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IN THE SUPREME COURT FOR THE STATE OF ALASKA

STATE OF ALASKA, DEPARTMENT OF NATURAL RESOURCES, Petitioner, vs. EXXONMOBIL CORPORATION, OPERATOR OF THE POINT THOMSON UNIT; BP EXPLORATION (ALASKA) INC.; CHEVRON U.S.A. INC.; CONOCOPHILLIPS ALASKA, INC., Respondents.	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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REPLY BRIEF OF PETITIONER 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

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INTRODUCTION

The superior court's Section 21 decision is contrary to the text of the Unit Agreement and unravels the "produce or return" bargain that underlies state oil and gas leases. It effectively shifts the obligation to develop such leases from Lessees to DNR, by making Lessees' responsibility to develop contingent on the state identifying specific development activities that pass muster under Section 21's standard.

The superior court held that, in the face of non-development and refusal to submit a POD that moves a unit towards production, DNR has no choice but to proceed to Section 21 (a provision with no textual link to Section 10), step into the shoes of the reluctant Lessees, formulate a development plan itself, and test it against engineering standards, disregarding the other regulatory criteria that guide consideration of PODs. This interpretation transforms state policy from one of requiring Lessees to submit acceptable PODs in order to preserve a unit and hold their leases beyond their primary terms, to one in which DNR has the untenable choice of either formulating a development plan itself and attempting to force it on the Lessees, or simply acceding to their refusal to develop.

Lessees fail to answer DNR's argument, based on the principles described above, that Section 21 is a *discretionary* power, and that it is contrary to the text of the Unit Agreement, Alaska oil and gas law, and public policy to *mandate* that DNR's only remedy, when it finds a POD inadequate for failure to propose any development, is to itself set rates of drilling and production under Section 21. Such a mandate renders

DNR's power to review and reject PODs under Section 10 meaningless and removes Lessees' incentives to work with DNR in formulating acceptable PODs. Because grafting Section 21 onto Section 10 upsets the balancing of the parties' rights and obligations under the Unit Agreement and unduly empowers Lessees, this Court should reverse the superior court's Section 21 decision.

The superior court also erred in extending this Court's decision in *In re Robson* by holding that counsel who represented DNR in the first appeal may not continue to advise the agency on remand. *Robson* articulated the simple proposition that agency personnel may not engage in both prosecutorial and adjudicatory functions, concluding that lawyers who appear before an agency decision-maker and then advise that same decision-maker violate this principle. But defending a decision on appeal is very different from appearing before a decision-maker and advocating for a certain outcome, and then advising that same decision-maker. *Robson* also passes no judgment on the appointment of Ms. Thomson as hearing officer, given that she never engaged in "advocacy" during the appeal. As used in *Robson*, "advocacy" is a term of art applying only to attorneys who appear and argue before a decision-maker. Expanding *Robson* to cover these situations would place a tremendous burden on DNR and all state agencies without any corresponding due process benefit.

Lessees' due process arguments reveal their underlying position: an independent decision-maker, not DNR, should have adjudicated this case on remand. But this Court has, on several occasions, confirmed DNR's authority to administratively adjudicate unit

termination and unit agreements generally.[1] That issue is not presently before this Court.

The Court should therefore reverse the superior court's decision and remand for further proceedings, including determination of what remedy is available to DNR when it rejects a proposed POD for failure to commit to development of a unit.

STATEMENT OF THE CASE

Lessees attempt to obfuscate several uncontested facts:

(1) Since the Unit was formed in 1977, no production has occurred from the Unit, despite its vast known liquid hydrocarbon reserves which could be shipped through the TAPS system;[2]

(2) Director Myers, in rejecting Lessees' 22nd POD, made clear that DNR was dissatisfied with how Lessees were proceeding with Unit development, gave Lessees the opportunity to submit a revised POD that committed to bring the Unit into production, and stated that failure to submit an acceptable POD would be grounds for default and termination of the Unit;[3]

(3) Lessees refused to address Director Myers's concerns and instead submitted a revised 22nd POD that steadfastly adhered to Lessees'

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[1] *See, e.g.*, *Danco Exploration, Inc. v. State, Dep't of Natural Res.*, 924 P.2d 432, 434 (Alaska 1996).

[2] Exc. 17, 375-76, 386-87.

[3] Exc. 374-96. Director Myers stated "[f]ailure to obtain approval of the unit plan is grounds for default under the Unit Agreement and the State oil and gas regulations. Effective October 1, 2005, the Unit Agreement is in default. Exxon has 90 days, until December 29, 2005 to cure the default by submitting a unit plan that commits to timely development and production of unitized substances." Exc. 375. He repeated "[t]he 22nd POD makes no commitment to timely develop and produce PTU oil, gas, or gas condensate. The 22nd POD is hereby denied. [. . .] Failure to obtain approval of the unit plan is grounds for default under the PTU Agreement and the State oil and gas regulations. The PTU Owners are hereby notified that effective October 1, 2005, the PTU Agreement is in default." Exc. 395. He went on, "[i]f the PTU Owners have been unable to identify a commercial project in nearly 30 years, it is time to terminate . . . ." Exc. 393. He reiterated that "[f]ailure to submit an acceptable plan of development is grounds for termination of the PTU." Exc. 396.

position that they would take no further steps to explore or develop the Unit until a gas line was constructed;[4]

(4) In response to Lessees' inadequate 22nd POD, DNR initially invoked Section 21 and gave notice that it would unilaterally impose a rate of prospecting and development;[5]

(5) DNR then decided not to invoke Section 21 and to delete the affirmative work orders directing that specific wells be placed into production and instead placed the Unit into default with notice that the Unit was subject to termination if Lessees did not cure by proposing a POD that committed to development;[6] and

(6) Less than two years after DNR's default and unit termination decision, Lessees submitted the 23rd POD, which, unlike the revised 22nd POD, proposed finally, after thirty years, to put the Unit into limited production.[7]

Lessees imply that DNR's development demands for the Unit were unreasonable.[8] But state oil and gas leases operate on a "produce or return" basis. There is nothing unreasonable about demanding that Lessees initiate some form of production if they wish to continue to retain their leases beyond their primary terms. In its decision rejecting the 22nd POD, DNR simply insisted Lessees begin development of reserves that had been known to exist for decades. And in rejecting the 23rd POD, the Commissioner noted that the proposed development might be a reasonable first step, but ultimately determined it

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[4] Exc. 412-28, 337-96. In the cover letter accompanying the revised 22nd POD, Lessees maintained that "an exploration/delineation well cannot be justified at this time, and the necessary well planning to safely and successfully drill an exploration/delineation well in the high pressure PTU formations has not been performed." Exc. 337.

[5] Exc. 351, 372.

[6] Exc. 374-96, 499-518, 519-31.

[7] Exc. 602-21.

[8] Lessees' Brief at 19-22.

was not in the public interest to accept the 23rd POD, in part because he did not find Lessees to be credible or reliable. Thus, there is no factual support for Lessees' suggestions that DNR was insisting on unreasonable development plans.

Lessees also assert that DNR has acted in a manner inconsistent with Unit termination because it has authorized drilling and development operations on two leases.[9] But DNR approved continued operations on lands that are part of the Unit based on the text of the individual leases applicable to that acreage, not the Unit Agreement.[10] Unit termination does not mean that all leases in the Unit immediately terminate. Rather, leases may continue beyond their primary terms if there are drilling operations.[11] DNR's decision to allow Lessees to drill on individual leases is fully consistent with its prior Unit decisions.

Overall, Lessees argue a different version of the unit history.[12] But ultimately the parties' differing views of this history are not directly relevant to the legal issues now

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[9] Lessees argue that "despite its purported termination of the PTUA, DNR has continued to approve extensive operations on the underlying leases in the PTU . . . ." Lessees' Brief at 4-5.

[10] *See, e.g.*, Exc. 1-9.

[11] *Id.*

[12] Lessees surprisingly try to rely on alleged statements that took place during negotiations for the failed gas line fiscal contract to argue that DNR was satisfied with the pace of development and should not have rejected the revised 22nd POD. The fact is the fiscal contract was never approved by the legislature. The fiscal contract negotiations represented an alternate way forward for Unit development, and once that process failed, Lessees could not reasonably continue to rely on the discussions surrounding this alternate development path. Indeed, nothing in the record indicates DNR told Lessees they would be absolved of their POD obligations under the Unit Agreement if the fiscal contract failed. To the contrary, DNR communicated to Lessees their obligations to submit a POD conforming to Director Myers's expectations. Exc. 334-36, 530. For

before the Court.[13] What is relevant is DNR's clear rejection of the 22nd POD—which the superior court found to be justified—and the events that followed. This Court must now decide what happens if DNR rejects a POD because it is dissatisfied with the lack of proposed development, particularly where the agency has struggled for decades to get Lessees to move the Unit towards production.

STANDARD OF REVIEW

DNR found on remand that application of Section 21 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."[14] This Court should apply the rational basis standard to this decision, which applies 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.[15]

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these reasons, the superior court expressly rejected Lessees' claims in the first appeal that the fiscal contract negotiations prevented DNR from rejecting the revised 22nd POD. Exc. 561-62.

[13] The overall chronology of events is relevant to the question of whether in light of this particular unit history, failure to submit an acceptable POD can constitute a material breach of the Unit Agreement justifying the remedy of unit termination. This Court has concluded that the material breach portion of the superior court's Section 21 ruling is not currently before this Court. *See State of Alaska, Dep't of Natural Res. v. ExxonMobil Corp., et al.*, No. S-13730 (Alaska June 24, 2011) (order striking portions of petitioner's opening brief.).

[14] Exc. 724-25.

[15] DNR Brief at 26; *Union Oil Co. of California v. State*, 804 P.2d 62, 64 (Alaska 1990).

Lessees argue "[n]o legal precedent allows one party, even the State, to demand that a court defer to its interpretation of a contract in a dispute concerning that contract."[16] But the Unit Agreement is not a typical "contract." Rather, it is an agreement executed by Lessees and approved by DNR if the agency finds unitization to be in the public interest.[17] DNR is not a signatory to the Unit Agreement, it is the regulatory agency that approves formation of a unit based on a unit agreement proposed by the Lessees, under the DNR regulations applicable to unit formation.[18] Further, unit agreements incorporate statutes and regulations, including DNR's mandate to manage state lands in the public interest.[19]

Lessees cite *Exxon Corp. v. State* for the proposition that interpretation of a contract is generally reviewed *de novo*.[20] But the *Exxon* court explained that when the trier of fact must determine the meaning of a unit agreement based on extrinsic evidence—including departmental regulations—that raises conflicting inferences, the Court reviews the trier of fact's conclusion to determine whether it is supported by substantial evidence.[21] There, the Court determined that DNR's decision to consider the

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16 Lessees' Brief at 33.

17 *See* 11 AAC 83.303, .306.

18 *ConocoPhillips Alaska, Inc. v. State, Dep't. of Natural Res.*, 109 P.3d 914, 917 n.16 (Alaska 2005) ("Unit agreements and participating areas are organizational schemes approved by the Department of Natural Resources to efficiently extract oil from a common reservoir that is the subject of multiple leases." (citing 11 AAC 83.303)).

19 Exc. 149.

20 Lessees' Brief at 32 n.143; 40 P.3d 786, 792 (Alaska 2001).

21 *Id.* at 792, 797.

state's best interests was supported by substantial evidence.[22] Similarly, *ConocoPhillips Alaska Inc., et al. v. State, Dep't. of Natural Resources* involved an oil and gas lease agreement, but the Court gave deference to the agency's interpretation of a lease provision that turned on application of regulations involving DNR's expertise.[23] And in *Usibelli Coal Mine, Inc. v. State of Alaska, Dep't of Natural Resources*, this Court held that in the context of a contract dispute, DNR's interpretation of non-competitive coal leases was entitled to deference.[24]

The rationale of these cases applies here. The Unit Agreement and DNR regulations give DNR the discretion to review PODs on a case-by-case basis to determine if they are in the public interest.[25] The Commissioner properly considered extrinsic evidence when he considered DNR's regulations and the public interest in interpreting the Unit Agreement. His decision that it would be contrary to public policy to apply Section 21 on remand was a discretionary decision regarding implementation of the Unit Agreement and involving interpretation of DNR regulations addressing PODs and the public interest incorporated into the Unit Agreement. This determination is thus entitled to deference.

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[22] *Id.* at 797.

[23] *ConocoPhillips Alaska Inc.*, *supra* n.18 at 919-920.

[24] 921 P.2d 1134, 1146 (Alaska 1996). Just prior to this filing, the Court reaffirmed that when interpretation of a unit agreement requires the application and interpretation of DNR regulations, the Commissioner's interpretation is reviewed under the deferential "reasonable basis standard." *Alaskan Crude Corp. v. State, Dep't of Natural Res.*, No. 6606, slip op. at 13-14 (Alaska October 7, 2011).

[25] AS 38.05.180(p); 11 AAC 83.343(b); Exc. 156.

ARGUMENT

I. DNR CORRECTLY CONCLUDED IT WAS NOT REQUIRED TO INVOKE SECTION 21 ON REMAND.

Lessees assert that "if DNR is not satisfied with the rate of development and production in a proposed POD and cannot obtain the WIOs' agreement to submit a modified or replacement POD that DNR is willing to approve, DNR may impose its preferred rates unilaterally only if it complies with Section 21."[26] DNR agrees that it cannot unilaterally order a specific rate of prospecting and development without first invoking Section 21 and applying its accompanying procedures. But here, DNR never attempted to set one.

Lessees' argument and the superior court's decision hinge on the assumption that rejecting a POD under Section 10 for reasons relating to development is functionally the same as invoking Section 21 and unilaterally imposing a specific rate of development. Lessees contend that in rejecting the proposed 22nd and 23rd PODs, DNR effectively or implicitly invoked Section 21 because DNR desired a higher rate of development than Lessees proposed in either POD.[27] But this indiscriminate mixing of Sections 10 and 21 and two entirely different remedies is contrary to the text of the Unit Agreement, Alaska oil and gas law, and public policy. Moreover, review of the record and the parties' past conduct reveals they have never considered rejection of a POD, by itself, to implicate Section 21.

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[26] Lessees' Brief at 38.

[27] Lessees' Brief at 37.

A. The Unit Agreement Does Not Require DNR To Invoke Section 21 Whenever it Rejects a POD Because it Wants Development.

1. Linking Sections 10 and 21 is contrary to the text of the Unit Agreement.

Nothing in the text of the Unit Agreement suggests the close link between Sections 10 and 21 found by the superior court. Section 10 gives DNR complete authority to determine whether a proposed POD is acceptable under Section 10's standards. It says nothing of requiring DNR to set a rate of development or production. And for its part, Section 21 requires DNR to follow certain procedures if it chooses to unilaterally impose a rate of prospecting and development, but it does not provide that DNR must impose such a rate whenever it rejects a POD under Section 10. Such a requirement would take away DNR's broad right under Section 10 to require a POD that is "as complete and adequate as the Director may determine to be necessary for timely development and proper conservation . . . ."[28] Injecting Section 21 into Section 10 reads all power out of Section 10, contrary to principles of contract interpretation.[29]

Nowhere does Section 10 say that it is a precursor to a Section 21 proceeding.[30] Sections 10 and 21 do not reference each other at all. And Section 10 does not provide that the POD review process is so limited that, while the agency perhaps can make

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[28] Exc. 156.

[29] *See Modern Constr., Inc. v. Barce, Inc.*, 556 P.2d 528, 530 (Alaska 1976) ("The court will if possible give effect to all parts of the instrument and an interpretation which gives reasonable meaning to all its provisions will be preferred to one which leaves a portion of the writing useless or inapplicable.").

[30] Indeed, 10 sections of the Unit Agreement separate the two provisions. Exc. 156-66.

suggestions, it cannot reject a POD without itself setting a replacement rate of development. Instead, Section 10 gives DNR unqualified authority to measure a proposed POD against its standards and to reject an inadequate or incomplete POD.

Lessees try to circumvent Section 10's broad grant of authority by reading its other provisions out of context. First, Lessees fall back on the Reasonably Prudent Operator Standard (RPO) argument they lost below.[31] Lessees previously argued that, as long as a proposed POD met the RPO standard, DNR was required to accept it. The superior court rejected this position, correctly holding that the RPO standard is a covenant by Lessees, not the standard by which DNR reviews PODs.[32] Lessees did not appeal that holding and it is not properly before this Court. Lessees revive their RPO argument by contending that DNR's ability to reject a POD without reference to the RPO standard must be tempered by requiring DNR to proceed to Section 21 upon rejection.[33] They provide no textual support or even logical link to suggest that because DNR need not consider the RPO standard in evaluating PODs, it must itself set a new level of activity and turn to Section 21 if it rejects an inadequate POD.[34]

Lessees also argue that DNR may not reject a POD without invoking Section 21 because Section 10 says an approved POD "shall be modified or supplemented when

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[31] Lessees' Brief at 40-42.

[32] Exc. 555-558.

[33] Lessees' Brief at 40-41.

[34] The superior court's ruling provides no support for this proposition. Rather, the superior court stated that "when Section 10 is interpreted in that manner, it cannot be the basis for establishing a material breach of the PTUA by the Appellants." Exc. 782. The superior court did not premise its Section 21 holding on the RPO standard.

necessary . . . to protect the interests of all parties to this agreement."[35] But this "protection of the parties" language applies to modification or supplementation of *approved* PODs, not the standards by which DNR considers *proposed* PODs.[36] There is no reason to think that because Section 10 places limitations on altering approved PODs, "[i]t follows that if DNR and the WIOs cannot agree to a POD containing a mutually acceptable rate of development and production . . . DNR must invoke the procedures and satisfy the conditions established in Section 21 . . . ."[37] More fundamentally, Lessees disregard that there are regulatory standards for POD evaluation, and that POD decisions are subject to judicial review.[38] These standards and procedures protect the Lessees' interests.

Lessees argue that Section 21 would have "no function" and that its protections would be "meaningless" unless DNR is required to invoke Section 21 upon rejecting a POD for lack of development.[39] This is simply untrue. The "function" of Section 21 is to allow DNR, should it so choose, to unilaterally impose a specific rate of prospecting and development on Lessees and require them to carry it out if the agency believes that is the best way to develop the Unit. That is a very important function, but it was not intended to be DNR's only remedy upon rejection of a POD.

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35 Lessees' Brief at 41; Exc. 157.

36 Lessees address an argument in their brief that the superior court rejected and DNR did not pursue either in the remand appeal or in its briefing to this Court—that Section 21 does not apply when there is no approved POD. Exc. 779-82; Lessees' Brief at 42.

37 Lessees' Brief at 41-42.

38 11 AAC 83.343(b); 11 AAC 02.010.

39 Lessees' Brief at 40.

2. Linking Sections 10 and 21 is not necessary to protect Lessees' rights and would unduly restrict DNR's remedies.

Lessees argue that where DNR rejects a POD, DNR cannot terminate the Unit, and that Section 21 is the only provision protecting their rights.[40] But if DNR chooses to default Lessees and seek Unit termination, Lessees' rights are still protected, as the present case indicates. Lessees are free to appeal DNR's default decision, argue that DNR should not have rejected the proposed POD and that, regardless, the circumstances do not justify termination.

Preserving DNR's Section 10 powers and remedies does not permit the agency to skirt the requirements of Section 21, or grant it unfettered authority. DNR's POD decisions must be consistent with regulatory criteria and are subject to agency and judicial review. DNR is not contending that it has *carte blanche* to seek Unit termination whenever it rejects a POD. Rather, DNR is arguing that the text of the Unit Agreement and public policy both dictate that the agency retain the option of default, and in appropriate circumstances, unit termination.

Lessees have argued throughout this case that DNR is obligated to work collaboratively with Lessees in the POD process to reach a "mutually acceptable rate of development and production."[41] But if this Court holds that DNR's only remedy in

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[40] *See, e.g.*, Lessees' Brief at 34, 41-42. Lessees make this argument despite having successfully asked this Court to strike the portions of DNR's brief addressing this issue, which serves to emphasize just how integral the issue is to resolution of issues before the Court. DNR recognizes that the issue of material default is not before the Court, but the agency addresses Lessees' arguments here in the context of DNR's argument regarding its management of state lands under the Unit Agreement.

[41] *See, e.g.*, Lessees' Brief at 11, 41-42.

rejecting a POD when it wants more development would be to invoke Section 21, Lessees would have little incentive to work with DNR during the POD process. Rather, Lessees could present PODs on a "take it or leave it" basis, knowing that DNR's rejection of a POD would require the agency to initiate a lengthy and costly Section 21 proceeding.[42]

DNR must comply with Section 21 when it seeks to unilaterally impose a specific rate of development. For example, if DNR repeatedly rejected a POD because it did not adhere to a DNR demand to drill a specific number of wells and produce a specified quantity of oil and gas, this might implicate Section 21. But that is not what happened here. Instead, in rejecting the 22nd POD, DNR simply asked for a POD that committed to *something*, without specifying what. Lessees refused, and DNR sought termination in light of Lessees' failure to commence production after 30 years of unitization. And DNR terminated the Unit again in 2008 because the Commissioner concluded it was not in the public interest to accept the 23rd POD, in part because he was not persuaded that Lessees

[42] Lessees make the surprising assertion that if DNR had invoked Section 21, all that was required was a hearing and that this case would likely be over by now. Lessees' Brief at 57. Lessees' characterization of what Section 21 involves indicates otherwise:

> All DNR must do in a Section 21 hearing is explain the rate of development or production it seeks to require the WIOs to meet and be prepared to demonstrate that this rate promotes the conservation objectives of the agreement, does not exceed what is required by good and diligent oil and gas engineering and production practices, and does not prevent the PTUA from "serving its purpose of adequately protecting all parties in interest."

Lessees' Brief at 56. Putting aside that Section 21 does not say anything about DNR bearing the burden with respect to the standards and only requires notice and a hearing, Lessees' statement indicates their view that a Section 21 proceeding would be a long and complex affair.

would follow through with 23rd POD or develop the Unit. Neither decision was the functional equivalent of unilaterally imposing a specific rate of development.

B. Superimposing Section 10 on Section 21 Is Contrary to Alaska Oil and Gas Law and Public Policy.

It is critical to DNR's ability to manage the state's oil and gas resources that it retain options other than invoking Section 21, including unit termination, in the face of recalcitrant lessees who refuse to submit an acceptable POD and develop unitized properties.[43]

The state's paramount interest in leasing its land is to secure timely production of its natural resources.[44] To ensure timely production, the Alaska Lands Act, DNR regulations, and the state's oil and gas leases mandate that a lease terminates by operation of law if the primary term has expired and the lessee has failed to produce oil or gas; assuming no other conditions extending the lease apply.[45] This is known as a habendum clause. The policy of the state, which is embedded in the habendum clauses to which lessees consent, provides a critical safeguard against speculators who do not produce hydrocarbons.[46] It is a cardinal principle of oil and gas leasing that "lessors should not be

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[43] DNR Brief at 30-32.

[44] AS 38.05.180(a); 3 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 604 at 46 (2008) ("The primary purpose of the lease clearly is to obtain production.").

[45] Exc. 1, 6; AS 38.05.180(m); 11 AAC 83.125-.140, .180.

[46] Courts in other states have affirmatively recognized this as a sound public policy. *See, e.g.*, *McCullough Oil, Inc. v. Rezek*, 346 S.E.2d 788, 797 (W. Va. 1986).

required to suffer a continuation of the lease after the expiration of the primary period merely for speculation purposes on the part of the lessees."[47]

Alaska's oil and gas leases include "savings clauses" that serve to extend the life of a non-producing lease beyond the primary term in certain circumstances.[48] Unitization is one.[49] When DNR authorizes the extension of non-producing leases beyond their primary term through unitization, the expectation is that production will occur within five years.[50]

Here, the parties agreed to amend the Unit Agreement's five-year term in order to provide Lessees extra time to put the field into production.[51] Extending the term, however, was not intended to allow a non-producing unit, containing over 40 non-producing leases well beyond their primary terms, to stay in force in perpetuity without production.[52] Moreover, there is nothing in the record to support that these amendments were meant to allow Lessees to hold valuable acreage without production unless DNR invoked Section 21, formulated its own plan of development, and had it established that Section 21's "good and diligent oil and gas engineering practices" standard justified that Lessees finally initiate production. Yet Lessees' interpretation of Section 21 leads to this exact result.

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47 *Garcia v. King*, 164 S.W.2d 509, 513 (Tex. 1942).

48 *See* AS 38.05.180(m); 11 AAC 83.125-.140, .190; Exc. 1-2, 6-7.

49 11 AAC 83.190.

50 11 AAC 83.336; Exc. 52.

51 R. 9448, 9452.

52 Exc. 376-79.

The present case illustrates the importance of preserving DNR's remedies under a robust Section 10 review process. Prior to DNR's rejecting the 22nd POD and placing the Unit into default, decades had passed with no development of known reserves. Yet less than two years after DNR first sought to terminate the Unit as a result of this default, Lessees, for the first time, submitted a development plan that offered to finally place the Unit into initial production and conduct additional exploration drilling. And less than four years after the termination decision, PTU 15, the first well in over 29 years, was drilled at Point Thomson.[53]

C. The Record and the Parties' Past Conduct Reveal that Rejecting a POD Under Section 10 Is Not Equivalent to Invoking Section 21.

1. DNR did not invoke Section 21 in rejecting the 22nd or 23rd PODs.

Lessees rely extensively on Director Myers's original 2005 decision in which DNR invoked Section 21 and ordered a particular rate of development for the 22nd POD. Lessees argue that this decision indicates DNR knew Section 21 was its only option in rejecting the POD.[54] To the contrary, this decision and the amended decision that followed demonstrate that DNR knew the difference between invoking Section 21 if DNR was going to itself set a rate of development, and rejecting a POD.

Director Myers's original decision illustrates what a DNR decision invoking Section 21 looks like:

> This decision provides notice under Article 21 of the PTU Agreement that Exxon must initiate development operations within the PTU by October 1,

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[53] Exc. 108-09, 724; R. 37.

[54] Lessees' Brief at 50.

> 2007. The Division will contact Exxon to schedule a hearing on this issue, which will be held not less than 30 days from the date of this decision.[55]

DNR could have continued down the Section 21 path and ordered Lessees to undertake specific development operations, as explained in the original 2005 decision. But DNR decided against itself ordering a specific rate, opting instead to issue an amended decision defaulting the Unit and deleting the affirmative work orders to place specific wells into production. Nothing cited by Lessees prohibits the agency from changing its mind. Nor is the fact that DNR changed its mind evidence that Section 21 was DNR's only remedy.

Lessees attempt to portray DNR's rejection of the 22nd and 23rd PODs as an attempt by DNR to "force an increase in the rate of development and production [at Point Thomson.]"[56] Lessees are correct that in rejecting the 22nd POD, DNR was clear that it wanted them to make a commitment to develop and produce from the Unit and *any* development would constitute a greater rate than what was proposed in the 22nd POD (which was nothing). But this demand does not, by itself, implicate Section 21. The Director's decision rejecting the 22nd POD gave Lessees example start dates but did not order specified rates of development.[57] Instead, the decision demanded that Lessees submit a plan by December 29, 2005, meaning Lessees themselves would have proposed rates of development.[58] Had DNR wanted to "modify" or "alter" a rate as contemplated

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[55] Exc. 351.

[56] Lessees' Brief at 37.

[57] Exc. 395-96.

[58] *Id.*

in Section 21, it could only have done so after receiving Lessees' plan. Lessees, however, refused to submit such a plan.

Lessees nonetheless argue that DNR's demand—that Lessees move from no development to at least some development—constitutes altering a rate as contemplated by Section 21.[59] But as DNR explained in its opening brief, "zero" is not a rate of development.[60] And demanding that Lessees do something, anything, more than nothing, is not equivalent to imposing a specific rate.

Holding that DNR's ability to require *any* development or production that is more than nothing is always conditioned by Section 21 would render the specific core provisions of Section 10 meaningless. Section 10 mandates a variety of specific provisions in "any plan" of development, including exploration of the area and enough development drilling to determine the area capable of producing in "every producing formation."[61] And plans must specify the number of wells to be drilled and their locations.[62] Thus, Section 10 imposes requirements for every plan without any qualification as to whether exploration and development is consistent with whatever Lessees think comports with Section 21's "good and diligent engineering practices."

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[59] Lessees' Brief at 44-47.

[60] DNR Brief at 47-51.

[61] Specifically, Section 10 states that "any" plan:

> <u>Shall</u> provide for the exploration of the unitized area and for the diligent drilling necessary for determination of the area of areas thereof capable of producing unitized substances in paying quantities <u>in each and every productive formation</u> . . . .

Exc. 156.

[62] *Id.*

Should the Director determine that the optimal path for the state is to not only reject a POD, but also, in addition, itself set a rate of development or production, in essence establishing its own plan, then Section 21 naturally applies. But the Director is empowered by Section 10 to determine the completeness of a POD and reject incomplete PODs, for instance one that does not provide drilling into all productive areas. When the 22nd POD did not provide for development, DNR acted within the powers and discretion granted by Section 10 in rejecting it. Rejecting a plan because it did not comply with the requirements of Section 10 cannot, by itself, implicate Section 21.

Lessees' argument that DNR's decision rejecting the 23rd POD set or modified a rate is entirely contrary to the record. That decision made clear that Commissioner Irwin was generally receptive to the rate of development proposed, but after applying the multiple factors set forth at 11 AAC 83.303, did not find accepting the 23rd POD to be in the public interest, in part, because he was skeptical of whether these particular Lessees would follow through on the POD's commitments.[63] His order addressed 11 AAC 83.303 for 45 pages, repeatedly discussing his concern over credibility, and including such issues as Lessees' failure to undertake studies they themselves had portrayed as necessary to present a credible plan of development, the fact that the plan was for too

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[63] Commissioner Irwin stated:

> The Plan describes how Appellants intend to test the reservoir and construct an initial production facility between now and 2014. Despite the fact that the plan may present a technically reasonable first step for developing these lands from a conservation perspective, it is an inappropriate remedy because I find no basis in this record to conclude that I can be assured that it will be completed as promised . . . .

Exc. 691.

long a term, the lack of meaningful benchmarks, and an entirely unacceptable proposed judgment that would require DNR to let the court take over DNR's Section 10 powers.[64]

2. <u>The parties' past conduct confirms that rejection of a POD under Section 10 does not require DNR to invoke Section 21.</u>

DNR rejected several prior PODs over the course of the unit's history and Lessees never argued that a Section 21 proceeding was necessary, let alone was mandatory, until the present dispute.[65] Lessees' only response is that Section 21 "operates as a last resort which may never need to be invoked," and that is why Lessees never referenced it in prior POD disputes.[66] But Lessees are arguing that DNR has *no choice* but to invoke Section 21 if it is dissatisfied with the rate of development in a proposed POD. If they truly believed this, Lessees would have reminded DNR of their belief every time there was a POD dispute in order to try and convince DNR to accept whatever rate they were proposing. Lessees' past silence on Section 21 in the face of prior POD rejections indicates that, until this dispute, Lessees understood that DNR had discretion to reject PODs without invoking Section 21.

D. This Court Should Remand With Instructions that Rejection of PODs Does Not Require DNR to Invoke Section 21.

DNR asks this Court to reverse the superior court's holding that DNR is required to invoke Section 21 every time it rejects a POD under Section 10 based on the rate of prospecting and development. The text of Section 10 does not support this conclusion.

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[64] Exc. 695-734, 737-61.

[65] DNR Brief at 52-53.

[66] Lessees' Brief at 47-49.

The text of Section 21 does not support this conclusion. Alaska oil and gas law and public policy argue against this conclusion. Rather, there are other options available when DNR rejects a POD. What these other options may be, however, is not before this Court. DNR thus respectfully requests that this Court reverse and remand for further proceedings.[67]

II. DNR'S CONSULTATION WITH COUNSEL AND APPOINTMENT OF A DNR EMPLOYEE AS HEARING OFFICER DID NOT VIOLATE LESSEES' DUE PROCESS RIGHTS.

A. DNR's Consultation with Counsel Who Handled the First Appeal in the Superior Court Did Not Violate Due Process.

1. *Robson* does not prohibit agency consultation with appellate counsel on remand.

In re Robson states that agency personnel may not engage in both prosecutorial and adjudicative roles and holds that agency attorneys who argue before an agency and then advise the agency's decision-maker violate this rule.[68] *Robson* does not prohibit agency decision-makers on remand from consulting with attorneys who represented the agency on appeal.[69] Lessees argue that there is no distinction between an initial proceeding and an appeal, and an attorney who participates in "any advocacy capacity," including defending the agency on appeal, must not subsequently advise the decision-

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[67] In the event of a remand from this Court, DNR may request that the superior court revisit its conclusion that rejection of a POD cannot constitute a material breach of the Unit Agreement, in part, because this holding was premised on the superior court's belief that Section 21 was DNR's exclusive remedy when it rejects a POD.

[68] 575 P.2d 771 (Alaska 1978).

[69] *Id.*; DNR Brief at 67-69.

maker on remand.[70] Lessees thus ask this Court to drastically expand *Robson*. The Court should decline to do so.

Robson involved one adversarial proceeding before one decisional body, not an administrative proceeding, appeal to an entirely different decisional body, and remand. *Robson*'s due process holding applies only to the type of situation actually addressed in *Robson*. It means that attorneys advocating for a result in a representative capacity *before a decision-maker* may not advise that same decision-maker.[71] But that situation is meaningfully distinct from what happened here. At no point did DNR counsel present and argue a case before the DNR Commissioner and then advise him in making his decision. Thus, the conduct of DNR's counsel bore no resemblance to the conduct that this Court disapproved in *Robson*.

Lessees cite numerous cases arguing that *Robson* is not an outlier, and DNR agrees. DNR does not dispute that it violates due process for agency personnel to litigate a matter before an agency decision-maker and then advise that same decision-maker regarding the proper disposition of the case they just argued, and thus it is not surprising that other courts have reached the same conclusion as *Robson*. Indeed, all of the cases cited by Lessees involve variations on this fact pattern and do not involve the

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[70] Lessees' Brief at 61-62.

[71] Lessees assert that *Robson* provides that agency personnel "who have been in an adversarial relation with a party" may not be present during the agency's adjudicatory decision-making. Lessees' Brief at 60. *Robson* makes no reference to the general notion of an "adversarial relation." Rather, the Court specifically addresses agency personnel who appeared *before the agency* in a contested adversary proceeding and then are present during agency decision-making in the same case.

circumstances here—agency personnel who only acted as appellate lawyers for the agency and never litigated or otherwise appeared before the agency.[72]

While *Robson* is consistent with case law from other jurisdictions, expanding *Robson* to apply to attorneys who defend agency decisions on appeal would be a departure from this case law. One case cited by Lessees, for example, analyzes participation on appeal by agency personnel and concludes such participation does *not* raise Constitutional concerns. In *Botsko v. Davenport Civil Rights Commission*, the court held, as in *Robson*, that the appearance of an agency executive director as an advocate *before the agency* precluded the director's participation in the agency's decision-making.[73] But the court also addressed the executive director's participation on appeal

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[72] Specifically, *Davenport Pastures, LP v. Morris Cnty Bd. of Comm'rs*, 238 P.3d 731, 740-42 (Kansas 2010) involved an attorney who presented a case before the agency, including making arguments and cross-examining witnesses, who in turn was present during agency deliberations as the agency attorney. In *Grolier, Inc. v. FTC*, 615 F.2d 1215, 1221 (9th Cir. 1980), the court noted that an ALJ who had previously been an attorney-advisor for the FTC may be precluded from hearing a matter if the ALJ had been involved with, or had knowledge of, the investigation dating back to the ALJ's time as attorney-advisor. Finally, in *Wong Yang Sung v. McGrath*, 339 U.S. 33, 45-46 (1950) (*superseded by statute on other grounds as stated in Ardestani v. INS*, 502 U.S. 129 (1991)), the United States Supreme Court, in concluding the Administrative Procedures Act (APA) applied to deportation proceedings, held that the practice of having one individual perform the roles of immigration inspector and adjudicator, albeit in different matters, violated the APA where "the inspector's duties include investigation of like cases; and while he is today hearing cases investigated by a colleague, tomorrow his investigation of a case may be heard before the inspector whose case he passes on today."

[73] 774 N.W.2d 841, 843 (Iowa 2009).

and concluded that "post-decision defense of agency action does not inject unacceptable risks of bias into the agency determination."[74] The court noted:

> [T]he involvement of agency staff in judicial proceedings after the agency has reached a final decision is not generally regarded as raising procedural due process problems. In this setting, the advocate is defending a final agency action that is unlikely to produce the same psychological commitment as when an agency staffer seeks to persuade the agency on the merits.[75]

Likewise, here, DNR counsel never sought to persuade the agency to make any particular decision.

2. Agency attorneys who defend agency decisions on appeal do not impermissibly serve dual roles when advising the agency on remand.

Lessees argue that defending a decision on appeal and then advising the agency on remand violates the general principle that agencies should not combine prosecutorial and adjudicatory functions in the same personnel.[76] But attorneys who represent agencies on appeal are only defending the agency's decision. They are not performing a prosecutorial function and trying to argue for a certain outcome other than to have the agency decision upheld. Indeed, the agency has already made its factual findings and decision, and the record already exists.

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[74] *Id.*

[75] *Id.* at 852 (citing Michael Asimow, *When the Curtain Falls: Separation of Functions in the Federal Administrative Agencies*, 81 COLUM. L.REV. 759, 777 (1981); *Ceres Marine Terminal, Inc. v. Md. Port Admin.*, No. 94-01, 1999 WL 287321, *6-*12 (F.M.C. April 16, 1999)).

[76] Lessees' Brief at 61-63. *Cf.* Asimow, *supra* note 75 at 779-82.

Lessees nonetheless argue that DNR's attorneys acted in a prosecutorial manner on appeal because they made factual arguments in their briefing.[77] Lessees again conflate appellate advocacy with advocacy before the agency decision-maker. DNR's lawyers were arguing facts from the record to support the agency's initial termination decision. This is not the same as trying to establish particular facts before a fact finder in the first instance, as a prosecutor does, to advocate for a certain outcome. DNR's lawyers were not trying to persuade the DNR Commissioner—that decision was already made. On remand, DNR's lawyers likewise did not make arguments or otherwise engage in advocacy to persuade the DNR Commissioner.

DNR counsel has never been responsible for "advocacy" to the agency regarding whether termination was proper. To the extent Lessees contend that the arguments DNR's lawyers made on appeal rendered them biased on remand, Lessees miss the point: on appeal DNR's lawyers *were speaking for the agency.* Lessees' argument thus proves too much because it implies that no agency decision-maker can engage in decision-making on remand.

Because agency appellate counsel are not serving a "prosecutorial" function, prohibiting them from advising an agency on remand would add no significant protections for Lessees. Such a prohibition would require DNR and other agencies to employ new staff and counsel every time a case is remanded. This would deprive agencies of the assistance of counsel and staff most familiar with the case, and would

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[77] Lessees' Brief at 62.

represent a significant expense.[78] It would also slow down remand proceedings, as new attorneys and staff would have to become conversant with complicated administrative records. Such delay would not be protective of Lessees' rights.

B. DNR's Appointment of Ms. Thompson as Hearing Officer Did Not Violate *Robson.*

Robson does not apply to Ms. Thompson's role as hearing officer on remand for two reasons—she was not a substantive decision-maker and her presence at counsel table as a client representative during the first appeal did not render her an "advocate."[79] Lessees claim Ms. Thompson engaged in "advocacy" because she expressed views regarding Lessees in various internal DNR e-mails in her capacity as Unit manager.[80] But the term "advocate" as used in *Robson* referred to attorneys who appear before a decision-maker in a representative capacity and argue for a certain result. Applying *Robson* to Ms. Thompson would require the Court to dramatically expand who is considered an "advocate."[81]

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[78] DNR Brief at 80. *See Botsko*, 774 N.W.2d at 851 ("'Agency technical staff is a limited and valuable resource' that should be available as a source of expertise to agency decisionmakers.") (quoting Asimow, *supra* note 75 at 776).

[79] DNR's attorneys introduced Ms. Thompson to the court. April 17, 2007 Tr. at 3, line 7-9. She never addressed the court.

[80] Lessees' Brief at 64-65.

[81] Lessees also argue that Ms. Thompson engaged in adjudication because she asked numerous questions of Lessees at the remand proceeding that Lessees apparently perceived as hostile or going to the substance of the Commissioner's decision. Lessees' Brief at 66-67. Lessees disregard that Ms. Thompson was only asking these questions to aid the Commissioner and was not the actual decision-maker.

Further, the e-mails cited by Lessees do not establish that Ms. Thompson was advocating against Lessees to DNR.[82] Rather, the e-mails show that Ms. Thompson was the employee charged with implementing DNR's policies regarding Point Thomson. This is well-illustrated by the history of permitting issues: when DNR's position was that Lessees did not have valid leases and should not be given permits,[83] Ms. Thompson abided by this directive.[84] When DNR issued its lease decision authorizing operations on the leases, thus determining that Lessees were entitled to permits, Ms. Thompson again followed this directive, and the permits were issued.[85] Further, as Lessees themselves note, Ms. Thompson was also the hearing officer at the DNR proceedings that resulted in DNR's decision to grant the permits.[86]

C. Lessees' Arguments Regarding DNR Counsel and Ms. Thompson are an Indirect Assault on DNR's Authority to Administratively Adjudicate Unit Termination.

At the root of Lessees' due process arguments is the concept that DNR should not be permitted to adjudicate disputes regarding contracts to which it is a party. For example, Lessees contend they asked for additional procedural protections because "DNR, in its regulatory capacity, was adjudicating whether DNR, in its proprietary

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82 Lessees' Brief at 65; Exc. 1053, 1063.

83 *See, e.g., Exxon Mobil Corp., Working Interest Owner and Operator of the Point Thomson Unit v. State, Dep't of Natural Res.*, 3AN-08-10825 CI.

84 All of the e-mails cited by Lessees date from when DNR's policy was that Lessees were not entitled to their requested permits. Lessees' Brief at 65; Exc. 762, 1053, 1063.

85 Exc. 762-64. Lessees do not include any DNR e-mails regarding the grant of these permits.

86 Lessees' Brief at 66 n.240.

capacity, had a contractual right" to termination.[87] Similarly, Lessees argue that they asked for an independent hearing officer to avoid the "conflict of interest inherent in allowing the decision as to the PTUA's future to be made by the agency that most stood to benefit if the Unit were terminated."[88] And Lessees argue that the remand proceedings were "inherently adversarial" because DNR had a proprietary interest in the issues it was adjudicating.[89] These arguments reveal that Lessees, in challenging the involvement of DNR counsel and Ms. Thompson, are in reality challenging DNR's ability to have adjudicated the remand proceeding at all. But this Court has on several occasions affirmed DNR's authority to adjudicate oil and gas leasing and unitization matters.[90] Recognizing this, the superior court properly held that DNR had the authority to administratively terminate the Unit.[91] Lessees have not appealed this issue, and the matter is not properly before this Court.

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87 Lessees' Brief at 58. Elsewhere in their brief, Lessees state "both the first appeal and the remand hearing were inherently adversarial because termination of the PTUA was the ultimate issue, and DNR in its proprietary capacity was a party to that contract." *Id.* at 67.

88 Lessees' Brief at 25.

89 Lessees' Brief at 69.

90 *See, e.g., White v. State, Dep't of Natural Res.*, 14 P.3d 956, 960 (Alaska 2000); *Danco Exploration, Inc. v. State, Dep't of Natural Res.*, 924 P.2d 432, 434 (Alaska 1996). Lessees argue that these cases do not establish how DNR should procedurally adjudicate these issues. Lessees' Brief at 70 n.250. While these cases do not address specific procedures, they do state that the *Commissioner*, not an independent decision-maker, is the final adjudicator of oil and gas leasing disputes. For this Court's decisions affirming DNR's power to adjudicate these issues administratively to have any meaning, DNR must, in fact, be allowed to be the adjudicator.

91 Exc. 567.

CONCLUSION

DNR respectfully requests that this Court reverse the superior court and affirm DNR's decision not to apply Section 21 in rejecting the 22nd POD and the proposed remedy of the 23rd POD, hold that when DNR rejects a POD because it generally wants development it need not invoke Section 21, and remand for further proceedings, including determining what other remedies are available to DNR when it rejects a POD. DNR also respectfully requests that the Court reverse the superior court's decision on due process and hold that allowing appellate counsel to advise the Commissioner on remand, and allowing a DNR employee to act as hearing officer, did not violate due process.

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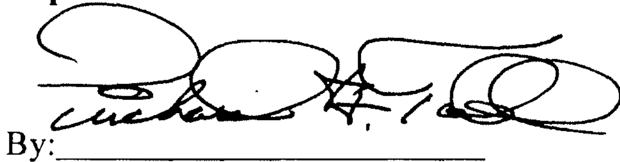

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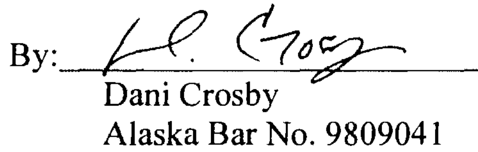

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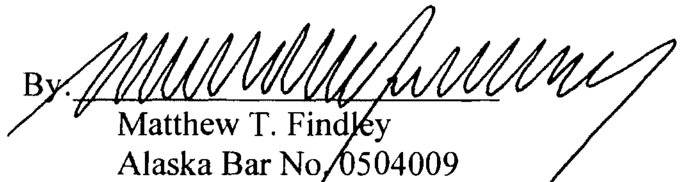

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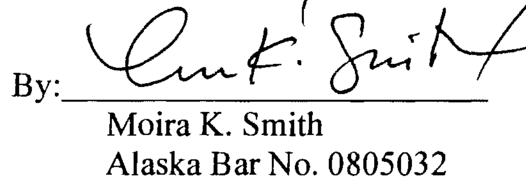

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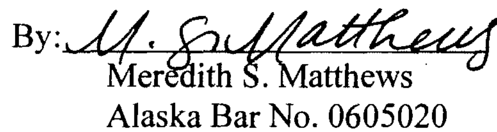

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