

# STATE OF ALASKA

## DEPARTMENT OF NATURAL RESOURCES

### OFFICE OF THE COMMISSIONER

OUTGOING

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January 3, 2008

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Susan Orlansky  
Feldman, Orlansky & Sanders  
Attorney for BP Exploration (Alaska) Inc.  
500 L Street, Suite 400  
Anchorage, AK 99501

Dear Mr. Serdahely, Mr. Sneed, Mr. Ellis and Ms. Orlansky:

On December 26, 2007, Superior Court Judge Sharon Gleason issued a Decision in 3AN-06-13751 Civil on all of the pending PTU Rule 600 appeals. She affirmed the Department's decision to reject the Appellants' proposed modified 22nd Plan of Development (POD). However, she remanded the matter to the agency "so as to accord to the Appellants notice and an opportunity to be heard before the agency as to the appropriate remedy when the Department has rejected the proposed modified 22nd Plan of Development for the Point Thomson Unit."

In accordance with Judge Gleason's remand, the Department hereby provides the Appellants with notice of the following:

- The Department is considering the appropriate remedy for failure to submit an acceptable plan. The Department is specifically considering the remedy of termination of the Point Thomson Unit.
- BP, Chevron, Conoco and ExxonMobil may submit briefing to DNR on the following issues: (1) whether the remedy of unit termination is the appropriate remedy for the Appellants' failure to submit an acceptable 22nd POD; and (2) if termination is not appropriate, what remedy would be an appropriate response to the Appellants' failure to submit an acceptable 22nd POD.

Appellants must submit briefing they want DNR to consider on the issue of the appropriate remedy for failure to submit an acceptable POD on or before Friday, February 4, 2008. In the near future, the Department will set a date for oral argument on the briefing. If Appellants want more procedure or proceedings on remand than written briefs and oral argument, they must request the additional

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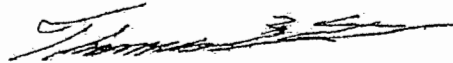
PTU REC 39505

Exc. 000581

Serdahely, Sneed, Ellis and Orlansky  
1/3/2008  
Page 2 of 2

procedure and proceedings in a written document submitted to the Commissioner on or before Friday, January 18, 2008.

Sincerely,



Thomas E. Irwin  
Commissioner

cc: Kevin Banks, Acting Director, Division of Oil & Gas  
Nan Thompson, Division of Oil & Gas  
Richard Todd, Department of Law  
Mark Ashburn, Ashburn & Mason, P.C.

PTU REC\_30506

Exc. 000582

**PATTON BOGGGS**  
ATTORNEYS AT LAW

DEPARTMENT OF  
NATURAL RESOURCES

JAN 18 2008

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January 18, 2008

VIA HAND-DELIVERY

Thomas E. Irwin  
Commissioner  
Department of Natural Resources  
550 W. 7th Avenue, Suite 1400  
Anchorage, Alaska 99501

RE: Response to Letter of January 3, 2008

Dear Commissioner Irwin:

Thank you for your letter of January 3, 2008, with respect to proceedings on remand from Judge Gleason's decision reversing the termination of the Point Thomson Unit. Your letter invites a request from the Working Interest Owners ("WIOs") in the event that they "want more procedure or proceedings on remand than written briefs and oral argument."

The WIOs do in fact believe that an opportunity merely to submit briefs and then to present oral argument is not sufficient to address properly the procedural and substantive issues set forth in Judge Gleason's decision. Judge Gleason specifically identified issues on which there are material factual disputes that need to be resolved, in order to "determine the appropriate remedy when DNR has rejected the modified 22<sup>nd</sup> Plan of Development." Judge Gleason's recent order retaining jurisdiction and requesting a final decision from DNR within 180 days provides ample time for a hearing with more adequate proceedings than the simple submission of a single set of briefs and oral argument.

Judge Gleason's decision recognized the absence of notice and due process in previous DNR proceedings. The WIOs should not be placed again in a position of having a hearing on briefs alone, without knowing exactly what issues or facts DNR might later contend were under review. Rather than have the WIOs submit briefs based on guesses about what legal standards DNR contends may apply, or what remedies other than termination of the Unit DNR might consider, the WIOs believe that, in advance of briefing or hearing of this matter, DNR should set forth its view of the appropriate legal standards and remedies, and the factual bases that DNR believes supports those remedies, so that the WIOs have fair and reasonable notice of the issues to be considered and the evidence that DNR believes is relevant to them. The WIOs will then be in a position to respond to the issues as DNR perceives them.

More specifically, the WIOs request that DNR adopt the following procedures. Nothing in this letter is intended to waive any issue the WIOs could raise in any further proceedings before Judge Gleason in the Superior Court or in the Supreme Court.

Washington DC | Northern Virginia | New Jersey | New York | Dallas | Denver | Anchorage | Doha, Qatar  
cc: Tom Irwin, Mary Rutherford

PTU REC 30507

Exc. 000583

Thomas E. Irwin  
Commissioner  
January 18, 2008  
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1. DNR should appoint an independent hearing officer in accordance with AS 44.64.030. Absent an unbiased and independent review, the appearance and reality of unfairness in proceedings conducted by a decision-maker with a financial interest in the proceedings will persist. Judge Gleason has noted "DNR's apparent violation of its own procedural regulations," and determined that DNR's previous proceedings denied due process to the WIOs. Moreover, confidential documents disclosed by DNR on appeal reveal that DNR, shortly before purporting to terminate the Unit, calculated what it believed would be the extent of the State's financial gain were it to terminate the Point Thomson Unit.<sup>1</sup> Given DNR's financial interest and the already demonstrated denial of due process in the previous proceedings, we do not believe that DNR can render an unbiased decision. Fundamental notions of fair play and due process therefore require that the decision be made by an independent decision-maker. Accordingly, an administrative law judge, acting pursuant to established regulatory procedures, should conduct these proceedings and determine the appropriate remedy.

2. Whoever presides at any further proceedings, DNR should acknowledge the adversary nature of the proceedings, and should treat DNR staff as one party to the proceedings that would submit briefing and evidence and respond to the WIOs' briefing and evidence. It is essential to due process that the factual materials and testimony on which the staff proposes to rely be identified and submitted for the record, that the WIOs have fair notice of the legal and factual positions that DNR is taking and the grounds and evidence that support them, and that the WIOs receive a fair opportunity to cross-examine DNR's witnesses and rebut the evidentiary materials offered by DNR staff and on which DNR proposes to rely in reaching its decision. In the prior proceedings, the Director's and Commissioner's Decisions relied on a number of purported facts which in our view had no support in the record or elsewhere and which the WIOs did not have any kind of fair opportunity to dispute. This type of procedure is not consistent with due process; and repeating it on the remand will produce only a second appeal and a second remand. If the Commissioner, rather than an independent hearing officer, presides at the hearing, the Commissioner should have independent counsel, so that the Attorney General's Office is not representing both a party and the deciding officer.

3. The WIOs have carefully reviewed the decisions of the Director of the Division of Oil and Gas in 2005 and the Commissioner in 2006. The WIOs intend to propose, as a remedy for the disapproval of the modified 22<sup>nd</sup> Plan of Development, that the Unit be brought into production at an early date consistent with Articles 10 and 21 of the Unit Agreement.

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<sup>1</sup> PTU Rec. 0016619-0016628. The WIOs do not agree with this assessment of the State's economic interests.

Thomas E. Irwin  
Commissioner  
January 18, 2008  
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4. Absent "clear written notice" to the contrary from DNR, the WIOs must assume that DNR's views for acceptable development of the Unit are those set out by the Director in 2005 and the Commissioner in 2006. To the extent that DNR expects to require the Unit to be developed in ways that are different or additional to those set forth in the Director's decision in 2005 or the Commissioner's Decision in 2006, fairness and due process require DNR promptly to give adequate notice of its proposals, allow adequate time for the WIOs to respond to them, and afford the WIOs a meaningful opportunity to be heard. To the extent DNR's proposals are consistent with Articles 10 and 21 and the other terms of the Unit Agreement, the WIOs intend to develop the Unit in accordance with those proposals. The WIOs therefore believe that they are entitled to fair notice of DNR's intentions as to development of the Unit. It would be a denial of both due process and fundamental fairness were DNR to insist on development requirements for the Unit that it did not communicate to the WIO's, or give the WIO's a fair opportunity to address.

5. DNR should schedule a hearing at which witnesses may testify and be cross-examined, and at which DNR staff should be prepared to present evidence in support of why it deems any proposed remedy to be consistent with Articles 10 and 21 of the Unit Agreement. Time should be allotted at the evidentiary hearing for testimony on at least the following material factual issues, all of which have bearing on the attaining of conservation objectives, on good and diligent oil and gas engineering and production practices, on the availability of transportation objectives, and on what is necessary to protect all parties in interest, and thus, consistent with Judge Gleason's remand, affect the appropriate remedy.

(a) New analysis and interpretation of information with respect to the quantity, nature, and location of hydrocarbons on the Unit.

(b) An appropriate schedule for development of the Unit and commencement of production of hydrocarbons.

(c) The appropriate boundaries for the Unit, given the manner in which the Unit should be developed and produced.

(d) The reasons that the manner in which the WIOs propose to develop and produce the Unit is consistent with reasonable engineering practice and is in the interest of conservation.

(e) The application of Articles 10 and 21 of the Unit Agreement to the development of the Unit and to the appropriate rate of exploration, development, and production of hydrocarbons from the Unit.

Thomas E. Irwin  
Commissioner  
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(f) The procedural and substantive import of Article 21 of the Unit Agreement on the development proposals made by the Director in 2005 and the Commissioner in 2006, and any additional proposals that DNR may make in response to paragraph (4) above.

(g) The procedural and substantive import of Article 10 of the Unit Agreement on the development proposals made by the Director in 2005 and the Commissioner in 2006, and any additional proposals that DNR may make in response to paragraph (4) above.

(h) Industry standards relevant to interpreting limitations on a lessor's freedom to impose development requirements consistent with the requirements in Article 10 and 21 of the Unit Agreement that the Operator must act as a reasonably prudent operator.

(i) Details of the manner in which the WIOs would commit to development and production of the field, including geologic, geophysical, engineering, and economic evidence in support of the WIO's proposals.

(j) Details of the manner in which DNR staff contends the field should be developed and produced, including geologic, geophysical, engineering, and economic evidence in support of DNR's contentions.

(k) Factual evidence, including industry standards, relevant to fashioning remedies for a lessor's claim of failure to produce an oil and gas lease in a timely fashion.

(l) The development practices that a reasonably prudent operator would undertake in 2008.

(m) The impact on the public interest of requiring the WIOs to undertake uneconomic activities.

(n) The impact on the State and the WIOs of other potential remedies as compared to carrying out the WIOs' proposals for developing and producing it.

(o) The impact of potential remedies on the State's efforts to advance a major gasoline project.

(p) The manner in which the WIOs propose to develop the Unit consistent with a future gas sales program.

PTU REC\_30510

Exc. 000586

Thomas E. Irwin  
Commissioner  
January 18, 2008  
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(q) Industry standards for the development of major hydrocarbon fields in remote locations.

(r) Industry standards for phasing of major oil and gas developments to account for and mitigate reservoir, technical and other risks, including uncertainties regarding the availability of transportation systems.

(s) DNR's practice and procedure with respect to the certification of wells as capable of producing in paying quantities and its effect on the development of the Unit.

(t) Production of hydrocarbons from wells that have been plugged or that have been "suspended" or "abandoned" pursuant to DNR regulations.

(u) Such other matters as may be pertinent to the matters properly addressed on remand from the Superior Court.

6. Because some of the information to be presented at the hearing is highly confidential, provisions must be made to conduct all or portions of the hearing in closed, rather than public, sessions.

7. The WIOs should have a reasonable opportunity, in advance of the evidentiary hearing, to ascertain, and therefore to address, the contentions of DNR staff with respect to the material factual issues listed in the previous paragraph and the facts and evidence, if any, upon which the contentions rest.

8. DNR's decision should rest on the record of evidence and argument presented at the hearing on remand.

In light of this request for an independent hearing officer, or, if DNR denies that readily available process, for procedures beyond those contemplated by your letter of January 3, the WIOs request that the briefing deadline of February 4, 2008, be vacated. The February 4 date could be used, instead for a prehearing conference to establish the procedures to be followed in this remand, and schedule appropriate early dates for the exchange of fact and expert witness lists, statements of contentions, exhibits, and hearing briefs. The WIOs contemplate a prompt evidentiary hearing, consistent with Judge Gleason's order, in early May of this year, with submission of briefs thereafter, and a decision meeting the 180-day schedule that Judge Gleason has established.

PTU REC\_30511

Exc. 000587



Thomas E. Irwin  
Commissioner  
January 18, 2008  
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The WIOs would be pleased to meet with you, an assigned hearing officer, or with DNR's staff or counsel, to answer questions, discuss procedures, including the timing and agenda for a prehearing conference, and develop a timeline in which an adequate evidentiary hearing can be held without undue delay.

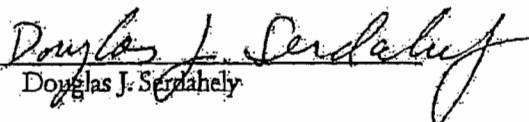
Very Truly Yours,

Susan C. Orlansky  
FELDMAN ORLANSKY & SANDERS  
Attorneys for BP Exploration (Alaska) Inc.

Stephen M. Ellis  
DELANEY WILES, INC.  
Attorneys for Chevron U.S.A., Inc.

Spencer G. Sneed  
DORSEY & WHITNEY LLP  
Attorneys for ConocoPhillips Alaska, Inc.

Douglas J. Serdahely, Esq.  
Kevin D. Callahan, Esq.  
PATTON BOGGS LLP  
Attorneys for Exxon Mobil Corporation

By:   
Douglas J. Serdahely

On behalf of all Appellants

DJS/mw

cc: Kevin Banks, Acting Director, Division of Oil & Gas  
Nan Thompson, Division of Oil & Gas  
Richard Todd, Department of Law  
Mark Ashburn, Ashburn & Mason, PC

PTU REC\_30512

Exc. 000588



# STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

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January 28, 2008

VIA EMAIL AND CERTIFIED MAIL, RETURN RECEIPT REQUESTED

Douglas J. Serdahely Patton Boggs, LLP Attorney for ExxonMobil Corp. 601 West Fifth Avenue, Suite 700 Anchorage, Alaska 99501	Stephen M. Ellis Delaney Wiles, Inc. Attorney for Chevron U.S.A., Inc. 1007 West Third Avenue, Suite 400 Anchorage, Alaska 99501
Spencer C. Sneed Dorsey & Whitney, LLP Attorney for ConocoPhillips, Alaska, Inc. 1031 West Fourth Avenue, Suite 600 Anchorage, Alaska 99501	Susan Orlansky Feldman, Orlansky & Sanders Attorney for BP Exploration (Alaska) Inc. 500 L Street, Suite 400 Anchorage, Alaska 99501

RE: PTU Proceedings on Remand

Dear Mr. Serdahely, Mr. Sneed, Mr. Ellis and Ms. Orlansky:

This is the response of the Alaska Department of Natural Resources to your letter to me of January 18, 2008. According to Judge Gleason's December 26, 2007 order in JAN-06-13751 Civil, the purpose of the remand proceedings is to give you the opportunity to be heard on the question of the appropriate remedy for your failure to submit an acceptable Plan of Development for the Point Thomson Unit and failure to cure in the year following the October 27, 2005 Director's Decision. This remand proceeding is your opportunity to explain any alternatives to unit termination which you believe are appropriate in this case.

My January 3, 2008 letter to you set January 18, 2008 as the deadline for you to request additional procedures on remand and set February 4, 2008 as the deadline for you to submit your joint or separate briefs to me on the appropriate remedy. This letter responds to the procedures you requested in your January 18, 2008 letter, and it also extends the date by which you must file joint or separate briefs describing the appropriate remedy and by which you must provide all documents you want me to consider in support of your proposed remedy to February 19, 2008.

Hearing is set to begin at 9:00 AM Monday, March 3, 2008. It will be held in the Atwood Building, Room 1270. That is the time and place for you to present and support your proposed remedy. You may make oral argument. You may present witnesses. It would assist me to make a decision and understand your proposal if your witnesses were made available for questions. On February 19,

*"Develop, Conserve, and Enhance Natural Resources for Present and Future Alaskans"*

PTU REC 30513

Exc. 000589

2008, you must submit of list of all witnesses you intend to call on at the March 3, 2008 hearing. That list must include a statement of the topics each witness will address.

The January 3, 2008 letter identified the issues to be briefed as: "(1) whether the remedy of unit termination is the appropriate remedy for the Appellant's failure to submit an acceptable 22<sup>nd</sup> POD; and (2) if termination is not appropriate, what remedy would be an appropriate response to the Appellant's failure to submit an acceptable 22<sup>nd</sup> POD." Please also explain why it is in the public interest for DNR to accept the remedy you propose. You should file all materials you want DNR to consider on the question of remedy on February 19, 2008 with your brief and witness list.

Regarding the specific requests set out in your letter of January 18, 2008:

1. Confidentiality - You raised the issue of confidential information that may be included in your submittals to DNR on remedy. Unitization and the status of the PTU are issues of public importance and interest. DNR will accord confidential and proprietary information submitted with your briefs the protection DNR is authorized to provide under AS 38.05.035(a)(9). You need to mark confidential each page of the information that you submit which you consider to fall within the scope of this statute. DNR will only keep confidential those portions of your submittals on remedy that fall within the scope of AS 38.05.035(a)(9).

If you intend to present confidential information through live witnesses, you need to indicate that on your witness list and in the record before each witness who will convey confidential information testifies. Testimony initially treated as confidential will not be further accorded confidential treatment if it does not contain the type of information which DNR is entitled to hold confidential under AS 38.05.035(a)(9).

2. Record - The record in this matter was established in the consolidated Rule 600 appeals before Judge Gleason. The appropriate remedy will be determined in light of that record. DNR will also consider additional materials you may include with your February 18, 2008 filings and in your March 3, 2008 presentation on remedy. DNR denies your request to limit the record to whatever you provide on remand because that would be inconsistent with Judge Gleason's decision.

3. Legal Standards - This is a DNR administrative proceeding on the question of remedy. The procedure is described in 11 AAC 02.010 et. seq. The standards of review for agency action are those that set out in Alaska case law. Additionally, the applicable legal standards are set forth in state law, the Unit Agreement, and applicable regulations.

4. Independent Hearing Officer and Adversarial Proceeding - Your requests for appointment of an independent hearing officer and an adversarial proceeding in which DNR is a party and its employees are subject to cross examination, are denied. You have demonstrated no circumstances to justify departing from the standard existing administrative process, a process that has been repeatedly validated by the Alaska Supreme Court. Additionally, DNR has the responsibility to administer state resources. It is my job to discharge that responsibility by determining the appropriate remedy. That decision will neither be passed off to third-party contractor nor will it turn on the views of my staff. I will attend the hearing, but I have asked Nan Thompson of my staff to act as the hearing officer at the March 3, 2008 hearing.

PTU Proceedings on Remand  
1/28/2008  
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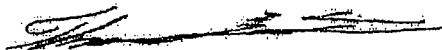
5. Remedies -- My January 3, 2008 letter advised you that DNR is considering the remedy of unit termination. The purpose of this proceeding is to consider your arguments about unit termination and any alternative remedies which you believe are appropriate given your failure to submit an acceptable POD.

The time to cure provided for in the Director's decision, and expanded by Commissioner Menge, has passed. Commissioner Menge found the amended 22nd POD was unacceptable and that finding has been affirmed by the superior court. Therefore, you should not treat the proceedings on remand as a further opportunity to the cure as described in the Director's decision. Because the time for cure has long passed, any "reliance" on past statements regarding cure is now unreasonable.

To the extent you chose to propose a new POD, you should consider the record that was developed before Judge Gleason. It shows that both AOGCC and DNR have requested the PTU lessees to drill sufficient wells to fully delineate all of the PTU reservoirs. DNR has repeatedly requested that the Lessees commit to full and timely development of all PTU reservoirs, including gas, gas condensate, and oil. You should also consider what assurances you can give DNR that whatever you propose as a remedy will be done.

DNR will consider the entire record to determine the appropriate remedy.

Sincerely,



Thomas E. Irwin  
Commissioner

cc: Kevin Banks, Acting Director, Division of Oil & Gas  
Nan Thompson, Division of Oil & Gas  
Mark Ashburn, Ashburn & Mason, P.C.  
Richard Todd, DOL

PTU REC 30515

Exc. 000591



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February 8, 2008

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VIA HAND-DELIVERY

Thomas E. Irwin  
Commissioner  
Department of Natural Resources  
550 W. 7<sup>th</sup> Avenue, Suite 1400  
Anchorage, Alaska 99501

Re: Procedures for hearing commencing on March 3, 2008

Dear Commissioner Irwin:

This letter further responds to your January 28, 2008 letter regarding procedures for the proceeding on remand.

1. Ex Parte Communications with DNR Staff. The WIOs request clarification that you, in your capacity as decision-maker, have not had and will not have undisclosed communications with DNR staff regarding the subject matter of the hearing.
2. Additional Evidence. The WIOs request notice by February 19, 2008 of any evidence, including testimony, that is not included in the record on appeal to Judge Gleason upon which you may rely in making your decision. The WIOs also request notice and a reasonable opportunity to respond to any evidence upon which you may rely in your decision that comes to your attention after February 19, including the opportunity to examine the sponsoring witnesses or source of the information.
3. Evidence From DNR Staff. The WIOs request that they be permitted an opportunity to take testimony from DNR staff at the hearing regarding specific DNR documents in the record that the WIOs will identify in their February 19, 2008 submissions.
4. Additional Documents. The WIOs request an opportunity to review prior to the hearing DNR documents that are not in the record but directly relate to or support specifically identified DNR documents that are in the record. The WIOs will identify such additional documents in their February 19, 2008 submissions.
5. Post-Hearing Briefing. The WIOs request an opportunity to submit briefs within twenty (20) days after the conclusion of the hearing and the closing of the evidence.

PTU REC 30519



Thomas E. Irwin  
Commissioner  
February 8, 2008  
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The WIOs request clarification regarding these matters at your earliest convenience.

Absent a specific written waiver, the WIOs do not waive (i) the requests made to you in their letter of January 18, 2008; (ii) the request made earlier today for procedures that conform to Section 21 of the PTUA, or (iii) the right to request additional procedures in the course of the remand proceedings.

Very Truly Yours,

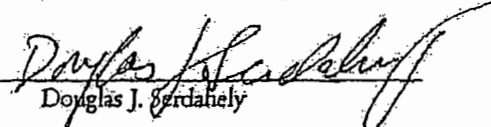
Susan C. Orlansky  
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DORSEY & WHITNEY LLP  
Attorneys for ConocoPhillips Alaska, Inc.

Douglas J. Serdahely, Esq.  
Kevin D. Callahan, Esq.  
PATTON BOGGS LLP  
Attorneys for Exxon Mobil Corporation

By

  
Douglas J. Serdahely

On behalf of all Appellants

DJS/mw

cc: Kevin Banks, Acting Director, Division of Oil & Gas  
Nan Thompson, Division of Oil & Gas  
Richard Todd, Department of Law  
Mark Ashburn, Ashburn & Mason, PC

PTUREC\_30520

Exc. 000593

STATE OF ALASKA  
DEPARTMENT OF NATURAL RESOURCES  
550 W. 7th Avenue, Suite 1400  
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DEPARTMENT OF  
NATURAL RESOURCES  
FEB 18 2008  
COMMISSIONER'S OFFICE  
ANCHORAGE

In re Remand Proceedings Pursuant to  
December 26, 2007 Order of Superior Court  
Regarding Point Thomson Unit Agreement

BRIEF OF EXXON MOBIL CORPORATION,  
BP EXPLORATION (ALASKA) INC., CHEVRON U.S.A. INC. AND  
CONOCOPHILLIPS ALASKA, INC. ON REMAND BY  
SUPERIOR COURT ORDER DATED DECEMBER 26, 2007

I. INTRODUCTION

Judge Gleason ruled that DNR violated the Owners' due process rights in terminating the PTUA. Op. 39-42. She remanded to DNR "for the purpose of according to the Appellants a hearing on the appropriate remedy to the State upon DNR's rejection of the proposed 22<sup>nd</sup> Plan of Development." Op. 42. She specifically instructed DNR to "consider the import of Section 21 of the PTUA, as amended in 1985, in determining the appropriate remedy." *Id.* DNR, however, has given notice only that it "is considering the appropriate remedy for failure to submit an acceptable plan" and "is specifically considering the remedy of termination of the Point Thomson Unit."<sup>1</sup>

As a matter of law, termination is not an "appropriate remedy to the State upon DNR's rejection of the proposed 22<sup>nd</sup> Plan of Development." Op. 42. There has been no default under the PTUA, and even if DNR rejection of the proposed 22<sup>nd</sup> POD were a default, it would not be a material default. Absent a material default, termination is not

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<sup>1</sup> Commissioner's January 3, 2008 letter.

payment by September 1 unreasonably "exposes miners to risk of forfeiture . . .").

These principles are directly applicable here. Approval of a new POD will result in no significant damage to the State's interests in the Point Thomson Unit. Termination, however, will plainly result in a forfeiture of the \$800 million that the Owners have invested in the unit, and of the substantial work they have done to explore the Unit and to model and understand its reservoirs. There is no basis in equity that all that work and investment should be thrown away, and the State itself denied the benefit of the knowledge base thus accumulated, merely because after approving 21 PODs, the Director disapproved the 22<sup>nd</sup>.

**D. Relevant Restatement Provisions Establish That There Has Been No Material Breach**

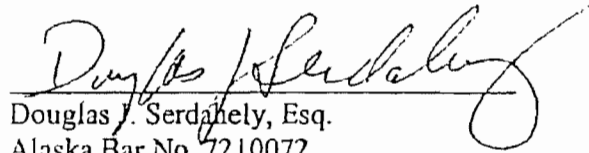
Turning to the more general principles that govern the circumstances in which a court can find a "material" breach, it is clear that those principles also preclude a finding of material breach here. The applicable law is given in Sections 237, 241 and 242 of the Restatement (Second) of Contracts (1979). Section 237 relieves a party of its duty to perform only if there is an "uncured material failure" of performance.<sup>27</sup> Thus, even if the Owners breached the PTUA, the State is not relieved of its obligations under the PTUA.

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<sup>27</sup> The Second Restatement's introduces the concept of cure as a separately-stated element of the test for whether a contract may be terminated. The idea is that if there is a "material" breach of contract (a "failure of performance" as Section 237 says), it only "suspends" (but does not "discharge") the other party's obligation to perform. An opportunity to cure must be given prior to the point in time when the non-breaching party's obligations are "discharged" and the contract may be terminated. See RESTATEMENT § 242, comments a, b.

DATED at Anchorage, Alaska this 19<sup>th</sup> day of February 2008.

PATTON BOGGS LLP

  
Douglas J. Serdahely, Esq.

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BIOGRAPHICAL DATA

Birth date: August 31, 1948  
Citizenship: United States

Marital Status: Married, two children

EDUCATION

College

B.S., Petroleum Engineering, Texas A&M University (1970)  
M.S., Petroleum Engineering, Texas A&M University (1974)  
Ph.D., Petroleum Engineering, Texas A&M University (1976)

Honor Societies

Tau Beta Pi (Engineering Honor Society)  
Pi Epsilon Tau (Petroleum Engineering Honor Society)

EXPERIENCE

Industrial

The Strickland Group, Inc, President (June 2001 to Present)  
Cawley, Gillespie & Associates, Inc., President (January 1991 – May 2001)  
Cawley, Gillespie & Associates, Inc., Executive Vice President (January 1988 - December, 1990)  
Cawley, Gillespie & Associates, Inc., Petroleum Consultant (July 1982 - December 1987)  
Reservoir Simulation Technology, Inc., President (December 1980 - May 1982)  
Simulation Technology, Partner (September 1974 - November 1980)  
Numerical Simulation Section, Phillips Petroleum Company, Reservoir Engineer (May 1974 - Sep. 1974)  
Atlantic Richfield, Reservoir and Production Engineer (1970 and 1972)  
Pan American Petroleum, Engineering Assistant (May 1969 - September 1969)  
Tidewater Oil and Gas, Engineering Assistant (May 1968 - September 1968)  
Getty Oil, Engineering Assistant (May 1967 - September 1967)

Educational

Associate Professor, Texas A&M University (September 1980 - May 1982)  
Assistant Professor, Texas A&M University (September 1976 - August 1980)  
Instructor, Texas A&M University (September 1975 - May 1976)

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Exhibit

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Military

US Army, South Vietnam, Infantry (September 1970 - February 1972)

PROFESSIONAL AFFILIATIONS

Society of Petroleum Engineers (SPE)  
Texas Society of Professional Engineers (TSPE)  
National Society of Professional Engineers (NSPE)  
NSPE - Professional Engineers in Private Practice (NSPE-PEPP)  
American Consulting Engineers Council  
Registered Professional Engineer in the State of Texas  
Sigma Xi

PROFESSIONAL COMMITTEE MEMBERSHIPS

Frost Bank Advisory Board (2000 to Present)  
Petroleum Engineering Industry Board, Texas A&M University (1995 - 2000)  
Society of Petroleum Engineers Editorial Review Committee (1978 - 1980)  
Student Development Committee of American Association of Engineering Studies (1979 - 1980)  
Society of Petroleum Engineers Education and Accreditation Committee (1981 - 1994)  
Engineering Accreditation Commission of ABET (1984 - 1987)  
Board of Directors of the Accreditation Board for Engineering and Technology (1988 - 1994)  
Chairman of the Fort Worth Section of the Society of Petroleum Engineers (1988)  
Board of Directors of the Fort Worth Section of the Society of Petroleum Engineers (1989 - 1992)

Texas A&M University Committee Memberships

Academic Council, Member  
College of Engineering Computing Committee, Member  
Petroleum Engineering Scholarship Committee, Chairman  
University Disciplinary Appeals Panel, Member  
L. F. Peterson Engineering Computing Center, Director  
College of Engineering Student Honors and Awards Committee, Chairman  
Brazos Valley Regional Science and Engineering Fair, Director

HONORS AND AWARDS

Outstanding Faculty Award, College of Engineering, Texas A&M University (April, 1980)  
Member, Graduate Faculty, Texas A&M University  
Dresser Professor of Petroleum Engineering  
Accreditation Board for Engineering and Technology - Fellow

PUBLICATIONS AND PRESENTATIONS

Strickland, R.F.: "An Analysis of Artificial Barriers for Controlling Water Coning," M.S. Thesis, Texas A&M University, May 1974.

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Strickland, R.F. and Morse, R.A.: "Artificial Barriers May Control Water Coning," Oil and Gas Journal, October 4 & 7, 1974.

Strickland, R.F.: "Gas Injection for Up-structure Oil Drainage," Ph.D. Dissertation, Texas A&M University, December 1976.

Strickland, R.F. and Jennings, J.W.: "Recent Developments in Texas A&M University's Lignite Gasification Project," 4th Annual Underground Coal Conversion Symposium. June 1978, Steamboat Springs, Colorado.

Strickland, R.F. and Jennings, J.W.: "Analysis of Geological Limitations to Underground Coal Gasification," In Situ, Vol. 3, Number 3, September 1979.

Strickland, R.F. and Morse, R.A.: "Gas Injection for Up-structure Oil Drainage," Journal of Petroleum Technology, October 1979, pp. 1323-1331.

Jennings, J.W., Strickland, R.F., and Von Gonten, W.D.: "Underground Lignite Gasification at Texas A&M," Presented at:

Symposium on Energy and Mineral Recovery Research, April 12-14, 1977, Golden, Colorado;

Third Annual Underground Coal Conversion Symposium, June 6-9, 1977, Fallen Leaf Lake, California;

Second Annual In-Situ Energy Recovery Technology, July 11-12, 1977, Albuquerque, New Mexico.

Strickland, R.F. "Short Courses for Industrial Representatives,"

Topics: Oil and Gas Technology  
Basic Reservoir Engineering  
Advanced Reservoir Engineering  
Numerical Simulation  
Thermodynamics and Phase Behavior  
Oil and Gas Property Evaluation  
Presented 1977 through 1990

Strickland, R.F. "Disputes about the Panhandle Field of Texas",  
Society of Petroleum Engineers, Dallas Section, November 1986, December 1989.  
Dallas Geological Society, February 1990.

Strickland, R.F. "Oil & Gas Property Evaluation - A Seminar for Fiduciaries",  
May 1988, May 1990.

Chen, R.D., Strickland, R.F., Lake, L.W., Yang, A.P., Malik, Prezbindowski, and Mairs. "Three Dimensional Conditional Simulation of Schneider (Buda) Field," paper SPE 23970 presented at the Permian Basin Oil and Gas Recovery Conference, Midland, TX, March 1992.

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*Richard F. Strickland*

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Strickland, R.F., "Attributes of the Petroleum Engineer of the Future", presented at the Society of Petroleum Engineers Fall Meeting, September 1993.

Strickland, R.F., "Outsourcing, The View of a Consultant", presented at the Society of Petroleum Engineers Annual Meeting, September, 1994. SPE Houston Section, November, 1994. SPE Dallas Section, December 1994. SPE Ft. Worth Section, March 1995.

Strickland, R.F., Shingler, T., "Comparison of US and UK Transactions: Expected Market Value, paper SPE 28191 presented at the SPE Oil & Gas Economics, Finance & Management Conference in London, UK, June 1994.

Strickland, R.F., Purvis, Dwayne C., Alexander, R.A., Quinn, M.A., "Coupling Probabilistic Methods and Finite Difference Simulation: Three Case Histories" paper SPE 38777 presented at the SPE Annual Technical Conference and Exhibition, San Antonio, TX, October 1997.

Strickland, R.F., Purvis, Dwayne C., "Problems Reconciling Probabilistic and Deterministic Reserve Classifications and Evaluations" paper SPE 68591 presented at the SPE Hydrocarbon Economics and Evaluation Symposium, Dallas, TX, April 2001.

Nickle, Brad, Strickland, R.F., Purvis, Dwayne C., "Resolving the Nightmare of Performance Reporting and Portfolio Management - A Web Based Approach" paper SPE 95164-PP presented at the SPE Hydrocarbon Economics and Evaluation Symposium, Dallas, TX, April 2005.

#### UNIVERSITY AND INDUSTRY SCHOOLS TAUGHT

##### University Courses

**Engineering Analysis:** Introduction to engineering analysis affording practice in analyzing and solving engineering problems including computational methods and devices.

**Petroleum Development:** Principles of oil field development including drilling equipment, drilling fluids, casing and cementing of wells and formation evaluation.

**Reservoir Rock Properties:** Systematic study of physical properties of petroleum reservoir rocks; lithology, porosity, fluid saturation, permeability, relative and effective permeability and capillary characteristics.

**Petroleum Development Laboratory:** Properties and the testing and treating of drilling fluids and cements; well surveying practices.

**Fluid Properties Laboratory:** Conventional and special core analysis. Analysis of drill cuttings. Determination of lithology, porosity, fluid saturation, capillary pressure characteristics, electrical properties, permeability and relative permeability.

**Reservoir Fluids:** Thermodynamic behavior of naturally occurring hydrocarbon mixtures. Evaluation and correlation of physical properties of petroleum reservoir fluids including laboratory and empirical methods.

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Petroleum Property Management: Factors which influence industrial organizations, securities and value of oil and gas properties. Preparation of valuation reports; taxation; introduction to mineral law. Regulation of petroleum production.

Petroleum Measurement and Transportation: Fluid static and dynamics. Theory and methods of gas and liquid measurements and transportation including mixed streams.

Measurements Laboratory: Flow and metering of gas and liquid in pipelines. Oil and gas well testing, field automation and optimization of sucker rod pumping installations.

Petroleum Engineering Numerical Methods: Use of numerical methods for petroleum problems. Application of numerical differentiation, integration, interpolation, and curve fitting. Introduction to numerical simulation.

Reservoir Engineering: Frontal advance processes. Influence of rock and fluid properties on reservoir performance. Well performance as related to various completion and stimulation techniques.

Materials Balance Methods: Materials balance methods. Identification of type of reservoir mechanism. Estimation of fluids in place and future production under primary recovery, gas injection and water influx.

Unsteady State Processes: Transient phenomena in fluid flow systems. Applications to finite and infinite reservoirs. Pressure build up and draw down, skin factor, interference, reservoir limits, drill stem testing, pulse testing.

Petroleum Recovery Methods: Secondary and tertiary oil recovery. Gas drive, water flooding, steam, hot water, in-situ combustion and miscible displacement. Use of carbon dioxide, surfactants, emulsions and viscous water for increasing oil recovery.

Special Topics in numerical methods and reservoir simulation.

#### Industry Schools

Basic Reservoir Engineering  
Advanced Reservoir Engineering  
Numerical Simulation  
Oil and Gas Property Evaluation  
Oil and Gas Technology  
Thermodynamics and Phase Behavior

#### COMMUNITY

##### Church

Ordinations: Deacon, Elder, The Church in Cityview

##### Recreational

Golf, Machinist

ExxonMobil Production Company  
P.O. Box 13650  
Anchorage, Alaska 99501-3650  
907 561 3321 (ext. 3321)  
907 564 3077 (fax)

Craig A. Haymes  
Alaska Production Manager  
Joint Interest U.S.

February 19, 2008

**ExxonMobil**  
Production

DEPARTMENT OF  
NATURAL RESOURCES

FEB 18 2008

COMMISSIONER'S OFFICE  
ANCHORAGE

Thomas E. Irwin  
Commissioner  
Department of Natural Resources  
550 W. 7<sup>th</sup> Avenue, Suite 1400  
Anchorage, Alaska 99501-3650

Dear Commissioner Irwin:

Exxon Mobil Corporation as Point Thomson Unit Operator, and on behalf of the Point Thomson Unit working interest owners, submits the attached Plan of Development (Plan) for the Point Thomson Unit (PTU) pursuant to the Point Thomson Unit Agreement and applicable ONR regulations. This Plan includes a firm commitment to put PTU on production by year-end 2014 and a drilling program to fully delineate and evaluate all PTU reservoirs.

As evidence of our sustained commitment to the development of Point Thomson, the working interest owners have invested over \$800 million and are submitting a plan to delineate the resources at the PTU and develop the Thomson Sand reservoir, at an additional cost of approximately \$1.3 billion. As a further demonstration of this commitment to develop Point Thomson, ExxonMobil has secured a rig for PTU drilling operations commencing in the 2008-09 winter season.

We continue to believe gas sales from the PTU resources will generate the maximum benefit for the State. However, we also recognize a gas pipeline project is still years away. Engineering and geoscience work completed over the past 18 months, which focused on reservoir evaluation and development planning, and development risks, indicate that initiating production from PTU through a phased development approach is a prudent step. The development project includes drilling a minimum of five wells to delineate Thomson reservoirs. Two of these wells, along with the construction of production facilities, pipelines, and support infrastructure, will be used to put the Thomson Sand reservoir on production. Approximately 200 million cubic feet per day of Point Thomson gas will be produced and 10,000 barrels per day of liquid condensate that is separated from the gas will be delivered for sale through new and existing oil pipelines. The remaining gas will be injected back into the Thomson Sand reservoir to maintain pressure for continued hydrocarbon recovery and for subsequent gas sales.

Following the initial phase of Thomson Sand development, subsequent field development will be determined which could include expanding the injection capacity, pursuing gas sales or some combination. The drilling program will help determine development opportunities within PTU. Evaluation of the Thomson Sand oil rim will also be undertaken during the POD period. If delineation drilling and well test results are positive, the production facilities could be designed to handle oil rim production. This plan does not depend on the status of a gas pipeline, actions by third parties, or any concessions by the State.

In addition, necessary engineering work will be completed to allow individual PTU working interest owners to participate in an open season for a gas pipeline. Each owner must individually decide whether to participate in a specific gas sales opportunity. ExxonMobil, as an individual owner, will

Director of Exxon Mobil Corporation

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fully participate in and make commitments for its Point Thomson gas in an open season for a gas pipeline (producer owned, third-party owned or some other combination) in that pipeline's open season on terms and conditions no less favorable to Exxon/Mobil than those upon which other shipping commitments are made.

The objectives of the phased development are to: 1) initiate production to progress development in a timely manner; 2) delineate Point Thomson reservoirs; 3) manage development risks; and 4) facilitate future development.

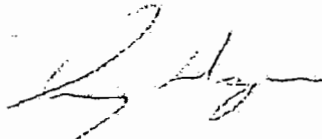
To summarize, key aspects of the initial development are:

- Provides jobs for Alaskans and revenue to the State
- Begins production of PTU hydrocarbon liquids in 2014 assuming prompt State approval and timely receipt of permits
- Invests approximately \$1.3 billion
- Commences drilling of wells in the 2008-09 winter season
- Constructs production facilities, pipelines, and support infrastructure, much of which can be used in subsequent phases of field development
- Produces 200 million cubic feet per day of gas and 10,000 barrels per day of liquid condensate from the Thomson Sand
- Injects gas into the Point Thomson reservoir to maintain pressure and increases total hydrocarbon recovery
- Delineates and develops hydrocarbon reservoirs in the PTU for liquid and gas sales utilizing phased development facilities at Point Thomson
- Completes engineering work for gas sales to allow each working interest owner to participate in a gas pipeline open season
- Continues data sharing process with the Alaska Oil and Gas Conservation Commission, initiated in August 2007, and applies for pool rules for gas sales
- Provides expansion capability for additional gas injection, oil production, gas sales or some combination
- Minimizes environmental impacts

The PTU working interest owners believe this POD meets the terms of the Point Thomson Unit Agreement. The working interest owners are prepared to proceed with the activities called for in the POD. Annual updates will be provided to allow DNR oversight and ensure adherence to the terms of the POD. We believe this Plan optimizes benefits to the State and to the working interest owners, and therefore seek Plan approval from the DNR.

We welcome the opportunity to review this Plan with you and look forward to working with you and your team to accomplish the work set forth in the POD and commence Point Thomson production.

Sincerely,



CAH:ddm

c: wattachment:

Mr. Kevin Banks, Acting Director, Division of Oil & Gas  
PTU Working Interest Owners

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## POINT THOMSON UNIT

### **Plan of Further Development and Operation For the period October 1, 2005 to December 31, 2014**

#### **1. Introduction**

This Plan of Further Development and Operation (POD) describes the timely delineation, development and operation, and proper conservation of the oil and gas resources of the Point Thomson Unit (PTU or Unit) area. The POD sets forth a plan to begin production of PTU hydrocarbons through a phased approach to fully delineate and develop both liquids and gas within the Unit area. The costs of work activities during the term of this POD are estimated at \$1.3 billion.

The initial phase of production constitutes a major development project. The project involves drilling wells beginning in the 2008-09 winter season and constructing production facilities, pipelines, and support infrastructure.

PTU hydrocarbons will be produced and processed at PTU. Liquid hydrocarbons will be delivered for sale through new and existing oil pipelines and all remaining gas will be injected back into the Thomson Sand reservoir to maintain pressure for continued hydrocarbon recovery and for subsequent gas sales. Production start-up is anticipated by year-end 2014. The overall project, including the schedule, is described in detail in this POD.

This POD provides a minimum of five wells to further delineate and develop the Thomson Sand reservoir and other hydrocarbon reservoirs in the PTU. The drilling program is described in Section 3. Specific plans are included for delineation, evaluation, and testing of the oil in the Thomson oil rim and the Brookian. All wells will be designed to be capable of being used as producers or injectors if viable.

This POD includes development work for initiating gas sales from the PTU. This encompasses reservoir and facilities engineering work and application for pool rules from the Alaska Oil and Gas Conservation Commission (AOGCC), all of which are needed for individual owner participation in a gas pipeline project open season.

The work in this POD will accomplish the following key objectives for the State and PTU owners:

- Establishes production of hydrocarbons in a timely manner, prior to gas sales, providing benefits to the people of Alaska in the form of taxes, royalties, and jobs;
- Minimizes environmental impacts;
- Provides for delineation, appraisal and development of reservoirs within the Unit area;
- Allows individual PTU owners to take advantage of gas sales opportunities and participate in an open season for a gas pipeline; and
- Extends infrastructure on the Eastern North Slope thereby facilitating other potential developments in the area.

This POD also describes work performed since expiration of the most recently approved plan of development. Exxon Mobil Corporation (ExxonMobil), as Point Thomson Unit



Operator and on behalf of the PTU Working Interest Owners (Owners), requests approval of this POD for the period October 1, 2005, through December 31, 2014.

## 2. Point Thomson Unit Development

### Resource Base

The Thomson Sand, the primary reservoir in the PTU, is a large high pressure gas-condensate reservoir. The Pre-Mississippian section directly underlies and is in pressure communication with the Thomson Sand. Because of the proximity and pressure communication between these reservoirs, development of the Thomson Sand will also deplete the Pre-Mississippian section.

The Thomson Sand contains an oil rim below the gas. The potential for production contribution from the oil rim is uncertain. The delineation program includes drilling, testing and evaluation of the potential for oil rim production. Thomson Sand reservoir wells will be designed to penetrate and evaluate the Brookian in one or more potential accumulation areas (e.g., either Flaxman, Iceberg, or Calloway). If encountered, formation evaluation (open-hole logging, sidewall cores, fluid samples and testing as appropriate) will be conducted to evaluate the potential for production contribution.

As part of owner efforts to determine an appropriate development plan for PTU, an extensive reservoir evaluation and development planning assessment was completed in 2007. This work included a Thomson Sand reservoir description and uncertainty analysis and provided comprehensive and integrated geologic and reservoir simulation models to allow for evaluation of a wide range of development options. The analysis provided an improved understanding of the factors having the greatest impact on resource size and reservoir performance and further confirmed that uncertainty exists due to variations in predictions of reservoir size, quality, and connectivity.

### Development Considerations

The optimal development plan for the PTU must take into account the following development considerations:

- Anticipated resource size, quality, performance and uncertainty associated with these parameters;
- Timing and availability of a gas pipeline;
- Minimizing impacts in an environmentally sensitive location;
- Management of technology related to high pressure gas production and injection and extended reach drilling in abnormally pressured formations; and
- Prudent management of capital, especially due to high cost of development in a remote arctic location.

A discussion of these development considerations and options to address them is included in this POD to provide the necessary context for PTU development plans.

A key consideration for any development plan is the uncertainty as to how the reservoir will perform under production. Certain development plans are more robust and better able to accommodate this uncertainty. The Thomson Sand gas contains the dominant share of the hydrocarbon resource in the PTU, and selling gas is central to any development plan to

provide greater hydrocarbon recovery and generate maximum value to all parties and interests from the resource within the Unit area.

In general, gas depletion for a major gas sale development is best at coping with downside reservoir scenarios because it is less sensitive to compartmentalization or reservoir heterogeneity while accessing the largest quantity of hydrocarbons. A gas sales development is the best way to develop the PTU resources for the maximum benefit of the State and the owners. However, it requires a gas pipeline and gas market, and it is recognized that a gas pipeline is at least a decade away.

There are other development options, such as gas injection that have the advantage of a readily available market for the condensate production and are not dependent on external enablers such as a gas pipeline, but introduce other challenges.

Any PTU development project must be implemented in a high cost environment which is driven by the development location (remote, arctic, environmentally sensitive location) and the resource characteristics (deep, high pressure, low yield gas condensate reservoir with a large areal extent). Gas injection has a number of challenges including the need for well communication over long distances and the fact that the majority of the liquids recovered in a gas injection project would be recovered in a gas sales development.

Based on the uncertain timing, viability and lengthy project execution period associated with a gas pipeline, alternatives to a gas sales development were considered with the goal of bringing the PTU hydrocarbon resources into production in a timely manner, prior to gas sales, utilizing a prudent development plan. When considering a gas injection project, two competing forces must be considered:

- Large scale development provides economy of scale and lower unit development costs but is exposed to greater impacts from uncertainties surrounding the key development parameters.
- Small scale development has reduced economy of scale and higher unit development costs but is less impacted by uncertainties surrounding the major development parameters. It also provides early confirmation of important development data to be used for full development of the PTU oil and gas resources.

Taking into account these development considerations, a phased development plan was determined to be the most prudent approach for PTU. To implement this approach, an initial production system (IPS), which incorporates gas injection into the Thomson Sand, was selected. The IPS development approach was selected because it will:

- establish production and revenue prior to gas sales
- test the key areas of uncertainty, which include:
  - + evaluation of the reservoir characteristics and performance to determine subsequent development option(s), which could include gas injection expansion and/or gas sales
  - + technology qualification and implementation to ensure development reliability and efficiency (i.e., to ensure minimal impacts to project cost, schedule and long-term operability). Key technology challenges include:
    - high pressure gas operations (~10,000 psi)
    - high pressure gas separation

- extended reach drilling into abnormally pressured formations
- high rate gas well production (i.e., well design and production)
- allow efficient use of capital and reduce the risk of under-utilized facilities
- establish infrastructure, including export pipeline, wells, gravel mine, gravel pads, communications facilities, airstrip, camp facilities, and a disposal well which are consistent with future development phases
- minimize environmental impacts
- provide maximum flexibility to incorporate learnings and utilize the installed infrastructure to develop additional oil and gas resources within the Unit area

IPS development plans are more fully described in Section 4. Subsequent phases of field development will depend upon delineation, IPS results and the status of a gas pipeline project. Development scenarios include: 1) expansion of gas injection, 2) gas sales, or 3) a combination of expanded gas injection and gas sales. Use of IPS facilities for potential delineation, long term production and development of the Brookian after initial Thomson Sand development, will also be determined.

### 3. Drilling

This POD fully delineates all of the PTU reservoir horizons. A multi-year drilling program will be commenced in the 2008-09 winter season to drill a minimum of five wells. The Point Thomson Delineation and Development Schedule in Section 5 depicts a continuous drilling program. Drilling will deliver production to IPS and evaluate Thomson Sand gas and oil rim potential, Pre-Mississippian, and Brookian oil potential. Delineation objectives of the program are provided below.

The drilling program involves wells drilled from the central, western, and eastern areas of the field. New gravel pads will be constructed to accommodate delineation wells to the western and eastern areas of the PTU and future drilling for full field development. The well program will be optimized during detailed well planning based upon results from previous wells to achieve the most efficient combination of delineation targets.

The drilling will begin from the Point Thomson No. 3 location with the central injector and producer wells for the IPS project. Operations from the PTU-3 site minimize environmental impacts by utilizing an existing gravel pad and provide greater drilling flexibility. The central gas injection well will develop an area located northwest of the PTU-3 site. The central producer will develop an area to the southeast of PTU-3. These wells will be fully evaluated using wireline logs, core, and samples and pressures from the reservoir. While the wells have been located to achieve project objectives, the overall IPS schedule, as detailed in Section 5, will allow time (without impacting production start-up) to side-track a well should it encounter reservoir conditions that are not anticipated and that could adversely impact performance.

A disposal well will also be drilled from the Point Thomson No. 3 location to support drilling, delineation and production operations.

Drilling from the western pad will target the Thomson Sand gas and oil legs and the Brookian. Where practicable, wells will penetrate the Pre-Mississippian. The area west of PTU-1 is an area of the field with uncertainty as to structure, facies and reservoir rock

quality. The program allows drilling toward the western syncline ("graben") and other western targets, including potential horizontal trajectory well bores in the oil column.

Drilling from the eastern pad will also target penetrating the Thomson Sand reservoir, including the eastern extent of the oil rim and the Brookian. Similar to the western area delineation drilling, the eastern pad drilling will evaluate structure, contacts and facies, with potential for a horizontal well into the oil rim.

Viable wells will be tied back to the IPS facilities.

The wells drilled under this POD will gather important information on stratigraphy, reservoir rock properties, structure, PVT data, fluid contacts and productivity. In particular, additional data acquired during the drilling program will be integrated with existing data to determine viability of oil production and potential integration with IPS facilities. The drilling program will provide opportunities for collection of critical dynamic reservoir information through testing or longer term production.

Delineation drilling provides definition for development optimization with the following objectives:

- Evaluate areas of Thomson Sand reservoir uncertainties (facies and structure) and confirm areas of high gas resource density
- Gain additional information on the Pre-Mississippian
- Obtain fluid properties from various locations and reservoirs
- Improve understanding of the oil characteristics and long-term productivity of the Thomson Sand oil rim
- Evaluate Brookian productivity and characteristics

The drilling program continues with a third well designed to evaluate oil production from the oil rim in addition to evaluating other PTU reservoir uncertainties. The presence of an oil rim in the Thomson Sand reservoir has been known for some time. Assessment of oil rim potential involves fluid sampling, coring, pressure monitoring and analysis followed by extended on-site well tests, where merited.

The remaining drilling objectives and locations will be determined in detailed design based on previous drilling results.

The Brookian reservoirs have substantial risks and uncertainties associated with their development as demonstrated previously on the North Slope at Badami. Results to date at PTU have been consistent with the poor reservoir quality seen at Badami. Past studies have found these developments to not be commercially viable on a stand-alone basis.

In wells planned for Thomson Sand development, LWD (logging while drilling) data will be collected in Brookian penetrations to evaluate one or more of the prospects known as Iceberg, Galloway or Flaxman. These results will be evaluated to determine the value of additional information such as sidewall cores, wireline logs and fluid samples.

Commercial development of the Thomson Sand is viewed as the best path to potential development of the Brookian by providing a shared infrastructure that would reduce appraisal and development costs. To facilitate Brookian delineation and development, the suitability of IPS surface facilities for a long term Brookian production test after initial Thomson Sand development will be determined.

#### 4. Development Work Scope

##### Initial Phase Production and Gas Injection Development

This POD is a firm commitment to drill wells and begin commercial production from the Thomson Sand utilizing an IPS. Production start-up is anticipated by year-end 2014, provided POD approval is received and required permits are obtained in a timely manner. During the POD period, owners will drill delineation/development wells, complete Conceptual Engineering, Front End Engineering and Design (FEED) and execution planning, obtain permits and authorizations and construct facilities for the IPS project. The IPS development schedule reflects an estimate of the time required to secure the necessary permits through multiple agencies.

##### Initial Production System (IPS) Development

IPS development will achieve production of PTU hydrocarbons and assist with full development of both liquids and gas through a phased approach. The IPS development is not dependent on an off-lease road. Thomson Sand development wells, a central production facility (CPF), and infrastructure to support operations will be located at the existing PTU #3 exploratory well gravel pad. The small footprint required and utilization of an existing gravel pad will minimize new gravel requirements and environmental impacts.

Drilling for the IPS project will begin in the 2008/2009 winter season with the central injector and producer wells from the Point Thomson No. 3. The central gas injection well will develop an area located northwest of the PTU-3 site. The central producer will develop an area to the southeast of PTU-3.

Additionally, a disposal well will be drilled at the PTU-3 site to support drilling and production operations.

The IPS will be designed to produce at a gas offtake rate of 200 million cubic feet per day. This will yield condensate rates of about 10,000 barrels per day. Gas production rates at this level may be achieved from a single production well in the high pressure Thomson Sand reservoir. The processed gas will be compressed and re-injected into the Thomson Sand reservoir through a gas injection well. Liquid hydrocarbons will be separated and stabilized at the CPF, then shipped through a new pipeline from the PTU to a Badami pipeline tie-in for delivery to the TransAlaska Pipeline System (TAPS).

The CPF will consist of two trains capable of processing 100 million cubic feet per day and 5,000 barrels per day each. Each train will be equipped with reciprocating compressors capable of re-injecting gas at the required injection pressures (~10,000 psi). The liquids pipeline will be sized to handle full field development. Disposal of waste liquids will be handled using an on-site disposal well. Other infrastructure such as camps, utilities, warehouse, in-field road and airstrip will be included. No permanent off-lease roads are necessary during the term of this POD. These facilities will be designed to accommodate future development options. Attachment A shows a preliminary IPS development plot plan and description. Attachment B shows a preliminary IPS process flow diagram.

The IPS performance will provide information to address reservoir and technical uncertainties and help manage those risks. Expected production and pressure response associated with the IPS have been evaluated in recent technical studies. Data obtained

during the drilling program will be used to test model predictions. Production response from the IPS will further narrow the range of resource uncertainty. Low-side scenarios will be identified relatively quickly, likely within the first year of production. High-side scenarios will take a longer production period to establish or differentiate.

#### Development Support

Technical and environmental activities will be conducted, including updating and/or supplementing previous environmental baseline studies, preparing and submitting applications, and working with regulatory agencies to secure necessary drill well and facilities permits and minimize environmental impacts. To minimize environmental impact, opportunities for use of adjacent infrastructure for logistical support will be evaluated.

#### Expansion of Gas Injection Development

The IPS project will be designed to provide flexibility for expansion. In addition to facility and drilling considerations, the reservoir development and monitoring plan will include acquisition of information to reduce resource uncertainty for analysis of expansion options. Additional details are provided in Section 8.

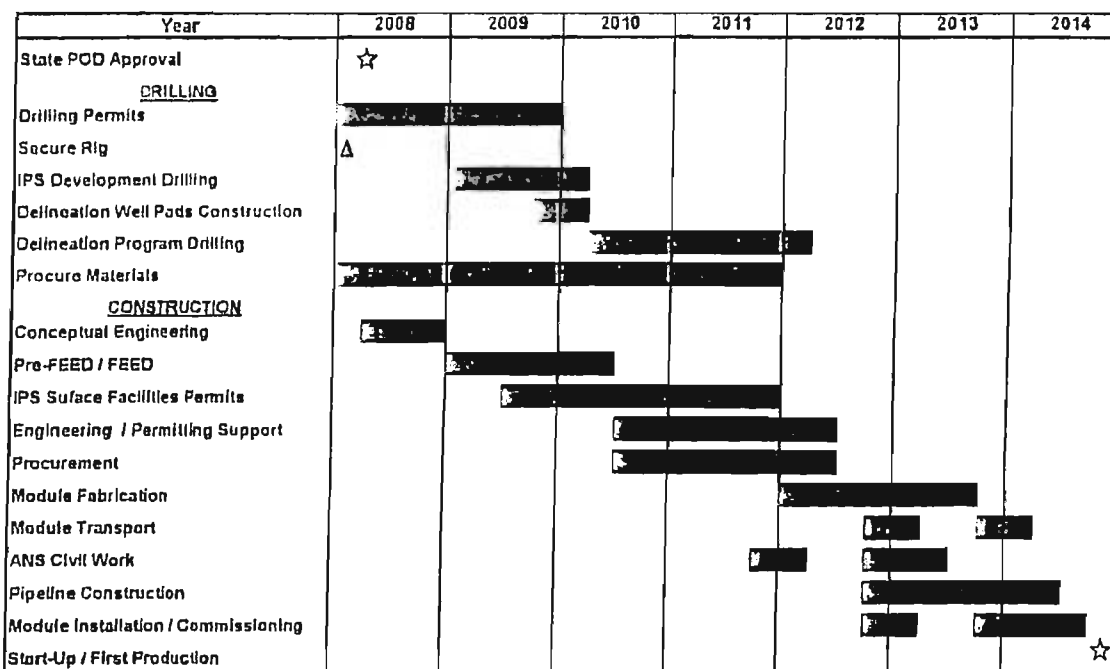
#### Combined Gas Sales / Expanded Gas Injection Development

Owners will have the ability to expand gas injection in the context of other development work, which would include development plans worked in parallel with the status of a gas pipeline. This work will be addressed in more detail in subsequent plans of development.

POD progress reports will be provided to the DNR by October 1 of each year. Technical review sessions will be conducted at logical completion points.

## 5. Point Thomson Delineation and Development Schedule

The current schedule for the delineation drilling and IPS development project is provided below (note that certain field activities may be dependent upon Alaska seasonal constraints).



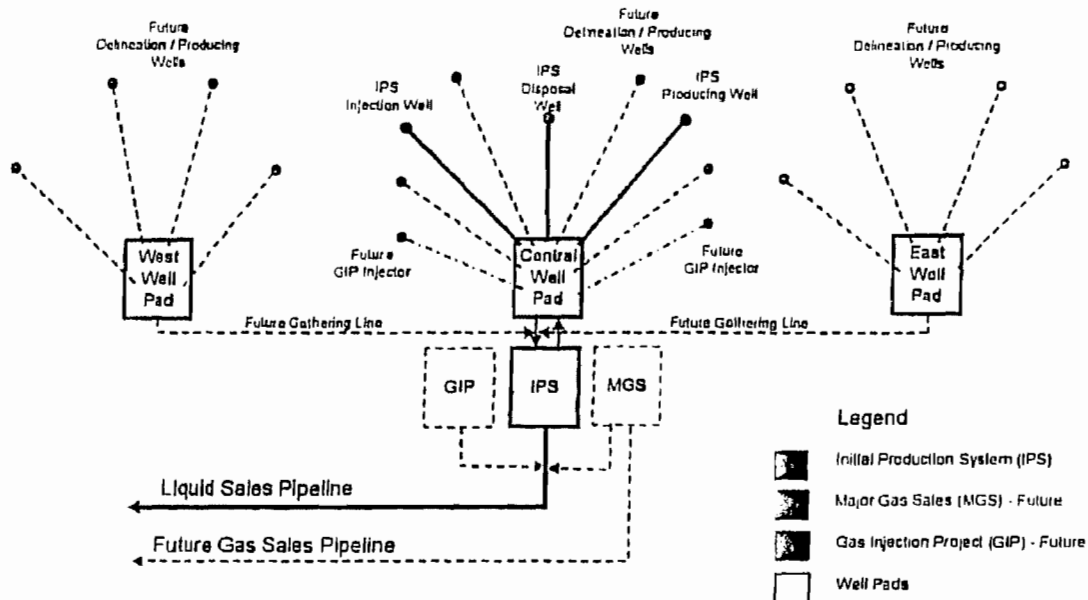
IPS project work will encompass the following activities:

- Perform Conceptual Engineering for the IPS project
- Perform FEED and execution planning to define the IPS project in sufficient detail to submit permit applications and update costs
- Initiate drilling in the 2008-09 winter season, upon receipt of permits
- Review and update environmental baseline studies, prepare permit applications, and support the permitting process to obtain the approvals
- Initiate construction, upon receipt of permits

## 6. Subsequent Delineation and Development

Subsequent phases of field delineation and development will be determined based upon reservoir and facilities performance with the IPS, the status of a gas pipeline project, expected hydrocarbon recovery, and commercial viability. Development scenarios include 1) expansion of gas injection, 2) gas sales or 3) a combination of expanded gas injection and gas sales. Use of IPS facilities for delineation, long term production and development of other reservoirs after initial Thomson Sand development will also be determined. Figure 4.1 is a diagram that depicts conceptual development plan scenarios for the options described above. Attachment A also provides a conceptual expansion plan for the CPF.

Figure 4.1 Conceptual Development Diagram



**DEVELOPMENT PHASING:**

- Initial Phase: Initial Production System or IPS (Solid Lines)
- Subsequent Phases (Dashed Lines) Could Include:
  - Gas Injection Project (GIP) Expansion
  - Major Gas Sales (MGS)
  - Combination of Both

**7. Point Thomson Gas Sales Development**

A significant step for a PTU gas sales development is to secure firm shipping capacity through a gas pipeline. To accomplish this, individual owners will need to make long-term commitments in an open season nomination process. This requires that the owners have confidence in the ability to produce the necessary volumes of gas from PTU and a good understanding of the cost of the facilities and wells required to implement a gas depletion development plan.

Owners will complete the work necessary to allow each individual owner to participate, subject to the terms and conditions each individual owner deems appropriate, in an open season for a gas pipeline after approval of pool rules by the AOGCC. PTU gas sales will require major facilities and pipeline additions / expansions and the drilling of additional wells. Gas sales Conceptual Engineering will be undertaken in parallel with engineering work for the IPS to ensure the IPS and potential gas sales development designs are integrated and compatible. Front End Engineering and Design (FEED) will be initiated during the POD period to ensure PTU gas sales development work can be accomplished in parallel with a gas pipeline. The following specific work tasks will be initiated and conducted during the POD period:



- Using geological modeling and reservoir simulation work completed in 2007, conduct Conceptual Engineering to develop the detail and quality of the facility design and cost estimate, including early project development basis, early project execution plan, safety system design philosophy, logistics plan, regulatory permitting plans and cost estimate.
- In conjunction with Conceptual Engineering, update drilling and completion plans and costs for gas sales development wells. This will include determining optimum drillsite locations and completion concepts, and selecting individual well locations and displacements, and estimating drilling and completion times and costs. This information will be important in determining total gas sales development costs and timing.
- Continue planning for the permitting process
- FEED for gas sales will be initiated during this POD period to ensure this work can be completed in advance of a gas pipeline project

As discussed in Section 9, owners have commenced the process for and will seek approval of pool rules from the AOGCC for the offtake rate and gas depletion development plan to allow individual owners to participate, subject to the terms and conditions each individual owner deems appropriate, in a gas pipeline open season.

## **8. Expanded Development**

### **Gas Development**

The IPS design will allow for expansion of gas injection development. Screening studies of expansion of gas injection development will be conducted after the IPS has commenced production and key performance information has been gathered. This work will be used to assess the potential for additional development through expansion at varying injection capacities. This work will be addressed in more detail in subsequent plans of development.

### **Oil Rim Development**

The Thomson Sand reservoir contains an oil column (oil rim) that underlies the gas and will be further appraised. Technical work that has been conducted to date indicates there are limited reservoir targets where high quality reservoir rock intersects the oil rim. To help address technical uncertainty regarding drilling cost, sand thickness, and producibility of the oil, delineation wells will be drilled to evaluate the Thomson oil rim, as discussed in Section 3.

Data collected during the drilling of each oil rim delineation well will be evaluated to determine the value of collecting additional information such as core, wireline logs, fluid samples and productivity. Depending upon the results from static data and other information gathered in drilling the wells, the next step would be to install temporary test equipment onsite and conduct a production test to improve understanding of the viability of developing and producing the oil rim.

During Conceptual Engineering and FEED for the IPS project, facilities will be designed to accommodate production from viable Thomson Sand oil rim wells. If oil rim testing results

are encouraging, production from viable wells will be processed at the IPS facilities. The pipeline, described in Section 4, for full scale liquid development of the PTU can accommodate production from the oil rim.

#### **9. PTU Pool Rules**

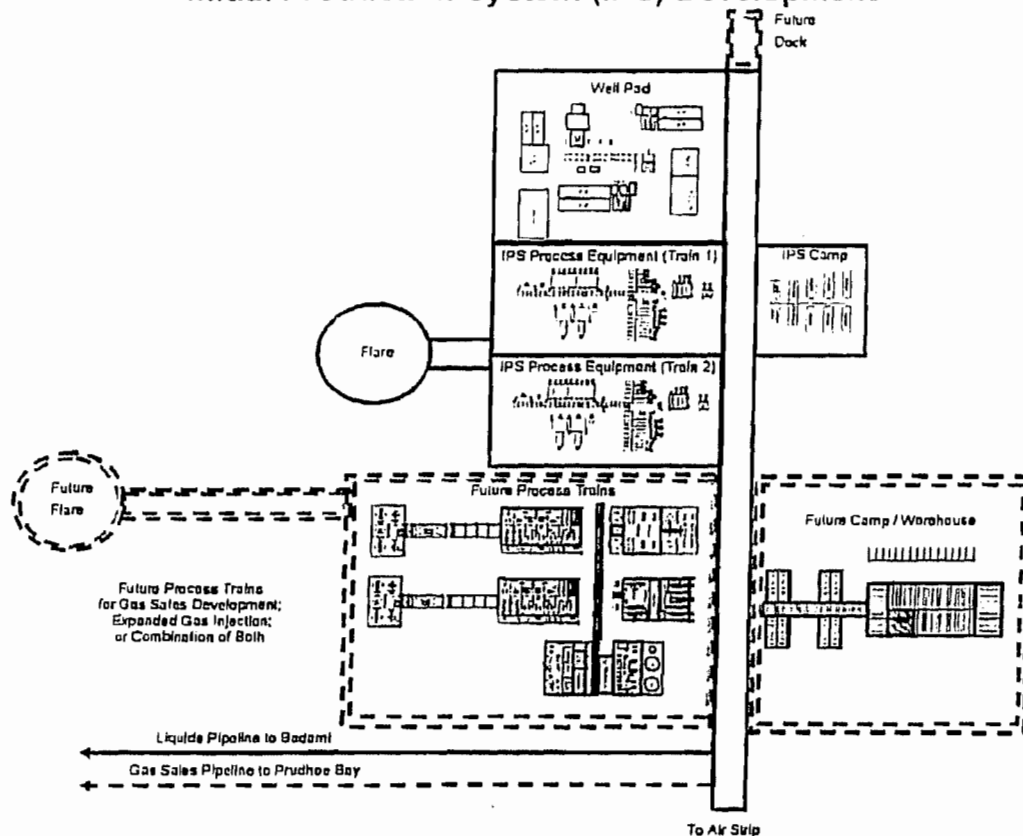
A key regulatory requirement for any PTU development is obtaining approval for pool rules from the AOGCC. As part of the process to obtain approval of pool rules, confidential PTU technical data has been shared with the AOGCC via a data room, beginning in August 2007. Following completion of the data room process, which is anticipated to be by year-end 2008, a request for approval of pool rules for the IPS development will be submitted to the AOGCC.

The data room also provides the AOGCC information that is relevant for gas sales. To ensure owners are able to individually participate in an open season process for a gas pipeline, approval of necessary pool rules to authorize the desired gas offtake rate for the gas depletion development plan will be requested. This submittal will be timed so the conservation order could be issued prior to the open season.

#### **10. Work Performed Since October 1, 2005**

A summary of the work performed since October 1, 2005, is described in Attachment C. This work will be reviewed with the DNR as soon as practicable.

## Attachment A Initial Production System (IPS) Development



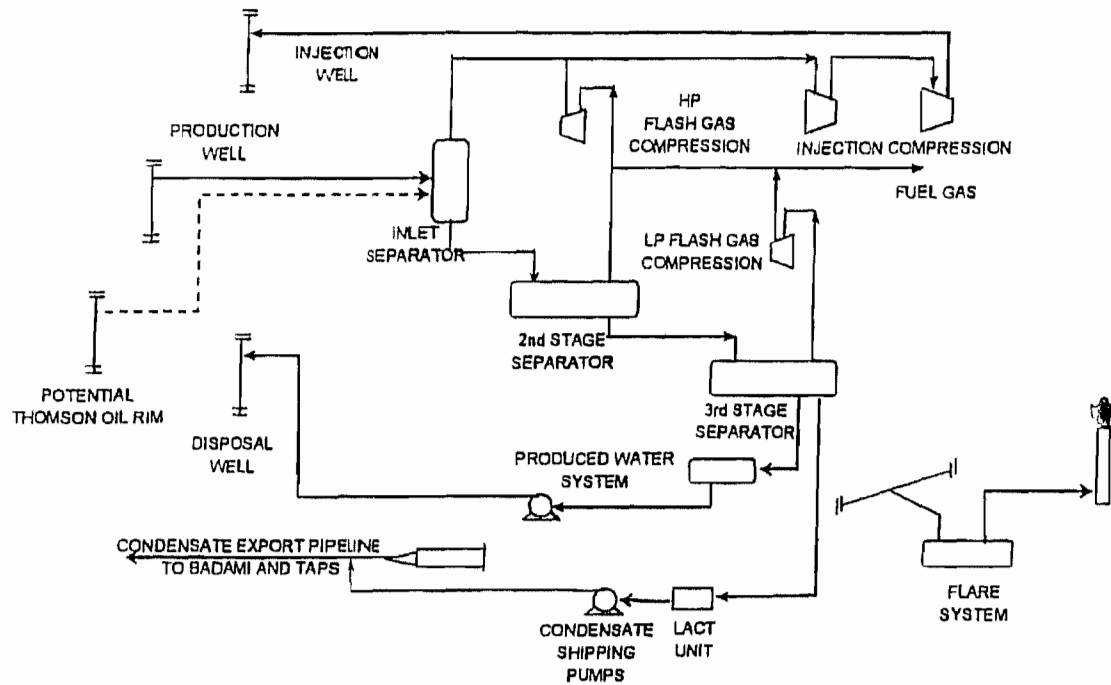
### IPS Design Basis

- Single pad with 3 initial delineation/development wells (producer, injector and disposal)
- Initial Production system for separation, compression and condensate stabilization
  - 2 train x 3 stage flash separation
  - 2 train x 2 stage gas injection compression (3,000 psi to 10,500 psi)
- Power, water, sewage, diesel and methanol tanks, telecom
- Liquid hydrocarbon export: 8" to 12" pipeline to Badami pipeline tie-in point
- Construction camp, operations camp and warehousing; airstrip

### Summary

- Initial Gas Rate: 200 million cubic feet per day
- Initial Condensate Liquids Rate: 10,000 barrels per day
- Initial oil rim liquids rate for processing at IPS facilities to be determined in conceptual engineering

# Attachment B IPS Process Flow Diagram



## Attachment C Summary of Work Performed To Date

A summary of the work performed since October 1, 2005, is described below.

- C.1 Consistent with owner efforts to determine an appropriate development plan for PTU and to prepare for a gas pipeline open season, an extensive Thomson Sand reservoir description and uncertainty analysis was performed from 2004 to 2008. The uncertainty analysis was designed to advance the technical definition of the Thomson Sand reservoir and ensure proper characterization of the uncertainty range. Base case, low side and high side geologic scenarios were constructed to incorporate distinct variations in key parameters. The modeling of these parameters allowed for analysis of their potential impact over the entire PTU area.

A rigorous investigation of the Pre-Mississippian section was undertaken and incorporated into the geologic modeling. Particular effort was directed to understanding the implications of the Pre-Mississippian section as a potential gas reservoir and aquifer. Seismic definition of the Pre-Mississippian section was augmented by examining Point Thomson well core and analog based modeling of potential fracturing. The impact of Pre-Mississippian section fracturing on permeability and porosity is modeled as sensitivities within reservoir simulation cases. Available well logs and test data from the Thomson and Pre-Mississippian were reviewed. The owners have concluded that the two appear to be in pressure communication. Furthermore, initial completions in the Thomson Sand could be expected to pressure deplete the Pre-Mississippian and would need to be positioned to avoid the risks of aquifer influx or fractured reservoir behavior.

An iterative preliminary reservoir model construction and simulation effort was completed in support of the overall uncertainty analysis. This work was used to evaluate changes in the geologic models and identify major factors impacting dynamic performance and recovery. A rigorous analysis of these major factors was implemented and formed the basis for input to the geologic models. After the geologic models were constructed and reviewed, they were used in full-field compositional reservoir simulations. These simulations form the core of a statistical analysis that studied key subsurface factors impacting a PTU development.

The factors having the greatest impact on resource size and performance were facies, porosity distribution, and structural uncertainty related to velocity-depth conversion. The facies distribution was varied to represent a reasonable range of possible depositional environments for the Thomson Sand, ranging from laterally amalgamated fan deltas to more discrete fan delta lobes with intervening lower quality siltstone facies. Correspondingly, the porosity ranges were varied to be consistent with the facies distributions. Three facies types are present in the Thomson Sand; conglomerates, sandstones and siltstones. Conglomerates exhibit high as well as low porosity due to the deleterious effects of cementation, sandstones exhibit the best porosity, and the siltstones generally exhibit the lowest porosity. The facies and porosity impacted both the resource size and recovery. The impact of structural uncertainty was analyzed and varied as a function of distance from well control by flexing the structure up and down. Structure primarily impacts the resource

size. Although these three factors had the most significant impact, other factors that could impact the resource and recovery were investigated as part of the uncertainty analysis such as reservoir thickness and water saturation, as well as Pre-Mississippian volume, connectivity, and faulting.

The results of the uncertainty analysis served as a guide in the selection of input parameters for the construction of representative low, high and base case models. Based on the geologic models completed in 2007, the In-place resource range for the Thomson Sand in the Point Thomson field was updated. The resultant simulation models formed the basis for the PTU development planning studies conducted in 2007.

- C.2 Development planning studies were completed to evaluate alternate development options. This included developing screening cost estimates for facilities and drilling. The alternate development options included gas injection and gas storage options. This work resulted in the selection of the IPS described in this POD as the appropriate way to bring the PTU into commercial production.
- C.3 Facilities and pipeline work was focused on preparing execution plans for Conceptual Engineering for both hydrocarbon liquids production via the IPS and gas sales. The execution plan includes a detailed scope of work listing each of the deliverables to be prepared, the degree of completion (initial, update, final) and responsible party (owner, Engineering Contractor). The plan also includes determination of organization and staffing level requirements. This will allow for a rapid initiation and ramp-up of Conceptual Engineering upon completion of the reservoir simulation work.
- C.4 Significant completion related technical studies were conducted including a laboratory study to measure and analyze rock compressibility data from Point Thomson core samples, a surface subsidence study, a well operability limit (WOL) study and a completion design study. The results of these studies will be used during the Conceptual Engineering phase to study, refine and optimize the completion concept selected.
- C.5 Previous permitting support documents were reviewed in preparation for permitting activities. A significant amount of work for the previous gas injection development has been identified as applicable for other development options.
- C.6 The process of applying for pool rules from the AOGCC was initiated. The AOGCC and the owners agreed to a protocol for the sharing of confidential data with the agency and the protocol was adopted by the AOGCC at a public meeting on April 26, 2006.

A comprehensive PTU review was held for the AOGCC and their consultants in May 2006. The review included discussion of the previous gas injection development efforts and introduced the owners' work to assemble a proprietary worldwide database of potential Point Thomson analogue reservoirs. The results of the analogue study and worldwide database were presented to the AOGCC in December 2006. The data room process was initiated in August 2007 with the first in a series of steps to share confidential subsurface description and development plans for the

Thomson Sand reservoir. Steps 1 and 2, comprising Reservoir Data & Interpretation and Structure & Seismic Interpretation, have been completed. Step 3 on Fluid Data & Analysis is ongoing.

- C.7 In preparation for commencing drilling in the 2008/2009 winter season, detailed well construction work has been performed to establish the functional and technical specifications for hardware (i.e., casing, tubing, wellhead, trees and subsurface drilling and completion equipment), drill rig requirements, fluid design (i.e. mud and cement), and well operability limits. A drill rig has been secured and purchase orders for long-lead materials placed to commence development drilling for the IPS.

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DEPARTMENT OF  
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FEB 19 2008

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In re Remand Proceedings from the  
Superior Court for the State of Alaska.  
Regarding:

Point Thomson Unit Agreement

WITNESS LIST  
(ConocoPhillips Alaska, Inc.)

ConocoPhillips Alaska, Inc. ("CPAI") submits the following list of witnesses it  
intends to call at the hearing scheduled to commence on March 3, 2008:

1. Mark M. Ireland (North Slope Gas Upstream Development Manager,  
CPAI)

Mr. Ireland will testify as to (i) the proposed plan of development, (ii) the PTU reservoirs, including their physical characteristics and uncertainties, and how this relates to potential development activity, (iii) oil and gas field development practices, (iv) the working interest owners' performance of their obligations to produce the PTU in a reasonably prudent manner, (v) potential remedies, including how they would or would not serve

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conservation objectives, cause the most economical and efficient recovery of hydrocarbons without waste, represent good and diligent oil and gas engineering and production practices, and adequately protect all parties in interest, and (vi) the consequences of termination of the PTUA.

2. Pete Frost (Pete Frost, Director of Regulatory Affairs, Gas & Power Marketing Group, ConocoPhillips Company)

Mr. Frost will testify as to the nature of open seasons and shipping commitments in the context of an Alaska natural gas pipeline.

3. Rebuttal Witnesses

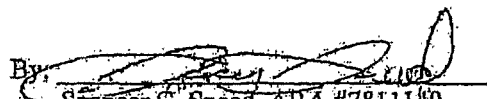
ConocoPhillips reserves the right to call any witness in case of surprise, as well as any witness whose testimony may be necessary to rebut or to respond to testimony or other evidence submitted by any other party to this proceeding, including the State of Alaska.

4. Other Witnesses

CPAI reserves the right to call any witness listed by any other party to this proceeding or called by the State of Alaska, as well as any witness whose testimony may be necessary or proper to respond to questions raised by the Commissioner or members of his staff concerning matters not addressed by Mr. Ireland or Mr. Frost or better addressed by other persons.

Dated at Anchorage, Alaska this 19<sup>th</sup> day of February, 2008.

DORSEY & WHITNEY LLP  
Attorneys for ConocoPhillips Alaska, Inc.

By:   
Spencer C. Sneed, ABA #7811140  
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CERTIFICATE OF SERVICE

I hereby certify that on the 19<sup>th</sup> day of February 2008, I caused a true and correct copy of the foregoing document to be served by U.S. Mail on:

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**DEPARTMENT OF NATURAL RESOURCES**

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In re Remand Proceedings Pursuant to  
December 26, 2007 Order of Superior Court  
Regarding Point Thomson Unit Agreement

DEPARTMENT OF  
NATURAL RESOURCES

MAR 21 2008

COMMISSIONER'S OFFICE  
ANCHORAGE

**POST-HEARING BRIEF OF EXXON MOBIL CORPORATION, BP  
EXPLORATION (ALASKA) INC., CHEVRON U.S.A. INC., AND  
CONOCOPHILLIPS ALASKA, INC.**

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The four largest Working Interest Owners ("WIOs"), Exxon Mobil Corporation, BP Exploration (Alaska) Inc., Chevron U.S.A. Inc., and ConocoPhillips Alaska, Inc. submit this brief with respect to issues that arose at the hearing before the Department of Natural Resources ("DNR") from March 3 to 7, 2008. The WIOs submitted comprehensive briefing before the hearing, and they incorporate, but do not reargue, the points in the WIOs' pre-hearing briefing and correspondence.<sup>1</sup> We thank Commissioner Irwin and the Hearing Officer for agreeing to hold the hearing and for their courtesies during it.

The hearing was on remand from Judge Gleason's decision that Commissioner Menge's decision to terminate the Point Thomson Unit ("PTU" or "Unit") was invalid because it did not afford due process to the WIOs. Judge Gleason's Decision on Appeal (Dec. 26, 2007) ("Decision") 39-42. The issue at the hearing was what "remedy" was appropriate for DNR's decision to reject the 22<sup>nd</sup> Plan of Development submitted by the WIOs. For reasons stated in the WIOs' Brief previously filed, and for reasons elaborated hereafter, the WIOs do not believe that there was a breach of contract, let alone a material breach of contract that could be grounds for termination of the Unit. On the contrary, the Court held expressly that DNR's rejection of a Plan of Development ("POD") was not a

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<sup>1</sup> The prehearing briefing and correspondence includes: the February 8, 2008, letters regarding procedures on remand from Douglas J. Serdahely on behalf of all Appellants; the February 21, 2008, letter from Douglas J. Serdahely on behalf of all Appellants; and the Brief of Exxon Mobil Corporation, BP Exploration (Alaska) Inc., Chevron U.S.A. Inc. and ConocoPhillips Alaska, Inc. on Remand by Superior Court Order Dated December 26, 2007, filed on February 19, 2008 ("WIOs' Brief").

"default." Decision 34-35. The Court also required the Commissioner to consider the import of Section 21 of the Point Thomson Unit Agreement ("PTUA") in determining what remedy is appropriate. Decision 42.

The WIOs believe that the appropriate "remedy" for the Commissioner's previous rejection of the 22<sup>nd</sup> POD is the submission and approval of a Plan of Development that meets the Commissioner's objectives and removes the objections that the Commissioner raised to the 22<sup>nd</sup> POD. In this case, given that the Commissioner did not specify what his objectives and objections were, the WIOs fashioned a POD that attempted to meet the objectives of the Commissioner as the WIOs understood them -- that is, a POD which provides for the delineation of all the Unit reservoirs and for prompt production of hydrocarbons from the Unit. The WIOs thus have presented the 23<sup>rd</sup> POD, which all the WIOs, as well as the Minority Interest Owners, fully support. For the reasons set out hereafter, the WIOs believe that the facts and the law require that the 23<sup>rd</sup> POD should be approved, that termination would be improper, that there is no basis for additional non-contractual sanctions or penalties imposed unilaterally as a condition of approval, and that such sanctions or penalties would be beyond the Commissioner's legal authority.

**I. THE APPROPRIATE REMEDY IS TO APPROVE THE 23<sup>rd</sup> PLAN OF DEVELOPMENT.**

**A. Introduction.**

The unrebutted evidence presented at the hearing on remand demonstrates that approval of the 23<sup>rd</sup> POD serves the best interests of all parties, including the State. Thus, the Commissioner should adopt this as the best remedy, even if the Commissioner

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believes termination of the PTU is a legal option. The 23<sup>rd</sup> POD provides for delineation of all the Unit reservoirs and for prompt production of condensate through a gas injection project. Testimony, and the affidavits submitted after the hearing, made clear that all the WIOs fully support the 23<sup>rd</sup> POD and have committed to fully funding the necessary investment, estimated at approximately \$1.3 billion, to delineate all PTU reservoirs and to bring the PTU into production. Furthermore, the POD contemplates facilities that are expandable, so as to allow for full development of all PTU resources that are demonstrated to be capable of commercial production. Testimony affirmatively established that the 23<sup>rd</sup> POD meets the obligations of a reasonably prudent operator. No testimony suggested that the 23<sup>rd</sup> POD is improper, inadequate, unworkable, or imprudent, given the known risks and uncertainties.

Section 10 of the PTUA, as interpreted by Judge Gleason, gives the Commissioner the power to reject a POD if it is not 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." Decision 21-22.<sup>2</sup> While this language on its face confers broad discretion, Alaska cases make clear that the Commissioner's ability to reject a POD as not "as complete and adequate as the Director may determine to be necessary" is constrained by an objective standard.<sup>3</sup> Section 10 does not permit the

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<sup>2</sup> For purposes of these remand proceedings, Judge Gleason's decision establishes the law of the case. The WIOs reserve the right to challenge any aspect of that decision, if this matter is eventually appealed to a higher court.

<sup>3</sup> See *Kennedy Assocs., Inc. v. Fischer*, 667 P.2d 174, 182 (Alaska 1983) ("In

Commissioner to reject a proposed POD based on whim or caprice. If the Commissioner rejects the 23<sup>rd</sup> POD, it must be on the basis of an objectively reasonable finding that the POD does not adequately provide for timely development of the Unit area, or because the POD does not satisfy legitimate conservation objectives. The record does not support either finding.

B. The 23<sup>rd</sup> POD Meets All the Criteria of the PTUA and Any Applicable Regulations.

Under the 23<sup>rd</sup> POD, the WIOs will substantially increase the rate of prospecting and development in the PTU. The WIOs will drill a minimum of five wells, which will delineate all PTU reservoirs and provide wells for production of unitized substances. The WIOs will plan and construct production facilities, and begin production, commencing an income stream for the State. No prior POD for the PTU contained a firm and unconditional commitment to production.

Three sections of the PTUA arguably have a bearing on whether the proposed POD should be accepted by DNR. The 23<sup>rd</sup> POD easily meets the criteria of these sections.

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adopting the preference for an objective test of satisfaction we expressly follow the RESTATEMENT (SECOND) OF CONTRACTS § 228 (1981), which provides: 'When it is a condition of an obligor's duty that he be satisfied with respect to the obligee's performance or with respect to something else, and it is practicable to determine whether a reasonable person in the position of the obligor would be satisfied, an interpretation is preferred under which the condition occurs if such a reasonable person in the position of the obligor would be satisfied.'").

PTUA Section 10 requires that any POD submitted pursuant to Section 10 must "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." It must specify the "number and location of any wells to be drilled and the proposed order and time for such drilling," and it must, "to the extent practicable, specify the operating practices regarded as necessary and advisable for the proper conservation of natural resources." It must 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." The plan must meet the standards of a reasonably prudent operator ("RPO").

The 23<sup>rd</sup> POD meets these requirements:

- The POD specifies the number and approximate location of the wells to be drilled, and the proposed order and time for such drilling.
- The POD specifies, to the extent practicable, the operating practices to be used to conserve natural resources. The focus on producing liquids (condensate and oil), before producing gas, meets the objections previously voiced by the Alaska Oil & Gas Conservation Commissioner ("AOGCC") when the WIOs contemplated a plan that emphasized gas blowdown, without any cycling. William Bredar and Dennis O'Brien testified specifically about how the current POD, with its focus on liquid production, conserves resources. Remarks by AOGCC Commissioner Foerster, read into the record, indicate her apparent concurrence that the 23<sup>rd</sup> POD meets conservation objectives.

- The POD provides for diligent drilling into all of the known reservoirs, to further delineate these reservoirs.
- The POD explains the route to production of every reservoir that is determined to contain quantities of hydrocarbons that will support commercial production.
- The POD meets the RPO standard. A reasonably prudent operator acts in good faith, with the expertise and competence of companies experienced in the industry, and with due regard for the interests of all parties, including the lessor and lessees. The WIOs put forth this plan in good faith, with a sincere commitment to attempt to resolve the litigation that has blocked development of the PTU and to provide a constructive and expedient way to move forward to first production of unitized substances. The WIOs have substantial experience in the industry and, after extensive work with employees and outside consultants, they have developed a robust plan that is feasible, realistic, and balanced, considering the unique challenges posed by this complex and remote field. The plan strikes a prudent balance between a desire to move quickly to production and the need to move carefully, based on adequate data and planning, in order to achieve a successful project and to avoid the added expense and likelihood of failure that follow almost inevitably when thoughtful planning and data collection are given short shrift. The plan protects the interest of the State as well as the lessees because it commits to permanent improvements in the Unit, including a minimum of five production wells, a full-scale liquid export pipeline to Badami, and expandable facilities

for the Initial Production System, all designed to begin producing revenue for the State in an expedient and prudent manner.

- Only DNR can say whether, applying the appropriate (and objective) standard, this POD is "as complete and adequate as the Director may determine to be necessary." No questions asked at the hearing suggested it is not. If DNR believes the POD is not "as complete and adequate" as the Director reasonably determines to be necessary, DNR's duty of cooperation as lessor requires it to work with the WIOs as lessees to identify and discuss any modifications that DNR deems necessary.<sup>4</sup>

PTUA Section 16 provides that all operations and production shall be conducted "to provide for the most economical and efficient recovery of [unitized] substances without waste, as defined by or pursuant to state law or regulation." As discussed above, the 23<sup>rd</sup> POD satisfies these conservation goals, including the interests of both the State and the WIOs in the economical recovery of unitized substances. The commitment to work with the AOGCC, and to complete the data room process, will ensure that that Commission has a fully informed basis for approving drilling and depletion plans that meet conservation objectives.

PTUA Section 21 provides that, when there is no approved plan of development in place, the Director has the authority to "alter or modify from time to time at his discretion

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<sup>4</sup> See Affidavit of Patrick H. Martin ("Martin Aff.") at 19-20 (submitted March 14, 2008); *Trinidad Petroleum Corp. v. Pioneer Natural Gas Co.*, 416 So. 2d 290, 297-98 (La. App. 1982) (duty of cooperation is a part of every oil and gas contract); see also *supra* at n.3 (stressing that any determination by DNR that the POD is "not good enough" must satisfy an objectively reasonable standard).

the rate of prospecting and development . . . in the interest of attaining the conservation objectives stated in this agreement,” but his authority shall not be exercised in any manner that would “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 that would prevent the agreement from “serving its purpose of adequately protecting all parties in interest . . . , subject to applicable conservation laws and regulations.” Section 21 also contains provisions entitling the lessees to notice and an opportunity to be heard before any new rate is imposed by the Director.

If the Director were to direct the WIOs to modify the current rate of prospecting and development by complying with the terms of the 23<sup>rd</sup> POD, the WIOs would not object, even though this POD substantially increases the rate of prospecting and development. The WIOs proposed this POD because it meets or exceeds the substantive standards of Section 21:

- The rate of prospecting, development, and production comports with good and diligent oil and gas engineering and production practices. The POD commits to activities that are consistent with diligent and sound practices, in a time frame that is reasonable. Faster prospecting or development would violate this standard.
- The POD serves the goals of attaining the conservation objectives of the PTUA and conservation of the resource, as discussed above.
- The POD protects the interests of all parties in interest, including the State, by committing to drilling a minimum of five wells, building a pipeline to link the

remote PTU to the Badami export system, and constructing expandable facilities to allow early liquid production. The POD also serves the interests of the Minority Interest Owners, whose interests would be irreparably damaged if the PTU were terminated.

Because the WIOs agree to the terms of the 23<sup>rd</sup> POD, DNR may impose these terms on the WIOs. DNR could not invoke Section 21 to impose any other, more demanding POD without complying with Section 21's procedural and substantive requirements, and the WIOs believe the record shows that faster drilling or a larger cycling project would not satisfy the standards of "good and diligent oil and gas engineering and production practices" or "adequately protecting all parties in interest."

Current regulatory standards governing approval of a POD are set forth in 11 AAC 83.303(a) and (b). This memorandum does not take a position legally on whether or not those regulations apply, since they were adopted after the PTUA took effect. DNR in the past has used these standards. If these standards are legally relevant, the 23<sup>rd</sup> POD satisfies them.

- The POD promotes conservation and avoids waste of natural resources, as discussed above.

- The POD promotes the prevention of economic and physical waste.

The POD is thoughtfully designed to begin with a prudently phased initial production project, in order to control risks and costs; the production facility design provides for expandability if the data gathered during delineation and early production demonstrate that a larger scale cycling project is viable. This phased approach is well known to be the

best way to avoid economic and physical waste.

- The POD provides for the protection of all parties in interest, including the State, the WIOs, the Minority Interest Owners, and overriding royalty owners. The Plan provides permanent improvements in the PTU, which will benefit the State as well as promote development of other nearby resource areas. Economic benefits will flow through the Alaska economy, and new jobs for Alaskans will be created almost immediately. Revenue from production will begin at the end of the POD. Work completed during the term of the POD will enhance the ability of all Unit lessees to participate in gas sales whenever a gas pipeline comes into existence, thereby ensuring that the major hydrocarbon resource in the PTU is available for commercialization at the first available opportunity.

No other remedy, beside approving the 23<sup>rd</sup> POD, will yield income to the State faster or more reliably. Testimony at the hearing established that termination of the Unit, followed by termination of the leases and re-leasing of the acreage, would delay development of the Unit by seven to ten years or more. After that lapse of time, the State and any new owners would be in exactly the same position that the State and the WIOs are today. That kind of delay will not serve anyone's interests, least of all the interests of the State in seeing its resources developed for the maximum benefit of all Alaskans.

#### 11. TERMINATION IS NOT AN APPROPRIATE REMEDY.

The Commissioner and Hearing Officer suggested, through their questions, that they considered that the history of non-production from the PTU could justify termination

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of the PTU, or at minimum imposition of non-contractual sanctions or penalties that would follow from any failure to complete the POD. The historical record does not justify either termination or imposition of non-contractual sanctions.

Until 2005, DNR itself approved the pace of development. Between 1977 and 2005, DNR approved 21 successive PODs. Once the Director approved each POD, that POD defined "the drilling and operating obligations" of the WIOs for that time period. PTUA § 10. If, prior to 2005, DNR had wanted faster development, it could have disapproved one or more of the first 21 PODs, and advised the WIOs what additional or different terms DNR wanted included. DNR did not do so. Instead, DNR was a full participant in determining the pace of development. Although the record reflects some differences of opinion between the WIOs and DNR over the decades, the record also shows that DNR approved each POD. After decades of approving exploration drilling, seismic studies, and various plans for development that did not commit to advancing into production, DNR may decide, as it did in 2005, that its approach to plans of development for the Unit should change. The 23<sup>rd</sup> POD is evidence that the WIOs are prepared to make reasonable accommodations to DNR's desires. But DNR may not treat conduct that it repeatedly approved as any kind of breach of the WIOs' obligations under the PTUA, much less rely on that conduct as a basis for depriving the WIOs of the ability to recoup their \$800 million investment in the Unit.

Similarly, termination of the PTU may not be justified on the theory that there has been a history of failure to comply with the terms of previous PODs. On the contrary, the

WIOs have performed their obligations under all approved PODs. The Affidavit of Craig Haymes, submitted March 14, 2008, addresses the examples of alleged "non-compliance" cited by the Hearing Officer during the hearing.<sup>5</sup> See Affidavit, Paragraph 30 *et seq.* The examples generally involve situations where the WIOs promised to drill a well or take some other action or pay a penalty or accept unit contraction. These were not situations where the WIOs failed to perform a promise; they are situations where the POD or other applicable document<sup>6</sup> gave the WIOs a choice, and they chose one alternative rather than the other. They are analogous to the "drill or pay" leases that were once common in the oil and gas industry: they do not involve a promise to drill, but a promise to drill or pay, and choosing one of the alternatives does not put the Operator in breach of its obligations.<sup>7</sup> They provide no basis for hypothesizing that the WIOs will not comply with the 23<sup>rd</sup> POD, since that Plan has no alternative obligations, no "drill or pay" provisions, no provisional offramps, but instead unconditional activities, including the development of unitized substances using an IPS and the drilling of at least five delineation wells.

There is also no basis for termination based on a supposed "failure to submit an acceptable plan of development." Although Judge Gleason held that DNR's rejection of

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<sup>5</sup> March 7, 2008 Tr. at 1028:3-1032:6.

<sup>6</sup> Recent issues in fact related to the terms of unit expansion agreements, not PODs.

<sup>7</sup> *Gloyd v. Midwest Refining Co.*, 62 F.2d 483, 485 (10<sup>th</sup> Cir. 1933); *Durbin v. Osborne*, 166 S.W. 2d 841, 843 (Ky. 1942); *McDaniel v. Hager-Stevenson Oil Co.*, 243 P. 582, 585 (Mont. 1926).

the 22<sup>nd</sup> POD was within DNR's discretion, even though the Plan met the reasonably prudent operator standard, she held expressly that DNR's rejection of the Plan was not a "default" by the Operator or the WIOs. Decision 34-35; *see* WIOs' Brief 17-21. A fortiori, it was not a material default that could justify termination. WIOs' Brief at 24-34.

Rejection of a Plan submitted by the WIOs means that there comes into play the duty of cooperation that is part of every oil and gas contract.<sup>8</sup> DNR must advise the WIOs of what it wants, and when it has done so the parties have a duty to work together to devise a new POD that promotes and protects the interests of all parties. The key here is *mutuality*: a POD should protect the interests of the State, but it must also take into account the interests of the lessees. If the parties negotiate a POD acceptable to all parties in interest, as they should, the controversy is over. If not, DNR may exercise its powers under Section 21 to accelerate the rate of production and development, consistent with the Unit Agreement. The result of a rejection is not an impasse, not an infinite series of PODs, and not termination of the Unit, merely a requirement that the parties *cooperate* to develop a *mutually* advantageous plan, consistent both with the Unit Agreement and with general principles of oil and gas law.

Here, DNR as yet has not fulfilled its duty of cooperation with respect to developing a mutually acceptable POD. The Commissioner's letter of January 28, 2008, expressly told the WIOs that placing reliance on prior DNR statements and proceedings would be "unreasonable," but the letter did not give the WIOs meaningful guidance as to

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<sup>8</sup> See n.4, *supra*.

what DNR thinks would be required in an acceptable POD. This is not adequate cooperation, but a lack of genuine participation in what should be a mutual process. To the extent DNR's January 28 letter did provide broad guidelines for an acceptable POD, the 23<sup>rd</sup> POD has met those guidelines. DNR said that an acceptable POD would need to "fully delineate all PTU reservoirs." The record shows clearly that the 23<sup>rd</sup> POD does that. DNR also said that an acceptable POD would need to "commit to full and timely development of all PTU reservoirs, including gas, gas condensate, and oil." The 23<sup>rd</sup> POD does that as well. It will produce liquids and re-inject gas. It will extract condensate from the gas. And it will drill wells into the oil rim which will evaluate the oil rim and which will be capable of producing oil if that is commercially viable. The WIOs have thus accommodated DNR's concerns fully, to the extent DNR has made them known. They have fulfilled their own duty of cooperation with DNR, as the Unit Agreement requires. DNR, however, would plainly breach that duty were DNR to terminate the Unit because the WIOs failed to divine and comply with DNR goals and criteria which DNR has not enunciated or explained despite repeated requests for guidance.

Finally, even if termination were permissible here, DNR would be required to define what it wants and give the WIOs an opportunity to cure before it could actually terminate the Unit. An opportunity to cure before termination is required under ordinary principles of oil and gas law, as Patrick Martin explained in his Affidavit. *See Martin Aff.* 22-25. It is also required by ordinary principles of contract law. *See WIOs' Brief* 28-35.

Previous proceedings never advised the WIOs that termination was contemplated, and certainly did not specify what was required to avoid termination; in any event they have been set aside by the Superior Court on the grounds that they lacked due process.<sup>9</sup> The current proceedings are the first occasion on which termination has been considered in a manner even arguably consistent with constitutional requirements. If termination may be ordered on the basis of a material breach, both oil and gas law and general contract law require an opportunity for a cure as a prerequisite. Martin Aff. 22-25; WIOs' Brief 28-35.

### III. ALTERNATIVE REMEDIES ARE NOT APPROPRIATE.

The questioning at the hearing also raised several issues about modifications that DNR might impose as a condition of its approval of the 23<sup>rd</sup> POD, or about potential non-contractual sanctions or penalties for non-compliance. The WIOs do not think that any such modifications, sanctions, or penalties would be appropriate.

As a procedural matter, if DNR intends to propose modifications to a submitted Plan of Development, 11 AAC 83.343(c) contemplates that the Commissioner will advise the WIOs of those modifications, and the WIOs will then have an opportunity to accept those modifications and qualify the POD for approval. The WIOs believe that 11 AAC

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<sup>9</sup> It is also clear that the decisions disapproving the 22<sup>nd</sup> POD did not comply with Section 21 of the PTUA. The Director's decisions in September and October 2005, affirmed in November 2006, both called for an alteration in the rate of prospecting and development in the Unit, and therefore required compliance with both the procedural and the substantive provisions of Section 21. Judge Gleason has rejected DNR's position that Section 21 applies only within the context of an approved POD. She held it must be considered in the context of termination or plan rejection as well.

83.343(c) provides a procedure to follow in this case.

Questions by the Commissioner and the Hearing Officer suggested imposing non-contractual sanctions or penalties that would give DNR additional assurance that the WIOs would carry out their obligations under the 23<sup>rd</sup> POD. The WIOs do not believe that any such additional assurance is needed above and beyond the clear assurances provided at the hearing and in the POD, including the straightforward and unconditional list of activities, the financial commitments, and the new voting provisions among the WIOs.

The WIOs have the will, the incentive, and the capability to perform the 23<sup>rd</sup> POD completely. The Plan contains no conditions or offramps in lieu of performance that would excuse not fulfilling the terms of the POD. The WIOs have affirmed under oath their intent to proceed, they are already working on assembling long lead-time items, there are clear milestones in the Plan so that DNR (and interested stakeholders) can see that the WIOs are on course, the Plan calls for the early investment of about \$400 million in drilling expenses, and the WIOs have even taken the unprecedented step of effectively lowering the voting threshold under the PTU Operating Agreement to a simple majority, so that no single owner can impede the implementation of the Plan. The largest WIOs have provided written evidence of their corporate commitment to the Plan, and to providing the associated funding. There is simply no objective reason to believe that the WIOs will not perform. And as previously stated, the standard for approval of a POD is objective. *See p.5 & n.3, supra.*

It is simply not the case that the WIOs have failed to meet previous commitments that might cause worry that they will not perform this time. And it is not reasonable to infer, because in a number of cases a plan provided for two alternative courses and the WIOs chose one of those permitted courses, that they will default on their obligations when, as here, the Plan of Development does not provide alternative courses, offramps, or payments in lieu of POD deliverables.

Modifications to the POD that involve non-contractual sanctions or penalties for non-conformance would also exceed DNR's power to impose them unilaterally. At the conclusion of the hearing on remand, the Hearing Officer requested briefing on exactly this legal issue:

- Does DNR Commissioner Irwin have the legal authority to enter an order approving a proposed unit plan of development ("POD") subject to sanctions for non-performance, including unit contraction, lease relinquishment or monetary payments?<sup>10</sup>

In an effort to accommodate DNR's concerns, an Agreed Final Judgment that would accept unit termination as a consequence of the WIOs' unexcused failure to perform specified POD milestones (assuming prompt approval of the POD and prompt entry of the Judgment) has been proposed.<sup>11</sup> Given this proposal, the Hearing Officer's question is moot. Nevertheless, if the issue is the Commissioner's legal authority to

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<sup>10</sup> March 7, 2008 Tr. at 1053:1-8.

<sup>11</sup> ConocoPhillips declines to join in this proposal on the ground that the proposal is not relevant to any remedy that DNR may lawfully impose. Nevertheless, ConocoPhillips would be willing to enter into a settlement agreement of the type proposed by the other WIOs outside the remand proceeding process.

impose sanctions or penalties unilaterally, as opposed to accepting a voluntary concession, the WIOs answer the above question "No."

First, the Unit Agreement and the regulations provide specified sanctions for failure to comply with a Plan of Development. Nothing in either the Unit Agreement or in the regulations gives the Commissioner legal authority to unilaterally order additional non-contractual sanctions for the Operator's non-performance of an approved POD, including any requirement that the WIOs forfeit their leaseholds in the Unit.

The PTUA is a contract that defines the parties' rights and obligations.<sup>12</sup> Judge Gleason noted that Section 10 "expressly confers upon the Division the authority to require a plan from the Lessees that '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 . . .'" She interpreted that provision to allow DNR to reject a proposed POD as not in the public interest, even if the Operator complied with the PTUA's reasonably prudent operator standard in preparing and submitting it.<sup>13</sup> But the authority to reject a proposed POD is separate and distinct from the authority to unilaterally prescribe terms and conditions of a POD. Section 10 provides no authority for the latter.

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<sup>12</sup> See *Exxon Corp. v. State*, 40 P.3d 786, 793-94 (Alaska 2001) (recognizing that DNR's rights are determined by a unit agreement's terms where no inconsistent statute or regulation exists on the effective date of the agreement).

<sup>13</sup> See Decision 21-22, 38.



Since the PTUA does not give the Commissioner the authority to *unilaterally* order unit contraction, lease relinquishment or monetary payments as sanctions for failure to perform a POD,<sup>14</sup> any such right must find its source in the statutes or regulations in effect at the time the PTUA was entered into. But there is no authority there either. "Administrative agencies rest their power on affirmative legislative acts. They are creatures of statute and therefore must find within the statute the authority for the exercise of any power they claim."<sup>15</sup> Judge Gleason has ruled that "neither the PTUA nor the applicable regulations and statutes in effect in 1977 permitted automatic termination whenever a POD was unacceptable to the State."<sup>16</sup> Therefore, the Commissioner has no authority to unilaterally impose conditions on a POD that automatically result in forfeiture. Similarly, the Commissioner has no authority to unilaterally order unit contraction or monetary payments as a component of POD approval.

Indeed, the most pertinent of DNR's own regulations appears expressly to deny DNR the power to impose conditions or modifications on a POD unilaterally. 11 AAC 83.343(c) allows the Commissioner to propose modifications to a submitted plan of development. But it says expressly that those modifications shall become part of the plan of development only if "accepted by the Operator." If the Commissioner had the power to impose modifications unilaterally, this provision of the regulations would be

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<sup>14</sup> PTUA §§ 10, 20 [R. 1259-60, 1267-68].

<sup>15</sup> *McDaniel v. Cory*, 631 P.2d 82, 88 (Alaska 1981).

<sup>16</sup> Decision 38.

meaningless.

A number of other considerations support the view that the Commissioner lacks power to impose non-contractual sanctions for non-performance. Some of the potential sanctions referred to in the Hearing Officer's question, such as unit termination, could be imposed contractually only for a material breach of the Unit Agreement, and could not be imposed without such a material breach. Indeed, DNR conceded in its brief before Judge Gleason that a material breach is a prerequisite to termination.<sup>17</sup> If there were a material breach, such a sanction would be available, not because DNR has general power to impose it, but because it is a generally available remedy for a material breach. But the reverse is also true. If a particular sanction is available under the Unit Agreement and the law only for a material breach, then it cannot be imposed unilaterally by DNR as a sanction for a non-material breach.

Also, any POD approved by DNR must satisfy the reasonably prudent operator standard, since the WIOs must carry it out consistent with Section 10 of the PTUA. That means that if the Commissioner had the power to impose modifications unilaterally on a POD submitted by the Operator, the POD as modified would have to meet the RPO standard, including any modifications or conditions. That means in turn that the POD as modified would need to protect the interests of the WIOS and Minority Interest Owners, as well as the interests of the State. A reasonable condition or assurance of performance,

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<sup>17</sup> See Brief of Appellee, *Exxon Mobil Corp. et al. v. State*, Case No. 3AN-06-13751 CI, at 58 (citing *Machado v. State*, 797 P.2d 677, 683 (Alaska Ct. App. 1990)).

tailored to the conduct in question, and reasonable in relation to it, might conceivably meet this standard. But a sanction or penalty for non-compliance disproportionate to the purpose, and which could in effect work a forfeiture of the Unit, clearly would not.

It is also worth noting the general limitations on the power of contracting parties to require assurances of performance. U.C.C. 2-609 adopted the concept that a party to a contract who has reasonable grounds for insecurity may require that the other party provide "adequate assurance of performance." This was enacted in Alaska as AS 45.02.609; the principle has since spread beyond the law of sales of goods (the subject matter of the U.C.C.) to contract law generally.<sup>18</sup> Alaska law, however, forbids recourse to this principle as a remedy for a pre-existing breach of the contract in question. *Sumner v. Fel-Air, Inc.*, 680 P.2d 1109, 1116 (Alaska 1984). Accordingly, if it is DNR's position that some action of the WIOs has resulted in a breach of the Unit Agreement, principles of Alaska contract law do not allow DNR to ask for assurances of performance as a remedy for that breach, in the absence of an objective basis for insecurity. The remedies available are instead those provided by the PTUA contract.

Similarly, a party to a contract may not rewrite it under the guise of asking for adequate assurance of performance.<sup>19</sup> Here the remedies for a breach were carefully specified in the Unit Agreement and in applicable regulations not inconsistent with the

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<sup>18</sup> RESTATEMENT (SECOND) OF CONTRACTS § 251; *L.E. Spitzer v. Barron*, 581 P.2d 213, 214 (Alaska 1978); *Drake v. Wickwire*, 795 P.2d 195, 197-98 (Alaska 1990).

<sup>19</sup> *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*, 532 F.2d 572, 582 (7<sup>th</sup> Cir. 1976); *Hope's Architectural Prod., Inc. v. Lundy's Constr., Inc.*, 781 F. Supp.

Unit Agreement. Those provisions of law may not be rewritten in the guise of seeking adequate assurances, and the Commissioner may not impose on the WIOs, in favor of himself, remedies that the Unit Agreement did not give to DNR.

#### IV. THE LEGAL STANDARD FOR REMOVAL OF THE OPERATOR.

Section 5 of the PTUA contains the following provision concerning operator removal:

The Operator may, upon default or failure in the performance of its duties or obligations hereunder, be subject to removal by the same percentage vote of the owners of working interest determined in like manner as herein provided for the selection of a new Unit Operator.

Thus, Section 5 establishes "default or failure" in the performance of contractual duties and obligations as the standard justifying removal of the Operator. After the PTUA became effective, however, the major working interest owners separately contracted to modify the standard for removal. Effective August 31, 2000, Exxon Mobil Corporation and BP Exploration (Alaska) Inc. entered into the Point Thomson Area Alignment and Exchange Agreement (the "Alignment Agreement"). That agreement contains a provision stating that the PTUOA would be amended by:

Inclusion of a provision that allows removal of the Unit Operator only for (i) "a substantial breach of a material provision of the Agreement" by the Unit Operator, or (ii) if the equity interest of the Unit Operator falls below 20%, upon a 98% affirmative vote by the other Working Interest Owners.

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711, 716 (D. Kan. 1991); *Scott v. Crown*, 765 P.2d 1043, 1047 (Colo. Ct. App. 1988).

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ConocoPhillips became a party to the Alignment Agreement, including the provision concerning removal of the Operator, on May 15, 2001. By agreement dated October 19, 2000 (but effective August 31, 2000), Chevron U.S.A. Inc. also became a party to the Alignment Agreement, including the provision concerning removal of the Operator. Thus, the relevant standard justifying removal is "substantial breach of a material provision . . . ."

A. Interpretation of "Substantial Breach of a Material Provision."

The WIOs have not identified any Alaska case specifically construing the term "substantial breach of a material provision." But under general rules of contract interpretation, the provision must be given effect according to the usual and customary meaning of those words. On its face, the "substantial breach of a material provision of the Agreement" language is substantively equivalent to "material breach of the Agreement."<sup>20</sup> The term "material breach" is well-defined in Alaska case law and elsewhere.

A "material breach" that will justify termination or rescission of a contract is one that "destroys the essence" of the bargain between the parties. *Estate of Lampert v. Stauffer*, 896 P.2d 214, 219 (Alaska 1995); *Dickerson v. Williams*, 956 P.2d 458, 463 (Alaska 1998); see also *American Computer Institute Inc. v. State*, 995 P.2d 647, 653 n.14 (Alaska 2000) ("goes to the essence"). It must significantly defeat the non-

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<sup>20</sup> "Material" and "substantial" are generally treated as equivalent. *First Interstate Bank v. Small Business Administration*, 868 F.2d 340, 344 (9<sup>th</sup> Cir. 1989); *In re Hamilton*, 18 B.R. 868, 872 (D. Colo. 1982); WILLISTON ON CONTRACTS, § 45:17.

breaching party's reasonable expectations under the contract, *Dutton v. State*, 970 P.2d 925, 928 (Alaska App. 1999), and "result in the other party not receiving substantially what [that party] bargained for." *Machado v. State*, 797 P.2d 677, 683 (Alaska App. 1990).

Thus, removal is justified under the "substantial breach of a material provision standard" when there has been conduct that destroys the essence of the bargain, and significantly defeats the reasonable expectations of the other WIOs. The determination of whether a breach is material must be made on the totality of circumstances. *Id.* These fundamental principles apply here and are common to the law of contracts everywhere.<sup>21</sup>

B. What Conduct Would Justify Removal of the Operator?

During the hearing, the non-operating WIOs were asked why they did not take action to remove the Operator after the Commissioner affirmed the rejection of the 22<sup>nd</sup> POD and the Modified POD, and terminated the Unit.<sup>22</sup> The answer is that no "substantial breach of a material provision" of the PTUA had occurred. Section 10 of the PTUA requires the Operator to submit "a plan for an additional specified period" before the expiration of the then-current POD. The Commissioner's POD rejections and subsequent improper unit termination decisions did not establish a "substantial breach of a material provision" of the PTUA or the PTUOA.

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<sup>21</sup> RESTATEMENT OF CONTRACTS (FIRST) § 275, comment a (1932); RESTATEMENT OF CONTRACTS (SECOND) §§ 241-42.

<sup>22</sup> Commissioner's Decision on Appeal From Director's October 27, 2005 Decision Denying the Proposed Plans for Development of the Point Thomson Unit, November 27,

Under Section 10 of the PTUA the Operator covenants "to develop the unit area as a reasonably prudent operator in a reasonably prudent manner." The Commissioner never found that the Operator failed to act in a reasonably prudent manner in preparing and submitting the rejected PODs. To the contrary, in purporting to terminate the PTU, the Commissioner expressly stated that he was not applying the contractual reasonably prudent operator standard.

The non-operating WIOs each approved the plans of development proposed by the Operator, and also agreed that the Commissioner's termination of the Unit was improper, and filed their own judicial appeals to successfully challenge the termination decisions. Under these circumstances, the Operator did not fail to fulfill an essential obligation of the PTUA or the PTUOA.

Commissioner Irwin also posited a hypothetical situation where, shortly after approval of the new POD, the Operator informed DNR that it would not commence drilling.<sup>23</sup> In that event, absent a legitimate excuse under Section 25 of the PTUA, the other WIOs would be justified in removing the Operator.

The unequivocal commitment to drill the five wells goes to the essence of the new POD. Each of the WIOs has expressed its commitment to support the POD. Section 10 of the PTUA requires the Operator to exercise "reasonable diligence . . . in complying with the obligations of the approved POD." An unexcused refusal by the Operator to

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2006 at 17-18.

<sup>23</sup> March 7, 2008 Tr. at 1006:5-24.

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follow the instructions of the WIOs and fulfill its obligations under a POD approved by the WIOs and DNR would destroy the essence of the WIOs' bargain and would defeat the reasonable expectations of the other WIOs and the DNR with respect to the POD, the PTUA, and the PTUOA. Such conduct would meet the "substantial breach of a material provision" standard and in that event, absent agreement of the parties or a legitimate excuse under Section 25 of the PTUA, the other WIOs would be justified in removing the Operator.

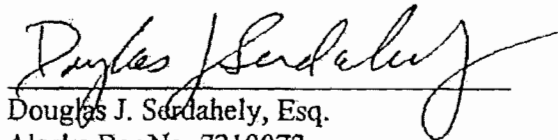
#### V. CONCLUSION

For the reasons stated, the Commissioner should approve the 23<sup>rd</sup> POD, or in the alternative join with the WIOs in asking the Superior Court to enter the proposed Agreed Final Judgment lodged herewith. In any event, the Unit Agreement should not be terminated.



DATED at Anchorage, Alaska this 21<sup>st</sup> day of March 2008.

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