SUPREME COURT LIVE

February 8, 2012
West High School, Anchorage

ORAL ARGUMENT CASE SUMMARY

State of Alaska, Department of Natural Resources,
Petitioner,
v.
Exxon Mobil Corporation, Operator of the Point Thomson Unit;
BP Exploration (Alaska) Inc.; Chevron U.S.A. Inc.; ConocoPhillips Alaska Inc.,
Respondents.

Supreme Court Case No. S-13730

Disclaimer: *This summary of the case highlights the major issues raised but is not intended to be comprehensive. It has been prepared for educational purposes only by the Supreme Court LIVE program coordinator and does not reflect the input or views of any member of the court.*

OVERVIEW OF THE CASE

This case concerns a dispute between the State of Alaska, Department of Natural Resources (DNR), and the major oil companies doing business in Alaska over whether DNR can terminate the production unit at Point Thomson on the North Slope upon its determination that the companies have made inadequate progress towards bringing the unit into production.

ATTORNEYS ARGUING THE CASE

Note: *The full list of attorneys in the case is attached as Appendix A.*

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Attorney arguing for the Respondents, Exxon Mobil Corporation; BP Exploration (Alaska) Inc.; Chevron U.S.A. Inc.; and ConocoPhillips Alaska Inc.:

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QUESTIONS PRESENTED ON APPEAL

- ✓ Did the State of Alaska, Department of Natural Resources, err in terminating the Point Thomson Unit on the North Slope, based on its determination that Exxon and other oil companies with holdings in the unit have failed to bring the unit into production in the past and offered no adequate plans for doing so in the future?

    - o ***"Section 10."*** Does Exxon's failure to submit a Plan of Development (POD) acceptable to DNR constitute a material breach of the parties' Point Thomson Unit Agreement (PTUA) sufficient to allow DNR to terminate the unit under "Section 10" of the agreement?

    - o ***Due Process.*** Did the hearing before the DNR Commissioner who issued the termination decision violate Exxon's due process rights?

    - o "***Section 21."*** Is Exxon entitled to a hearing under "Section 21" of the PTUA before termination of the unit can occur?

        - At a "Section 21" hearing, should Exxon be entitled to show that no breach of the PTUA occurred because its development plans for Point Thomson have conformed to "good and diligent oil and gas engineering and production practices?"

MAJOR AUTHORITIES TO CONSIDER

U.S. Constitution

- **Article I, section 10.** Powers Prohibited of States.
- **14th Amendment, section 1.** Citizenship Rights (Due Process)

Alaska Constitution

- **Article I, section 7.** Due Process.
- **Article I, section 15.** Prohibited State Action.
- **Article VIII, section 1.** Statement of Policy.
- **Article Viii, section 2.** General Authority.

Alaska Statutes

- **AS 38.05.020.** Authority & Duties of the Commissioner.
- **AS 38.05.180(a), (b), (m), (p), (q), & (t).** Oil and gas and gas only leasing.
- **AS 44.64.050(b).** Hearing Officer Conduct

Alaska Regulations

- **2 AAC 64.040(a).** Conflicts.
- **11 AAC 83.303.** Criteria (Unit Agreements).
- **11 AAC 83.343.** Unit Plan of Development.

- **11 AAC 83. 374.** Default.
- **11 AAC 83. 315 (1974).** Rates of prospecting and production.

Alaska Supreme Court Case Law

- ***ConocoPhillips Alaska, Inc., et al. v. State, Department of Natural Resources,*** 109 P.3d 914, 917 n. 16 (Alaska 2005) (Purpose of unit agreements)
- ***Gottstein v. State, Dep't of Natural Resources,*** 223 P.3d 609, 611 n. 1 (Alaska 2010) (Conditions for extending leases)
- ***In re Robson,*** 575 P.2d 771, 774 (Alaska 1978). (Due process)
- ***Shepherd v. State, Dep't of Fish and Game,*** 897 P.2d 33, 40 (Alaska 1995). (Alaska's natural resources)
- ***White v. State, Department of Natural Resources,*** Op No. 0811, *8 (Alaska March 6, 1996) (Unpublished Opinion) (Purpose of oil and gas leases)

SUMMARY OF THE CASE

Exxon Mobil Corporation, BP Exploration (Alaska) Inc., Chevron U.S.A., Inc., and ConocoPhillips [hereinafter "Exxon"] are oil companies with state lease holdings at Point Thomson on the North Slope. In 1977, the State and Exxon entered into a "Point Thomson Unit Agreement" (PTUA) to facilitate oil and gas production in the area, and Exxon, as the major leaseholder, was designated "Unit Operator." As Unit Operator, Exxon was required to submit an annual "Plan of Development" (POD) to DNR for approval, under both the terms of the agreement and state law. During the early years of the agreement, the companies made active efforts to explore the unit: a discovery well proved promising, seven wells were drilled, and four additional wells were underway. But beginning in 1983, Exxon submitted plans that proposed no further drilling activities in the unit, and in 1985 Exxon indicated that drilling efforts would be halted. No drilling activities have occurred in the unit since 1982.

In August 2005, Exxon submitted its 22nd proposed POD to DNR. In a decision dated September 30, 2005, the Director of DNR's Division of Oil and Gas rejected Exxon's POD for Point Thomson, asserting that DNR had tried unsuccessfully for many years to spur production in the unit, and that the new plan proposed nothing that would meaningfully further production. A series of proceedings followed this decision, with DNR asserting its right by law and contract to terminate units in the interest of the people of Alaska, and the oil companies countering that DNR lacks the authority to require them to carry out a development plan if development is not reasonable by oil industry standards. A brief chronological history of the proceedings is as follows:

- ***DNR/DOG Director Decision, September 2005***. The Director of DNR's Division of Oil and Gas issues a decision giving Exxon until October 2007 "to initiate development operations within the PTU." Exxon was given the opportunity for a hearing on the decision under "Section 21" of the PTUA, a provision that requires

DNR to afford the companies a hearing if DNR seeks to change the "rate of prospecting, development and production" in the production unit.

- ***DNR/DOG Director Amended Decision, October 2005.*** The DOG Director issues an amended decision concluding that Exxon was in default under the terms of the agreement for failing to pursue production at Point Thomson, and offering Exxon the opportunity to cure the default by submitting an acceptable POD. This amended decision eliminated the October 2007 deadline, but also eliminated the opportunity for a hearing under "Section 21," based on the Director's finding that the section didn't apply to the decision on whether to approve the POD.

- ***Modified 22nd POD & 1st DNR Hearing, October-November 2006.*** Exxon submits a modified 22nd POD in an attempt to address DNR's concerns, and a hearing is held on the proposed plan before the DNR Commissioner in November 2006.

- ***1st DNR Commissioner Decision, November 2006.*** The DNR Commissioner issues a Decision on Appeal affirming most of the Director's decision and rejecting the modified 22nd POD. The Commissioner held that decisions on the adequacy of the POD must be based on the public interest, not the perspective of a "reasonably prudent operator" in the oil industry. The Commissioner's decision states that Exxon had "unambiguously refus[ed] to adequately explore, delineate, or produce massive known hydrocarbon reserves," and that continuing the unit is not in the public interest.

- ***1st Anchorage Superior Court Decision, December 2007.*** Exxon files an administrative appeal from the Commissioner's decision, and Anchorage Superior Court Judge Sharon Gleason issues a decision. Judge Gleason held that DNR had the authority to reject the 22nd POD in the public interest, notwithstanding industry standards. But she also held that rejecting the POD does not automatically terminate the PTU, and reversed and remanded the case for consideration of the proper remedy for a rejected POD.

- ***23rd POD Submitted, February 2008.*** Exxon submits a 23rd POD as a proposed remedy and asks for an adversarial "Section 21" hearing to demonstrate that its conduct conforms to the "good and diligent …practices" of the oil industry.

- ***2nd DNR Hearing, March 2008.*** The DNR Commissioner rejects the request for a "Section 21" hearing, but holds an administrative hearing on whether the 23rd POD is adequate and whether termination is the proper remedy for failure to submit an adequate POD. The DNR Commissioner appoints attorney Nanette Thompson, an employee of the agency who had consulted with the Commissioner in earlier proceedings against Exxon, to serve as hearing officer. Other attorneys who advised the agency in the earlier proceedings continue to advise the Commissioner.

- ***2nd DNR Commissioner Decision, April 2008.*** The DNR Commissioner issues a decision concluding that the 23rd POD is not adequate to ensure timely development of the Point Thomson Unit and is not in the public interest. The Commissioner again finds that the companies are in material breach of the PTUA and terminates the unit, stating "I do not believe, based on this record, that the Appellants will perform as promised this time." The Commissioner specifically rejects Exxon's request for a hearing under "Section 21" of the PTUA because, in the Commissioner's view, the section applies only when rates of development are changed in ongoing prospecting, development, or production operations, not when there are "no ongoing operations" in cases such as Point Thomson.

- ***2nd Anchorage Superior Court Decision, January 2010.*** Judge Sharon Gleason ruled against DNR in the decision that underlies the current Petition to the Alaska Supreme Court. See "Decision Below."

DECISION BELOW

In a January 2010 decision, Judge Gleason reversed the Commissioner's decision, concluding (1) that Exxon's failure to submit a 23rd POD acceptable to DNR "does not of itself constitute an act of default or a material breach of the PTUA" by Exxon sufficient to terminate the unit; (2) that the 2008 hearing before the DNR Commissioner violated Exxon's due process rights because it failed to ensure an impartial tribunal; (3) that Exxon was entitled to a hearing under "Section 21" because DNR's action directly affected the rates of prospecting, development, and production in the unit; and (4) that under "Section 21" DNR must consider the "good and diligent oil and gas engineering and production practices" before determining whether a material breach has occurred sufficient to terminate the unit.

LEGAL ISSUES GENERALLY

i. Contract Interpretation: PTUA, Section 10.

The parties disagree over the proper course of action when DNR rejects a POD under Section 10 of the PTUA. Section 10 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…The Unit Operator expressly

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

DNR's Position. In DNR's view, the constitutional and statutory framework for oil and gas development in Alaska is designed to ensure that decisions about development are based on the public interest.[1] When the 23rd POD failed to ensure that reasonable steps would be taken to bring the Point Thomson Unit into production, both state law and the language of Section 10 give DNR the authority to terminate the unit. Exxon was given the opportunity for a hearing on DNR's decision under Section 10, and is not entitled to additional proceedings.

Exxon's Position. In Exxon's view, DNR's rejection of the 23rd POD did not in and of itself entitle DNR to terminate the unit under Section 10. Another section of the parties' contract—Section 21—grants Exxon the right to a hearing when DNR attempts to change the rate of development in the unit, and DNR's effort to bring the unit into production is in effect an effort to impose a rate change—from zero production to some level of production. While DNR has broad authority to regulate oil and gas development, it cannot do so in a manner that violates the contractual rights of the oil companies.

II. Constitutional Claims: Due Process.

Both the U.S. and the Alaska Constitutions prohibit agencies of the government from depriving persons of their rights without "due process of law." Specifically, the Alaska Constitution provides:

> No person shall be deprived of life, liberty, or property, without *due process of law*. The right of all persons to fair and just treatment in the course of legislative and executive investigations shall not be infringed.[2]

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[1] See, e.g., Alaska Constitution, Article VIII, sections 1 and 2; AS 38.05.020; AS 38.05.180(a), (m), (p), (q), & (t); 11 AAC 83.303; 11 AAC 83.343; 11 AAC 83. 374; 11 AAC 83. 315 (1974).

[2] *Alaska Constitution, Article I, section 7.*

A key component of due process is the right to "an impartial tribunal."[3] Exxon argues that the participation of DNR's attorneys as advisors to the Commissioner in the 2nd agency proceeding, and the Commissioner's appointment of attorney Nanette Thompson, a DNR employee, as the hearing officer in the 2nd proceeding, made the process unfairly biased against them. The DNR attorneys and Thompson had all participated as advisors to the Commissioner in DNR's earlier proceedings against Exxon, and were thus vested in the positions DNR had taken. As a result, Exxon was denied its right to an impartial tribunal.

DNR's Position. DNR argues that the proceedings before DNR provided adequate due process to the oil companies. The agency's lawyers provided legal advice and guidance to the Commissioner only, and were not advocates or direct participants in the earlier proceedings or in the hearing itself, since the hearing was "non-adversarial" and involved a unilateral presentation to the hearing officer and Commissioner by the oil companies in which DNR attorneys did not take part. Furthermore, Hearing Officer Thompson performed primarily administrative functions as an employee of DNR, not as an attorney representing DNR. And the Commissioner, not the hearing officer, was the ultimate decision-maker, so any prior role Thompson had played in the case could not unfairly taint the decision-making process. The agency appropriately followed long-established procedures for agency adjudications that, contrary to Exxon's claims, do not require a completely independent forum.

Exxon's Position. Exxon argues that the hearing held before the DNR Commissioner was unfairly biased for two reasons. First, the agency failed to separate its *advocatory* function, under which it sought to terminate the unit and took an adversarial position against Exxon, from its *adjudicatory* function, under which it was required to provide an adversarial proceeding to Exxon in a neutral, impartial forum. Allowing agency attorneys who had played advocatory roles in agency actions taken against Exxon to later serve as both the hearing officer and advisors to the commissioner in the adjudicatory phase violated Exxon's right to an impartial proceeding. Second, DNR failed to provide minimal procedural protections to ensure a fair proceeding during the agency adjudication, such as ensuring a neutral decision-maker, providing adequate notice of the issues to be decided and the burden of proof to be applied, and prohibiting *ex parte* contacts between DNR staff and the Commissioner, which could unduly influence the Commissioner's decision-making. In Exxon's view, this case is comparable to *In re Robson,* in which the Alaska Supreme Court 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.

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

According to Exxon, DNR failed to "assure both the fact and appearance of impartiality in (its) decisional function," as required by the court in *Robson*.

III. Contract Interpretation: PTUA, Section 21.

The parties disagree over the applicability of Section 21 of the PTUA, which gives DNR the discretion to set the rates of production in the unit, provided (1) that the rates are not set in excess "of that required *under good and diligent oil and gas engineering and production practices,"* and (2) that the companies are afforded a hearing before the rates are changed. Section 21 originally provided as follows:

> 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.

In 1985, when several new leases were added to the unit, the second paragraph of Section 21 was amended 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 <u>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</u>

parties in interest hereunder, subject to applicable conservation laws and regulations.

DNR's Position. DNR maintains that Section 21 does not apply when the agency terminates a production unit for a material *breach* of the obligation to bring a unit into production, but instead applies only when there has been no breach and the agency seeks to adjust *rates* of production. Also, Section 21's reference to "rates" of development means it applies only when units are already in production, with existing infrastructure, not when units are undeveloped and dormant. Put simply, Section 21 gives DNR a "power" to determine the rates of development, but does not impose a "burden" on DNR's exercise of its other duties, such as approving or rejecting PODs or extending or terminating production units. DNR's interpretation of this section of the parties' contract should be upheld by the court because of the agency's special experience and expertise in managing oil and gas leasing in the state. Also, the provision should be interpreted in the context of Alaska's constitutional, statutory and regulatory framework for oil and gas development, which clearly contemplates that DNR's decisions will be made based on the public interest, not oil industry standards. Interpreting Section 21 as the companies urge in this case would unfairly elevate oil industry standards for whether and when development should occur over the best interests of the public.

Exxon's Position. Exxon maintains that DNR's interpretation ignores the plain language of Section 21 and DNR's own references to its goal of advancing the "rate" of production at Point Thomson. Further, the right to a hearing under the section was intended for just the type of circumstances that have arisen in this case, when the state wants to increase the pace of production in the unit. Interpreting Section 21 to allow a hearing that would address whether Exxon's conduct in the unit conforms to industry practices does not undermine DNR's overall authority to manage Alaska's oil and gas development or run counter to the laws that apply. To the contrary, state law contemplates that any termination of a production unit that is found to be in default will occur through judicial proceedings, not through the administrative process. 11 AAC 83.374(d). A Section 21 hearing, with due process safeguards, would allow a fair framework for decision-making to be implemented when the state and companies are in dispute about the proper rate of development and would recognize not only the state's interests but also the significant investments and interests of the oil companies.

QUESTIONS FOR STUDENTS TO CONSIDER

1. Each of the three branches of Alaska's state government has played a role in the history of oil and gas development in the state.

    a. Which branch enacted the relevant statutes?
    b. Which branch exercises regulatory authority and adopted the relevant regulations?

c. Which branch interprets the laws in question?

2. Read the above summary and the "Introduction and Summary of Argument" sections of the parties' briefs (*Petitioner's Brief* at 1-8; *Respondent's Brief* at 1-4.) For each of the major issues raised, which party in your view raises the strongest arguments, and why?

   a. Whether DNR has the authority to reject the 23rd POD and terminate the unit:

      DNR____ Exxon _____ Why?_____

   b. Whether DNR's process for terminating the unit violated Exxon's due process rights:

      DNR_____ Exxon _____ Why?_____

   c. Whether Exxon is entitled to an adversarial hearing under Section 21, at which it can show that its development rate for the unit conforms to industry practices:

      DNR_____ Exxon _____ Why?_____

3. What is the difference between a Petition for Review and an Appeal? Will the Alaska Supreme Court's decision be the final decision in this case?

4. The constitutional right to "due process" is a major issue in this case. In your own words, describe what "due process" means and why it's important. Can you think of other specific circumstances in your every day life where the right to due process would apply?

5. The issues at stake in this case are important ones with potentially wide-reaching impacts. Describe possible impacts of a decision in DNR's favor on any or all of the major issues. Describe possible impacts of a decision in Exxon's favor on any or all of the issues.

6. Following the rule of law means looking to the law and the facts of a case to determine the outcome, not personal views, political influence, or public pressure. What are your personal views about the most desirable outcome in this case? Why? Do your views differ from your view of what the law requires? If so, how? Can you think of other legal questions where your personal views or sympathies might favor an outcome that differs from what the law requires?

APPENDIX

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