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 Case No. 3AN-07-04620 CI Case No. 3AN-07-04621 CI
v.	)	
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.
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> 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.

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[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.
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> 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:
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> (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. . . .
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> 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 . . . .
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> 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.
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> · Before proceeding to termination, DNR needed to comply with its obligations under Section 21 and its duty of cooperation.
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> · The Commissioner's decision must be reversed since no adjudication of the fundamental issue of material breach has yet occurred.
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> · 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.
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> · 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

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[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

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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.*,

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[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"

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[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.

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[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

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[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

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[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.

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[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

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[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]

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[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

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[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

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[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) AG
☐ CSED ☐ AG ☐ PD ☐ DA
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Dawn
Ballew/Ashley
Ruskin
Nozell
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Deputy Clerk / Secretary

[signature]
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.

IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT AT ANCHORAGE

ExxonMobil Corporation, Operator of the Point Thomson Unit; BP Exploration (Alaska) Inc.; Chevron U.S.A. Inc; ConocoPhillips Alaska, Inc.,	**Case No.: 3AN-06-13751 CI**
	(Consolidated Appeals)
	Case No. 3AN-06-13760 CI
Appellants,	Case No. 3AN-06-13773 CI
	Case No. 3AN-06-13799 CI
vs.	Case No. 3AN-07-04634 CI
	Case No. 3AN-07-04620 CI
State of Alaska, Department of Natural Resources,	Case No. 3AN-07-04621 CI
Appellee.	

ORDER DENYING APPELLANTS' MOTION TO SUPPLEMENT OR AUGMENT RECORD ON APPEAL

This Court, having considered Appellants' Motion to Supplement or Augment the Record and Appellees' Opposition, ~~and any reply thereto~~, hereby DENIES the motion. It is moot in light of this court's issuance of the Decision on Remand on this date.

DATED: 1-11-10

Sharon Gleason

The Honorable Sharon L. Gleason
SUPERIOR COURT JUDGE

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)
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[signature]
Deputy Clerk / Secretary

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Serdahely
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