IN THE SUPERIOR COURT FOR THE STATE OF ALASKA
THIRD JUDICIAL DISTRICT AT ANCHORAGE

CONOCOPHILLIPS ALASKA, INC.,

Appellant,

v.

STATE OF ALASKA, DEPARTMENT OF NATURAL RESOURCES, and OIL SEARCH (ALASKA), LLC

Appellees.

Case No. 3AN-22-09828 CI

~~[PROPOSED]~~ DECISION AND ORDER

In this case, Appellant ConocoPhillips Alaska, Inc. ("CPAI"), as operator for and on behalf of the KRU oil and gas lease lessees (collectively the "KRU Lessees"),[1] appeals a final order by the Commissioner of Appellee Department of Natural Resources ("DNR") upholding the grant of a miscellaneous land use permit ("MLUP") to Appellee Oil Search (Alaska), LLC ("OSA") for the right to use 75.5 miles of the Kuparuk River Unit ("KRU") Road System. The parties collectively submitted over 200 pages of briefing, including an extensive record, and also engaged in a lengthy oral argument. This Court carefully reviewed and considered the briefing, record, and arguments of counsel. For the reasons stated below, the Court concludes that CPAI's legal arguments correctly interpret and apply the relevant contractual, statutory and regulatory language and authorities. DNR has no

[1] Throughout this Order, references to CPAI are intended to include ConocoPhillips Alaska, Inc., as the KRU operator, acting on behalf of itself and the other KRU Lessees, Chevron U.S.A. Inc. and ExxonMobil Alaska Production Inc.

legal basis or authority to grant a third party the right to use CPAI's leasehold improvements, by Permit or other means, even though they are built on state land. Granting OSA the right to use CPAI's leasehold improvements also constitutes an impermissible taking under the U.S. and Alaska Constitutions. For both independent reasons, this Court reverses the Commissioner's December 1, 2022 Decision and vacates the Permit issued by the March 29, 2022 Director's Decision, effective immediately.

I. RELEVANT BACKGROUND

This Court assumes the parties' familiarity with the factual and procedural history, which is fully chronicled in CPAI's briefing. In summary, in 1963, the State of Alaska and CPAI's predecessor-in-interest entered into oil and gas exploration and development leases covering tracts of state land within the North Slope, west of Prudhoe Bay (the "KRU Leases").[2] Form No. DL-1 [Exc. 1]. In 1981, DNR approved a proposal to unitize the leases to form the Kuparuk River Unit. Pursuant to the KRU Leases and the December 1, 1981 Unit Agreement (the "KRU Agreement"), the KRU Lessees built a network of roads to support their operations within the KRU. Schell Affidavit [Exc. 136] at ¶ 6; KRU Agreement [Exc. 5]. The KRU Lessees constructed the roads at their sole expense, and over their 40+ years of use have continued to incur all ongoing construction, maintenance, repair, and management expenses at a cost of approximately $10-$20 million per year.

[2] The KRU Lessees operate the vast majority of tracts in the KRU pursuant to the KRU Leases. A minority of tracts within the KRU are subject to the DMEM-4-83 form, offered by the State in the 1980s. KRU Lease Map [R. 692]. To the extent there are differences between the leases, those differences do not impact the Court's conclusion that the State did not reserve the right to grant third party use of leasehold improvements during the lease term.

Schell Affidavit [Exc. 136] at ¶¶ 11-14. The cost to build comparable roads today would exceed $1 billion.[3] CPAI's March 23, 2022 comments [Exc. 96] at 5. The KRU Lessees also incur annual property taxes on the assessed value of the KRU facilities, including the roads. May 24, 2021 Certificate of Determination, Appeal of Revenue Decision No. 21-56-01, [Exc. 38]; Schell Affidavit [Exc. 136] at ¶ 15. The KRU roads have never been open to the public, and prior to issuing the Permit, DNR never attempted to exert dominion or control over the KRU Road System. Schell Affidavit [Exc. 136] at ¶¶ 8, 15. Instead, DNR directed third parties that use of the KRU roads would be subject to commercial agreement with the KRU Lessees. *Id.;* January 3, 2020 Director's decision re ADL 421228 [R. 3313] at 4.

OSA is the operator of the Pikka Unit, an oil and gas development on the North Slope west of the KRU. OSA sought to use CPAI's KRU roads to access the Pikka Unit for its pre-development activities, and CPAI granted OSA such use under a March 2, 20218 Ad Hoc Road Access and Use Agreement. [R. 1137]. Under that agreement, OSA used the KRU roads at no cost for years. *Id.* In exchange, OSA agreed, among other things, "not to make any claim of title, right of use, or right to occupy for any purpose whatsoever, whether by transfer, prescription, easement, right-of-way or otherwise, to any part of the KRU Road System." *Id.*, ¶ 2.2.

[3] At oral argument, DNR contended this case concerns a "gravel road that's been there for decades." CPAI countered: "They are gravel roads that are eight-feet tall. They are 30- to 40-feet wide. The 75 miles of KRU roads includes 12 bridges. Suffice it to say these are substantial structures that cost over a billion dollars to construct. And over time, as we've already talked about, ten to $20 million per year just to maintain."

When OSA sought long-term use of the KRU Road System to construct and operate the Pikka Unit, the parties began commercial discussions about a new agreement. Schell Affidavit [Exc. 136] at ¶¶ 16, 18. CPAI describes the Pikka Unit development as several times larger than other projects CPAI has allowed to use the KRU roads, *id.*, and CPAI expected any new agreement with OSA to take into account OSA's planned change in road use to include regular heavy-truck traffic. *Id.* CPAI also expected any new agreement to consider the KRU Lessees' prior and continuing investment in the construction and maintenance of the roads, and the increased risk and liability associated with OSA's expected Pikka Unit activity. *Id.* ~~In negotiating with OSA,~~ CPAI proposed commercial terms that were substantially equivalent to terms OSA previously offered a third party for the sale and leaseback of OSA's own Pikka Unit roads and bridges.[4] CPAI's March 23, 2022 comments [Exc. 96] at 2; August 5, 2020 OSA Presentation [Exc. 83, 92]. OSA rejected those terms. *Id.*

At the same time OSA was negotiating with CPAI, OSA sought the use of another road: the Mustang Road, which was being operated by Brooks Range Petroleum Corporation ("BRPC"). BRPC Mustang Road Easement [R. 2289]. The Mustang Road is a 4.3-mile road that serves the Mustang Unit and sits geographically between the KRU to

[4] In its briefing, OSA did not dispute that CPAI's proposed commercial terms were substantially equivalent to terms OSA had proposed for use of its own roads. At oral argument, OSA's counsel stated he believed this was incorrect but did not cite any record support. In its decision granting the Permit, DNR determined that whether CPAI's commercial proposal was substantially equivalent to OSA's proposed terms for its own roads was "not relevant" in determining whether the Permit should be issued. Director's Decision [Exc. 111] at Appendix C, p. 3 [Exc. 133].

the Pikka development. *Id.* Rather than negotiate a commercial agreement with BRPC, OSA petitioned DNR to grant OSA an easement overlapping the Mustang Road. OSA Mustang Road Easement Application [R. 2344]. Over the objection of BRPC, on January 2, 2020, DNR issued a decision granting OSA use of the Mustang Road via a non-exclusive easement[5] overlapping in part BRPC's easement. January 2, 2020 Director's Decision [R. 1640]. The Decision allowed OSA to use the road without compensating BRPC. *Id.* This was the first time DNR granted a third-party use of a road system in a North Slope production unit over the objection of the unit operator. BRPC Appeal [R. 2366]. On January 23, 2020, BRPC filed an appeal, seeking to overturn the easement on the grounds that DNR exceeded its authority and took BRPC's private improvement without compensation. *Id.*

Two years later, on February 9, 2022, OSA applied to DNR for a miscellaneous land use permit under 11 AC 96.010(3), which, when granted, would give OSA free use of the KRU Roads. MLUP Application [R. 13]; Schell Affidavit [Exc. 136] at ¶ 19. But instead of seeking an easement, this time OSA requested that DNR grant a miscellaneous land use permit under 11 AC 96.010(3). *Id.* OSA claimed in the permit application that it was unable to reach agreement with the KRU Lessees "on what constitutes 'reasonable concurrent use'" of the roads. *Id.* Over CPAI's objection, the Director of the Division of Oil and Gas of DNR issued a decision on March 29, 2022 (the "Director's Decision") [Exc.

[5] While DNR's grant under AS 38.05.850 of an overlapping non-exclusive easement to use the Mustang Road is different in form from its grant of an MLUP to use the KRU roads, the effect is the same: both the easement and the Permit ~~improperly~~ allow OSA to use private roads without the consent of or compensation to the road owners.

111] granting OSA a miscellaneous land use permit to use the 75.5 miles of KRU roads (the "Permit"). CPAI timely appealed the issuance of the Permit to the DNR Commissioner, who issued a final decision denying CPAI's appeal and upholding the Permit on December 1, 2022 (the "Decision") [Exc. 157]. On December 30, 2022, CPAI timely appealed that decision to this Court.

Although 11 AC 96.010 was promulgated over 50 years ago, the record shows, and DNR concedes, that the OSA Permit represents the first time the agency has issued a miscellaneous land use permit to grant a third party the right to use private leasehold improvements on state land. Decision [R. 1057] at 22.

II. STANDARD OF REVIEW

This case involves the analysis and interpretation of contracts, statutes, regulations and constitutional provisions. The parties do not dispute this Court should review constitutional questions using its independent judgment. [DNR Br. at 13; OSA Br. at 11]. The parties also agree that courts generally exercise their independent judgment when considering contract or statutory interpretation. [OSA Br. at 11-12; DNR Br. at 13-15]. Appellees ask the Court to forego its independent judgment in favor of a reasonable basis review because the contracts and statutes at issue, according to Appellees, contain specialized terms on which DNR has expertise. The Court disagrees and finds the relevant contract and statutory terms, including (but not limited to) the terms "said land" and "state land," do not implicate agency expertise, longstanding agency interpretation, or broad policy formulations. Accordingly, no deference to the agency's interpretation is warranted. *N. State Envtl. Ctr. v. Dep't of Nat. Res.*, 2 P.3d 629, 632 (Alaska 2000).

With respect to the regulatory issues this case presents, an agency generally receives deference when interpretating its own regulations. But where, as here, the questions before the court are whether a regulation has been properly applied and whether the agency has exceeded its authority, the Court's independent judgment should apply. *Municipality of Anchorage v. Stenseth*, 361 P.3d 898, 905 (Alaska 2015). Appellees' request for deference in applying 11 AAC 96.010 is especially unwarranted given DNR's admission that it has never used the regulation to grant third-party use of improvements and therefore cannot claim expertise in how Section 96.010 has been applied here.

Finally, the record reflects and DNR conceded there are no factual findings in dispute warranting agency deference. [DNR Br. at 13]. Thus, to the extent any issue turns on a factual matter, this Court's independent judgement applies because this case involves "parties draw[ing] different conclusions and inferences from facts or dispute[s] [about] the applicability of facts." *Wood v. Collins*, 812 P.2d 951, 956 n.4 (Alaska 1991).

For all these reasons, this Court will apply an independent-judgment review to the questions of law at issue in this appeal. However, even if the Court were to apply a more deferential reasonable basis standard, the Court would still conclude that DNR exceeded its contractual, statutory, and regulatory authority by granting third party OSA use of CPAI's leasehold improvements, as provided in the disputed Permit.

III. ANALYSIS

~~The record briefing frames the parties' dispute on this appeal.~~ The ultimate question of law before this Court is whether DNR has the power to grant a third party the right to use a privately-built leasehold improvement—here, the KRU Road System—simply

because that improvement is built on state land. Implicit in this legal question is whether references to "land" or "state land"—in the KRU Leases, the regulation, the enabling statutes, and the Constitution—are intended to mean both the land and any improvements on the land. Because this Court concludes that (1) DNR is not empowered to grant OSA the right to use the KRU Road System, and (2) that granting OSA use of CPAI's private leasehold improvements constitutes a per se taking in violation of the US and Alaska Constitutions, the Decision must be reversed and the Permit must be vacated.

DNR relies on three sources for its authority to grant the Permit: (1) the reservation in the KRU Leases, (2) DNR's own regulation that it promulgated, 96.010; and (3) general Constitutional policy statements. [DNR Br. at 23, 25, 27-28]. For the Permit to be upheld, this Court would need to find in DNR's favor on at least five questions of law: First, that CPAI and the State jointly intended, via the reservations in the KRU Leases, that the State could allow others to enter upon and use not just the land, but also improvements installed on the land by the KRU Lessees. Second, that granting OSA use of the KRU roads via a MLUP is a purpose authorized by law and not inconsistent with the KRU Lessees' rights as required by 29(e) of the reservation. Third, that 11 AAC 96.010(3) can be applied to grant OSA access to the KRU roads, even though an MLUP has never before been used to allow a third party to use private leasehold improvements. Fourth, that the enabling statutes on which 11 AAC 96.010 is based authorize DNR to exercise control over private leasehold improvements. Fifth, that DNR's issuance of the Permit, allowing OSA to use the KRU roads, is not a per se taking in violation of the US and Alaska Constitutions.

Starting with the leases, for their part, the KRU Lessees maintain that the plain terms of the KRU Leases and the KRU Agreement, along with the parties' decades of performance, reflect their intent that DNR's reserved right to "enter upon and use said land" is limited to the land itself. According to the KRU Lessees, DNR does not have authority to control access to the KRU's private leasehold improvements (here, the KRU roads) during the lease term. In response, Appellees contend that Paragraph 29(e) of the KRU Leases reserves to the State the power to grant others (here, OSA) the right to enter upon and use the KRU roads, in addition to the land itself, "for any other purposes now or hereafter authorized by law and not inconsistent with the rights of Lessee under this lease." KRU Lease [Exc. 1], ¶ 29. DNR makes no effort to construe Paragraph 29 and instead argues its interpretation is only sensible. [DNR Br. at 25]. This Court finds the KRU Lessees' position is more persuasive and supported in the relevant record and applicable law.

The reservation in 29(e) is modified by the State's right to "enter upon and use **said land.**" *Id.* (emphasis added). There can be no ambiguity as to what "said land" means because there is an explicit definition, and it makes no reference to improvements. "Said land" is defined in Paragraph 1 of the KRU Leases as referring only to the land itself, not what sits upon its surface. *Id.*, ¶ 1. "Said land" is used similarly throughout the KRU Leases to refer only to the land itself. *Id.*, ¶¶ 26, 30, 34, 36. "Said land" must have the same meaning wherever it is used in the KRU Leases, including in the Reservation. Because "said land" means only the actual land, DNR did not reserve the right to exercise dominion over the KRU roads (or any other improvements).

Accordingly, DNR reserved the right to allow itself or third parties to enter upon and use the unimproved acreage within the KRU for any purpose that does not unreasonably interfere with CPAI's rights and otherwise comports with Paragraph 29. But nothing more. This Court concludes that CPAI has offered the only interpretation of Paragraph 29 that is reasonable, consistent with the circumstances at the time the KRU Leases were entered, and that comports with the terminology used throughout the Leases. The record does not support (and it is not credible to argue) that CPAI entered into the KRU Leases intending to give the State the right to allow third parties to use its infrastructure—for free and without consent. Because DNR did not reserve the right to grant third-party use of CPAI's improvements, the Permit must be revoked on this basis alone.[6]

The regulation on which DNR relied to grant the Permit also does not authorize third-party use of leasehold improvements, even if on state land. DNR granted OSA use of the KRU roads via a miscellaneous land use permit pursuant to 11 AAC 96.010(a)(3), a regulation the Commissioner promulgated in 1970 to effectuate DNR's statutory responsibilities. Decision [Exc. 157] at 20; AS 38.05.020(b)(1). As a state agency, DNR's power extends only as far as the Alaska Legislature has determined is proper, as conferred by the Legislature's enabling statutes. *McDaniel v. Cory*, 631 P.2d 82, 88 (Alaska 1981). The validity of the Permit therefore depends on DNR's authority, as derived from the

[6] The result is no different under the KRU Agreement, which recognizes the same rights and reservations as the KRU Leases—and reinforces that improvements placed by the lessee on the land are the private property of the lessee during the lease term. KRU Agreement [Exc. 5], ¶¶ 3.6, 3.7.

enabling statutes, to grant a third-party use of private improvements under 11 AAC 96.010. *Warnke-Green v. Pro-West Contractors, LLC*, 440 P.3d 283, 289 (Alaska 2019).

Of the six enabling statutes cited as a basis for promulgating 11 AAC 96.010, the Court concludes that none provide DNR authority to grant a third-party use of private leasehold improvements; nor do any of the statutes treat "land" and "improvements" as one and the same. 11 AAC 96.010 (citing AS 38.05.020, AS 38.05.035, AS 38.05.131, AS 38.05.133, AS 38.05.180, and AS 38.05.850 as enabling statutes). On the contrary, AS 38.05.35, which outlines the "Powers and Duties of the Director" expressly limits the DNR Director's "management" and "control" over "improvements" to those "belonging to the state." AS 38.05.35(a)(2). Likewise, AS 38.05.850(A), which grants DNR the power to issue Permits, does not provide authority for DNR to grant a permit for use of existing leasehold improvements. DNR cannot rewrite the enabling statutes to reach its desired result and trump the legislature by enlarging its own power in hindsight. If DNR had the power it claims in issuing the Permit, the Court would expect to find that power clearly articulated in AS 38.05.35 or 38.05.850(A), or likely both.

In response, DNR makes no real attempt at statutory interpretation, and instead claims that its ability to regulate private improvements is consistent with the Commissioner's broad authority to manage state land under AS 38.05.020. But DNR has not identified any express language in AS 38.05.020 or anywhere else in the Land Act that allows DNR to control third-party improvements, and the general authority described in AS 38.05.020 cannot empower the Director to grant a third party use of such improvements without running afoul of AS 38.05.35(a)(2) and 38.05.850(A). To suggest that the

Commissioner could affirm the Permit even if the Director did not have the power to issue it in the first place would lead to an absurd result. DNR's interpretation of 96.010 as applying to private improvements is inconsistent with the enabling statutes on which it is based and would cause the regulation to be invalid.

Under DNR's interpretation, any third party could: (1) offer uneconomic terms for using any private improvement (whether pipelines, production facilities, or any other structures); and (2) if rejected, DNR could issue a permit or other state grant to allow free use. Even when pressed, Appellees were unable to articulate a limit on DNR's authority over private improvements under their interpretation of 96.010. At oral argument, Appellees acknowledged their belief that 96.010 would allow DNR to grant third-party use of a pipeline or building constructed by a lessee on state land. This interpretation would frustrate both the regulation's purpose and the Constitutional maxim of "maximum use" that DNR claims to advance. The Court concludes that 11 AAC 96.010(3) cannot be applied to grant OSA access to the KRU roads, and further finds that granting OSA use of the KRU roads is not authorized by law and would be inconsistent with the KRU Lessees' rights.[7] On this additional basis, the Permit must be revoked.

Appellees also claim that CPAI's interpretation of the KRU Leases, enabling statutes, and regulations is inconsistent with the State's: (1) obligation under Articles VIII,

[7] Contrary to DNR's argument, the Permit is not somehow saved by its conditions and stipulations, [DNR Br. at 7-9; OSA Br. at 8-9], which are irrelevant to the question of DNR's authority to grant the Permit in the first place.

Sections 1 and 2, to "make its lands available for 'maximum use" and "maximum benefit of its citizens"; and (2) the requirement under Article VIII, Section 8 that "all State land subject to an oil and gas lease be available for "reasonable concurrent use." But like the reservation in the KRU Leases, the constitutional provisions on which Appellees rely pertain to the use of state land—not the concurrent use of improvements by multiple oil and gas operators. Further, there are no record facts that support DNR's claim that CPAI has frustrated DNR's right to maximize land use or allow reasonable concurrent use of the unimproved acreage that encompasses the KRU leases. Indeed, OSA has been able to access the Pikka Unit to conduct operations before and during this litigation. March 2, 20218 Ad Hoc Road Access and Use Agreement. [R. 1137].

There likewise is no basis in the record or applicable law to find that a MLUP or other grant or authorization by DNR is required to serve the State's interests in developing Pikka. The record reflects that CPAI has never refused OSA's request to use the KRU roads to access the Pikka Unit, and instead has sought to negotiate a commercial agreement with OSA. Schell Affidavit [Exc. 136] at ¶¶ 16, 18. Despite DNR stating "unequivocally ... that the desired outcome would be a commercial road use agreement between OSA and CPAI and eventual revocation of the Permit," Decision at [R. 1070], the Court finds that the Permit disincentivizes OSA to engage in commercial negotiations because OSA currently has free use of the KRU roads.

In addition, the constitutional maxims of "maximum benefit" and "reasonable concurrent use" of land do not empower DNR, in the absence of contractual agreement or

legislative authority, to grant one oil and gas lessee concurrent use of another lessee's improvements in order to develop an entirely different tract of land.

At the hearing, CPAI reiterated its belief that the parties can reach a commercial agreement if the Permit is vacated.[8] If, however, the parties are unable to reach agreement, and the State determines it is in the public's best interest that OSA have free use of the KRU Road System, the State is not without a remedy. The federal and state constitutions and the Alaska Legislature have prescribed an eminent domain process; DNR cannot circumvent that process by granting OSA uncompensated use of the KRU roads by MLUP or any other grant. Even the Legislature could not write a law that grants DNR ownership over private property without complying with the takings clauses in the US and Alaska Constitutions.

Because the KRU Lessees' fundamental right to exclude third parties from using the KRU roads has been taken from them via the Permit, they have suffered a per se taking under federal law. *Cedar Point Nursery v. Hassid*, 141 S. Ct. 2063, 2071 (2021). DNR's issuance of the Permit also constitutes a taking under the Alaska Constitution, which "provides broader protection than that conferred by the Fifth Amendment of the Federal Constitution," *State v. Hammer*, 550 P.2d 820, 824 (Alaska 1976), and is "interpreted liberally in favor of the property owner." *Anchorage v. Sandberg*, 861 P.2d 554, 557

[8] "This appears especially true given the comments of OSA's Sr. Vice President of External Affairs to the Senate Resources Committee on February 5, 2024: "there's not anything that is in the way of our progress, the state has multiple tools to assure access, and I am confident that the department would continue to work with us to assure access, ***and frankly I think, the operator at Kuparuk would probably allow us to continue to work***, they'd just be running a register, right? And happy to hand us a bill at the end." (Emphasis added.)

(Alaska 1993). DNR cannot expropriate the roads for the benefit of OSA, without any authority, or due process, or any regard for the proper procedures or fair compensation, all under the guise of a miscellaneous land use permit. USCS Const. Amend. 5, Part 1 of 13; Alaska Const., Art. I, §18. For this additional, independent reason, the Permit must be revoked.[9]

IV. CONCLUSION

For the foregoing reasons, and those outlined in the briefing of Appellant ConocoPhillips Alaska, Inc., which this Court adopts in full, the court REVERSES the Commissioner's Decision and GRANTS Appellant's request to vacate the Permit. The Commissioner's Decision and Permit are vacated, effective immediately.

ORDERED this 17th day of December, 2024

I certify that on 12/17/24 a copy of the following was mailed/ faxed/ hand-delivered to each of the following at their addresses of record. B. Jamieson; T. Galligan; J. Hardin; E. Fjelstad; E. Romerdahl; M. Grambling;

Administrative Assistant KKOK

The Honorable Judge Andrew Guidi
Superior Court Judge

[9] Given this Court reviews the Permit in the context of an administrative appeal, the Court will not make a finding with respect to the precise damages due to CPAI as a result of the taking. At argument, CPAI noted its reservation of right to pursue damages via inverse condemnation or other proceeding that would allow a more fully developed record on that point.