STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES

REMAND REMEDY PROCEEDING
POINT THOMSON UNIT

COMMISSIONER'S DECISION ON RECONSIDERATION

JUNE 11, 2008

PTU REC_31520

I. INTRODUCTION

On May 12, 2008, Appellants ExxonMobil Corporation, BP Exploration (Alaska), ConocoPhillips Alaska, Inc., Chevron U.S.A., Inc and Leede Operating Company, LLC ("Appellants") filed a Request for Reconsideration ("Request") of my April 22, 2008 Findings and Decision ("Decision").[1] I granted partial reconsideration on May 22, 2008, and I am issuing this decision pursuant to 11 AAC 02.020(d).

In the Request, Appellants raise a variety of alleged errors. It is difficult to analyze many of their legal points because Appellants fail to adequately describe the basis of perceived errors and they do not raise new legal arguments to support their position. In the case of alleged factual errors, Appellants simply assert that "no evidence" supports a particular factual finding, but they do not cite to the transcript or record to rebut the citation relied upon in the decision. Likewise, they cite no legal authorities to rebut those in the decision. Because it is devoid of any legal or factual citations, the Request is flawed.

Despite these deficiencies, Appellants' view on several issues merits a response so that a reviewing court has the benefit of DNR's perspective. This decision supplements my Decision. My decision to terminate the Point Thomson Unit stands.

Units are formed to facilitate the development and production of the state's valuable oil and gas resources. The state grants leaseholders the right to extend their leasehold rights to explore and develop state lands in exchange for a commitment to

[1] Request [R. 31485-31494]; Decision [R. 31389-31467].

diligently work to bring the resources to market. In the more than thirty years since the Point Thomson unit was formed, no oil or gas has been brought to market and none of the infrastructure necessary for development has been built. This unit is terminated because the Point Thomson unit working interest owners failed to fulfill the commitments made in the unit agreement.

II. APPELLANTS' DEMAND THAT DNR TELL THEM WHAT THEY NEED TO DO TO AVOID TERMINATION IS INCONSISTENT WITH THE REMEDY PROCEEDINGS.

The purpose of the remand proceedings was to give Appellants an opportunity to inform DNR of what they considered an appropriate remedy for their failure to submit an acceptable plan of development (" POD") and for their failure to meet their obligations to develop state oil and gas leases. The remedy proceeding was also a forum for Appellants to state the reasons why unit termination is an inappropriate remedy. As a remedy, Appellants offered the 23rd POD which proposed modest production of 10,000 barrels a day of gas condensate beginning at the end of 2014 and suggested that Appellants might produce more gas condensates if studies conducted during the 23rd POD supported additional production. The 23rd POD did not include a date by which gas production would begin or a commitment to produce the unit's considerable oil reserves.

Appellants claim that if DNR found the 23rd POD deficient, it was obligated to disclose what it wanted Appellants to do to avoid termination. This claim misinterprets

the purpose of the remand proceeding and constitutes an effort to put the responsibility for unit development on DNR.

The unit was initially terminated in 2006 for two primary reasons: the failure to submit an acceptable POD and the failure to meet the obligation to develop oil and gas leases. The purpose of the remand proceeding was to allow Appellants to describe what they were willing to do to remedy their failures.

Appellants' proposed remedies were assessed in light of the testimony and exhibits offered at the remand hearing, the unit history and other factors set out in 11 AAC 83.303. Appellants' presentations on remand lacked credibility in several respects which are addressed in Section V in broader scope and detail. Appellants' efforts to make the decision on remand turn on a DNR presentation of an acceptable POD under section 21 of the unit agreement and the reasonably prudent operator standard is inappropriate because the issue at hand is whether, given Judge Gleason's decision that DNR properly rejected the 22nd POD, it is in the public interest for the unit to continue.[2]

Appellants contradict their contention that DNR is obligated to tell them what it wants to remedy the breach by saying DNR cannot demand assurances of Appellants' performance if, as DNR believes, they have already breached the contract. Specifically, they state that "principles of Alaska contract law do not allow DNR to ask for assurances of performance as a remedy . . . in the absence of an objective basis for insecurity."[3] A request for assurances of performance is justified here. As an initial matter, there is "an

---

[2] *ExxonMobil et. al. v. State*, 3 AN-06-13751 (Consolidated), p. 25 and 32.

[3] *See* Post-Hearing Br. at 21 [R. 31181].

objective basis for insecurity" that Appellants will perform on their proposed remedy – the thirty-year unit history detailed in my initial decision.

Appellants also misconstrue Alaska law on reasonable assurances. It is true that the Alaska Supreme Court has held that the remedy of assurances of performance as set forth in AS 45.02.609 is inapplicable where a party has already breached a contract.[4] This principle follows common sense – there can be no assurances of performance where one has already failed to perform. But here, Appellants' willingness to perform the 23rd POD is a live issue. While Appellants have breached the unit agreement, they have also proposed a remedy asking that the contract not be terminated and future performance be permitted. In the context of this proceeding, where the question is whether it is in the public interest to continue a unit with a history of broken promises and failures to meet work commitments, it is completely appropriate to query Appellants as to why I should believe they will carry out their work commitments and what assurances they can offer me that I can believe them.

Appellants also argue that termination is inappropriate because Alaska contract law demands that Appellants be afforded a chance to cure.[5] Appellants ignore that they were afforded opportunities to cure prior to Commissioner Menge's termination decision[6], and have been granted another chance to cure with this remand proceeding.

---

[4] *See Sumner v. Fel-Air, Inc.*, 680 P.2d 1109, 1116 (Alaska 1984).

[5] *See* Pre-Hearing Br. at 28-31. *See, generally, Allen v. Vaughn*, 161 P.3d 1209 (Alaska 2007) (noting that forfeiture is disfavored in land sale contracts and opportunities to cure default should be allowed). *But see* Alaska Constitution, Article 8, Section 8 (oil and gas leases forfeited for breach).

[6] [R. 200-3; 644, 648, 1958-60]

Appellants' request provides no basis for giving them a fourth chance to cure their default.

III. DNR PROPERLY CONSIDERED ALL INTERESTS WHEN IT REVIEWED AND REJECTED THE PROPOSED REMEDY.

Appellants contend that DNR improperly focused on the public interest in terminating the unit and that the agency failed to adequately consider Appellants' interests.[7] I disagree.

In evaluating the proposed remedy, DNR is required to consider the public interest. The Alaska Constitution and the Alaska legislature have stated that it is the policy of the State to "provide for the utilization, development, and conservation of all natural resources belonging to the State . . . for the maximum benefit of its people."[8] The Alaska legislature has, in turn, charged DNR with the responsibility of administering State programs for the conservation and development of natural resources.[9] I have been granted the authority to do all things necessary to "exercise the powers and do the acts necessary to carry out the provisions and objectives. . . " of the Alaska Land Act.[10] One of my central tasks is oversee the development of natural resources to maximize economic and physical recovery.[11] Finally, under 11 AAC 83.343, I can only approve a

---

[7] Request at 4 (C.1.a.6) [R. 31488].
[8] Alaska Constitution Article 8, Section 2.
[9] *See* AS 44.37.020(a).
[10] AS 38.05.020(b)(4).
[11] *See* AS 38.05.180(a)(1)(A).

POD if it complies with the factors set forth in 11 AAC 83.303, including protection of the state's interest and consideration of the public interest. My analysis of Appellants' proposed remedy, under the 11 AAC 83.303 factors, led me to conclude that it was not in the public interest to accept the POD and allow the unit to continue.

My decision specifically found that this proposed remedy failed to meet the section 303 criteria. Based on the cumulative impact of my analysis, I found that Appellants' proposed remedy was not in the public interest.

Appellants further argue that termination is not in the public interest because it "ensures no one will be in a position to rely on Point Thomson gas in making shipping commitments in any open season" and could ". . .delay for years any gas pipeline from the North Slope. . ."[12] Appellants would have me ignore that if I accepted their proposed remedy of 10,000 barrels per day of production, it would be at least 40 years before Point Thomson gas is available to Alaska. There are hundreds of millions of barrels of oil and gas condensates that must be produced before gas is available from the reservoir.[13] Thus, Appellants' proposed remedy could not make gas available from Point Thomson during

---

[12] *See* Reconsideration Request at 2. [R. 31486] In the Reconsideration Request, Appellants note that "[T]he Decision erred in characterizing the commitment made in an open season as being a commitment of gas, whether from the PTU or otherwise, rather than a commitment to pay for shipping capacity." Reconsideration Request at 6, C.1.b.16. [R. 31490] While DNR utilized common industry terminology in referring to a commitment of gas, Appellants are technically correct that a commitment in an open season is to pay for shipping capacity, not gas. Of course, no reasonable company would pay for capacity without the intent to ship gas, so buying capacity is essentially a commitment of gas. Regardless, the substance of my discussion referencing commitment of gas (Page 40-1 of the Decision) [R. 31431-2] is not affected by this technicality.

[13] [R.30069, 628, 5608-09] *See also* AS 31.05.030, 11 AAC 83.303(a)(2).

an initial open season; Appellants would have to dramatically increase their rate of oil production or obtain the AOGCC's approval to not recover the oil.

Appellants further complain that I did not adequately consider their interests when I terminated the unit. In the Decision I extensively considered the unit's history, analyzed the potential benefits and drawbacks of the proposed POD, and evaluated a multitude of other issues, including the Appellants' interests. My 75-page decision establishes that DNR considered all interests prior to termination.

The unit history also demonstrates that DNR has given Appellants' interests close and generous consideration for many years. DNR agreed to give Appellants many opportunities to conduct the studies and other activities they considered necessary preconditions to development, and DNR refrained from taking punitive action when Appellants repeatedly breached their various work commitments.

IV. TERMINATION FOR FAILURE TO SUBMIT AN ACCEPTABLE POD IS JUSTIFIED GIVEN THE HISTORY OF THIS UNIT.

Appellants argue that failure to submit an acceptable POD does not constitute a default, let alone a breach of contract that justifies termination. Appellants ignore portions of Judge Gleason's Order and misread others. My Decision succinctly stated why Appellants were in breach of their obligations under the unit agreement and applicable laws.

Appellants nonetheless argue that their failure to submit an acceptable POD does not justify termination, even if it is a breach of the PTUA. This conclusion again misreads the judge's order, the PTUA and applicable law. The purpose of unitization is to effect efficient production of oil and gas resources.[14] Unit development and production is ensured through PODs which move the unit to development and production. If the POD does not meet these development goals, then the purpose of unitization has not been realized and the public interest is not protected. Therefore a POD is a key requirement of unitization, and failure to secure POD approval constitutes a material breach and grounds for unit termination.[15]

Appellants further ignore that their failure to submit an acceptable 22nd POD was the culmination of over thirty years of failure to develop. My decision to terminate the PTU was not merely based on some technical defect in a POD. Rather, one must take into account the unit's history where DNR had been struggling for years to get the unit into production. Indeed, Commissioner Menge and Acting Commissioner Rutherford noted that Appellants' failure to develop the unit supported termination.[16] In my decision, I analyzed the unit history and agreed with their conclusion that Appellants have failed to develop the unit and effectively warehoused massive quantities of hydrocarbons in these leases for more than forty years.

---

[14] *Exxon Corp. v. State*, 40 P3d 786, 788 (Alaska 2001)("A unit agreement is a contract between the department and lessees that allows for the efficient development of a reservoir that underlies multiple leases owned by different lessees.")

[15] DNR also has the authority to terminate the PTU pursuant to Article 8, Section 8 of the Alaska Constitution; AS 38.05.020; 11 AAC 88.100 et seq.; 11 AAC 83.336, 11 AAC 83.374(c), and Sections 10 and 20(c) of the unit agreement.

[16] [R. 5686, R. 9290]

Moreover, the record does not support Appellants' contention that DNR's approval of 21 PODs means that it approves the state of development. The last unit well was drilled in 1983. Since 1983, DNR has repeatedly requested or demanded that more wells be drilled to move the unit towards production.[17] Appellants promised to drill 10 wells between 1984 and 2001 (1985 well, 1990 well, 2003 well, seven wells with drilling to start by 2006), which DNR trusted would be drilled. Not one of these ten wells was drilled.

DNR approved most of the PODs, but it did not agree with the pace of unit exploration and development. In addition to repeatedly requesting that Appellants drill more wells, and entering into agreements where DNR thought wells would be drilled, DNR has responded to the lack of exploration and development work by: contracting the unit in 1985, 1990, and 2006;[18] threatening to contract the unit in 1993-95;[19] rejecting PODs because they did not commit to sufficient development;[20] and threatening to default the unit.[21] Further, as detailed below and in the April 22, 2008 decision, DNR approved many PODs that had commitments that were not timely fulfilled as promised. Thus, while DNR approved PODs, Appellants failed to meet their commitments. DNR also expected that Appellants would fulfill promises made in expansion agreements that

---

[17] [R. 11258, 11250, 10022, 10163-64, 11404–5, 11555, 11735, 321, 324, 14841, 11829-30, 1561, 12757–66, 12736–42, 26404–10, 1520–48]

[18] [R.10025, 9564, 1121]

[19] [R. 10163, 11725, 14438]

[20] [R. 11626, 11618]

[21] [R. 327–30, 11621]

were used to induce DNR into approving PODs. Appellants' failures to fulfill these promises delayed development.

In sum, termination for failure to submit an acceptable POD is an appropriate remedy here, particularly where Appellants have held leases to this world class resource for 43 years, made a significant discovery of oil in 1975, knew in the early 1980s that the PTU contained oil and at least 350 million barrels of condensates in Thomson Sands,[22] and yet have not commercially produced any hydrocarbons.

V. DNR'S FINDINGS REGARDING CREDIBILITY/INTENT AND UNIT HISTORY ARE SOUND.

Appellants contend that DNR erred by terminating the unit ". . .based upon an unsupported conclusion about the Owners' intent to perform their legally-enforceable contractual obligations".[23] Appellants make a similar point when they maintain that my recitation of the unit's history is unsupported by the record.[24]

Credibility matters because Appellants have asked DNR to trust that they will perform the commitments contained in the proposed 23rd POD. Credibility matters because they ask DNR to trust that they will expand production beyond the 10,000 barrels a day of gas condensate they plan to begin producing by the end of 2014 if their test results accumulated over the next six years are favorable and all permitting issues are

---

[22] [R. 14351]

[23] Reconsideration Request at 5 (C.1.b.10) [R. 31489].

[24] Reconsideration Request at 7-8 (D.1, D.3, D.4, D.6, D.9) [R. 31491-2]; *see also* C.1.a.4 [R. 31488].

resolved. Credibility matters because Appellants have made no commitment about when or how they will produce any of the 8 trillion cubic feet of gas in this unit, nor have they made a commitment to produce the hundreds of millions of barrels of oil. Credibility matters because they are asking DNR to have faith that despite the long history of broken development commitments, they will eventually bring the state's oil and gas to market. They have offered nothing to compensate DNR if they fail to perform, and suggest that this omission somehow reinforces the credibility of their commitment. The opposite is true.

To approve the 23rd POD, I would need to be certain that Appellants will complete the proposed remedy. The testimony at the hearing and Appellant's perspective on the unit history convinced me that Appellants have a different view than I do on what honoring a commitment means. To analyze trustworthiness, I carefully considered the credibility of certain witnesses that testified at the hearing in my decision. Likewise, I carefully reviewed the history of the unit. What I found was a pattern of broken promises and misleading communications by Appellants that did not result in any production of oil or gas. Despite this record of unfulfilled commitments, Appellants continue to perpetuate the myth that their past actions to develop the unit were adequate and they have done everything that could reasonably be expected to develop these valuable state resources. [25] This assertion undermines my ability to find their current commitments to development plausible.

[25] [R. 31491]

Without citing the extensive record or my Decision, Appellants challenge my findings on credibility, trust and intent. My decision carefully outlines which witnesses I found not to be credible, and why.[26] Absent any citation to the transcript or record in an effort to convince me that my conclusions were wrong, there is no reason to change my finding about credibility. During the week-long hearing, I carefully observed and listened to the witnesses and did not find their testimony about making a firm commitment to develop to be credible.

Appellants also assert that my factual findings about the unit's history are wrong. Again, they fail to point to any part of the record or testimony at the hearing that contradicts my findings, and thus it is very difficult to address their position. However, the unit history set forth in the Decision carefully outlines the history with supporting citations to the record.[27] I reviewed the record again to prepare this decision with Appellants' assertion in mind and found numerous instances where they previously acknowledged their failure to fulfill development commitments.[28] Despite this history,

---

[26] [R. 31449-51]

[27] [R. 31400-18]

[28] In 1986, Appellants conceded that they failed to complete a well data trade, which was not completed for another three years [R. 11213, 11799]; form a common database [R. 11213]; develop a plan for a delineation well [R. 11213]; and enter into a cost sharing agreement for the delineation well [R. 11213]. In 1987, Appellants acknowledged that the following commitments were not satisfied: the "completion" of a confidential data trade [R. 11214, 11206]; the formation of a common database [R. 11206]; interim cost sharing plan for the common database [R. 11214]; consideration of the number and location of delineation wells still needed [R. 11214, 11206]; and the remapping of reservoir structure [R. 11214, 11206]. In 1988, Appellants again promised to "complete" a data trade from three confidential wells [R. 11214], but ExxonMobil was only able to *acquire* data from two of the three confidential wells [R. 11531] – Appellants did not share the data from the confidential wells until 1994. [R. 14713, 11799]. During the 8th

Appellants assert in their reconsideration request that the decision ". . . mischaracterizes the WIOs' undertakings and performance under prior PODs. . ."[29]

My decision carefully detailed Appellants' litany of broken commitments, including: (1) failure to abide by commitments made in PODs; (2) wholesale rejection of commitments made in expansion agreements; and (3) broken promises used to induce DNR to accept PODs. I have reviewed the record, and it unequivocally establishes that

---

POD, Appellants conceded that they failed to fulfill the following POD commitments: the "completion" of 3-D seismic interpretation, which they initially promised would be completed by 1990 [R. 11457, 11458]; and the "completion" of consensus map by mid-1991 [R. 11457]. After Appellants failed to meet these commitments, they renewed their promise to initiate and complete the consensus maps. But Appellants later conceded that they failed to accomplish both tasks – they did not initiate the consensus mapping by the 4th Quarter of 1990 [R. 11457, 11431] and they were unable to "complete" the consensus map by "the last quarter 1991." [R. 11457, 11426-27, 11205] Appellants conceded that the 11th POD commitment to "complete" petrographic modeling construction in 1993-94 was not timely fulfilled. [R. 4590] In the 13th POD, ExxonMobil wrote: "The Owners are committed to completing Phase I and commencing Phase II by June 1996."[28] [R. 11689] Appellants also committed to complete a Reservoir Characterization Study Committee study by December 1995. [R. 11688] These promises were not timely fulfilled. [R. 11649, 11651] Appellants further failed to complete promised environmental studies and surveys made in the 16th POD. [R. 1455] In the 18th POD, Appellants also committed to filing environmental permits with various federal and state agencies by 2002, but they did not do so. [R. 385, 387-89] Appellants also did not complete data analysis of environmental baseline studies as promised. [R. 387-89] In the 19th POD, Appellants committed to assess the commercial viability of the gas-cycling project. Appellants informed DNR that this commitment was not fulfilled because permit stipulations were not finalized and permit costs were unknown: "As a result, the Owners were not in a position to assess commercial viability during POD 19." [R. 4401] Appellants told DNR that the commitment to pursue major permits needed for development by 2004 was not accomplished because of "project uncertainties." [R. 4424] Appellants also acknowledged that they failed to analyze the Pre-Mississippian reservoir as promised. [R. 4426] Finally, in the 20th POD, Appellants committed to progress the project towards the next phase of funding by 2004, but this did not happen. [R. 4426]

[29] Reconsideration Request at 4 (C.1.a.4) and 7 (D.1) [R. 31488, 3149].

Appellants failed to fulfill commitments made to DNR. Some of the broken commitments are highlighted below.

In 1983, DNR approved the 7th POD with the expectation that Appellants would drill the well promised in 1985, which was part of their first expansion request. DNR approved unit expansion with the condition that the lessees of ADLs 28386 and 28387 "explicitly agree to commence a well on lands covered by those leases prior to March 31, 1985. . ."[30] This drilling commitment was not an option. The First Expansion Decision added: "Diligent exploration and delineation of the reservoirs underlying the proposed expansion areas will be conducted by the Unit Operators under the [POD] . . . approved by the State."[31] When DNR approved the 7th POD, Director Brown stated: "Approval of the seventh plan does not relieve any lessee of a drilling commitment or other work commitment attached to the lease as a condition for approval of an expansion. . ."[32] Appellants responded: "Thank you for your letter . . . approving, with additional terms and conditions, our Seventh Plan of Further Development . . . Exxon, as Unit Operator, hereby accepts such additional terms and conditions." [R. 11249] DNR, therefore, expected that the 1985 well would be drilled as part of the 7th POD.[33] But the 1985 well was never drilled.[34]

---

[30] [R. 10040, 10122]

[31] [R. 10041]

[32] Appellants accepted this condition as a part of the POD. [R. 11249-50]

[33] Appellants cannot credibly argue that this commitment to drill the 1985 well was only part of the expansion agreement and was not included in the 7th POD. Throughout the history of the unit, DNR often conditioned POD approval on work commitments which Lessees did not appeal. [R. 10021-2, 10015, 11250] Appellants recognized such

Appellants also committed to fulfill their promise from the first expansion to drill a 1990 well.[35] ExxonMobil noted in its proposed 8th POD that the well location had been approved by DNR, and it promised to drill the 1990 well if ". . .WIO approval to drill the well is obtained[.]"[36] But the well was not drilled because ExxonMobil was allegedly unable to secure approval from the other Appellants.[37] Significantly, DNR thought the commitment to drill the expansion agreement well was a firm commitment incorporated into the 8th POD.[38] Further, because the First Expansion Decision provided that this well was an obligation incorporated into a future POD, DNR and Appellants never viewed this well requirement as an option. Indeed, Appellants acknowledged that this well was a "requirement"[39] and characterized the well as a "drilling obligation."[40]

Not only have Appellants broken many firm commitments, but they also induced DNR to approve PODs and unit expansions by suggesting they would drill wells and begin production. For example, in the 1st POD, Appellants suggested to DNR that they would produce the unit's oil by shipping it down TAPS, but they have not done so despite the presence of massive quantities[41] of oil and gas condensates.[42] When DNR

---

conditions to be POD requirements and made efforts to comply with them. [R. 11249, 11257, 11532, 11426, 11387, 11648-49, 11757]

[34] [R. 10025]

[35] [R. 14350; 11532]

[36] [R. 11532; 11426]

[37] [R. 11532; 11426]

[38] [R. 11537]

[39] [R. 11532]

[40] [R. 11457]

[41] [R. 30069] (confidential)

[42] Appellants maintained during the remand hearing that they cannot produce any of the unit's oil because there is too much uncertainty. [R. 30005, 30008] Since 1983,

approved amending the unit agreement to prevent the unit from expiring in 1982, Appellants had created the impression that production would begin in the late 1980s.[43]

Appellants suggested in 1985 that they would begin gas cycling by the early 1990s.[44] In 1986, Appellants suggested that a gas-cycling project could begin in 1993.[45] In annual progress reports, Appellants suggested that more delineation wells would be drilled.[46] In the 16th POD, Appellants suggested that they would produce liquids through a gas-cycling project with eight producing wells.[47] Appellants did not follow through on any of these suggestions.

In their second expansion proposal in 2001, Appellants said they would drill eight wells and likely start producing through a gas cycling program.[48] DNR initially rejected the expansion proposal because there were "no firm commitments" to explore and develop the unit.[49] DNR stated that the expansion agreement would only be approved if Appellants made unequivocal commitments to explore and develop the unit.[50] Several months later, Appellants submitted a formal application to expand the unit which committed, as part of the 18th POD, to contract a drill rig by July 2001; drill a delineation

---

DNR has repeatedly requested that Appellants drill wells to deal with this uncertainty, but Appellants have either made promises that were not fulfilled or have refused to drill wells. Thus, the first POD's promise to produce the oil remains unfulfilled because Appellants have been unwilling to make the necessary investments to determine the volume and recoverability of the PTU's oil reserves. [R. 11366, 14351]

[43] [R. 9463]
[44] [R. 11224, 10024, 11238]
[45] [R. 11218-19]
[46] [R. 11213, 11214]
[47] [R. 11760, 11806]
[48] [R. 15874-76, 15872]
[49] [R. 15471]
[50] [R. 15471-73]

well during the 2002-03 season; drill a second delineation well by 2004-2005; and begin development drilling (i.e., for production) within five years of approval of the expansion agreement.[51] If Appellants failed to meet these commitments, Appellants agreed that the leases would automatically contract out of the PTU and revert to the State, and that they would pay a performance penalty.[52]

Eventually, after some discussion with DNR about work commitments, ExxonMobil told DNR: "The owners have endeavored . . . to unambiguously demonstrate our commitment to the development of the [PTU]. We are committing to an aggressive work program and the expenditure of substantial funds that will put us in a position to initiate project execution activities[.]"[53] These work commitments included the drilling of wells and a commitment to advance the PTU towards commercial production by completing a series of environmental and engineering studies.[54] ExxonMobil wrote: "The owners further commit to the beginning of a continuous Thomson Sand development drilling program ... by June 1, 2006, should Preliminary Engineering confirm commerciality and should we receive permits that do not contain stipulations that are prohibitive."[55] ExxonMobil added that it was committed to putting

---

[51] [R. 16102]
[52] [R. 16102]
[53] [R. 15870]
[54] [R. 15874-76, 15872]
[55] [R. 15872]

the Sourdough and Lynx prospects into production by 2010.[56] ExxonMobil concluded that its work commitments "will be administered under the Unit Plan of Development".[57]

On July 31, 2001, based on these promises, DNR approved ExxonMobil's expansion agreement proposal.[58] ExxonMobil responded: "The affected PTU owners, with the noted exception [Murphy Oil], do hereby accept all the terms and conditions of the conditional approval of the Point Thomson Unit Expansion/Contraction per your July 31, 2001 letter[.]" [59] After approval of the 2nd Expansion Agreement, DNR approved PODs 18 through 21 by incorporating Appellants' 2nd Expansion Agreement work commitments and with the understanding that Appellants would begin development drilling by 2006.[60]

However, in December 2003, ExxonMobil informed DNR that studies showed the gas cycling project was not commercially viable.[61] DNR responded by reminding Appellants that they could surrender the expansion acreage and pay a $10 million charge if they had determined they could not begin development drilling by 2006. [62] Appellants did not relinquish the leases or pay the penalty, leading DNR to believe that they still planned to begin development drilling by 2006.

---

56 [R. 15873]
57 [R. 15873]
58 [R. 12757, 61-65]
59 [R. 12736]
60 [R. 15952, 393-94, 415, 1916]
61 [R.1581]
62 [R. 1585]

In September 2004 Appellants submitted their proposed 21st POD. The plan announced for the first time in a POD that the gas cycling project was uneconomic.[63] DNR responded by approving the POD with two conditions: Appellants had to submit data to support their contention that the gas cycling project was uneconomic and that the 22nd POD "must contain specific plans for development drilling within the PTU." [64] ExxonMobil appealed this decision arguing that Director Myers could not impose either condition. I affirmed Director Myers' conditional approval and found that "Exxon is not relieved from the commitments made in connection with the 2nd Expansion."[65] Appellants did not appeal this decision and, therefore, these conditions were incorporated into the 21st POD.

In June 2005, ExxonMobil requested that DNR drop the expansion agreement drilling commitments while allowing it to retain the expansion acreage. [66] Director Myers rejected this proposal, but offered to modify the expansion agreement commitments to begin development drilling by 2006 if, in the 22nd POD, Appellants would drill a delineation well by June 2006. [67] Had Appellants agreed to this proposal, DNR would extend the expansion agreement commitment to begin development drilling by one year.[68] Appellants rejected this offer, and Director Myers defaulted the unit. [69] Thus, the

---

[63] [R. 419]
[64] [R. 4433]
[65] [R. 12279]
[66] [R. 16293]
[67] [R. 216-17]
[68] [R. 218]
[69] [R. 220, 11142]

2nd Expansion Agreement work commitments were incorporated into the 18th through 21st PODs. DNR approved these PODs with the understanding that Appellants would drill wells and begin development drilling, which would lead to production by 2006. Appellants, however, failed to meet every major work commitment contained in the 2nd Expansion Agreement. Further, while Appellants make much of the fact that they determined in late 2003 that the gas cycling project was uneconomic, they had an opportunity to relinquish the expansion acreage if they thought they could not meet the 2006 development drilling deadline.[70] Appellants never pursued this option leading DNR to believe that development drilling would begin in 2006.

DNR reviewed and approved PODs and expansion agreements in the context of Appellants' commitments. The failure to fulfill the commitments cited above – which is not an exhaustive list – not only undermines Appellants' credibility, especially in light of their continued insistence that they have nearly always satisfied their commitments, but also demonstrates their failure to meet their development obligations. Based on this record, and without any penalties to compensate DNR for the losses it will suffer if the acreage continues to be warehoused, it is reasonable for DNR to doubt that Appellants will complete the work described in the 23rd POD and to doubt Appellants will continue to expand production to at or near the units potential.

[70] [R. 1585]

VI. THE RECORD SUPPORTS DNR'S POSITION REGARDING PENALTIES.

Appellants contend that DNR made inconsistent statements in the April 22, 2008 Decision about the value of proposed penalties.[71] Appellants do not identify which portions of the decision they find to be inconsistent. I refer to penalties several times in the decision,[72] but the statements are not inconsistent.

What Appellants may fail to appreciate is the interplay between credibility and history with respect to assurances. For example an ExxonMobil witness characterized the penalties for non-performance contained in previous PODs and expansion proposals as "off-ramps" or an alternative to development.[73] In other words, ExxonMobil perceived penalties as a legitimate way to *avoid* promised performance, not as an *assurance* of performance aimed at securing development and compensating the State. It also discounted the importance of commitments contained in expansion agreements, asserting that these commitments were independent of their contractual obligations in PODs. To the contrary, the expansion commitments were intertwined with those in the PODs. For instance, the 7th POD and 8th PODs incorporated the First Expansion

---

[71] Request for Reconsideration at 6 (C.2.e) [R. 31490].

[72] On page 55 I identify a number of performance benchmarks that Appellants might have offered to encourage DNR to accept the proposed POD as a remedy. On page 32 I indicate that, given the unit's history, there is no effective way to ensure performance. On page 69, I state that the unit history and credibility eliminate the value of stipulated penalties. [R. 31446, 31423, 31460]

[73] Decision pages 59-60, [Tr. at 690, 1016].

Decision requriements, and the 18th through 21st PODs included the 2001 expansion requirements.[74]

The attitude towards penalties expressed at the hearing demonstrates that assurances and penalties mean little to Appellants. The unit history corroborates this finding. For example, in the context of the 2001 Expansion Agreement, Appellants and DNR agreed that failure to drill promised wells meant that the expansion leases contracted from the unit and the leases that were beyond their primary term automatically reverted back to the State. Likewise, Appellants agreed not to appeal these penalties should they fail to drill.[75]

Nonetheless, after failing to abide by its commitments in the expansion agreement, ExxonMobil tried to avoid these so-called "off ramps" by filing an original action for injunctive and declaratory relief, and by filing an application for compulsory unitization of these leases with the AOGCC. Additionally, ExxonMobil appealed DNR's decision on lease contraction in direct derogation of Appellants' contractual commitment.[76] The unit history, therefore, substantiates my view that Appellants do not feel bound by their agreements.

In the same vein, Appellants take issue with DNR's reliance on statements of intent in prior PODs, essentially arguing that such statements did not constitute promises that DNR could count on.[77] There is an irony here; Appellants' proposed remedy relies

---

[74] [R. 10041, R. 11250, 14350, 11532, R. 15952, 393-94, 415, 1916, 11257]
[75] [R. 12736]
[76] *ExxonMobil v. State, DNR*, Case No. 3AN-06-13826 CI
[77] Reconsideration Request at 5 (C.1.b.9) [R. 31489].

heavily on statements of intent with no assurances or penalties, yet they encourage DNR to rely upon these statements and accept the remedy. This echoes Appellants' past tactics where they would induce DNR to approve a POD or expansion agreement based on statements of intent and promises, and then fail to perform.[78] If DNR cannot take Appellants' statements at face value, then why should DNR accept a six-year POD as a remedy and rely on Appellants' statement of intent to expand facilities and production at the end of six years? Overall, Appellants have an elastic view of accountability.

VII. THE STIPULATED ORDER OFFERED BY APPELLANTS TO RESOLVE THIS MATTER WAS INAPPROPRIATE ON BOTH POLICY AND PROCEDURAL GROUNDS.

Appellants contend that DNR was obligated to resolve this case by accepting a judgment they proposed after the close of the hearing.[79] But the proposed order was unacceptable for a number of reasons. ConocoPhillips did not support the order. It contained conditions and caveats that made it a poor vehicle for effecting the parties' obligations. The order inappropriately transferred DNR's responsibility for making factual determinations in the administrative process to a judge in the judicial process. It also left DNR without the ability to initially determine whether Appellants had breached one of the 23rd POD milestones. As a matter of policy, I was not willing to stipulate away DNR's authority and obligation to make important factual determinations

[78] *See, e.g.*, Decision at 42 (discussing promised wells that Appellants never drilled) [R. 31433].

[79] Reconsideration Request at 4 (C.1.a.5) [R. 31488].

impacting Point Thomson. Further, the provision requiring that the DNR's PTU default and termination decisions be vacated, and the unit be treated as if it has always been in good standing, was completely unacceptable not only from a historical standpoint but from a policy standpoint.

VIII. CONCLUSION

I carefully reconsidered my April 22nd, 2008 Decision based on Appellants' argument and it remains unchanged. Appellants' proposed alternative remedy for failure to submit an adequate plan of development, the 23rd POD, does not meet the criteria for approval in .303 and does not protect the state's interests.

Commissioner Tom Irwin
June 11, 2008

STATE OF ALASKA

SARAH PALIN, GOVERNOR

550 WEST 7TH AVENUE, SUITE 1400
ANCHORAGE, ALASKA 99501-3650
PHONE: (907) 269-8431
FAX: (907) 269-8918

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

January 27, 2009

Appeal by Exxon Mobil Corporation, BP Exploration (Alaska) Inc., Chevron USA, Inc., ConocoPhillips Alaska, Inc. and Exxon Mobil Oil Corporation, Working Interest Owners, of the Notice of the Director, Division of Oil and Gas, dated August 4, 2008, entitled Lease Expiration Due To Elimination From Unit for Oil and Gas Leases ADL 28380 et al.

CONDITIONAL INTERIM DECISION

This is a conditional interim decision in appeals from the August 4, 2008, decision of the DNR Director of Oil and Gas that 31 of the leases included in the former Point Thomson Unit had expired. BP Exploration (Alaska) Inc., Chevron USA, Inc., ConocoPhillips Alaska, Inc., and ExxonMobil Corporation appealed from that decision. The initial phase of the evidentiary hearing was held on January 12 through 16, 2009, and the hearing is continued to February 12, 2009.

I am issuing this conditional interim decision because, in part, Appellants offered testimony that their development plans to drill a well during this winter season could still go forward if DNR provided them with an ice road permit before the end of this month and authorized drilling activities on the leases. For this reason, I have decided to issue this decision.

At the initial phase of the hearing, Appellants offered testimony and evidence regarding their plans for development of certain leases in the former Point Thomson Unit, referred to by Appellants as the "Point Thomson Project." Appellants have testified that this project provided for the drilling and producing from wells by 2014. Appellants have specifically testified that they are unconditionally committed to the initiation and continuation of drilling during this 2008 and 2009 winter season, including drilling a well out of the conductors with a rig capable of drilling through the Thomson Sands on that lease, and completing the drilling of two wells, both penetrating the Thomson Sands reservoir, by 2010. Appellants testified that in furtherance of this commitment, they have: (1) mobilized equipment and materials to the North Slope to support the operations; (2) retained subcontractors to support this operation; (3) modified a drill rig to make it suitable for the high pressure Thomson Sands reservoir; and (4) applied for and pursued all necessary permits. Given this testimony, I find that it is in the public interest to authorize Appellants to drill these two wells. If Appellants provide the documents listed below, the record will be adequate to support reinstatement of the two leases and issuance of permits to authorize drilling of these two wells.

I am not, however, ruling on whether any of the remaining 29 leases are engaged in drilling operations, or are extended by another lease provision, because the record is incomplete and there are many outstanding questions that Appellants need to address.

Nonetheless, assuming Appellants can provide the documentation listed below, I find that Appellants have demonstrated that ADL 47559 and ADL 47571 have been extended by the drilling operations savings clause because they have: (1) testified that they are unconditionally committed to the initiation of drilling during this winter season, including drilling a well out of the conductors with a rig capable of drilling through the Thomson Sands on that lease, and completing the drilling of two wells on these two leases, both penetrating the Thomson Sands reservoir, by 2010; (2) mobilized equipment and materials to the North Slope to support these operations and awarded subcontracts; and (3) unconditionally committed to bring those two wells on the two leases into production by 2014.

Based on the testimony and evidence presented at the hearing, I have decided to:

(1) direct my staff to issue the ice road permit as soon as possible so that the rig can be mobilized to the drill pad this winter;

(2) direct my staff to process all permits necessary for drilling these two wells that are pending before DNR;

(3) inform local, state, and federal agencies that Appellants are authorized to drill these two wells on the two leases; and

(4) reinstate ADL 47559 and ADL 47571 on the following conditions:

a. Appellants must abide by their unconditional commitments they made on the record including: (1) initiate drilling during this winter season, including drilling a well out of the conductors with a rig capable of drilling through the Thomson Sands on that lease; (2) completing these two wells on these two leases, both penetrating the Thomson Sands reservoir, by 2010; (3) continue to diligently move towards production by constructing the necessary facilities for processing and transporting hydrocarbons from these leases to market; and (4) commence sustained commercial production and transportation of hydrocarbons from these two wells on these two leases to market by 2014;

b. Appellants must obtain AOGCC and DNR approval for the precise location and bottom hole of each well;

c. Appellants must obtain DNR's approval for its Plan of Operations for the drilling of these two wells;

d. Appellants must diligently pursue all necessary permits, including working in good faith with all permitting agencies; and

e. Appellants must provide, within two weeks, all of the answers and documentation I requested during the initial phase of the hearing regarding Appellants' drilling plans for these two wells, including the precise well locations, drilling dates and production dates for each well. Appellants must also include a drill rig contract for each well, unconditional AFEs for each well signed by all parties, an AFE for the production infrastructure, and affidavits from each Appellant stating its willingness to pay its share of the costs for each well and for the production infrastructure.[1]

Additionally, unitization of these leases will likely be appropriate in order to properly conserve natural resources. I will address unitization issues in a final decision once the record is complete.

This conditional interim decision is intended to effect more expeditious production of state oil and gas resources. However, I remind Appellants that, under the terms of these two leases, the failure to diligently pursue drilling operations in good faith for the purpose of production will result in the automatic termination of these leases.

This interim decision will be followed by a final agency decision in the lease appeals once the record is complete, setting out my findings, rationale, and decision in detail. The time for appeal to the superior court will run from the date of issuance of the final agency decision.

In summary, I am issuing this conditional interim decision because Appellants have offered testimony and evidence that they are engaged in "drilling operations" for the purpose of diligently working in good faith to bring ADL 47559 and ADL 47571 into production, and that they will proceed with the project this winter season. The decision is conditional upon Appellants abiding by the conditions set forth above. I still need to review contracts and other documents that I have requested in order to make a final agency decision.

Jan. 27, 2009

Thomas E. Irwin
Commissioner

Date

[1] Compliance with this condition does not relieve Appellants from providing all of the other answers and documentation requested during the initial phase of the hearing.

IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT AT ANCHORAGE

EXXON MOBIL CORPORATION, Operator of the Point Thomson Unit; BP Exploration (Alaska) Inc.; Chevron U.S.A., Inc.; and ConocoPhillips Alaska, Inc.,	)	Case No. 3AN-06-13751 CI (Consolidated)
Appellants,	)	Case No. 3AN-06-13760 CI Case No. 3AN-06-13773 CI Case No. 3AN-06-13799 CI Case No. 3AN-07-04634 CI
v.	)	Case No. 3AN-07-04620 CI Case No. 3AN-07-04621 CI
STATE OF ALASKA, Department of Natural Resources,	)	
Appellee.	)	

DECISION AFTER REMAND

This case is before this Court on appeal for the second time following an administrative determination on remand by the Commissioner of the Department of Natural Resources (DNR) terminating the Point Thomson Unit. Because the contractual agreement between DNR and the Appellants precludes the termination of the Point Thomson Unit in these circumstances without consideration of "good and diligent oil and gas engineering and production practices,"[1] and because DNR failed to accord the Appellants their constitutional right to procedural due process in the remand proceeding, DNR's decision is reversed.

[1] PTU REC at 794 (Section 21, paragraph 2 of the Point Thomson Unit Agreement). Given the procedural history of this matter, portions of the record are paginated multiple times. In this decision, citations to particular pages of the record are to the page numbers provided by the "PTU REC" pagination.

FACTS AND PROCEDURAL HISTORY

In March 1977, Exxon Corporation (now ExxonMobil) and the Commissioner of DNR entered into the Point Thomson Unit Agreement (PTUA).[2] The agreement was intended to facilitate the production of oil and gas at Point Thomson, an area on the North Slope of Alaska.[3] ExxonMobil holds the largest percentage of leasehold interests at Point Thomson and is identified in the PTUA as the Unit Operator. The other Appellants -- BP Exploration (Alaska) Inc., Chevron U.S.A., Inc. and ConocoPhillips Alaska, Inc. -- each have leasehold interests within the Point Thomson Unit (PTU).

In 1977, when the parties entered into the PTUA, Section 21 of the agreement provided:

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

---

[2] "Unit agreements . . . are organizational schemes approved by the [DNR] to efficiently extract oil from a common reservoir that is the subject of multiple leases." *ConocoPhillips Alaska, Inc. et al. v. State, Dep't of Natural Res.*, 109 P.3d 914, 917 n.16 (Alaska 2005), *reh'g denied.*

[3] *See* PTU REC at 1253-1271.

PTU REC at 1268.

During the first several years of the PTU's existence, DNR concluded that the Appellants had been "diligent in exploring the unit area." *Id.* at 9464.[4] By January 1982, a discovery well had indicated that the PTU was capable of producing in paying quantities, seven wells had been drilled within or near the PTU, and four more wells were then being drilled. *Id.*

But in October 1983, Exxon submitted its seventh proposed Plan of Development (POD) to DNR. This plan proposed that there be "no further drilling activities" in the PTU for the next five years, unless "contracts for actual construction of a feasible transportation system for the gas are let" before that time. *Id.* at 11252. On November 29, 1983, DNR approved this seventh POD but noted that "[a]pproval of the seventh plan does not relieve any lessee of a drilling commitment or other work commitment that may be attached to the lease as a condition for approval of an expansion of the Point Thomson Unit to include the lease in the unit area." *Id.* at 11250. Several months later, in March 1984, DNR conditionally granted an application to add more leases to the PTU. DNR's decision to grant the expansion application included several express conditions, one of which was that a well be drilled on lands covered by certain expansion leases by March 31, 1985. *Id.* at 10040. Another condition was that the Appellants submit to DNR acceptable proposed amendments to the PTUA aimed

[4] Kay Brown, then the Acting Director of DNR's former Division of Minerals and Energy Management, wrote this in a January 1982 memorandum to John Katz, DNR Commissioner at that time. *Id.* at 9463-64.

primarily at addressing the inclusion of additional leases within the PTU with royalty rates other than the standard 12.5%. *Id.* at 10039.

Against this backdrop, in late 1984 Exxon submitted proposed amendments to the PTUA to DNR. *Id.* at 790-95. In January 1985, DNR approved a number of these amendments. *Id.* at 787-88. Included among these amendments was a rewording of the second paragraph of Section 21 of the PTUA as follows:

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

Id. at 794 (amended language underlined).[5]

On March 12, 1985, the lessees of certain of the expansion leases notified DNR that "efforts to promote the drilling of a well on the subject lessees have been unsuccessful and the required well [due by March 31, 1985] will not be drilled." *Id.* at 10026.

The instant dispute began over twenty years later, in August 2005, when the Appellants submitted their proposed 22nd POD to DNR. The Director of DNR's Division of Oil and Gas initially rejected the proposed 22nd POD on September 30, 2005. In this

[5] Before the Appellants submitted their proposed amendments, DNR had notified them that "the State would find acceptable" this amendment to Section 21. *Id.* at 10039, 10051.

initial decision, the Director concluded that "[f]ailure to submit an acceptable plan of development is grounds for termination of the PTU." *Id.* at 8948. Referring expressly to Section 21 of the PTU, the Director's initial decision provided:

> This decision provides notice under Article 21 of the PTU Agreement that Exxon must initiate development operations within the PTU by October 1, 2007. The Division will contact Exxon to schedule a hearing on this issue, which will be held not less than 30 days from the date of this decision. . . . The PTU Owners shall have an opportunity for hearing regarding this notice to modify the rate of PTU development.

Id. at 8927, 8948.

One month after issuing the September 2005 initial decision referencing Section 21, the Director issued an amended decision on October 27, 2005. The amended decision concluded that the Appellants had defaulted under the PTUA and applicable oil and gas regulations and accorded the Appellants an opportunity to cure the default by submitting an acceptable POD. *Id.* at 12304. But the amended decision also held that Section 21 does "not apply to the Division's evaluation of the Unit Operator's proposed plans for development of the Point Thomson Unit." *Id.* at 12282. Accordingly, the amended decision deleted the requirement contained in the initial decision that the Appellants commence development operations at the PTU by October 1, 2007 and deleted the provision that the Appellants would have an opportunity for a hearing under Section 21 of the PTUA regarding modification of the rate of PTU development. *Id.* at 12305. Instead, the amended decision shifted the burden to the Appellants to propose an acceptable POD, stating that "[a]n acceptable unit plan must contain specific commitments to timely delineate the hydrocarbon accumulations underlying the PTU and develop the unitized substances." *Id.* at 12304-05.

The Appellants were granted extensions of time to appeal from the Director's decision during negotiations with the State under the Stranded Gas Development Act. On October 18, 2006, the Appellants submitted a modified 22nd POD, *id.* at 3089-3105, and oral argument on the proposed modified 22nd POD was held before the Commissioner of DNR on November 20, 2006. Although the Appellants did not request an evidentiary hearing at that time, over 5,000 pages of documents regarding the modified proposed 22nd POD were submitted to the Commissioner prior to the hearing.

The Commissioner issued a Decision on Appeal on November 27, 2006. As summarized by the Commissioner at that time, that decision:

> (1) denies the request for modification of the 2001 Expansion Agreement, as amended, which affects only the expansion leases; (2) affirms the Director's Decision in all respects to the extent it is consistent with this Commissioner's Decision, but the Director's Decision is disapproved to the extent that it can be read to mean the PTU contains certified wells; (3) adopts and incorporates into the Commissioner's Decision the findings and rationale of the Director's Decision as modified by this Decision; (4) rejects the cure or revised 22nd PTU POD submitted by the Lessees on October 18, 2006; and (5) terminates the PTU.

Id. at 5671.

After the Commissioner denied their request for reconsideration, the Appellants appealed the Commissioner's decision to this Court. In a decision issued on December 26, 2007, this Court affirmed in part and reversed in part. *Exxon Mobil Corp. et al. v. State, Dep't of Natural Res.*, 3AN-06-13751 CI (Consolidated) (Dec. 26, 2007) (hereinafter, "2007 Decision").

This Court affirmed DNR's rejection of the proposed modified 22nd POD under Section 10 of the PTUA. Section 10 of the PTUA provides:

> 10. PLAN OF FURTHER DEVELOPMENT AND OPERATION. Within six months after completion of a well capable of producing unitized substances in paying quantities, the Unit Operator shall submit for the approval of the Director an acceptable plan of development and operation for the unitized land which, when approved by the Director, shall constitute the further drilling and operating obligations of the Unit Operator under this agreement for the period specified therein. Thereafter, from time to time before the expiration of any existing plan, the Unit Operator shall submit for the approval of the Director a plan for an additional specified period for the development and operation of the unitized land. The Unit Operator expressly covenants to develop the unit area as a reasonably prudent operator in a reasonably prudent manner.
>
> Any plan submitted pursuant to this section shall provide for the exploration of the unitized area and for the diligent drilling necessary for determination of the area or areas thereof capable of producing unitized substances in paying quantities in each and every productive formation and shall be as complete and adequate as the Director may determine to be necessary for timely development and proper conservation of the oil and gas resources of the unitized areas, and shall:
>
> (a) specify the number and location of any wells to be drilled and the proposed order and time for such drilling; and,
>
> (b) to the extent practicable, specify the operating practices regarded as necessary and advisable for the proper conservation of natural resources. . . .
>
> Said plan or plans shall be modified or supplemented when necessary to meet changed conditions, or to protect the interests of all parties to this agreement. Reasonable diligence shall be exercised in complying with the obligations of the approved plan of development.

PTU REC at 600-01. The Appellants had asserted that the "reasonably prudent operator" language contained in the first paragraph of Section 10, in conjunction with applicable statutes, "ma[d]e clear that DNR may not require the Operator to carry out a plan that is not reasonable from the perspective of the Operator, because it does not adequately protect the lessees' interests." 2007 Decision at 21 (quoting Jt. Br. at 54). This Court rejected that argument and concluded instead that Section 10 grants to DNR the authority to reject a proposed POD without regard to the reasonably prudent operator standard: "To interpret Section 10 of the PTUA to focus on the Lessee's perspective, so as to preclude rejection of any plan of development that the Lessees

asserted was unreasonable for them, irrespective of the public interest, would be inconsistent with" the applicable regulations and statutes. *Id.* at 22. But this Court strived to make clear that the contractual rights of the parties were not fully resolved under Section 10 of the PTUA, concluding that "rejection of a proposed plan of development does not result in automatic termination under the PTUA . . . [and] a separate administrative determination as to the appropriate remedy is required in such instance." *Id.* at 39. Accordingly, this Court reversed the termination of the PTU and remanded the matter to DNR as follows:

> DNR's rejection of the Lessees' proposed modified 22nd Plan of Development . . . is affirmed. DNR's determination as set forth in the Commissioner's Decision and the Decision on Reconsideration that terminated the Point Thomson Unit is reversed and remanded, 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.

Id. While the Court left open what standard to apply in the remand proceeding, the 2007 Decision did provide that: "on remand, the agency should also consider the import of Section 21 of the PTUA, as amended in 1985 . . . ." *Id.* at 42.

Promptly after this Court issued its December 2007 decision, the Commissioner sent a letter to the Appellants notifying them that DNR "is specifically considering the remedy of termination of the Point Thomson Unit." PTU REC at 30505. The Commissioner invited the Appellants to submit briefing 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." *Id.* The Commissioner also alerted the Appellants that DNR's

planned remand proceedings would consist of oral argument and the submission of written briefs unless the Appellants requested and were accorded additional proceedings. *Id.* at 30505-06.

The Appellants responded with a number of procedural requests. *Id.* at 30507-11. The Appellants contended, among other things, that due process required that an independent hearing officer conduct the remand hearing, that the Commissioner institute procedures to prevent *ex parte* contacts with DNR staff on the subject of the remand hearing, and that DNR participate as an adversary during the proceeding. The Appellants also asserted that the hearing should be conducted in accordance with Section 21 of the PTUA. *Id.* at 30507-10, 30519. In that regard, they requested notice under Section 21 "of the specific nature and timing of the development activity DNR now finds necessary and proper . . . and the reasons for that belief." *Id.* at 30517. While the Commissioner denied most of the Appellants' requests, he did grant their request to present witnesses during the remand proceeding. *Id.* at 30513.

On February 19, 2008, the Appellants submitted a 23rd POD as a proposed remedy for DNR's rejection of the 22nd POD. *Id.* at 30000-19. An administrative hearing was then held from March 3 through 7, 2008, during which the Appellants called multiple witnesses to testify and submitted additional written materials. The Commissioner presided at the hearing and also designated Nanette Thompson, an employee of DNR's Division of Oil and Gas, to participate as the hearing officer. *See id.* at 30514. Ms. Thomson had previously appeared as DNR's representative before this Court during the 2007 administrative appeal. During the remand hearing, the

Commissioner was also advised by the same attorneys who had defended the agency in the original appeal.[6]

On April 22, 2008, the Commissioner issued a 75 page decision and concluded: "The 23rd POD proposed by Appellants as the remedy for rejection of the 22nd POD does not meet the standards in 11 AAC 83.303 and does not serve the public interest. It is not adequate to insure timely development as required by Section 10 of the PTUA. The Point Thomson Unit is terminated." *Id.* at 31465. In his decision, the Commissioner explained that the 23rd POD "does not adequately develop all of the known hydrocarbon resources in the unit area." *Id.* at 31464. The Commissioner also concluded, "most importantly, the public's interest would not be protected if I approve the 23rd POD because I do not believe, based on this record, that the Appellants will perform as promised this time." *Id.* at 31465.

The Commissioner's decision on remand expressly considered the import of Section 21, as instructed by this Court, and found that section of the PTUA inapplicable:

> Section 21 does not apply to my evaluation of Appellants' proposed remedy. Section 21 only applies where there is ongoing prospecting, development, or production operations. In this case, there are no ongoing operations. . . . The most recent drilling activity by the unit operator was in 1982, twenty-six years ago. The last seismic data was gathered almost a decade ago, in 1999. Thus, Section 21 is not implicated because there is currently no prospecting, development or production. This construction is most consistent with the PTUA as a whole . . . .
>
> Moreover, Section 21 does not supersede the applicable statutes and regulations which authorize unitization only when it is in the public interest. It does not trump Section 10 and the regulations, which give DNR the discretion to determine the adequacy of a proposed POD. Thus, Appellants' argument that if DNR rejects the 23rd POD, Section 21 shifts

[6] See Order Denying Motion for Partial Trial de Novo dated January 13, 2009 at 8-9.

> the responsibility to DNR to design an acceptable POD is inappropriate as a matter of public policy and inconsistent with DNR's authority.

Id. at 31455-56.

The Appellants sought reconsideration, and in a decision on reconsideration issued on June 11, 2008, the Commissioner affirmed. *Id.* at 31520-44. The Commissioner again rejected the Appellants' proposition that Section 21 applied to these proceedings: "Appellants' efforts to make the decision on remand turn on a DNR presentation of an acceptable POD under section 21 of the unit agreement and the reasonably prudent operator standard is inappropriate because the issue at hand is whether, given Judge Gleason's decision that DNR properly rejected the 22nd POD, it is in the public interest for the unit to continue." *Id.* at 31523.

The Appellants appealed the Commissioner's decision on remand to this Court. *See* AS 22.10.020(d). The parties' briefing on this second appeal was completed on May 26, 2009, and oral argument was held on July 20, 2009.

In their briefing to this Court, the Appellants summarized their primary issues on appeal as follows:

> · The procedures followed by the Commissioner on remand were constitutionally inadequate.
>
> · Before proceeding to termination, DNR needed to comply with its obligations under Section 21 and its duty of cooperation.
>
> · The Commissioner's decision must be reversed since no adjudication of the fundamental issue of material breach has yet occurred.
>
> · DNR's change of development policy did not give rise to a material breach of the unit agreement by the Appellants and could not have provided a basis to terminate.
>
> · Termination was unavailable as a remedy since there was no uncured material breach.

· The Commissioner committed legal error in evaluating the 23rd plan of development.

Br. of Appellants at i-iii.

DISCUSSION

A. Standard of Review

Four different standards apply to a court's review of the merits of an agency's rulings: "(1) the 'substantial evidence test' for questions of fact; (2) the 'reasonable basis test' for questions of law involving agency expertise; (3) the 'substitution of judgment test' for questions of law involving no agency expertise; and (4) the 'reasonable and not arbitrary test' for review of administrative regulations." *ConocoPhillips*, 109 P.3d at 919 (footnote omitted).

For the reasons explained below, this Court finds that the interpretation of Section 21 of the PTUA is dispositive of this appeal. The Appellants contend that DNR was required to comply with the provisions of Section 21 on remand, while DNR argues that Section 21 was inapplicable to the remand proceedings. The interpretation of this contract provision does not require DNR's administrative expertise. Accordingly, on remand this Court should substitute its own judgment to determine this legal issue.[7] *Quality Asphalt Paving, Inc. v. State, Dep't of Transp. & Pub. Facilities*, 71 P.3d 865, 872 n.10 (Alaska 2003) ("[W]e will substitute our own judgment for questions of law not

[7] In contrast, this Court applied the reasonable basis standard of review in its December 2007 decision as to DNR's determination to accept or reject a POD under Section 10 of the PTUA because that determination involved the exercise of agency expertise. 2007 Decision at 17.

involving agency expertise, such as contract interpretation."); *Alaska Hous. Fin. Corp. v. Salvucci*, 950 P.2d 1116, 1119 (Alaska 1997) ("Interpretation of a contract is a question of law on which this court substitutes its own judgment.").[8]

When interpreting a contract, this Court is "to give effect to the reasonable expectations of the parties." *Exxon Corp. v. State*, 40 P.3d 786, 793 (Alaska 2001) (citation omitted), *reh'g denied.* Those expectations should be determined "by looking to the words of the contract and any extrinsic evidence regarding intentions when they entered into a contract, including evidence of the parties' subsequent conduct." *Kay v. Danbar, Inc.*, 132 P.3d 262, 269 (Alaska 2006). The language of the contract is the "most important evidence of [the parties'] intention." *Id.* Unless words are defined otherwise within the contract, they are to be given their "ordinary, contemporary, common meaning." *Norville v. Carr-Gottstein Foods Co.*, 84 P.3d 996, 1001 n.3 (Alaska 2004).

B. Are the Appellants Entitled to a Section 21 Hearing?

Section 21 of the PTUA accords to DNR's Director of the Division of Oil and Gas[9] the authority to "alter or modify from time to time in his discretion the quantity and rate of

---

[8] It bears noting that this Court's 2007 Decision remanded the legal issue of the applicability of Section 21 to the agency to address in the first instance, consistent with the principle of primary agency jurisdiction. *See Eidelson v. Archer*, 645 P.2d 171, 176 (Alaska 1982) ("If [a complaining party] is required to pursue his administrative remedies, the courts may never have to intervene. And notions of administrative autonomy require that the agency be given a chance to discover and correct its own errors. Finally, it is possible that frequent and deliberate flouting of the administrative processes could weaken the effectiveness of an agency by encouraging people to ignore its procedures.") (*quoting McKart v. United States*, 395 U.S. 185, 194-195 (1969)).

[9] The PTUA references the Director of DNR's Division of Lands, a division which has been eliminated since the parties entered into the contract. PTU REC at 595; *see* Revisor's Notes to AS 38.05 (LexisNexis 2008) ("Through administrative reorganization, the Department of Natural

production when such alteration or modification is in the interest of attaining the conservation objectives stated in [the PTUA]" and not in violation of state law. PTU REC at 1268. However, under the amendments to Section 21 agreed to by DNR and the Appellants in 1985, the Director may not exercise this power

> in a manner that would (i) require any increase in the rate of prospecting, development or production in excess of that required under good and diligent oil and gas engineering and production practices; or (ii) alter or modify the rates of production from the rates provided in the approved plan of development and operations then in effect or, in any case, curtail rates of production to an unreasonable extent, considering unit productive capacity, transportation facilities available, and conservation objectives; or (iii) prevent this agreement from serving its purpose of adequately protecting all parties in interest hereunder, subject to applicable conservation laws and regulations.

Id. at 794 (underlining in original). Section 21 also expressly provides that the Appellants are entitled to notice and a hearing whenever the Director seeks to exercise the powers vested in him by that section. *Id.*

The Appellants argue that they were entitled to a hearing under Section 21 on remand because "the entire thrust of DNR's position, from its initial consideration of POD 22 through its most recent brief, has been that the rate of development at Point Thomson has not been fast enough, so that the rate of development needs to be increased and production needs to be obtained." Reply Br. of Appellants at 30-31 (*citing* Br. of Appellee at 2-7).

DNR argues Section 21 is not applicable for several reasons. Its position can be parsed into five arguments: (1) "Section 21 is only triggered when DNR takes unilateral action and seeks to order a change in the rate of prospecting, development or

---

Resources has eliminated the division of lands. Duties and responsibilities given to the division of lands under this chapter have been assigned to other divisions of the department.").

production" and does not apply when DNR simply rejects a POD;[10] (2) Section 21 does not apply when "there are no ongoing operations, and thus no existing functioning infrastructure;"[11] (3) a Section 21 hearing is precluded by this Court's December 2007 decision;[12] (4) to accord a Section 21 hearing to the Appellants in these circumstances would undermine the authority conferred upon DNR by certain statutes and regulations;[13] and (5) according the Appellants a Section 21 hearing in these circumstances would inappropriately shift the burden of establishing a development plan to DNR, or, as stated by DNR in its brief: "the Appellants are trying to manipulate Section 21 in a manner requiring that DNR devise a remedy measurable against Section 21's standards."[14] Each argument is addressed in turn.

1. Is Section 21 Triggered by the Rejection of a Proposed POD?

DNR argues that Section 21 is inapplicable to the remand proceedings because Section 21 does not apply when DNR has rejected a proposed POD. For the following reasons, the Court disagrees.

First, the language of Section 21 itself indicates that its application is not limited to only those situations where DNR seeks to modify an existing POD. When interpreting a contract, a court should strive to give effect and reasonable meaning to all provisions of the instrument. *Alaska Constr. & Eng'g, Inc. v. Balzer Pac. Equip. Co.*,

---

[10] Br. of Appellee at 48.

[11] *Id.* at 47.

[12] *Id.* at 49.

[13] *Id.* at 51-53.

[14] *Id.* at 50.

130 P.3d 932, 937 (Alaska 2006), *reh'g denied*. Here, subsection (ii) of the second paragraph of Section 21 provides that DNR's powers under Section 21 "shall not be exercised in a manner that would . . . alter or modify the rates of production from the rates provided *in the approved plan of development* and operations then in effect *or, in any case*, curtail rates of production to an unreasonable extent . . . ." PTU REC at 794 (emphasis added). Thus, subsection (ii) applies not only to situations in which DNR seeks to change the terms of approved POD but also to "any case" – which would include cases in which there is no approved POD. Additionally, subsection (i) of that same paragraph provides that DNR's powers under Section 21 "shall not be exercised in a 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" and makes no mention of applying only to approved POD's. *Id.* To interpret Section 21 of the PTUA as applicable only when DNR seeks to alter the terms of an approved POD would be inconsistent with the language of both subsections (i) and (ii) of the second paragraph of Section 21.

Second, as the Appellants noted in their reply brief, throughout the proceedings before both the DNR and this Court, DNR has repeatedly expressed its dissatisfaction with the rate of development of the PTU as a basis for its determinations.[15] In both the initial and amended decisions rejecting the 22nd POD, the Direcctor wrote, "The Director has the authority to modify the rate of development to achieve the conservation objectives under the PTU Agreement, and *I find that increasing the rate of development in the PTU is necessary and advisable.*" PTU REC at 8947, 12328 (emphasis added).

[15] Reply Br. of Appellants at 30-31 (*citing* Br. of Appellee at 2-7).

On appeal from the Director's amended decision, the Appellants submitted a revised 22nd POD. In rejecting this revised POD and ultimately terminating the PTU, the Commissioner largely adopted and incorporated the findings and rationale of the Director's amended decision, *see id.* at 5671, and characterized the Appellants' conduct as "unambiguously refus[ing] to *adequately* explore, delineate, or produce massive known hydrocarbon reserves." *Id.* at 5686 (emphasis added). And after this Court affirmed the Commissioner's decision to reject the revised 22nd POD under Section 10 and remanded the matter to the Commissioner, the Appellants submitted a proposed 23rd POD as an alternative to termination of the PTU. In rejecting this proposed POD, the Commissioner found that the 23rd POD was "*not adequate* to insure timely development" of the PTU. *Id.* at 31465 (emphasis added).

Third, a Section 21 hearing is the natural progression from the rejection of a POD under Section 10 when the proposed 23rd POD was rejected because DNR seeks to increase production in the Point Thomson Unit. This Court's December 2007 Decision addressed the standard under which DNR may reject proposed PODs pursuant to Section 10 of the PTUA and held DNR is accorded the authority under Section 10 to reject a proposed POD based solely upon consideration of the factors set forth in 11 AAC 83.303(a).[16] This Court rejected the Appellants' position that the reasonably prudent operator (RPO) standard should apply to DNR's assessment of a POD, reasoning that Section 10's reference to the RPO standard only obligated the Appellants to act as reasonably prudent operators – it did not obligate DNR to apply that standard when evaluating a proposed Plan of Development. 2007 Decision at 22-24.

[16] 2007 Decision at 22-23.

But when Section 10 is interpreted in that manner, it cannot be the basis for establishing a material breach of the PTUA by the Appellants. Stated differently, in December 2007 this Court recognized that the rejection of a proposed POD under Section 10 of the PTUA does not of itself constitute an act of default or a material breach of the PTUA by the Appellants. *Id.* at 34-35.

2. Does Section 21 Apply if the Current Rate of Prospecting, Development, or Production is Zero?

DNR next argues that Section 21 does not apply because there is no ongoing production in the PTU. By its terms, Section 21's applicability is limited to where DNR seeks to "alter or modify . . . the quantity and rate of [the PTU's] production[.]" PTU REC at 1268. DNR asserts that, "[w]here, as here, there are no ongoing operations, and thus no existing functioning infrastructure (such as active wells, production facilities and pipelines) Section 21 is not the proper provision of the PTUA" to apply to this proceeding. Br. of Appellee at 47.

The question presented is whether "rate of production" as used in Section 21 includes the rate of zero production. Nowhere in Section 21 is there an express limitation of its applicability to DNR proceedings undertaken only when the PTU is actively producing oil or gas. Further, the term "rate" is not defined in the PTUA. Therefore, this Court will look to the "ordinary, contemporary, common meaning" of the word "rate" to discern whether Section 21 of the PTUA should be interpreted to apply where there is no ongoing production in the unit and DNR seeks to increase that rate from zero so as to require production. *Kay*, 132 P.3d at 269.

"Rate" is a word with a variety of meanings. For example, it may refer to the price paid for a particular good or service, Black's Law Dictionary 1375 (9th ed. 2009)

(definition 2 of "rate *n*") (i.e., a hotel room rate), or it may be used as a verb, meaning "to set an estimate on" or "to determine or assign the relative rank or class of." Webster's Ninth New Collegiate Dictionary 976 (1990) (definitions 3a and 3b of "rate *vb*") (i.e., to rate an athlete's abilities). But in Section 21 of the PTUA, it is apparent from the context in which the term is used that "rate" refers to the amount or speed of production in the PTU. Black's Law Dictionary defines "rate" as a "[p]roportional or relative value; the proportion by which quantity or value is adjusted." Black's Law Dictionary 1375 (9th ed. 2009). Other dictionaries provide the following relevant definitions: "a fixed ratio between two things," Webster's Ninth New Collegiate Dictionary 976 (1990) (definition 3a of "rate *n*"), "a quantity, amount, or degree of something measured per unit of something else," *id.* (definition 4a of "rate *n*"), "[a] stated numerical amount of one thing corresponding proportionally to a certain amount of some other thing," The New Shorter Oxford English Dictionary on Historical Principles Vol. 2 2481 (1993) (definition 4 of "rate n^1"), and "[s]peed of movement, change, etc., the rapidity with which something takes place; frequency of a rhythmic action." *Id.* (definition 5 of "rate n^1").

Each of these ordinary, contemporary, and common definitions of "rate" lead this Court to conclude that "rate of production," as used in Section 21 of the PTUA encompasses not only situations in which there is active production, but also the situation in which the rate of production is zero. The referenced dictionary definitions of "rate" provide that the term refers to a proportional value or ratio. In the context of oil production, the common proportional measure of the rate of production is barrels per day, *see, e.g., Amber Res. Co. v. U.S.*, 87 Fed. Cl. 16, 20 (Fed. Cl. 2009); *Trees Oil Co. v. State Corp. Comm'n*, 105 P.3d 1269, 1274 (Kan. 2005); *Harken Sw. Corp. v. Bd. of*

Oil, Gas & Mining, 920 P.2d 1176, 1180 (Utah 1996), and, in the context of gas production, the common proportional measure of the rate of production is cubic feet per day. *See, e.g., Exxon Mobil Corp. v. State, Dep't of Revenue*, 219 P.3d 128, 132 (Wyo. 2009); *Cimarron Oil Corp. v. Howard Energy Corp.*, 909 N.E.2d 1115, 1120 (Ind. Ct. App. 2009). These definitions of "rate" encompass the possibility that oil may be produced at a "rate" of zero barrels per day and gas may be produced at a "rate" of zero cubic feet per day. This reading of "rate" is in line with the usage of the term "rate" in decisions from other courts.[17] *See Amara v. Cigna Corp.*, 534 F.Supp.2d 288, 324 n.18 (D. Conn. 2008) (emphasis added) (referencing an Internal Revenue Service ruling mentioning "a period of *zero* annual rate of accrual"); *State Bd. of Health v. Godfrey*, 290 S.E.2d 875, 877 (Va. 1982) (emphasis added) (referencing an expert witness's testimony regarding "slow or *nil* rates of absorption"); *Nw. Pipeline Corp. v. Adams County*, 131 P.3d 958, 960 (Wash. Ct. App. 2006) (emphasis added) (referencing the possibility that a company would have a "*zero* growth rate"). This Court concludes that the fact that the PTU currently has a zero rate of production does not preclude the applicability of Section 21.

3. Does This Court's December 2007 Decision Preclude a Section 21 Hearing?

DNR also contends that the Appellants were not entitled to a Section 21 hearing on remand because this Court's December 2007 decision precludes such a hearing. DNR argues that this Court's prior decision remanded to the agency for a "remedy"

[17] The Court's research has not located any Alaska appellate cases construing the word "rate." However, as noted above, DNR's Director of the Oil and Gas Division initially applied Section 21 in this case to a production rate of zero. *See* p. 5, *supra*.

proceeding. DNR maintains that this Court has already found the Appellants in default of the PTUA and limited the scope of the remand proceedings to giving the Appellants an opportunity to cure a material breach. DNR contends:

> [T]he court has already determined 'what happens' after DNR properly rejects a proposed POD under Section 10 of the PTUA: 'this matter is remanded to the 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 22nd Plan of Development.' . . . The court did *not* remand to give Appellants another chance to cure their material breach. Rather, because this court affirmed DNR's rejection of the revised 22nd POD and confirmed that the agency applied the proper legal standards in doing so, the sole issue on remand was 'the appropriate *remedy* to the State upon DNR's rejection of the proposed 22nd Plan of Development.

Br. of Appellee at 49, 78.

DNR accords too broad of an interpretation to the use of the term "remedy" in this Court's December 2007 decision. As explained above, this Court's 2007 Decision did not find that DNR's rejection of a POD under Section 10 constituted a material breach of the PTUA by the Appellants.[18] Rather, in that decision, this Court interpreted Section 10 to accord to DNR the right to reject a POD based primarily on a consideration of the public's interest and remanded the case to address the appropriate remedy in that circumstance. "Remedy," as used in the December 2007 decision, meant the following dictionary definition of the term: "[t]he means of enforcing a right." Black's Law Dictionary 1407 (9th ed. 2009). A Section 21 hearing is the contractual means by which DNR may enforce its right to seek increased production in the PTU. Stated differently, DNR has the right to seek increased production in the PTU, but it can only enforce that right in accordance with the provisions of the PTUA, including Section 21.

---

[18] *Supra* at 17.

4. Does the application of Section 21 after DNR rejects a proposed POD undermine DNR's authority conferred by statutes and regulations?

DNR also asserts that if Section 21 is applicable when DNR rejects a proposed POD, it would undermine the agency's authority to reject a POD under the applicable statutes and regulations. In this regard, DNR asserts:

> Section 21's "good and diligent" practices standards, which Appellants assert should have been applied on remand, are very different in kind from the criteria set out in Section 10 and 11 AAC 83.343. The phrase "good faith and diligent oil and gas engineering and production practices" was added as part of the 1985 amendments to the PTUA, and thus must be read consistently with 11 AAC 83.343 which was in existence in 1985 ... Injecting Section 21 standards into this analysis would have taken away the Commissioner's ability to consider the unit agreement, statutory, and regulatory POD criteria.[19]

DNR adds, "If section 21 [were] applied in the manner advocated by Appellants, its 'good and diligent' practices standard would be impermissibly elevated over the 'public interest.'"[20]

This Court finds DNR's argument in this regard to be unavailing. Rather, this Court agrees with the Appellants' analysis of the applicable statutory and regulatory provisions that apply when DNR rejects a proposed POD on the basis that it does not increase the rate of prospecting, development, or production to a level satisfactory to DNR.[21] And while this Court's 2007 Decision held that Section 10 of the PTUA accords DNR considerable discretion to reject a proposed POD, Section 21 accords specific contractual rights that the Appellants may then exercise to protect their interest in the

---

[19] Br. of Appellee at 53 (footnotes omitted).

[20] *Id.* at 54.

[21] *See generally* Reply Br. of Appellants at 29-31, including footnotes therein.

PTU. This contractual interpretation is consistent with the underlying statutes that were in place when the PTU was created in 1977 and incorporated into Section 1 of the PTUA. *See former* AS 38.05.180(m) and (n).[22]

5. Does a Section 21 Hearing Impermissibly Shift the Burden to DNR to Determine the Appropriate Rate of Production?

DNR's final argument with respect to the applicability of Section 21 asserts that the agency would be inappropriately "saddled with the burden of designing an adequate POD" at Point Thomson if the PTUA is interpreted to require a Section 21 hearing whenever a POD is rejected. Br. of Appellee at 52. But this Court finds that the provisions of Section 21 are reasonable contractual burdens that DNR knowingly assumed both in both 1977 and again when the PTUA was amended in 1985.[23]

For the foregoing reasons, upon DNR's rejection of the 22nd POD under Section 10, the Appellants are entitled to a hearing in accordance with Section 21 of the PTUA.

C. Further Proceedings and the Appellants' Right to Due Process

This Court having determined that the Appellants did not receive the Section 21 hearing that they should have been accorded under the PTUA, it is clear that further proceedings are necessary. The Appellants have taken the position that "it is now

---

[22] *See also* 11 AAC 83.343, adopted in 1981, which indicates that if the POD is disapproved, the Commissioner of DNR may propose modifications that would qualify the POD for approval, but is otherwise silent on how such modifications are to be proposed. *Cf.* 11 AAC 83.336, adopted in 1981, discussed in this Court's 2007 Decision at 36-39.

[23] Moreover, it would appear that the burden on DNR may well be considerably less onerous in a case such as this in which no production has been occurring, given the language contained in Section 20(c) of the contract, which provides that after a valuable discovery of unitized substances has been made, the PTUA shall remain in effect only for "so long as unitized substances can be produced in quantities sufficient to pay for the cost of producing same from wells on unitized lands within any participating area established hereunder . . . ." PTU REC at 608-09, 9448.

necessary that the dispute be referred to an independent hearing officer." Reply Br. of Appellants at 15 (citing AS 44.64.030(b)). Alternatively, the Appellants asserted in their opening brief that this Court should grant a trial *de novo*. Br. of Appellants at 94. For its part, DNR asserted that briefing of any remedy issues should be deferred until this Court has determined whether further proceedings are necessary. It maintains that if this Court finds a due process violation, "it makes the most sense to wait until the court identifies how DNR violated due process and exactly what process is due Appellants before the parties argue whether trial de novo or remand is the best way to address any deficiencies." Br. of Appellee at 43.

Accordingly, analysis of the due process issues raised by the Appellants is clearly necessitated.[24] The Appellants have identified several procedures that the Commissioner employed on remand that they assert were constitutionally inadequate. They maintain that DNR failed to separate the advocacy of its proprietary interests from its quasi-judicial adjudicatory functions by permitting the same staff and counsel who had defended the first appeal to assist the Commissioner in the remand proceeding. Br. of Appellants at 24-27. They also assert that DNR failed to accord the Appellants an adversarial hearing with the minimum procedural protections consistent with a fair proceeding. Specifically, they maintain that they were not accorded a neutral decision maker, adequate notice and adequate discovery, an appropriate burden of proof, an adversarial hearing in which DNR staff participated as a party, and a preclusion on *ex parte* contacts between the decision maker and any party. *Id.* at 27-33.

[24] The Court should address constitutional issues on appeal "only when a case cannot be fairly decided on other grounds." *Frost v. Spencer*, 218 P.3d 678, 682 (Alaska 2009).

This Court previously found in its 2007 Decision that DNR does have the authority to administratively adjudicate disputes related to the PTUA.[25] But it must do so consistent with the constitutional protections that are to be accorded to all litigants. "An impartial tribunal is basic to a guarantee of due process."[26] While an administrative agency may perform adjudicatory functions, it must do so in a way that adequately separates the adjudicatory function from the agency's administrative and investigatory functions so as to insure that all parties appearing before the agency are accorded their constitutional right to due process.[27]

In this case, it is undisputed that during the remand proceedings before the agency, the Commissioner, acting in an adjudicative role, was advised by the same attorneys who had represented the agency in the first appeal to this Court. Those attorneys are also representing the agency in this second appeal. In addition, the Commissioner appointed Ms. Thompson to serve as the hearing officer at the remand proceedings. She had previously been DNR's representative when the agency was defending its first decision in the 2007 appeal before this Court.

The Appellants assert that when the same attorneys who had defended the agency in the first appeal, together with Ms. Thompson, provided legal guidance to the Commissioner in private during the remand proceedings, it constituted a deprivation of their constitutional right to due process, citing *In re Robson*, 575 P.2d 771. In *Robson*, an attorney faced disciplinary proceedings before the Disciplinary Board of the Alaska

---

[25] 2007 Decision at 20.

[26] *In re Robson*, 575 P.2d 771, 774 (Alaska 1978) (citations omitted).

[27] *Id.* at 774.

Bar Association. A member of the Bar Association's Executive Director's staff had investigated Mr. Robson's alleged attorney misconduct and prosecuted the case before the Board. The Executive Director was then present during the Disciplinary Board's private deliberations, although there was no indication that she actually took any active part in the deliberations. The Bar asserted that she was present during deliberations "to advise [the Board] on procedural matters, should the need arise."[28]

Mr. Robson then appealed the Board's decision to suspend his license to practice law, contending that he was deprived of procedural due process because the Executive Director had been present during the Board's deliberations. The Alaska Supreme Court agreed and held:

> When an administrative official has participated in the past in any advocacy capacity against the party in question, fundamental fairness is normally held to require that the former advocate take no part in rendering the decision. The purpose of this due process requirement is to prevent a person with probable partiality from influencing the other decision-makers.[29]

The Appellants assert that just as the Executive Director in *Robson* had participated in an advocacy capacity against Mr. Robson, so had the attorneys and Ms. Thompson previously participated in an advocacy capacity against the Appellants in this case, such that their assistance to the Commissioner during the remand proceedings constituted a violation of the Appellants' constitutional right to due process.[30]

---

[28] *Id.* at 775.

[29] *Id.* at 774. *See also In re Brion*, 212 P.3d 748, 754-55 (Alaska 2009); *Amerada Hess Pipeline Corp. v. Regulatory Comm'n of Alaska*, 176 P.3d 667, 677 (Alaska 2008) (per curiam); *In re Walton*, 676 P.2d 1078, 1082 (Alaska 1983). *Cf. Caperton v. A.T. Massey Coal Co.*, 129 S.Ct. 2252, 2262 (2009).

[30] Br. of Appellants at 26-27.

DNR asserts that *Robson* is distinguishable. It asserts that DNR's lawyers at the Attorney General's Office and private outside counsel "only provided legal guidance to the agency and were not 'advocates' or participants at the hearing"[31] and that Ms. Thompson's role on remand was not problematic because "Ms. Thomson was *not* the decision maker in the remand proceedings."[32]

This Court finds DNR's arguments on this issue to be unavailing. The advocates for DNR in the first appeal before this Court were advising the Commissioner during the subsequent remand proceedings before the agency. As DNR's attorneys before this Court in the first appeal, they "participated in the past in an advocacy capacity against the [Appellants]."[33] Furthermore, the hearing officer appointed by the Commissioner to assist him at the remand proceedings defended DNR's position in the original appeal before this Court, participating on behalf of the agency as the agency's unit manager for the PTU.[34] Under *Robson* and the due process requirement articulated by the Alaska Supreme Court in that decision, these advocates were precluded from providing legal guidance or, as was the case in *Robson*, simply being present whenever the Commissioner deliberated on remand. As such, the private interaction of these advocates with the Commissioner in the course of the remand proceeding resulted in a denial of due process to the Appellants, as it failed to "assure both the fact and

---

[31] Br. of Appellee at 30.

[32] *Id.* at 44 (emphasis in original).

[33] *Robson*, 575 P. 2d at 774.

[34] *See* audio recording of April 17, 2007 hearing. Media Number 3AN-6307-62.

appearance of impartiality in the [agency's] decisional function." *Robson*, 575 P.2d at 775.

DNR argues that any procedural infirmity was rectified by the Commissioner's issuance of a written decision on remand.[35] In this regard, it asserts that "the case that is more applicable to these facts is *Alyeska Pipeline Service Company v. State, Department of Environmental Conservation*."[36] But the *Alyeska* decision involved the propriety of an administrator making a written fee determination on an $8,073 fee invoice for costs incurred by the administrator related to a permit challenge -- a circumstance quite distinct from the termination of the PTU that is at issue in this litigation. *See Alyeska*, 145. P.3d at 563-64; *see also Mathews v. Eldridge*, 424 U.S. 319, 334-35 (1976) (one factor in determining the extent of process that is due is the nature of the private interest at stake).

Just as the Alaska Supreme Court found in *Robson*, there is no indication that the advocates in this case took any active part in the substantive deliberations of the Commissioner, and this Court has no doubt that the purpose of their private meetings with the Commissioner during the remand proceeding was entirely ethical.[37] Nonetheless, in order to assure both the fact and appearance of impartiality when the Commissioner was exercising his decisional function, DNR's litigation counsel should not have been providing legal guidance to the Commissioner at the remand hearing, nor

---

[35] Br. of Appellee at 31.

[36] *Id.* (citing 145 P. 3d 561, 572 (Alaska 2006)).

[37] *See Robson*, 575 P. 2d at 775.

should DNR's agency representative in the first appeal have served in the position of hearing officer at the remand proceeding.

The remainder of the alleged due process violations would appear to be substantially mooted by this Court's rulings as set forth above concerning the applicability of Section 21 and the constitutional entitlement of each party to a proceeding in conformance with the dictates of procedural due process.

In light of the foregoing, the parties are invited to provide the Court with further briefing regarding whether this Court should again remand this matter for an administrative proceeding[38] or retain jurisdiction and conduct a *de novo* proceeding. With respect to a *de novo* proceeding, the parties' briefing may address whether the appointment of a special master pursuant to Civil Rule 53 is appropriate. The parties shall each have thirty days from the date of this decision to submit additional briefing on these issues. No responsive briefing shall be filed thereafter unless otherwise ordered.

CONCLUSION

For the foregoing reasons, the DNR Commissioner's Findings and Decision on Remand is REVERSED. The parties shall have thirty days from the date of this decision to submit additional briefing as set forth above. This Court shall retain jurisdiction over this matter pending further order of the Court.

ENTERED at Anchorage, Alaska this 11th day of January 2010.

I certify that on 1-11-10 a copy of the above was mailed to each of the following at their address of record (list name if not an agency)
☐ OSED ☐ AG ☐ PD ☐ DA
Deputy Clerk / Secretary

Sharon Gleason
SHARON L. GLEASON
Superior Court Judge

[38] As the Appellants note in their brief, Alaska Statute 44.64.030(b) permits DNR to request that the Office of Administrative Hearings conduct the hearing. Br. of Appellants at 35.