit Agreement.[137]

The question of how the POD process in Section 10 of the Unit Agreement relates to Section 21 involves agency expertise: the agency is charged with managing oil and gas resources in the public interest and has decades of experience administering the Unit Agreement and hundreds of other unit agreements across the state. Further, Sections 10 and 21 are based on statutes and regulations that are directly incorporated into the Unit Agreement, and DNR should be afforded deference in its interpretation of its own statutes and regulations.[138]

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135 *Union Oil Co. of California v. State*, 804 P.2d 62, 64 (Alaska 1990).

136 *See* 11 AAC 83.301 *et seq.*

137 Exc. 149.

138 *See, e.g., State of Alaska, Dep't of Revenue v. Atlantic Richfield Company*, 858 P.2d 307, 308 (Alaska 1993) (where issues in case centered around interpretation of

The independent judgment standard applies to DNR's due process rulings because those issues present questions of law that do not involve agency expertise.[139]

VI. ARGUMENT

A. DNR Correctly Declined to Apply Section 21 on Remand – The Superior Court Was Mistaken When it Held that DNR's Only Remedy for Lessees' Failure to Submit an Acceptable POD Under Section 10 was to Conduct a Section 21 Proceeding

DNR found on remand that application of Section 21 of the Unit Agreement to Lessees' proposed remedy of the 23rd POD would be contrary to public policy because Lessees were trying to use Section 21 to "relieve themselves of the obligation created in Section 10 of the [Unit Agreement] to submit an acceptable POD" and that this was inconsistent with DNR's "oversight role to protect the State's interests."[140] DNR further concluded that Section 21 was inapplicable because there was no actual ongoing production from the Unit. Accordingly, DNR reviewed Lessees' proposed remedy under the POD evaluation standards provided by regulation and Section 10.[141]

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complex tax statute and regulations implicating the special expertise of the Department of Revenue, the rational basis standard of review applied); *Bd. of Trade, Inc. v. State, Dep't of Labor*, 968 P.2d 86, 89 (Alaska 1998) (agency's interpretation of its own regulation is reviewed under the reasonable basis standard and is normally given effect unless it is plainly erroneous or inconsistent with the regulation).

139 *ConocoPhillips Alaska, Inc. v. State of Alaska, Dep't of Natural Res.*, 109 P.3d 914, 919 (Alaska 2005).

140 Exc. 724-25.

141 *Id.*

The superior court reversed and ruled that Section 21 could apply even when there is no ongoing actual production.[142] The court went a step further, concluding that DNR *must* invoke Section 21 any time it is dissatisfied with a POD submitted under Section 10. The superior court's reading of Section 21 ignores DNR's public policy determination and fundamentally limits, if not eviscerates, DNR's ability to manage state lands in the public interest. DNR's POD review process is the cornerstone of its ability to ensure timely and efficient production from state lands; the superior court has eliminated DNR's primary remedy for failure to submit an acceptable POD. This remedy is particularly important when lessees are using unitization to warehouse state leases. DNR must be able to default units for failure to abide by unit development obligations and seek the return of public lands from recalcitrant lessees in order to protect the public interest.

The superior court's reading of Section 21 also violates fundamental principles of contract interpretation. Specifically, its conclusions: (1) are contrary to the text and purpose of Section 10; (2) are contrary to the text and purpose of Section 21; (3) fail to read these sections in harmony and instead eviscerate Section 10, rendering it effectively meaningless; (4) ignore the parties' past understanding of the Unit Agreement; and (5) are inconsistent with the statutes and regulations that are part of the Unit Agreement. When Commissioner Irwin's remand decision is read in light of the proper interpretation of Section 21 and its relationship (or lack thereof) to Section 10, it is clear that he did not

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142 Exc. 780-84.

invoke Section 21 or otherwise trigger its procedures and that he was not required to do so.

When analyzing Section 21, it is important to remember that the Unit Agreement is a contract between the Lessees that is approved by the State of Alaska if it is in the public interest.[143] It should be analyzed in accord with both contract principles and the statutes and regulations in effect when the agreement was executed. Regulations enacted later that are not inconsistent may also be considered.[144] When interpreting a contract, this Court looks to the text of the agreement and gives effect to the parties' intent.[145] The Court strives to read agreements as a whole and to give effect to every provision of a contract.[146] This Court also looks to the parties' past practice and understanding to discern the meaning and intent of the parties' agreement.[147]

In interpreting the Unit Agreement, the Court must read it in its unique context as an oil and gas agreement between Lessees and DNR, which DNR approves and manages in the public interest.[148] DNR has the constitutional and statutory responsibility to manage state lands for the benefit of all Alaskans, and the statutory, regulatory, and Unit

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143 *See Exxon Corp. v. State*, 40 P.3d 786, 788 (Alaska 2001).

144 Exc. 149.

145 *Estate of Polushkin ex rel. Polushkin v. Maw*, 170 P.3d 162, 167 (Alaska 2007).

146 *Grant v. Anchorage Police Dept.*, 20 P.3d 553, 556 (Alaska 2001).

147 *Exxon*, 40 P.3d at 795 (considering the parties' course of performance to help determine the meaning of a contract).

148 *See* 11 AAC 83.301 *et seq.*; AS 38.05.180(p). *See Casey v. Semco Energy, Inc.*, 92 P.3d 379, 383 (Alaska 2004) (courts should look to "purposes of the contract, [and] the circumstances surrounding its formation").

Agreement responsibility to protect the public interest by requiring that a unit operate under a plan that advances development and production.[149] DNR also has specialized expertise and years of experience in negotiating, drafting, approving, interpreting, and administering unit agreements and PODs.

1. DNR Correctly Determined that Application of Section 21 to Lessees' Proposed Remedy Would Violate Public Policy – Section 21 Cannot be Interpreted in a Manner that Eliminates DNR's Ability to Manage State Lands in the Public Interest

DNR found that Section 21 "does not supersede the applicable statutes and regulations which authorize unitization only when it is in the public interest" and that it does not "trump Section 10 and the regulations, which give DNR the discretion to determine the adequacy of a proposed POD."[150] DNR thus rejected Lessees' argument on remand that if DNR rejected the proposed remedy of the 23rd POD that Section 21 shifts the responsibility to DNR to design an acceptable POD.[151] DNR's public policy determination and its interpretation of Section 21 in light of DNR's applicable statutes and regulations – which in turn is demanded by the Alaska constitutional requirement to manage state lands to benefit the public interest – was correct and is entitled to deference.[152]

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149 AS 38.05.180(p); AS 38.05.020; AS 44.37.020; *State, Dep't of Nat. Res. v. Arctic Slope Reg'l Corp.*, 834 P.2d 134, 143 (Alaska 1991) (DNR manages natural resources for the benefit of Alaskans).

150 Exc. 724-25.

151 *Id.*

152 *See supra* n.4, 131.

In order for DNR to exercise its constitutional responsibility to manage state lands in the public interest and to ensure timely development, it must be able to reject PODs that do not commit to development after thirty years of unitization or that are contrary to the public interest and, if necessary, default units and seek the return of state lands so they can be released to other lessees who are willing to develop the state's resources. The need to ensure timely development of state lands is embodied in the constitutional mandate to the legislature to "provide for the utilization, development, and conservation of all natural resources belonging to the State . . . for the maximum benefit of its people."[153] The Unit history here reveals the importance of DNR's ability to reject PODs and put units into default. Until DNR defaulted the Unit, and ultimately terminated it, Lessees had sat on the Unit for over thirty years without producing a drop of hydrocarbons from the Unit's massive known reserves, and had repeatedly refused to commit to developing the Unit.

Concluding that DNR's sole remedy when it rejects a deficient POD is to invoke its Section 21 powers effectively eliminates DNR's ability to ensure that lessees of state land submit appropriate PODs and timely develop state resources. As discussed in detail below, Section 21 confers a discretionary DNR power to demand specific increases or decreases in production from lessees in limited circumstances. Section 21 focuses not on the broad public interest applicable to DNR's Section 10 POD review, but, rather, on the narrow technical issue of "good and diligent oil and gas engineering practices." It is

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[153] ALASKA CONST., art. VIII, § 2.

inappropriate to import Section 21 into Section 10 because doing so allows lessees to avoid the consequences of their refusal to submit an acceptable POD. Instead, Section 21 shifts the burden to DNR to formulate a unit development plan that is only reviewed against the backdrop of "good and diligent oil and gas engineering practices," as opposed to the broader public interest standards applicable PODs.

In short, if DNR is to have the ability to achieve its constitutional and statutory mandates—to advance development of the resource in a manner that protects the public interest—the good and diligent engineering practices standard of Section 21 should not supersede the statutory and regulatory criteria mandating that PODs be reviewed with respect to the broader public interest. The superior court's conclusion to the contrary means that DNR cannot terminate a unit with known reserves that has not been produced for 30 years. Lessees will be empowered to insist that DNR either accept any POD they submit, or subject the agency to a complex, protracted proceeding under Section 21, and as this case demonstrates, engage in years of appeals and further litigation. This process shackles DNR to recalcitrant lessees who would be allowed to indefinitely warehouse state lands as long as they could establish that lack of development was consistent with "good and diligent oil and gas engineering practices." As discussed below, the text of the Unit Agreement and the applicable statutes and regulations counsel against any interpretation of the Unit Agreement that leads to this untenable result.

2. The Text and Purpose of Section 21 Make Clear It is a Power, Not a Burden

a. Section 21, by its Terms, Applies Only When Affirmatively Invoked by DNR; It Does not Apply Automatically When DNR Rejects a POD under Section 10

In the Decision After Remand, the superior court interpreted Section 21 as an extension of the POD submission process, finding that "a Section 21 hearing is the natural progression from the rejection of a POD under Section 10 when the proposed 23rd POD was rejected because DNR seeks to increase production in the Point Thomson Unit."[154] The superior court characterized Section 21 as a "burden" that DNR assumed and a right that Lessees could "exercise."[155] But the court misunderstood Section 21's text and contractual purpose: Section 21 is a *power* DNR may choose to "exercise" to force Lessees to act. Nothing in the Unit Agreement *requires* DNR to invoke its Section 21 powers when DNR rejects a POD under Section 10, or when DNR defaults a unit for failure to propose development of hydrocarbon reservoirs discovered decades before.

Section 21 provides in relevant part:

> 21. RATE OF PROSPECTING, DEVELOPMENT AND PRODUCTION. The Director is hereby vested with authority to alter or modify from time to time in his discretion the quantity and rate of production under this agreement . . . . Without regard to the foregoing, the Director is also hereby vested with authority to alter or modify from time to time *at his discretion*

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154 Exc. 781.

155 Exc. 786-87.

the rate of prospecting and development and the quantity and rate of production . . . .[156]

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[156] Exc. 787 (emphasis added). When the parties entered into the PTUA in 1977, Section 21 provided in full:

> 21. RATE OF PROSPECTING, DEVELOPMENT AND PRODUCTION.
>
> The Director is hereby vested with authority to alter or modify from time to time in his discretion the quantity and rate of production under this agreement when such quantity and rate is not fixed pursuant to state law or does not conform to any statewide voluntary conservation or allocation program which is established, recognized and generally adhered to by the majority of operators in such state, such authority being hereby limited to alternation [sic] or modification in the public interest, the purpose hereof and the public interest to be served thereby to be stated in the order of alteration or modifications. Without regard to the foregoing, the Director is also hereby vested with authority to alter or modify from time to time at his discretion the rate of prospecting and development and the quantity and rate of production under this agreement when such alteration or modification is in the interest of attaining the conservation objectives stated in this agreement and is not in violation of any applicable state law.
>
> Powers in this section vested in the Director shall only be exercised after notice to Unit Operator and opportunity for a hearing to be held not less than fifteen (15) days from notice.

The parties amended the second paragraph of Section 21 in 1985:

> Powers in this section vested in the Director shall only be exercised after notice to Unit Operator and opportunity for hearing to be held not less than thirty (30) days from notice, and shall not be exercised in a manner that would (i) require any increase in the rate of prospecting, development or production in excess of that required under good and diligent oil and gas engineering and production practices; or (ii) alter or modify the rates of production from the rates provided in the approved plan of development and operations then in effect or, in any case, curtail rates of production to an unreasonable extent, considering unit productive capacity, transportation activities available, and conservation objectives; or (iii) prevent this agreement from serving its purpose of adequately protecting all parties in interest hereunder, subject to applicable conservation laws and regulations.

Exc. 53, 129.

This provision, by its terms, grants DNR an affirmative power it can choose to invoke *in its discretion.* Notably, Section 21 does not mention Section 10 or PODs generally. Likewise, Section 10, in setting forth DNR's POD review process, does not mention Section 21. Section 10, while granting DNR the power to reject a POD, does not grant the corollary power to *impose* a specific plan for capital expenditures and operational commitments to effect a development operation. That power is granted by Section 21, but DNR may choose to invoke it only in certain circumstances, such as where a change in production is necessitated by considerations of conservation. Section 21 is thus unique in granting DNR an affirmative discretionary power to force a lessee into specific performance, and is not related to the separate powers over PODs conferred by Section 10.

3. Section 21 is an Optional Path for DNR; Nothing in the Text of Section 21 Requires DNR to Invoke Its Powers and Procedures Upon Rejection of a POD.

The express language of Section 21 makes clear that the provision gives DNR the power to force Lessees to take certain actions *if* the agency chooses to invoke its Section 21 powers. But the agency is not required to proceed under Section 21. If DNR rejects a proposed POD because it does not commit to development, the agency has two choices: (1) consider the failure to submit an acceptable POD a material breach of the unit agreement, place the unit in default, and demand a cure, with the possibility of terminating the unit if the cure is not implemented; or (2) invoke Section 21 and literally

force lessees to undertake work the agency believes necessary for proper development of the unit, subject to limitations set forth in Section 21.[157]

One option, if the facts warrant it, could be termination of the unit. This would have risks and benefits. DNR's decision is subject to appeal, meaning the termination may be reversed with no unit progress in the interim, but, if upheld, the agency would be able to issue new leases to operators willing to develop the public's resources. The second option, invoking Section 21, also has *pros* and *cons*. DNR must comply with the standards of Section 21, and the result may be movement on unit development, but the agency could be left partnering with reluctant lessees.[158]

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[157] In its first decision, the superior court wrote in a footnote that "Section 21 . . . specifies that the Department may not require any increase in the rate of production or development 'in excess of that required under good and diligent oil and gas engineering and production practices.' This section may well have applicability when determining the appropriate remedy when DNR rejects a proposed plan of development." Exc. 559 at n.7. This footnote was correct, insofar as it recognized that the agency had the authority to impose, in the remedy phase or otherwise, a particular rate of development and production in the Unit. But DNR declined to invoke its Section 21 powers.

[158] In fact, Director Myers' September 30, 2005 decision referenced Section 21 and gave Appellants' notice that DNR would hold a Section 21 hearing and ordered Lessees to start development operations by October 1, 2009, and to put seven leases into production. Exc. 351, 372. The October 27, 2005, amended decision eliminated the order to commence development and production by specific deadlines and deleted references to Section 21. Exc. 374. In short, DNR decided that the "cons" of invoking Section 21 and attempting to force these Lessees to move the unit into production outweighed the "pros" of doing so: "The Decision included notice that the Division would hold a hearing under Article 21 of the . . . Unit Agreement. The Decision is amended to remove certain items of work and all references to Article 21 because they do not apply to the Division's evaluation of the Unit Operator's proposed plans for development of the . . . Unit." Exc. 374.

Here, when presented with Lessees' proposed 23rd POD as a remedy for Lessees' default, DNR considered, among other factors, Lessees' repeated failure to submit an acceptable POD and Lessees' pattern of not following through with drilling and development commitments, and selected the first option.

As noted above, limiting DNR's options to invoking Section 21 when faced with recalcitrant lessees who will not submit an acceptable POD improperly limits DNR's ability to ensure lessees will develop state lands, and eliminates DNR's ability to protect the public interest by defaulting units and seeking return of state lands.

a. Section 21's Origins Confirm That Its Purpose Is To Grant Power to DNR to Mandate Action by Lessees; Not to Impose a "Burden" Limiting DNR's Powers to Review PODs Under Section 10

(1) Section 21 Was Authorized By a 1977 DNR Regulation Addressing DNR's Authority to Modify the Rate of Prospecting and Development

The history and background of Section 21 reveals its status as a stand-alone power, unrelated to the POD process. The agency included Section 21 in the Unit Agreement through administrative authority granted in 11 AAC 83.315, a regulation in effect in 1977:

> **Rates of Prospecting and Production.**
> The Director may require that any unit agreement contain a provision vesting authority in the director or other person, committee, or agency as may be designated in the agreement and satisfactory to the director, to alter

> or modify from time to time the rate of prospecting and development and the quantity and rate of production under the agreement.[159]

The regulation granted *power* to DNR to alter or modify the rate of prospecting and development as well as the quantity and rate of production under a unit agreement. Nothing in the regulation suggests that DNR must exercise its authority when rejecting a POD. In fact, the regulation does not mention PODs at all.

(2) The Parties' 1983 Amendment to Section 21 Was Intended to Provide Lessees With Protection in the Event DNR Invoked its Powers to Mandate Specific Rates of Prospecting and Development – Not to Limit DNR's POD Review Power Under Section 10

Several years after the parties executed the Unit Agreement, they agreed to amend Section 21 to clarify how DNR may exercise this broad authority and what standard applies to any Section 21 order. Specifically, in 1985, the parties amended Section 21 so that DNR could not order an increase in the rate of prospecting, development, or production in excess of that required by "good and diligent oil and gas engineering and production practices."[160] Nor could DNR modify rates of production from those in an

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[159] 11 AAC 83.315 (1974). *See also* AS 38.05.180(n) (1974); AS 38.05.180(q).

[160] The amendment provided in full:

> Powers in this section vested in the Director shall only be exercised after notice to Unit Operator and opportunity for hearing to be held not less than thirty (30) days from notice, and shall not be exercised in a manner that would (i) require any increase in the rate of prospecting, development or production in excess of that required under good and diligent oil and gas engineering and production practices; or (ii) alter or modify the rates of production from the rates provided in the approved plan of development and operations then in effect or, in any case, curtail rates of production to

approved POD or, in any case, "curtail rates of production to an unreasonable extent . . . ."[161] Prior to this amendment, Section 21 only limited DNR's Section 21 authority to "alternation [sic] or modification in the public interest."[162] This amendment narrowed that focus on the public interest to addressing the specific issue of "good and diligent oil and gas engineering and production practices."

None of these amendments specifically reference DNR's POD review process or otherwise address the contents of a POD. Notably, while precluding DNR from invoking its Section 21 powers when Lessees are operating under an approved POD, the parties did not also amend Section 10 to preclude DNR from rejecting PODs unless it could demonstrate that diligent oil and gas practices required a different level of development. Rather, the parties left intact DNR's broader Section 10 review standard—whether a POD is consistent with the public interest. The Section 21 amendment, among other things, focused DNR's exercise of its Section 21 power on the narrower issue of whether

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> an unreasonable extent, considering unit productive capacity, transportation facilities available, and conservation objectives; or (iii) prevent this agreement from serving its purpose of adequately protecting all parties in interest hereunder, subject to applicable conservation laws and regulations. Exc. 125-32.

[161] The amendment also changed the 15 days' notice requirement to 30 days. Exc. 129.

[162] This limitation did not apply however, to a Section 21 order intended to achieve "conservation objectives." Exc. 53 ("Without regard to the foregoing, the Director is also hereby vested with authority to alter or modify from time to time at his discretion the rate of prospecting and development and the quantity and rate of production under this agreement when such alteration or modification is in the interest of attaining the conservation objectives stated in this agreement and is not in violation of any applicable state law.").

the pace of ongoing operations conformed to "good and diligent oil and gas engineering and production practices."

(3) Section 21's Language is Based on Federal Law, Which Likewise Grants the Power to Mandate a Change to the Rate of Prospecting and Development, Separate From the Power to Review PODs

Section 21 is drawn from federal regulations adopted in the 1930s to avoid over-drilling and over-production. As explained below, federal legislative history and case law support DNR's interpretation of Section 21 as a powerful tool for the government to force a particular action or activity, as opposed to a provision that applies whenever there is a rejection of a POD.

The language found in Section 21 originated in the Model Federal Onshore Unit Agreement, which is based on a 1931 amendment to the Mining Act of 1920.[163] The amendment gave the Secretary of the Interior authority to control the rate of production of oil and/or gas in units.[164] Legislative history makes clear that Congress intended Section 21's language to bestow *power* to control levels of production in a unit, not to

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163 *See* 43 C.F.R. § 3186.1 (2006).

164 The language of Section 21 originated in the 1931 amendment:

> Any cooperative or unit plan of development or operation, which included land owned by the United States, shall contain a provision whereby authority, limited as therein provided, is vested in the Secretary of the department or departments having jurisdiction over such land *to alter or modify from time to time in his discretion the quantity [and] the rate of production under said plan.*

Act of Mar. 4, 1931, 74 Cong. Rec. 347 (1931) (codified as amended at 30 U.S.C. § 226(m) (1931)).

burden or otherwise limit management of federal land.[165] Section 21's language referencing "the rate of prospecting and development" was added in 1935 when the section was expanded to address concerns with oil and gas permits for unproven lands.[166]

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[165] The comments of Senator Walsh of Montana explained that the provision bestowed considerable power on the Secretary:

> In the first place, [the amendment] is intended thus to reduce the cost of carrying on the development necessary to take oil out of the claim. In the second place, in the case of the Kettleman Hills, in California, particularly, an enormous production of both oil and gas was encountered, so that for the immediate future the market was entirely glutted. It was proposed to have the work done systematically and to put the material out as the market demanded it, but inasmuch as under this arrangement those adjoining could limit production, the Secretary of the Interior is authorized at all times either to extend or restrict the amount which could be produced under the cooperative agreement.

74 CONG. REC. S6125 (daily ed. Feb. 26, 1931) (statement of Sen. Walsh).

Representative Colton expressed the same purpose for the amendment:

> Under the provisions of this proposed measure the Secretary of the Interior is authorized at all times either to extend or restrict the amount of oil or gas which would prevent an excessive supply from flooding the market. At the present time when an enormous production of both oil and gas is encountered, so that for the immediate future the market is glutted, an arrangement to have the work done systematically and to put the material out as the market demands is impossible because those lessees or permittees adjoining can limit production. This bill gives the Secretary of Interior authority to restrict or extend production in such cases.

74 CONG. REC. H7203 (daily ed. Mar. 3, 1931) (statement of Rep. Colton).

[166] Specifically, prior to 1935, Section 17 authorized the Secretary to lease only those federal lands with known oil and gas reserves in a currently producing field; the agency issued permits for unproven lands. But in 1935, Congress amended Section 17 to allow the Secretary to also lease unproven federal lands:

> Sec. 17. All lands subject to disposition under this Act which are known or believed to contain oil or gas deposits ... may be leased by the Secretary of the Interior ....

4. Concluding That Rejection of a POD Requires DNR to Invoke Section 21 is Inconsistent with the Plain Language and Purpose of Section 10

a. Section 10 Exclusively Governs the POD Process

Under Section 10, a POD "shall be as complete and adequate as the Director may determine to be necessary for timely development and proper conservation . . . ."[167] A proposed POD must specify the number, location, order, and timing of wells.[168] Section 10 further provides: "The Unit Operator expressly covenants to develop the unit area as a reasonably prudent operator in a reasonably prudent manner."[169]

In that same amendment, Congress added the "prospecting and development" language:

> Any cooperative or unit plan of development and operation, which includes lands . . . shall contain a provision whereby authority, limited as therein provided, is vested in the Secretary . . . to alter or modify from time to time in his discretion the rate of production and development and the quantity and rate of production under said plan.

Thus, when Congress expanded the Secretary's authority to lease lands beyond those currently producing, it simultaneously (and logically) authorized him to modify rates of prospecting and development, in addition to production. Act of Aug. 21, 1935, 79 CONG. REC. 12761 (1935).

167 Exc. 156.

168 *Id.*

169 *Id.* Section 10 provides in relevant part:

> 10. PLAN OF FURTHER DEVELOPMENT AND OPERATION. Within six months after completion of a well capable of producing unitized substances in paying quantities, the Unit Operator shall submit for the approval of the Director an acceptable plan of development and operation for the unitized land which, when approved by the Director, shall constitute the further drilling and operating obligations of the Unit Operator under this agreement for the period specified therein. Thereafter, from time to time before the expiration of any existing plan, the Unit Operator shall submit for the approval of the Director a plan for an additional specified period for

Section 10 is the exclusive Unit Agreement provision on POD approval and rejection. It alone governs the parties' rights and obligations in the POD process. By empowering DNR to require each POD to be as "complete and adequate" as DNR may find necessary "for timely development and proper conservation of the oil and gas resources," Section 10 leaves to DNR's expertise how much activity is required for "timely development."

Other Section 10 language highlights DNR's broad power. Most critically, it requires PODs to contain the number, location, order, and time for drilling wells.[170] Thus, the Unit Agreement clearly envisions that DNR's Section 10 discretion extends to concrete details of drilling programs and drilling rates (for instance, the timing of wells), not just their general outlines. Nothing in Section 10 suggests that these discretionary powers are limited if DNR rejects a POD for reasons related to a failure of development or production.

In its initial Decision on Appeal, the superior court recognized that Section 10 grants broad power to the Director: "The PTUA, when read in conjunction with the

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> the development and operation of the unitized land. The Unit Operator expressly covenants to develop the unit area as a reasonably prudent operator in a reasonably prudent manner.
>
> Any plan submitted pursuant to this Section shall provide for the exploration of the unitized area and for the diligent drilling necessary for determination of the area or areas thereof capable of producing unitized substances in paying quantities in each and every productive formation and shall be as complete and adequate as the Director may determine to be necessary for timely development and proper conservation of the oil and gas resources of the unitized area, ..." Exc. 156

[170] *Id.*

regulations in effect in 1977, clearly accorded to DNR the ability to administratively determine whether the Unit Operator is in compliance with Section 10 of the Unit Agreement."[171] But in the later Decision After Remand, the superior court reversed itself and severely limited DNR's Section 10 powers by tying disapproval of a POD to Section 21, which does not address or mention PODs in any way. Specifically, the court held that Section 21 is a "natural progression from the rejection of a POD under Section 10 when the proposed 23rd POD was rejected because DNR seeks to increase production in the Point Thomson Unit."[172] According to the court, DNR may reject a proposed POD under Section 10 for failure to commit to development, but must then invoke Section 21's discretionary procedures for mandating a specific change in the rate of prospecting and development.[173]

The court's interpretation converts a discretionary power into a mandatory hurdle and replaces the broad standards of Section 10 with the narrower standards applicable to Section 21. Section 21, because it grants DNR the power to force Lessees to take action, directs that any DNR order be evaluated primarily with regard to whether it is consistent with "good and diligent oil and gas engineering and production practices."[174] This standard, by its terms, does not provide for the broader consideration of the public interest provided for in Section 10. It is therefore improper to import this narrower "good

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171 Exc. 555.

172 Exc. 781.

173 *Id.*

174 Exc. 167.

and diligent oil and gas engineering and production practices" standard into Section 10, which grants DNR broad discretion to evaluate and approve PODs, and to require a POD that adequately addresses "timely development and proper conservation." Put another way, Section 10 (and the public interest factors made applicable to Section 10 by regulation) provides for consideration of not only good and diligent oil and gas practices, but also a wide array of factors bearing on the public interest and the requirements placed on oil and gas lessees in Alaska by statute and regulation. Section 21 requires a narrower and more focused analysis, which is appropriate given the power Section 21 confers on DNR.

Linking Section 21 and Section 10 together effectively amends Section 10 to remove consideration of the broader public interest as mandated by regulation. If rejection of a POD then requires DNR to initiate a Section 21 proceeding where the agency is directed to primarily consider the narrow issue of "good and diligent oil and gas practices," and not also the broader public interest, then the discretionary power granted by Section 10 to determine that a POD be "as complete and adequate as the Director may determine to be necessary" is rendered effectively meaningless. But that is exactly the interpretation that the superior court adopted.

b. Linking Section 21 to Section 10 Fails to Give Meaning to Both Sections

In *Modern Construction, Inc. v. Barce, Inc.*,[175] this Court stated: "The court will if possible give effect to all parts of the instrument and an interpretation which gives a reasonable meaning to all its provisions will be preferred to one which leaves a portion of the writing useless or inexplicable." Here, the superior court's interpretation would completely neutralize DNR's Section 10 authority over PODs and rewrite Section 21.

The superior court initially agreed that a POD "shall be as complete and adequate as the Director may determine to be necessary for timely development and proper conservation . . . ."[176] It further agreed that DNR has discretionary power to reject a POD on this record.[177] But then the court prohibited the agency from exercising its discretion. Instead, the court required DNR to hold a Section 21 proceeding and measure its judgment exercised under Section 10 against a narrower "good and diligent" practices standard.[178] The court's interpretation renders DNR's discretion under Section 10 virtually meaningless because it leaves DNR without a discretionary remedy if it rejects a POD.

If the agency's rejection of a POD for failure to commit to production after three decades automatically forces DNR to invoke Section 21, demand a specific rate of

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175 556 P.2d 528, 530 (Alaska 1976).

176 Exc. 556-57.

177 Exc. 558-59.

178 Exc. 786-87.

prospecting and development, and assess whether that rate of prospecting and development is consistent with "good and diligent oil and gas engineering practices," as opposed to the broader public interest that applies to Section 10 review, the Director's discretionary Section 10 power to require a POD as "complete and adequate as [DNR] may deem necessary" is illusory.

c. DNR Correctly Concluded That Section 21 Is Not Applicable If There Is No Ongoing Actual Unit Production

The Commissioner's Remand Decision concluded that Section 21 did not apply where there was no ongoing rate of production.[179] The superior court disagreed and held that Section 21's language allowing DNR to "alter or modify . . . the quantity and rate of production" includes situations where there has never been production because "rate" can mean a rate of zero.[180] DNR was correct. The superior court's holding misreads the text of Section 21 and related case law.

The second paragraph of Section 21 provides that DNR cannot "alter or modify the rates of production from the rates provided in the approved plan of development and operations then in effect or, in any case, curtail rates of production to an unreasonable extent, considering unit productive capacity . . . ."[181] This language makes clear that "rate of production" refers to actual production by preventing DNR from changing a rate

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179 Exc. 723-25.

180 Exc. 782-84.

181 Exc. 167.

of production contained in a POD then in effect and by use of the word "curtail." DNR could not "curtail" a rate of production that was zero.

Further, the reference to "good and diligent oil and gas engineering and production practices" bears this out. This phrase is similar to the term "good oil field engineering practices" as that term is used in the regulations of the Alaska Oil and Gas Conservation Commission.[182] These regulations make express the implied duty of producers to operate according to established, safe practices.[183] Limiting the authority to order an alteration in the rate of prospecting and development to what is consistent with "good and diligent oil and gas engineering and production practices" makes sense because it protects against an order to increase (or decrease) production beyond what is safe or consistent with good conservation practices. These safety and conservation principles are inapplicable, however, when there is no production at all.

Application of the "good and diligent oil and gas engineering practices" standard makes little sense when there is no actual ongoing unit production. With no production, oil and gas engineering practices are not implicated. When there is no production, the unit management is primarily a lands issue, i.e., whether and when production should commence. Once production has begun, unit management also encompasses reservoir

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182 *See, e.g.*, 20 AAC 25.200, .270, .526 .235.

183 *See, e.g.*, 20 AAC 25.526, *Conduct of Operations* ("An operator shall carry on all operations and maintain the property at all times in a safe and skillful manner *in accordance with good oil field engineering practices* and having due regard for the preservation and conservation of the property and protection of freshwater.") (Emphasis added)

issues, i.e., is this level of production consistent with safety and conservation standards. If a lessee were to argue that it was not consistent with "good and diligent oil and gas engineering practices" to initiate production, the remedy would be to return the leases to the state, not warehouse the lease forever

Application of the "good and diligent oil and gas engineering practices" standard makes little sense when there is no actual ongoing unit production. With no production, oil and gas engineering practices are not implicated. When there is no production, DNR's unit management is a lands issue, *i.e.*, whether and when production should commence. Once production has begun, DNR's unit management is a reservoir issue, *i.e.*, is this level of production consistent with safety and conservation standards. If a lessee were to argue that it was not consistent with "good and diligent oil and gas engineering practices" to initiate production, the remedy would be to return the leases to the state, not warehouse the lease forever.

Interpreting Section 21's "rate of production" language to refer to actual production is consistent with the rest of the Unit Agreement and the Operating Agreement. The Operating Agreement, which Lessees entered into pursuant to Section 7 of the Unit Agreement, defines "production" as "all Unitized Substances produced and saved" from the Unit property, except any that are held out to be used in operations.[184] This definition clearly treats "production" as hydrocarbons that are actually produced. At

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[184] *See* Point Thomson Unit Operating Agreement (PTUOA) § 1.7. Exc. 17.

least 13 other Operating Agreement provisions demonstrate that Lessees believe "production" means actual production.[185]

While "rate of production" is not defined in the Unit Agreement, the context in which "production" is used in other provisions demonstrates that the reference to "rate of production" in Section 21 means *actual production*. For example, Section 9 allows the Unit to be held by discovery of reserves that can be produced in paying quantities.[186] The original participating area clause, Section 11, required a proposal at least 90 days "prior to commencement of production."[187] Section 12 deals with allocation of "production," which obviously refers to actual production, as do the discussions of "production" in Section 13.[188]

The DL-1 lease form, which applies to most of the leases in the Unit, is consistent with DNR's view of "rate of production." Specifically, under this standard lease, there

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185 PTUOA § 1.11 (talking about completing and equipping a well "for production"); § 1.12 (same on completing or recompleting); § 6.1B (provision on allocation of production"); § 6.2 (talking about if a well is completed as a producer, "the Production therefrom"); § 6.3 (taking-in-kind provision for disposing of "share of Production") and § 6.4 (failure to take in kind, and what happens to share of Production); § 10.2 (parties' rights on "Production therefrom" if non-operator drills a well); § 12.3 (non-consent penalty over after proceeds "of Production" equal specified percentages of drilling and operating costs); § 15.4 (operator's right to place lien on non-operator's "proceeds of such Party's share of Production"); § 20.2 (payment of lease burdens on production); §24.1 (discussing measurement and method of measuring "the Production"); § 24.2 (salvage provision structured like distribution of proceeds of Production); § 25.2 (above ground facilities paragraph discussing treating "Production"). Exc. 11-37.

186 Exc. 155.

187 Exc. 157.

188 Exc. 160-61.

are three phases of an oil and gas project: (1) exploration, involving drilling the test well and exploring for new zones; (2) development, requiring lessees to drill wells to fully exploit an already discovered formation; and (3) production, involving production of the reserves discovered by exploration and drilling.[189]

In short, Section 21's reference to "rate of production" refers to *actual production.* Even ConocoPhillips, one of the Lessees, agrees. In its briefing to the superior court in the first appeal, ConocoPhillips recognized Section 21 as vesting authority to modify the rate of prospecting, development, and production, but argued that it cannot apply to rejection of the 22nd POD because production has not yet commenced "and so the *rate of production cannot be altered.*"[190] Because there has been no actual production from the Unit, DNR's rejection of a POD that refuses to commence production cannot, by itself, trigger Section 21.

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[189] Alaska law reflects these widely-recognized phases of physical operations. *See, e.g.*, AS 38.05.180(a)(1)(B) (discussing competition to "explore and develop" resources; AS 38.05.180(a)(2)(A)(ii) (discussing minimizing the impact of "exploration, development, production, and transportation activity"). Indeed, the clause granting the leasehold interest in the DL-1 form tracks these phases, allowing DNR to grant a lease "for the sole and only purposes of exploration, development, production, processing and marketing."

[190] Exc. 534 (emphasis added).

5. The Parties' Past Conduct Demonstrates that Section 21 Does not Automatically Apply When DNR Rejects a POD Under Section 10

The object of contract interpretation is "to determine and enforce the reasonable expectations of the parties."[191] Extrinsic evidence, including the subsequent conduct of the parties, is an indication of the parties' intentions and expectations.[192] In this case, however, the superior court ignored evidence that Lessees have never before raised Section 21 in response to DNR's pre-2006 rejections of proposed PODs. Specifically, DNR had previously rejected PODs for reasons related to development and production from the Unit, but Lessees never invoked Section 21 or otherwise suggested it comes into play.

For example, DNR rejected Lessees' proposed 12th POD because it did not commit to delineate or market the Unit's resources.[193] Lessees simply submitted a different POD; they did not assert that DNR was bound to follow Section 21.[194] Similarly, in approving the 21st POD, Director Myers conditioned approval on Lessees committing to drill a well in the 22nd POD. Lessees appealed this decision to the Commissioner, but they never argued that Section 21 applied.[195] In fact, Lessees did not

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191 *Norville v. Carr-Gottstein Foods Co.*, 84 P.3d 996, 1004 (Alaska 2004).

192 *Municipality of Anchorage v. Gentile*, 922 P.2d 248, 256 (Alaska 1996).

193 DNR extended the 11th POD after reviewing and not approving Lessees' proposed 12th POD. DNR never approved the 12th POD. Exc. 145-46, 171-78.

194 Exc. 171-72, 179-83.

195 Exc. 306.

even mention Section 21 when they appealed Director Myers' default decision to Commissioner Menge in 2004.[196]

And in the 205 pages of briefing submitted by Lessees during the first appeal to the superior court they raised every imaginable objection but Section 21 is mentioned only once by Lessees and *dismissed as inapplicable*: "Section 21(a) is no source for the exploration and production demands made by DNR in this case."[197]

If Lessees genuinely believed that Section 21 applies when DNR rejects a POD for reasons related to prospecting, development, or production, they surely would have said so. In reality, they never even considered Section 21 to be a consequence of POD rejection until the superior court referenced it in the Decision on Appeal.

In sum, Lessees' historical failure to invoke Section 21 after multiple rejections of proposed PODs is strong evidence that the parties to the Unit Agreement never expected Section 21 to apply to the POD approval process, and weighs heavily in favor of DNR's interpretation of Section 21.

6. Linking Section 21 to Section 10 is Contrary to the Statutes and Regulations in Effect in 1977

Alaska law is clear that agencies cannot "contract around" statutes or regulations.[198] Accordingly, where possible, contracts must be interpreted consistent with

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196 Exc. 306-11.

197 Exc. 534.

198 *Exxon Corp. v. State*, 40 P.3d 786, 796-97 (Alaska 2001).

related laws.[199] Here, the superior court's interpretation of Section 21 is contrary to Alaska's oil and gas laws.

Lessees offered the 23rd POD as a "remedy" to cure DNR's finding of default, not as a "normal" POD submitted pursuant to Section 10. It was appropriate, however, for the Commissioner to apply the POD evaluation criteria required by Alaska law, specifically, by 11 AAC 83.303(b), when considering it.[200] The regulation provides:

> (b) In evaluating [a POD], the commissioner will consider
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> (1) the environmental costs and benefits of unitized exploration and development;
> (2) the geological and engineering characteristics of the potential hydrocarbon accumulation or reservoir proposed for unitization;
> (3) prior exploration activities in the proposed unit area;
> (4) the applicant's plans for exploration or development of the unit area;
> (5) the economic costs and benefits to the state; and
> (6) any other relevant factors, including measures to mitigate impacts identified above, the commissioner determines necessary or advisable to protect the public interest.[201]

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[199] The Unit Agreement expressly incorporates the oil and gas statutes and regulations in Section 1, Enabling Act and Regulations. Exc. 149.

[200] 11 AAC 83.343 requires the unit operator to submit a unit plan of development and the commissioner must then determine whether the plan is consistent with the provisions of 11 AAC 83.303.

[201] The phrase "good faith and diligent oil and gas engineering and production practices" was added as part of the 1985 amendments to the PTUA, and thus must be read consistently with 11 AAC 83.343, which was in existence in 1985. *See ConocoPhillips Alaska, Inc. v. State, Dep't of Natural Res.*, 109 P.3d 914, 921-22 (Alaska 2005).

In addition, AS 38.05.180(m), in effect at the time the parties entered into the Unit Agreement, allowed DNR to require a POD that protected "all parties in interest."[202] Thus, in evaluating a POD under Section 10, DNR is required to consider the .303(b) public interest factors and to ensure that any proposed POD protects all parties in interest. For these reasons, DNR applied these factors in evaluating Lessees' proposed remedy of the 23rd POD.[203]

The superior court's decision regarding Section 21 turns this process on its head and concludes that if, in applying these factors, DNR is dissatisfied with a POD, its only remedy is to invoke Section 21 to determine whether any ordered rate of prospecting and development is consistent with "good and diligent oil and gas engineering and production practices." The effect of the superior court's reading of Section 21 is to supplant the broad .303(b) public interest factors applicable to PODs with the narrower "good and diligent oil and gas engineering and production practices" standard from Section 21. This is improper because, as noted above, the "good and diligent oil and gas engineering and production practices" standard effectively restricts DNR discretion by limiting DNR's consideration to one discrete issue, as opposed to the broader consideration of the public interest provided for in .303(b). Section 21 does not address the public interest and other requirements imposed on oil and gas lessees in Alaska, primarily because it addresses an instance where DNR is invoking a power to force specific action in one narrow context,

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202 [R. 880] Current AS 38.05.180(p) and (t) are to the same effect.

203 Exc. 694-734.

rather than acting as a lands manager overseeing development of public land by third parties.

DNR's interpretation, on the other hand, harmonizes the Unit Agreement provisions and the regulations: Section 21—with its direction to consider no criteria other than the "good and diligent oil and gas engineering and production practices" standard—applies only when the agency chooses to invoke the provision and order a specific alteration to the rate of prospecting, development, and production; the broader .303(b) public interest factors, in contrast, apply to PODs submitted under Section 10, which provides for broad DNR discretion in reviewing PODs. DNR's interpretation also preserves its obligation to manage state-owned lands such as Point Thomson in the public interest.[204] The superior court disregarded this obligation by substituting Section 21's narrower "good and diligent oil and gas engineering and production practices" standard for the statutory and regulatory POD criteria, which mandate that PODs be reviewed in the public interest.

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[204] *See* AS 38.05.020 ("The commissioner shall supervise the administration of the division of lands. . . [and] exercise the powers and do the acts necessary to carry out the provisions of this chapter"); AS 38.05.180 (oil and gas and gas only leases effectuate interests of people of Alaska in the development of the state's oil and gas resources and the Commissioner manages the leasing process); AS 44.37.020 (DNR shall administer oil and gas resources for development); 11 AAC 83.303 (DNR commissioner will approve proposed unit agreement if "necessary or advisable to protect the public interest"); *Kachemak Bay Conservation Soc'y v. State,* DNR, 6 P.3d 270, 276 (Alaska 2000) ("the legislature delegated to DNR much of its authority to ensure that such leasing of state land or interests in state land is consistent with the public interest."); *State, Dep't of Natural Res. v. Arctic Slope Reg'l Corp.*, 834 P.2d 134, 143 (Alaska 1991) (DNR manages natural resources for benefit of Alaskans).

The superior court also disregarded the concept behind unitization and the reasons that Alaska law provides for a POD process governed by the public interest. As noted above, unitization confers significant benefits on oil and gas lessees by permitting them to hold leases beyond their primary term and to hold leases without drilling or producing from the lease. As part of this trade-off, DNR retains its ability to protect the public interest and effect efficient and timely development through the POD process. This balance is reflected in both the text of the Unit Agreement and the underlying statues and regulations.[205] The superior court's reading of Section 21 undermines this balance by effectively eviscerating DNR's power to review PODs in the public interest. Indeed, oil and gas lessees should not be able to hold leases in a unit in perpetuity simply because the lessees claim production is not consistent with "good and diligent oil and gas engineering practices." The proper remedy is for the leases to expire and return to the State. The State effects this remedy through the POD review process and by exercising its discretion under Section 10 to terminate units altogether if lessees repeatedly fail to submit PODs that promote the public interest. The perverse effect of the superior court's interpretation is to deprive the State of this necessary power.

7. The Commissioner's Decision on Remand did not Specifically Invoke Section 21 or Otherwise Reject Lessees' Proposed Remedy in a Way that Would Trigger Section 21

When Commissioner Irwin's remand decision is read in light of the proper interpretation of Section 21 and its relationship (or lack thereof) to Section 10, it is clear

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[205] Exc. 147-70; AS 38.05.180(m), (p); 11 AAC 83.303.

that he did not invoke Section 21 or otherwise trigger its procedures. The Commissioner did not issue an order changing the rate of production. Rather, he rejected the 23rd POD altogether, as a remedy for Lessees' failure to cure their default by submitting yet another unacceptable POD, against the background of Lessees' refusal to develop the Unit for over thirty years.[206] He concluded that it would not be in the public interest to accept the 23rd POD as a remedy, and he also concluded, in part, that Lessees lacked credibility.[207] Neither of these grounds for rejection under Section 10 seeks to force Lessees to take any specific action or impose specific rates of prospecting, development, or production under Section 21. Thus, Commissioner Irwin's decision should be reviewed on its merits, under the provisions relevant to POD approval, rather than rejected because it did not apply Section 21.

B.

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206 Exc. 734.

207 Exc. 717-21.

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C. DNR Did Not Violate Lessees' Due Process Rights

1. The Court Misread and Misapplied *Robson*

a. *Robson* Prohibits Attorneys Who Argue Before an Agency from Participating in Agency Decision-Making, Circumstances not Present Here

In re Robson stands for the straightforward principle that it violates due process when an advocate in an adversarial administrative proceeding also participates in the agency's decisional process.[230] *Robson* deals with the scenario in which agency personnel perform both a prosecutorial and an adjudicatory role, and recognizes that in adversarial scenarios, advocates performing a role analogous to a prosecutor will develop a "probable partiality."[231] The risk in this scenario is that a prosecutor will impermissibly influence the outcome if allowed to participate in decision making.[232] But where agency

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230 575 P.2d 771 (Alaska 1978).

231 *Id.* at 774.

232 *Id.*

personnel do not perform dual roles of prosecutor and decision-maker, no similar risk exists.

In *Robson,* the Alaska Bar Association subjected an attorney convicted of a felony to disciplinary proceedings in a two-stage process.[233] First, the Hearing Committee conducted a hearing and made a recommendation to the Disciplinary Board. The Board then considered the record and forwarded a recommendation to the Alaska Supreme Court.[234] The Bar Rules provided that the Bar Association's Executive Director and its assistant attorneys serve as "Bar Counsel" and prosecute disciplinary proceedings before the Hearing Committee and Disciplinary Board.[235]

The problem in *Robson* was that the Executive Director was present during the Disciplinary Board's deliberations. This Court held: "[w]hen an *administrative official* has participated in the past *in any advocacy capacity* against the party in question, fundamental fairness is normally held to require that the former advocate take no part in rendering the decision."[236] This Court likened the proceedings to a court case and held "that to assure both the fact and appearance of impartiality in the Disciplinary Board's

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233 *Id.* at 773.

234 *Id.* at 772-73.

235 *Id.* at 773 (citing Alaska Bar Rule II-15).

236 *Id.* at 774 (emphasis added).

decisional function, counsel associated with either the prosecution or defense should not be present during deliberations."[237]

Robson addressed a specific circumstance—where a lawyer was an advocate *before the agency*, the agency decision-maker cannot then consult with the same counsel during its deliberations. Here none of DNR's counsel served dual roles. They did not advocate against Lessees before the agency. The only role they played in the non-adversarial administrative proceeding was to advise the Commissioner. None of DNR's attorneys presented an argument, questioned a witness, or ever spoke during the administrative hearings. For *Robson* to apply, DNR's counsel would have had to participate as advocates in administrative proceedings against Lessees, which they did not do. There was no mixing of prosecutorial and adjudicative roles.

b. *Robson* Does not Prohibit Agencies from Consulting With Counsel Who Represent the Agency on Appeal

Agency attorneys defending final agency action on appeal are not prosecutors advocating for a specific outcome before triers of fact. Instead, these attorneys defend the decision of the agency, whatever it may be.[238]

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[237] *Id.* at 775. *See also Amerada Hess Pipeline Corp. v. Regulatory Comm'n of Alaska*, 176 P.3d 667, 677 (Alaska 2008) (*Robson* stands "for the self-evident proposition that all advocates, the prosecution and the defense alike, are *per se* excluded from the jury room or its functional equivalent.").

[238] *Ceres Marine Terminal, Inc. v. Maryland Port Administration*, 1999 WL 287321 *7-8 (F.M.C. April 16, 1999) (concluding that agency staff attorneys who represented the Commission before the Fourth Circuit were not engaged in the performance of investigative or prosecuting functions and stating "[t]he job description of the agency staff attorney is to defend the [agency's] position in court, no matter what that

The superior court nonetheless quoted from this Court's decision in *Robson* to conclude that representing an agency on appeal precludes an attorney from advising the agency on remand:

> When an administrative official has participated in the past in any advocacy capacity against the party in question, fundamental fairness is normally held to require that the former advocate take no part in rendering the decision. The purpose of this due process requirement is to prevent a person with probable partiality from influencing the other decision-makers.[239]

The court then concluded that DNR's counsel had acted as "advocates" against Lessees during the previous appeal, and thus these attorneys could not continue to advise the agency on remand.[240] The superior court's reading of *Robson* confuses advocacy designed to persuade a decision-maker, and advocacy designed to defend a decision-maker's decision before an appellate tribunal. *Robson* involved the former, this case the latter.

This Court's reference to "advocacy capacity" in *Robson* referred specifically to functioning as an advocate *before the agency in an adversarial proceeding.*[241] These were the facts of *Robson.* Here, the proceeding began as a non-adversarial hearing, was appealed in an adversarial setting to the superior court, and was then remanded back to a

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position is. The 'will to win' in this context is a will to show that the agency was correct in its decision. This is distinguished from an investigator or prosecutor, who develops 'a psychological commitment to achieving a particular result' . . . and then attempts to effect that outcome.").

239 Exc. 790 (citing *Robson*, 575 P.2d at 774).

240 Exc. 791-93.

241 *Robson*, 575 P.2d at 774.

non-adversarial proceeding. In the initial and remanded non-adversarial administrative proceedings before the Commissioner, no one performed a prosecutorial role—Lessees made their case before the Commissioner, and no agency-affiliated personnel presented a case to the contrary. DNR's staff and attorneys' only role was to advise the Commissioner. Then on appeal, the attorneys advocated before the superior court on behalf of DNR, defending its final decision. The attorneys did not act in a prosecutorial manner, that is, try to establish that Lessees had committed the acts or omissions that led the Commissioner to make his decision. Instead, they were attempting to establish that the Commissioner did not err in making his decision.

Nothing in ordinary experience suggests that appellate attorneys should be disqualified when a case is remanded because of any personal stake in the outcome of agency decisions.[242] This is particularly true where, as here, there are no adversaries on

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[242] For this reason, it is no surprise that Lessees are unable to allege or establish any actual personal bias on the part of DNR's counsel. *See Gottstein v. State v. Dep't of Natural Res.*, 223 P.3d 609, 628 (Alaska 2010) ("We . . . reiterate that agency personnel are presumed to be impartial until a party shows actual bias or prejudgment."). DNR's attorneys have no personal stake in DNR's decisions in this matter and simply act to advise the agency and provide appropriate assistance in implementing its decisions. Lessees argued below that because DNR's counsel appeared as Lessees' "litigation opponents" in the first appeal, this meant that DNR counsel were "proponents of DNR's contract claims and the prior termination decision" and had a "clear incentive" to "limit the scope of proceedings DNR would allow on remand" and to "shape the Commissioner's decision that they would be defending on any subsequent appeal." *Reply Brief of Appellants ExxonMobil Corporation, BP Exploration (Alaska) Inc., Chevron U.S.A. Inc., and ConocoPhillips Alaska, Inc.*, May 26, 2009, p. 10. Lessees provided no factual or legal basis for this inflammatory allegation. Nor does it make any sense. Lessees are presuming that DNR counsel has a personal stake in DNR's decisions and that DNR counsel would abandon professional obligations to advise their client.

remand and the appellate attorneys did not participate in the remand proceedings themselves. When the case was remanded, the attorneys re-assumed the neutral role of adviser to the Commissioner (in the initial administrative proceeding, DNR counsel likewise did not present a case to the Commissioner or participate in the proceedings). Lessees presented the case for acceptance of the 23rd POD to remedy the default and cure the defects in 22nd POD.[243] No one from DNR presented a case to the Commissioner *against* accepting the proposed POD. Instead, as was the case with the initial administrative proceeding, the attorneys' sole function was to advise the agency as a client, which is not a due process violation.

In concluding that Commissioner Irwin could not consult with DNR's counsel because they had "participated in an advocacy capacity against the [Appellants]" in the previous appeal, the superior court divorced *Robson's* reasoning from its facts. There is no sound basis to take the phrase "advocate" out of the factual context of *Robson* to conclude that a lawyer who defends an agency decision on appeal is prohibited from continuing to advise the agency in remanded adjudicatory proceedings.

Further, Lessees ignore that DNR is the decision-maker and DNR is the only party that would be a "proponent" of its contract claims.

[243] March 3-7, 2008 Tr. at pages 64-1054.

2. Commissioner Irwin's Designation of Ms. Thompson as Hearing Officer Does Not Trigger the Due Process Concerns Addressed in *Robson* Because She was not an Advocate in any Proceeding, Including the Superior Court Appeal

The superior court concluded that *Robson* required DNR to employ a hearing officer on remand who had not advocated for the agency on prior appeal to the court.[244] The court stated that "the hearing officer appointed by the Commissioner . . . defended DNR's position in the original appeal before this Court, participating on behalf of the agency as the agency's Unit manager for the PTU."[245]

Ms. Thompson was not an advocate for DNR on appeal. Her only role was that of the representative client: she simply attended the April 17, 2007 oral argument and sat at counsel table and DNR's attorneys introduced her to the court.[246] She never spoke, much less advocated for the agency. She was the client, not an advocate. She was a stand-in for her boss, Commissioner Irwin. In fact, had schedules allowed, the Commissioner himself might have attended oral argument as the client representative. Nothing about sitting at counsel table would have transformed him into an advocate disqualified from participating in future administrative proceedings. Likewise, Ms. Thompson's mere presence at oral argument as a DNR employee standing in for the Commissioner does not support the conclusion that Ms. Thompson was an advocate on appeal.

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244 Exc. 791.

245 *Id.*

246 April 17, 2007 Tr. at 3, line 7-9.

On remand, Ms. Thompson's role in the administrative hearing was akin to a parliamentarian, assisting Commissioner Irwin with the orderly administration of procedural matters.[247] Ms. Thompson participated in the hearing to the extent necessary to ensure proper development of the record, but did not advocate for any outcome. Ultimately, Commissioner Irwin, not Ms. Thompson, was the decision maker. *Robson* – which this Court clarified as a rule restricting advocates from the jury room or its functional equivalent[248] – cannot apply to an agency employee who was never an advocate in any proceeding.

3. The Superior Court's Application of *Robson* to DNR's Proceedings Adds no Procedural Safeguards and is Unduly Burdensome

The superior court's Decision After Remand suggests that in order to protect due process agencies must add safeguards to remand proceedings such as requiring that (1) agency personnel who act as the client representative on appeal not serve any role whatsoever on remand; and (2) attorneys who defend agency decisions on appeal do not advise the agency during non-adversarial proceedings on remand.[249] This well-meaning but impractical decision places an onerous burden on DNR and other administrative agencies that employ a similar model without adding any procedural value.

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[247] Hearing Officer Thompson conducted the prehearing conference to resolve procedural issues such as marking exhibits and maintaining the confidentiality of sensitive information. *See, e.g.*, February 27, 2008 Prehearing Conference Tr. at 3-59.

[248] *Amerada Hess Pipeline Corp. v. Regulatory Comm'n of Alaska*, 176 P.3d 667, 676-77 (Alaska 2008).

[249] Exc. 791-93.

Procedural due process is analyzed on a case-by-case basis.[250] To determine the requirements of due process in any given context, courts balance three factors: (1) the private interests that will be affected by the official actions; (2) the risk of erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and (3) the government's interest, including the function involved and the burdens that additional or substitute procedural requirements would impose.[251] Application of this framework to the remand proceedings illustrates that DNR's procedures comport with due process, and the procedures added by the court below do not provide additional safeguards.

a. Lessees' Private Interest at Stake is the Ability to Hold Multiple Point Thomson Leases Beyond their Primary Term Without Production

Lessees will presumably argue that the private interest at stake is the property interest they have in the potential revenue from development of Point Thomson. There is no doubt that Point Thomson's rich oil and gas deposits, if properly developed, will yield tremendous revenue for Alaska and Lessees. But characterizing this revenue potential as the private interest at stake is misleading. In reality, the private interest at stake is Unit

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[250] *See, e.g., State, Dep't of Natural Res. v. Greenpeace, Inc.*, 96 P.3d 1056 (Alaska 2004) ("Due process does not have a precise definition, nor can it be reduced to a mathematical formula.") (citing *Green v. State*, 462 P.2d 994, 996-7 (Alaska 1969) (citations omitted)).

[251] *Mathews v. Eldridge*, 424 U.S. 319 (1976). *See also City of Homer v. State, Dep't of Natural Res.*, 566 P.2d 1314, 1319 (Alaska 1977) (looking to *Mathews v. Eldridge* to determine whether administrative procedure met requirements of due process).

termination. As explained above, unitization allows Lessees to coordinate development and allocate production between multiple leases.[252] Terminating the Unit does not result in automatic termination of the underlying leases.[253] Even if the Unit is terminated, individual leases that have drilling operations, wells capable of producing in paying quantities, or production, will continue beyond their primary terms.[254] Moreover, nothing in state law prevents a lessee from applying to DNR to form a new unit with the underlying leases. The individual leases that formerly comprised the Point Thomson Unit were the subject of a separate administrative proceeding.[255] In other words, Unit termination does not, by itself, terminate the underlying leases or take away potential revenue.

b. DNR's Procedures Protected Lessees from Erroneous Deprivation of their Interest in Operating a Unit and the Additional Procedures Contemplated by the Superior Court Add no Meaningful Safeguards

In the hearing on remand, DNR employed standard administrative hearing procedures, which this Court has previously reviewed and approved.[256] Lessees received

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252 AS 38.05.180(p).

253 AS 38.05.180(m), (p).

254 AS 38.05.180(m).

255 On January 27, 2009 Commissioner Irwin issued a Conditional Interim Decision recognizing that ongoing and continuous drilling operations extended the term of two leases under 11 AAC 83.140. Exc. 762-64. No final decision has been issued in Lessees' appeal of lease terminations.

256 *White v. State, Dep't of Natural Res.*, 14 P.3d 956, 960 (Alaska 2000) ("The department's regulations require oil and gas lessees to pursue all grievances through administrative remedies . . . . The commissioner is the final administrative

notice and an opportunity to be heard.[257] The Commissioner appointed a hearing officer to help ensure that procedures necessary to safeguard Lessees' interests were in place and adhered to during the hearing.[258] DNR's attorneys from the Attorney General's office and private outside counsel advised the Commissioner specifically to ensure that remand directives were followed.

Under the court's decision, attorneys defending DNR on appeal and staff members who sit as the client representative on appeal cannot advise on remand. But imposing these restrictions does not provide additional due process protection.[259] If DNR engaged new attorneys, they would be duty-bound to become just as familiar with the appellate record as the attorneys who represented the agency on appeal and to advise the Commissioner accordingly. Learning an entire case from a record that may consist of thousands and thousands of pages is time consuming and costly for the State. Once the new attorney has thoroughly learned the record, that attorney will be no more or less able to fairly and adequately advise the agency decision maker than the attorney who

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adjudicator of such grievances . . . ."); *see also Danco Exploration, Inc. v. State, Dep't of Natural Res.*, 924 P.2d 432, 434 (Alaska 1996) (challenges to DNR leasing decisions must be by appeal to the commissioner followed by appeal to the superior court).

257 Exc. 589-91.

258 Exc. 590.

259 *Cf.* 1 RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 8.6 (5th ed. 2009) ("The role of an agency's staff is a vital part of the administrative process, for which it is a source of special strength. The strength springs from the superiority of group work—from internal checks and balances, from cooperation among specialists in various disciplines, from assignment of relatively menial tasks to low-paid personnel so as to utilize more economically the energies of high-paid personnel, and from the capacity of the system to handle huge volumes of business and at the same time maintain a reasonable degree of uniformity of policy determinations.").

represented the agency on appeal. Concluding otherwise requires the conclusion that DNR staff and attorneys who are involved in the first appeal will ignore the outcome of the appeal and instead "advocate" for the agency's initial decision. This argument proves too much because the same logic can be applied to the actual decision-maker, and there is no legal basis for arguing that an agency may not decide cases on remand.

The logical result of the superior court's decision regarding agency staff capable of serving as a hearing officer (and there was no requirement to have one in the first place) is either that there would be no hearing officer at all, or there would be a less qualified hearing officer.[260] Involving new agency staff would also be a waste of State resources and would delay proceedings, a result that is certainly not protective of Lessees' interests. To the contrary, preserving continuity of counsel and agency staff protects Lessees because it helps ensure that those with firsthand knowledge of the initial appeal are advising the agency on remand. Thus, requiring DNR to be advised on remand by an entirely new set of attorneys and staff who are unfamiliar with the case and did not participate in the appeal only adds expense and delay, without any offsetting due process value.

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[260] Adding procedures to preemptively eradicate any possibility of prejudgment on the part of agency staff does not comport with the rule that agency employees are presumed to be impartial. This Court has made clear that "agency personnel are presumed to be impartial until a party shows actual bias or prejudgment." *Gottstein v. State, Dep't of Natural Res.*, 223 P.3d 609, 628 (Alaska 2010).

4. The Burden of Implementing the Procedures Required by the Superior Court's Order Would Interfere with DNR's Ability to Fulfill its Constitutional Mandate and with the Attorney-Client Relationship Between DNR and its Attorneys

DNR is legally bound to manage Alaska's oil and gas resources to benefit all Alaskans.[261] As observed by this Court, "the legislature delegated to DNR much of its authority to ensure that such leasing of state land is consistent with the public interest."[262] DNR's mandate is to ensure that the business interests of the wealthiest and most sophisticated oil and gas companies in the world are harmonized with the public interest of Alaskans. Consistent with these principles, this Court has on several occasions affirmed DNR's administrative authority to adjudicate oil and gas leasing and unit disputes.[263] Likewise, the superior court rejected Lessees' arguments that DNR could not administratively terminate the Unit and that Commissioner Irwin could not act as the decision-maker on remand.[264]

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[261] *See* ALASKA CONST., art. VIII, § 1; AS 38.05.020; AS 38.05.180; AS 44.37.020.

[262] *Kachemak Bay Conservation Soc'y v. State, Dep't of Natural Res.*, 6 P.3d 270, 276 (Alaska 2000).

[263] *White v. State, Dep't of Natural Res.*, 14 P.3d 956, 960 (Alaska 2000) ("*White II*") ("[DNR's] regulations require oil and gas lessees to pursue all grievances through administrative remedies, making no exception for contract claims. The commissioner is the final administrative adjudicator of such grievances."); *Danco Exploration, Inc. v. State, Dep't of Natural Res.*, 924 P.2d 432, 434 (Alaska 1996) (challenges to DNR leasing decisions must be by appeal to the commissioner followed by appeal to the superior court); *Exxon Corp. v. State*, 40 P.3d 796, 798 (Alaska 2001) (DNR has discretion to administratively adjudicate whether unit should be expanded).

[264] Exc. 789 (citing 2007 Decision on Appeal at 20) ("DNR does have the authority to administratively adjudicate disputes related to the PTUA").

The superior court's misapplication of *Robson* is inconsistent with DNR's authority and places a heavy burden on DNR and other agencies that employ a similar model, including the Regulatory Commission of Alaska and the Alaska Oil and Gas Conservation Commission. The superior court's decision would alter how DNR (and all state administrative agencies) handle remanded administrative matters. Requiring an entirely new set of attorneys every time an agency decision is remanded would be extraordinarily costly, because the new lawyer team would have to start at ground zero to become familiar with the extensive administrative record. The court's decision thus means tremendous expense and delayed commencement of remand proceedings.[265]

In addition to disqualifying the most informed attorneys and staff members from assisting the commissioner, the superior court's decision interferes with the attorney-client relationship between the agency and its counselors.

Commissioner Irwin, with Ms. Thompson's assistance, conscientiously observed procedural safeguards to provide Lessees with a fair hearing on the proper remedy. The procedures were extensive and meticulous. When viewed in light of due process in the administrative context and DNR's paramount interest in administering oil and gas leases, it is clear that the procedures were sufficient to protect Lessees' interests.

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[265] *See, e.g.*, 2 RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 9.5 (5th ed. 2009) ("Formal procedural safeguards can impose even greater indirect costs on agencies, on society, and on the class of individuals that are the putative beneficiaries of the procedures.").

The superior court misapplied *Robson* to this case. Neither Ms. Thompson nor DNR's attorneys ever mixed prosecution-like advocacy and adjudicatory functions. The additional procedures required by the court's 2010 order add no additional safeguards and would create unworkable and expensive inefficiency for many agencies in Alaska. DNR afforded Lessees due process, and the superior court's decision to the contrary was error.

VII. CONCLUSION

DNR respectfully asks the Court to reverse the superior court's decision and hold that: (1) DNR was not required to hold a Section 21 proceeding on remand because rejection of a POD under Section 10 does not trigger Section 21 unless DNR specifically invokes this section; (2) as a matter of law, failure to submit an acceptable POD may constitute a material breach of the Unit Agreement; and (3) participation of DNR counsel in the remand proceedings and appointment of Ms. Thomson to conduct the hearing for Commissioner Irwin did not violate Lessees' due process rights.

DNR further requests that the Court remand this matter to the superior court with directions to resolve any issues remaining over termination of the Unit consistent with this Court's opinion.

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