

11937 SENATE RESOURCES

(B) extends at least 50 feet from the mean high water line on the side to be leased or conveyed, and on both sides of the mean high water line if land on both sides is to be leased or conveyed; and

(2) may reserve an alternative upland access route, if the department finds that access along an easement reserved under (1) of this subsection might be difficult because of topography or obstructions.

(d) Before the department grants a lease of the land estate or conveyance of land adjacent to or containing any inland water determined under 11 AAC 51.035 to be navigable water, the department

(1) will reserve along that water an access easement that

(A) is continuous, unless topography or land status prevents a continuous easement; and

(B) extends at least 50 feet upland from the ordinary high water mark;

(2) will retain the bed of that water in state ownership; and

(3) may reserve an alternative upland access route, if the department finds that access along an easement reserved under (1) of this subsection might be difficult because of topography or obstructions.

(e) Before the department grants a lease of the land estate or conveyance of land adjacent to or containing any inland water determined under 11 AAC 51.035 to be public water, the department

(1) will reserve, along and on the bed of that water, an access easement that

(A) is continuous, unless topography or land status prevents a continuous easement; and

(B) extends at least 50 feet upland from the ordinary high water mark; and

(2) may reserve an alternative upland access route, if the department finds that access along an easement reserved under (1) of this subsection might be difficult because of topography or obstructions.

(f) Before the department grants a lease of the land estate or conveyance of land adjacent to or containing water determined under 11 AAC 51.035 to be navigable or public water, and if

(1) an existing trail, road, or other overland route provides access to the water but does not already have a reserved easement, the department will reserve an access easement, with a minimum width as required under 11 AAC 51.015(d)(1)(E);

(2) a trail, road, or other overland access route to the water does not exist, but a public road or a public trail lies within two miles of the navigable or public water, and if overland access from the road or trail to the water is feasible, the department

(A) will reserve, from the road or trail to the water, an access easement with a minimum width of 50 feet, or with a minimum width of 60 feet if the department also determines that the need for increased public access to

navigable or public water may justify construction of a road along an easement; and

(B) will reserve access easements under (A) of this paragraph, at intervals of approximately one mile, from the water to a public road or a public trail that lies parallel to the water; in reserving these easements, the department may designate

(i) a section-line easement under AS 19.10.010 as an access easement, to the extent that the section-line easement runs on state land, and if the section-line easement provides a practical route to the shore; and

(ii) an access easement along a tributary waterway for access to another water body or waterway, if the easement along the tributary waterway provides a practical and reasonably direct route from the road or trail to the other water body or waterway; or

(3) a trail, road, or other overland access route to the water does not exist, but a public railroad crossing authorized by the railroad operator lies within two miles of the navigable or public water, and if overland access from the railroad crossing to the water is feasible, the department will reserve, from the railroad crossing to the water, an access easement with a minimum width of 50 feet, or with a minimum width 60 feet if the department also determines that the need for increased public access to navigable or public water may justify construction of a road along an easement.

(g) If reserving access easements under (f) of this section, the department may reserve additional access easements to a water body or waterway to accommodate existing or anticipated heavy use, to protect portage routes, or to secure access between aircraft landing sites and nearby navigable or public water.

(h) In determining the access easements to be reserved to and along navigable or public water, the department will solicit comments from the Department of Fish and Game and from a municipality or other person entitled under AS 38.05.945 to notice of the preliminary or proposed written decision under AS 38.05.035(e). (Eff. 5/3/2001, Register 158)

Authority: AS 38.04.005
AS 38.04.055

AS 38.04.900
AS 38.05.020

AS 38.05.035
AS 38.05.127

Editor's note: The subject matter of 11 AAC 51.045 was formerly located at 11 AAC 53.330. The history note for 11 AAC 51.045 does not reflect the history of the earlier section.

11 AAC 51 is amended by adding a new section to read:

11 AAC 51.055. IDENTIFICATION OF R.S. 2477 RIGHTS-OF-WAY. (a) Before reporting to the legislature in accordance with AS 19.30.400(b), the department will issue a proposal to identify a historic road or trail as an R.S. 2477 right-of-way that has been accepted by the state or territory of Alaska or by public user or construction.

(b) In a proposal under (a) of this section, the department will consider if sufficient evidence

(1) exists to locate the potential R.S. 2477 right-of-way on a United States Geological Survey topographical map at a scale of 1:63,360 (one inch = one mile) or on an equivalent or more detailed map;

(2) shows that the potential R.S. 2477 right-of-way crossed federal land that was unappropriated and not reserved for public use at the time of any acceptance described in (3)(A) or (3)(B) of this subsection; and

(3) exists of historical use; that evidence must include a reliable historical account, or information supplied by a knowledgeable person, to show that

(A) public use or construction constituted acceptance of the right-of-way grant under R.S. 2477 in accordance with applicable law; or

(B) a positive act on the part of a public authority constituted acceptance of the right-of-way grant under R.S. 2477 in accordance with applicable law.

(c) The department will consider any relevant evidence that

(1) supports or is contrary to evidence considered under (b) of this section; and

(2) is offered during a public comment period of at least 30 days after the department gives public notice

(A) on the Alaska Online Public Notice System developed under AS 44.62.175, or in a newspaper of statewide circulation;

(B) in a newspaper of general circulation in the vicinity of the route;

(C) by posting at a post office in the vicinity of the route, or by public service announcements in media serving the vicinity of the route;

(D) to a municipality through whose boundaries the route passes;

(E) to a regional corporation established by 43 U.S.C. 1606(a) (sec. 7(a), Alaska Native Claims Settlement Act) through whose region the route passes and

(F) to a village corporation organized under 43 U.S.C. 1607(a) (sec. 8(a), Alaska Native Claims Settlement Act) if the route is within 25 miles of the village for which the corporation was established; and

(G) to the Department of Fish and Game.

(d) After the comment period held under (c) of this section, the department will prepare a written decision whether to identify the route, in whole or in part, as an R.S. 2477 right-of-way. The department will base its decision on evidence considered or received, and will include a response to comments received. The department will give notice of its identification decision to any person who commented during the comment period.

(e) If under (d) of this section the department identifies a historic road or trail as an R.S. 2477 right-of-way, the department will show the approximate location of the right-of-way on a map described in (b) of this section.

(f) The department's identification decision may be appealed under 11 AAC 02 if the appellant demonstrates that questions of fact remain to be resolved on a route's

qualification as an R.S. 2477 right-of-way. The possible adverse impacts that public use of a route may cause to private property are not grounds for an appeal of the department's identification of an R.S. 2477 right-of-way. However, the department will consider adverse impacts in the department's management of the right-of-way, and the property owner may raise them if petitioning under 11 AAC 51.065 to vacate or relocate the right-of-way.

(g) After reporting to the legislature under AS 19.30.400(b), the department will manage use by the general public of an R.S. 2477 right-of-way that is identified under this section unless the

(1) R.S. 2477 right-of-way is part of the state highway system or the department transfers the R.S. 2477 right-of-way to the Department of Transportation and Public Facilities for management; or

(2) the department transfers management authority to a municipality, with the municipality's consent; however, management by a municipality does not include the right to vacate the right-of-way. (Eff. 5/3/2001, Register 158)

Authority:	AS 19.30.400	AS 38.04.058	AS 38.05.020
	AS 38.04.055	AS 38.04.900	AS 38.05.035

11 AAC 51.060 is repealed:

11 AAC 51.060. EVALUATION CRITERIA FOR DEPARTMENTAL DECISION.

Repealed. (Eff. 5/14/92, Register 122; am 11/10/93, Register 128; repealed 5/3/2001, Register 158)

11 AAC 51 is amended by adding a new section to read:

11 AAC 51.065. VACATION OF EASEMENTS. (a) An affected person or a municipal assembly or city council may petition the department to vacate, modify, or relocate,

(1) in accordance with AS 19.30.410, an R.S. 2477 right-of-way, including a section-line easement under AS 19.10.010 that the department manages under AS 19.30.400 and AS 38;

(2) in accordance with AS 38.05.127(d), an access easement reserved under AS 38.05.127 and 11 AAC 51.045;

(3) in accordance with AS 40.15.300 - 40.15.380, a platted easement dedicated to public use and managed by the department under AS 38;

(4) on land that the state currently owns or formerly owned, a public easement reserved along a section line under AS 19.10.010; or

(5) another state-owned public easement managed by the department.

(b) A petition to the department under (a) of this section must also be submitted to the platting authority for consideration, including public notice and a public hearing, in accordance with the procedures set out in

(1) AS 29.40.120 - 29.40.150, if the platting authority is established under AS 29.40.080 by a municipality described in AS 40.15.070(a); or

(2) AS 40.15.305 and 11 AAC 53.250, as applicable, if the platting authority is the department in accordance with AS 40.15.070(b).

(c) If a municipal platting authority declines to consider the petition in accordance with the procedures set out in AS 29.40.120 - 29.40.150, on the grounds that the public easement is unplatted or is an R.S. 2477 right-of-way, the department will give notice of the petition in a newspaper of general circulation in the vicinity of the public easement and provide a comment period of at least 30 days. The petitioner shall reimburse the department for the costs of notice.

(d) In addition to a notice, comment opportunity, or hearing provided under (b)-(c) of this section by a municipal platting authority or the department, the department will give notice of a petition under (a) of this section and provide a comment period of at least 30 days by publishing notice in a newspaper of statewide circulation, posting notice on the Alaska Online Public Notice System developed under AS 44.62.175, and notifying other parties known or likely to be affected by the action, including the Department of Transportation and Public Facilities and the Department of Fish and Game. The petitioner shall reimburse the department for the costs of notice.

(e) In its administrative review and finding under this section whether to vacate, modify, or relocate a public easement is in the best interests of the state, the department will include

(1) consideration of any recommendation or decision, as applicable, from the platting authority;

(2) a comparison of the public easement sought to be vacated, modified, or relocated with alternate access proposed in accordance with (f), (g), or (h) of this section, as applicable, in terms of underlying land ownership, land management policies, current public use patterns, and practicality of use; and

(3) consideration of public and agency comments that are material to the comparison undertaken in (2) of this subsection.

(f) Before any vacation, modification, or relocation of a public easement described in (a)(2) - (a)(5) of this section, the petitioner must demonstrate to the satisfaction of the department that equal or better access is available. Equal or better access must be access that is

(1) protected by an easement of record that is adequately wide for the purpose; if the easement of record is new, the petitioner must arrange for a note in the vacation document to be recorded under (j) of this section that identifies the new easement as a replacement for the vacated easement; and

(2) at least equally usable, considering length, type of terrain, and level of improvement, as the easement to be vacated; if development or improvement is needed to make the replacement easement at least equally usable, the petitioner must arrange for the development or improvement to be completed before the vacation takes effect.

(g) For purposes of any department determination to vacate, modify, or relocate, in accordance with AS 19.30.410(1), an R.S. 2477 right-of-way described in (a)(1) of this section,

(1) the petitioner must demonstrate to the satisfaction of the department that a reasonably comparable, established alternate right-of-way or means of access exists that is sufficient to satisfy all present and reasonably foreseeable uses;

(2) a right-of-way or means of access is reasonably comparable if it provides

(A) equal or better access as described in (f) of this section; and

(B) access between the same destinations as the R.S. 2477 right-of-way, for an R.S. 2477 right-of-way other than a section-line easement;

(3) a right-of-way or means of access is established if, before any vacation takes effect, all necessary surveying, platting, and recording have been completed, and the alternate access is ready for its intended use; the petitioner must arrange for a note in the vacation document to be recorded under (j) of this section that identifies the right-of-way or means of access that serves as a replacement for the vacated R.S. 2477 right-of-way; and

(4) a right-of-way or means of access is sufficient to satisfy all present and reasonably foreseeable uses if it is suitable for future trail development, road development, and utility installation, if the department finds that those uses may be needed in the future, and if the department finds that the R.S. 2477 right-of-way to be vacated is suitable for those uses; for purposes of this paragraph,

(A) if poorly drained soils make an R.S. 2477 right-of-way suitable only for winter use, the alternate right-of-way or means of access must also be suitable for winter use, but need not be suitable for an all-season road;

(B) the alternate right-of-way or means of access may be provided through more than one route, each suitable to a particular use; and

(C) the alternate right-of-way or means of access may be provided at a reduced width, either along the original alignment or elsewhere, if the reduced width is sufficient for all present and reasonably foreseeable uses.

(h) For purposes of any department determination to vacate, modify, or relocate, in accordance with AS 19.30.410(2), an R.S. 2477 right-of-way described in (a)(1) of this section,

(1) the department will not consider a municipal assembly or city council to have requested the vacation unless vacation is requested by ordinance; and

(2) the petitioner must demonstrate, to the department's satisfaction, that a reasonable alternative means of access is available; a reasonable alternative means of access need not qualify as equal or better access as described in (f) of this section; the petitioner must arrange for a note in the vacation document to be recorded under (j) of this section that identifies the alternative means of access that serves as a replacement for the vacated R.S. 2477 right-of-way.

(i) The department will not approve the vacation, modification, or relocation of a section-line easement or R.S. 2477 right-of-way described in (a)(1) or (a)(4) of this section, including an R.S. 2477 right-of-way that has been identified under 11 AAC 51.045(f)(2)(B)(i) as an access easement to navigable or public water, without the consent of the commissioner of transportation and public facilities under AS 19.05 - 19.30.

(j) A vacation, modification, or relocation of a public easement is not final until a
 (1) plat is recorded evidencing the vacation, modification, or relocation, if the public easement being altered was previously identified by a recorded plat; or
 (2) document is recorded identifying the affected lot, tract, or parcel and describing the manner in which the affected public easement is being altered, if the easement was not previously identified by a recorded plat; the department will not require a plat to be prepared and recorded unless a plat is necessary to locate a new easement that will replace the easement being altered.

(k) An owner of land affected by an unplatted R.S. 2477 right-of-way may request the department's approval to reroute the right-of-way elsewhere on that owner's land to an alignment that less adversely affects the landowner's interests. The department will approve the realignment if the realignment provides access reasonably comparable to the original, does not affect land in other ownership, and connects to the original route where it enters and exits the landowner's land. The realignment of an R.S. 2477 right-of-way under this subsection within a parcel of land does not constitute a vacation under this section. (Eff. 5/3/2001, Register 158)

Authority:	AS 19.30.410	AS 38.04.900	AS 38.05.127
	AS 38.04.058	AS 38.05.020	AS 40.15.070
	AS 38.04.200	AS 38.05.035	AS 40.15.305

11 AAC 51.070 is repealed:

11 AAC 51.070. APPEAL. Repealed. (Eff. 5/14/92, Register 122; repealed 5/3/2001, Register 158)

Editor's note: The subject matter of 11 AAC 51.070 was relocated to 11 AAC 51.910.

11 AAC 51 is amended by adding a new section to read:

11 AAC 51.075. SURVEYING AND FIELD MARKING OF EASEMENTS. (a) The department may require as a condition of any sale, lease, grant, or other disposal of state land that the purchaser, lessee, or grantee survey, mark, or both survey and mark access easements reserved or retained under this chapter in a manner consistent with the following requirements:

(1) marking of an access easement across uplands must include clearly visible monuments or signs at the following places:

(A) at the intersection of the access easement and any public road, railroad, trail, or aircraft landing site;

(B) at the intersection of the access easement and any navigable or public water;

(C) along the access easement at intervals reasonably sufficient to allow the route to be followed, unless the easement's route is shown by a clearly visible trail or road;

(2) marking of an access easement along a water body or waterway must include a clearly visible monument or sign where the access easement intersects any public road or trail.

(b) Both the purchaser, lessee, or grantee and the successors or assignees of that person shall perpetuate and maintain any marking required under (a) of this section.

(c) A person may not obstruct, move, or destroy a marking on an access easement without written permission from the department. (Eff. 5/3/2001, Register 158)

Authority:	AS 38.04.005	AS 38.04.900	AS 38.05.035
	AS 38.04.050	AS 38.05.020	AS 38.05.127
	AS 38.04.055		

Editor's note: The subject matter of 11 AAC 51.075 was formerly located at 11 AAC 53.350. The history note for 1 AAC 51.075 does not reflect the history of the earlier section.

11 AAC 51.080 is repealed:

11 AAC 51.080. FINAL DECISION AND JUDICIAL APPEAL. Repealed. (Eff. 5/14/92, Register 122; repealed 5/3/2001, Register 158)

Editor's note: The subject matter of 11 AAC 51.080 was relocated to 11 AAC 51.910.

11 AAC 51 is amended by adding a new section to read:

11 AAC 51.085. ACCESS AND UTILITY EASEMENTS TO MENTAL HEALTH TRUST LAND. Before disposing of land, or granting or reserving an easement across land, the department will, after consulting with the executive director of the mental health trust land or it established under AS 44.37.050, either reserve or ensure the department's future ability to reserve adequate and feasible access and utility easements to any adjoining or adjacent Alaska mental health trust land without cost to the Alaska mental health trust. (Eff. 5/3/2001, Register 158)

Authority:	AS 37.14.009	AS 38.05.020	AS 38.05.801
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Editor's note: The subject matter of 11 AAC 51.085 was formerly located at 11 AAC 53.305. The history note for 11 AAC 51.085 does not reflect the history of the earlier section.

11 AAC 51.090 is repealed:

11 AAC 51.090. CLASSIFICATION. Repealed. (Eff. 5/14/92, Register 122; repealed 5/3/2001, Register 158)

11 AAC 51.100 is amended by adding new subsections to read:

11 AAC 51.100. MANAGEMENT OF PUBLIC EASEMENTS, INCLUDING R.S. [RS] 2477 RIGHTS-OF-WAY.

(e) If an access use or access development activity on a public easement managed under AS 38 may not occur without a permit under 11 AAC 96.010 or other authorization by the department, and if the permit or authorization sought is for new access construction

(1) that would displace or preclude a traditional means of access for a traditional outdoor activity on the easement, including construction of a road on a trail traditionally used for hiking or snowmachine travel, the department will provide public notice and an opportunity for comment of at least 14 days before deciding whether to issue the permit or authorization; or

(2) on an unsurveyed easement that crosses land not managed under AS 38, the department will provide notice and a comment opportunity of at least 14 days to the owner of the land determined to be subject to the easement before deciding whether to issue the permit or authorization.

(f) Even of notice is not required under (e)(1) or (e)(2) of this section, the department may provide notice and a comment opportunity to the owner of the land subject to an R.S. 2477 right-of-way;

(g) If a permit or authorization is sought for new access construction as described in (e)(2) of this section, the department will require the permit applicant to survey the public easement, in order to show the relationship between property boundaries and that easement and to reduce the possibility of unintentional trespass. However, the department will not require a survey if the location of the public easement may readily be determined, and if a dispute does not exist regarding whose land the easement crosses. The survey is subject to approval by the department. The survey must be conducted by a surveyor, must show the relationship of the easement to the boundaries of the land it crosses, and must be performed to Class III standards under 11 AAC 53.110.

(h) The department or a person may complete a trail easement diagram showing the location of an existing trail or road. An applicant who is subject to (g) of this section may not use a trail easement diagram as a survey unless the trail easement diagram satisfies the requirements for a survey set out in that subsection.

(i) On land subject to a public easement managed under AS 38, uses and activities by the landowner that are consistent with the landowner's property rights and that do not restrict public use of the easement do not require a permit under 11 AAC 96.

(j) If the state holds only a public easement, and another person holds the other interests in the land, the department will issue a permit under 11 AAC 96 only for uses and activities related to access. (Eff. 5/14/92, Register 122; am 11/10/93, Register 128; am 5/3/2001, Register 158)

Authority:	<u>AS 38.04.045</u>	AS 38.04.900	AS 38.05.027
	AS 38.04.058	AS 38.05.020	AS 38.05.035

ARTICLE 3. (RESERVED).

ARTICLE 4. GENERAL PROVISIONS.

Section

900. (Repealed)

910. Appeal

990. Definitions

11 AAC 51.900 is repealed:

11 AAC 51.900. DEFINITIONS. Repealed. (Eff. 5/14/92, Register 122; repealed 5/3/2001, Register 158)

Editor's note: The subject matter of 11 AAC 51.900 was relocated to 11 AAC 51.990.

11 AAC 51 is amended by adding new sections to read:

11 AAC 51.910. APPEAL. (a) In accordance with 11 AAC 02, an eligible person may appeal a decision issued under this chapter, including

(1) an R.S. 2477 right-of-way identification decision under 11 AAC 51.055(d) or a decision following notice under 11 AAC 51.100(f), if the appellant demonstrates that there are questions of fact to be resolved on the route's qualification as an R.S. 2477 right-of-way;

(2) a permit decision following notice under 11 AAC 51.100(e)(1) or (e)(2), on the basis that new construction or use of an easement will adversely affect the appellant's access or use, or that the easement's surveyed location is incorrect.

(b) The commissioner's decision on an appeal under 11 AAC 02 is the final administrative order and decision of the department for purposes of appeal to superior court. (Eff. 5/3/2001, Register 158)

Authority:	AS 38.04.900	AS 38.05.035	AS 44.37.011
	AS 38.05.020		

Editor's note: The subject matter of 11 AAC 51.910 was formerly located at 11 AAC 51.070 and 11 AAC 51.080. The history note for 11 AAC 51.910 does not reflect the history of the earlier sections.

11 AAC 51.990. DEFINITIONS. As used in this chapter, unless the context requires otherwise,

(1) "access easement" means a public easement that is identified to allow access by the public, including access to private property by the owners of that private property and their invitees, and that may be used for any mode of transportation commonly employed for access purposes, subject to any restrictions noted on the plat, deed, recorded reservation, or other legally applicable document;

(2) "arterial road" means a road that is used primarily for traffic through and beyond the area, rather than for access to adjacent land;

(3) "commissioner" means the commissioner of natural resources;

(4) "department" means the Department of Natural Resources;

(5) "land estate" means any interest in land other than an interest reserved under AS 38.05.125;

(6) "mean high water line" means the tidal datum plane of the average of all the high tides, as would be established by the National Geodetic Survey, at any place subject to tidal influence;

(7) "navigable water" has the meaning given in AS 38.05.965;

(8) "neighborhood service road" means a road that is primarily for traffic within a residential area;

(9) "ordinary high water mark" means the mark along the bank or shore up to which the presence and action of the non-tidal water are so common and usual, and so long continued in all ordinary years, as to leave a natural line impressed on the bank or shore and indicated by erosion, shelving, changes in soil characteristics, destruction of terrestrial vegetation, or other distinctive physical characteristics;

(10) "pedestrian easement" means an access easement that is identified for travel

(A) on foot;

(B) by a hand- or foot-propelled vehicle, including a wheelchair or bicycle; or

(C) by dogsled;

(11) "platting authority" means the applicable platting authority identified in AS 40.15.070;

(12) "public water" has the meaning given in AS 38.05.965;

(13) "R.S. 2477" means former 43 U.S.C. 932 (Act of July 26, 1866, 14 Stat. 251);

(14) "state highway system" or "Alaska highway system" means all roads constructed, managed, operated, or maintained by the Department of Transportation and Public Facilities;

(15) "state land" has the meaning given in AS 38.05.965; "state land"

(A) includes an interest in land that is owned by the state and managed under AS 38; and

(B) does not include Alaska mental health trust land as defined in 11 AAC 99.990 and managed under AS 37.14.009 and AS 38.05.801;

(16) "survey easement" means a public easement that the department identifies for access to a survey control station set by the United States, the department, or a private surveyor;

(17) "surveyor" means a professional land surveyor who is registered under AS 08.48 (Architects, Engineers, and Land Surveyors Registration Act);

(18) "utility easement" means a public easement that is identified for use by utility services, and not for public access unless the

(A) landowner gives permission for public access; or

(B) easement is also identified as an access easement;

(19) "vacate" means to relinquish, release, or extinguish a right or interest in property;

(20) "water body" means a natural, well-defined body of water;

(21) "waterway" means a natural, well-defined channel of water produced wholly or in part by a definite flow of water, whether continuous or intermittent. (Eff. 5/3/2001, Register 158)

Authority: AS 38.04.900
AS 38.05.020

AS 38.05.035

AS 38.05.127

Editor's note: The subject matter of 11 AAC 51.990 was formerly located at 11 AAC 51.900. The history note for 11 AAC 51.990 does not reflect the history of the earlier section.

**CHAPTER 53. RECORDS, SURVEYS, AND PLATTING.
ARTICLE 3. EASEMENTS AND RIGHTS-OF-WAY.**

Section

- 300. **(Repealed)** [EASEMENTS AND RIGHTS-OF-WAY]
- 305. **(Repealed)** [ACCESS AND UTILITY EASEMENTS TO MENTAL HEALTH TRUST LAND]
- 310. **(Repealed)** [DETERMINATION OF NAVIGABLE AND PUBLIC WATER]
- 320. **(Repealed)** [WRITTEN DECISION CONCERNING EASEMENTS]
- 330. **(Repealed)** [EASEMENTS TO AND ALONG NAVIGABLE AND PUBLIC WATER]
- 340. **(Repealed)** [DIRECTORY OF EASEMENTS]
- 350. **(Repealed)** [SURVEYING AND FIELD MARKING OF EASEMENTS]
- 360. **(Repealed)** [LIABILITY FOR INJURY OR ACCIDENT]
- 370. **(Repealed)** [LIABILITY FOR DAMAGES]

Register 158, July 2001 NATURAL RESOURCES

11 AAC 53.300 - 11 AAC 53.370 are repealed:

11 AAC 53.300. EASEMENTS AND RIGHTS-OF-WAY. Repealed. (Eff. 3/27/80, Register 73; repealed 5/3/2001, Register 158)

Editor's note: The subject matter of 11 AAC 53.300 was relocated to 11 AAC 51.015.

11 AAC 53.305. ACCESS AND UTILITY EASEMENTS TO MENTAL HEALTH TRUST LAND. Repealed. (Eff. 3/31/97, Register 141; repealed 5/3/2001, Register 158)

Editor's note: The subject matter of 11 AAC 53.305 was relocated to 11 AAC 51.085.

11 AAC 53.310. DETERMINATION OF NAVIGABLE AND PUBLIC WATER. Repealed. (Eff. 12/29/77, Register 64; repealed 5/3/2001, Register 158)

Editor's note: The subject matter of 11 AAC 53.310 was relocated to 11 AAC 51.035.

11 AAC 53.320. WRITTEN DECISION CONCERNING EASEMENTS. Repealed. (Eff. 12/29/77, Register 64; repealed 5/3/2001, Register 158)

Editor's note: The subject matter of 11 AAC 53.320 was relocated to 11 AAC 51.035.

11 AAC 53.330. EASEMENTS TO AND ALONG NAVIGABLE AND PUBLIC WATER. Repealed. (Eff. 12/29/77, Register 64; am 3/27/80, Register 73; repealed 5/3/2001, Register 158)

Editor's note: The subject matter of 11 AAC 53.330 was relocated to 11 AAC 51.045.

11 AAC 53.340. DIRECTORY OF EASEMENTS. Repealed. (Eff. 12/29/77, Register 64; am 3/27/80, Register 73; repealed 5/3/2001, Register 158)

11 AAC 53.350. SURVEYING AND FIELD MARKING OF EASEMENTS. Repealed. (Eff. 12/29/77, Register 64; repealed 5/3/2001, Register 158)

Editor's note: The subject matter of 11 AAC 53.350 was relocated to 11 AAC 51.075.

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11 AAC 53.360. LIABILITY FOR INJURY OR ACCIDENT. Repealed. (Eff. 12/29/77, Register 64; repealed 5/3/2001, Register 158)

11 AAC 53.370. LIABILITY FOR DAMAGES. Repealed. (Eff. 12/29/77, Register 64; repealed 5/3/2001, Register 158)

DATE: November 3, 2003

SUBJECT: Motorized access in parks, refuge, other CSUs, including Wilderness

The following summarizes provisions for motorized access by the public on federal lands under the Alaska National Interest Lands Conservation Act and the implementing regulations:

ANILCA Section 102 defines "*conservation system unit*" (CSU) to include refuges, parks, and designated wilderness areas. Motorized access provisions in ANILCA Section 1110(a)¹ and Section 811² apply to all conservation system units, thus modifying prohibitions on such access generally applied outside Alaska. Through these provisions, ANILCA amends the Wilderness Act for Alaska (see Section 707) in a manner that leaves most refuge and park lands "open until closed" for access by snow machines, airplanes, motorboats, and other surface transportation. Off-road vehicle (ORV) access for subsistence use is also protected by ANILCA Section 811 on CSUs, including wilderness.

The access guarantee for subsistence under ANILCA Section 811 includes motorized "*traditional methods*" and under Section 1110(a) by specified methods for "*traditional activities*." Pre-ANILCA traditional activities include those generally occurring in the area, such as subsistence and recreation. Motorized access by snow machines, motorboats, and airplanes for "*traditional activities*" and by other "*traditional methods*" of surface transportation (e.g., Off Road Vehicles) for subsistence activities "*shall be permitted*" in the refuge (including designated wilderness) unless restricted through a codified process of public notice and a finding of damage.

The process for permanent restrictions of access for these activities on park and refuge land (including wilderness) is found in 43 CFR 36.11, for ORVs for subsistence on refuges at 50 CFR 36.12, and ORVs for subsistence on parks at 36 CFR 13.46. Snow machine access for "*traditional activities*" protected by ANILCA Section 1110(a) on parks and refuges is subject to regulations in 43 CFR 36.11, a process that requires a finding of damage, public hearings, and federal regulations. Motorized access for subsistence activities is protected by ANILCA Section 811 subject to reasonable regulations for their conduct, which regulations are found at 50 CFR 36.12(d) for refuges and 36 CFR 13.46(d) for park units. Such use can only be further restricted pursuant to the process in 50 CFR 36.12(a)-(c) for refuges and 36 CFR 13.46(a)-(c) for parks.

Other sections of ANILCA authorize motorized access and equipment for public access, access to in holdings, commercial fishing, general hunting and fishing, access to conduct studies, and for transportation and utility corridors, among others. The regulations that address these additional access provisions are primarily found in 43 CFR Part 36. The definition of "traditional" was not included in the 43 CFR Part 36 regulations, and the preamble states this should be defined on a case or unit basis. Activities and methods of access were addressed by Congressional committees with directions to the land managers to liberally interpret as those "generally occurring in the area" of the refuge or park unit prior to ANILCA and to specifically not require a pre-existing use test. The state consistently requests the federal managers cooperatively study and document pre-ANILCA access and activities prior to pursuing restrictions on access, except in those cases where such access is damaging the unit.

¹ Sec. 1110(b) applies to all CSUs plus wilderness study areas.

² Sec. 811 applies to all "public lands" where the subsistence activity is allowed thus would not apply where subsistence is not allowed.

ANILCA Section 102(4) defines "conservation system unit" as:

The term "conservation system unit" means any unit in Alaska of the National Park System, National Wildlife Refuge System, National Wild and Scenic Rivers Systems, National Trails System, National Wilderness Preservation System, or a National Forest Monument including existing units, units established, designated, or expanded by or under the provisions of this Act, additions to such units, and any such unit established, designated, or expanded hereafter.

A list of all CSUs follows additional discussion on "non-CSUs" below (wilderness units of the refuge and park system are within the refuges and parks so not listed separately).

The BLM units, Steese National Conservation Area and White Mountains National Recreation Area, are not CSUs. These BLM units are managed according to the Federal Land Policy and Management Act of 1976. The National Forests, Wilderness Study Areas, and Wild and Scenic study rivers are also not defined as CSUs. However, many significant public use provisions of ANILCA include some of the above units when "public lands" are listed along with the CSUs.

ANILCA Section 604 identified 12 rivers to be studied for possible designation per Section 5(a) of the Wild & Scenic Rivers Act. Those 12 studies were completed in the 20+ years since ANILCA, and only one was recommended as suitable for designation. The study rivers are not CSUs unless and until Congress designates them:

1. Colville
2. Etivluk-Nigu
3. Utukok
4. Kanektok
5. Kisaralik
6. Melozitna
7. Sheenjok (lower segment)
8. Situk
9. Porcupine
10. Yukon (Ramparts section)
11. Squirrel
12. Koyuk

National Trails System is a problematic category. The National Trails System Act (P.L. 90-543, as amended through P.L. 107-325, December 4, 2002) establishes a national trails system:

- National Recreation Trails may be established by the appropriate secretary.
- National Scenic and National Historic Trails can only be authorized and designated by Congress. Congress designated the Iditarod National Historic Trail and directed the "Gold Rush Trails in Alaska" to be studied.
- Connecting or Side Trails may be established by the appropriate secretary as components of a national recreation, national scenic, or national historic trail.

Under ANILCA, the Congressionally designated Iditarod National Historic Trail is clearly part of the "National Trails System" and thus a CSU to be managed under all the applicable provisions of ANILCA. The status of the National Recreation Trails is not so clear. The trails listed on the National Trails System website that would appear to be included under ANILCA's list of CSUs are listed below. However, **Congress likely intended CSUs to only include those it so designates;**

thus, the recreational and other trails administratively created within the Trails System are not considered CSUs.

1. Mt Edgecombe National Recreation Trail (within Tongass National Forest)
2. Naha River National Recreation Trail (within Tongass National Forest)
3. Resurrection Pass National Recreation Trail (within Chugach National Forest)
4. Swanson River Canoe Route National Recreation Trail (within Kenai Wildlife Refuge)
5. Swan Lake Canoe Route National Recreation Trail (within Kenai Wildlife Refuge)
6. Crane Lake National Recreation Trail (within Tongass National Forest)
7. Deer Mountain-John Mountain National Recreation Trail (within Tongass National Forest)
8. Mendenhall Moraine Ecology National Recreation Trail (within Tongass National Forest)
9. Petersburg Lake National Recreation Trail (within Tongass National Forest)
10. Pinnell Mountain National Recreation Trail (within BLM)
11. Williwaw National Recreation Trail (within Glacier Ranger District, Chugach Forest)
12. Tony Knowles Coastal National Recreation Trail (within Municipality of Anchorage)

Conservation system units in Alaska, as defined by Section 102(4) are:

“any unit in Alaska of the National Park System”:

1. Aniakchak National Monument and Preserve
2. Bering Land Bridge National Preserve
3. Cape Krusenstern National Monument
4. Denali National Park and Preserve (encompasses Denali Wilderness unit)
5. Gates of the Arctic National Park and Preserve (encompasses Gates of the Arctic Wilderness)
6. Glacier Bay National Park and Preserve (encompasses Glacier Bay Wilderness)
7. Katmai National Park and Preserve (encompasses Katmai Wilderness)
8. Kenai Fjords National Park
9. Klondike Gold Rush National Historical Park
10. Kobuk Valley National Park (encompasses Kobuk Valley Wilderness)
11. Lake Clark National Park and Preserve (encompasses Lake Clark Wilderness)
12. Noatak National Preserve (encompasses Noatak Wilderness)
13. Sitka National Historical Park
14. Wrangell-St. Elias National Park and Preserve (encompasses Wrangell-St. Elias Wilderness)
15. Yukon-Charley Rivers National Preserve

“any unit in Alaska of the . . . National Wildlife Refuge System”:

1. Alaska Maritime National Wildlife Refuge (encompasses Aleutian Islands Wilderness, Semidi Wilderness, and Unimak Wilderness)
2. Alaska Peninsula National Wildlife Refuge
3. Arctic National Wildlife Refuge (encompasses Mollie Beattie Wilderness)
4. Becharof National Wildlife Refuge (encompasses Becharof Wilderness)
5. Innoko National Wildlife Refuge (encompasses Innoko Wilderness)
6. Izembek National Wildlife Refuge (encompasses Izembek Wilderness)
7. Kanuti National Wildlife Refuge
8. Kenai National Wildlife Refuge (encompasses Kenai Wilderness)
9. Kodiak National Wildlife Refuge
10. Koyukuk National Wildlife Refuge (encompasses Koyukuk Wilderness)
11. Nowitna National Wildlife Refuge
12. Selawik National Wildlife Refuge (encompasses Selawik Wilderness)

13. Tetlin National Wildlife Refuge
14. Togiak National Wildlife Refuge (encompasses Togiak Wilderness)
15. Yukon Delta National Wildlife Refuge (encompasses Andreafsky Wilderness and Nunivak Wilderness)
16. Yukon Flats National Wildlife Refuge

"any unit in Alaska of the . . . National Wild and Scenic Rivers Systems":

1. *Alagnak National Wild River (main stem plus Nonvianuk River within Katmai Preserve and portions of the main stem and Nonvianuk tributary outside and west of Katmai Park/Preserve and running to the west boundary of T 13 S, R 43 W))
2. Alatna National Wild River (main stem with Gates of the Arctic Park)
3. Andreafsky National Wild River (that portion from its source, including all headwaters, and the East Fork, within Yukon Delta Refuge)
4. Aniakchak National Wild River (portion including its major tributaries, Hidden Creek, Mystery Creek, Albert Johnson Creek, and North Fork Aniakchak River, within Aniakchak Monument and Preserve)
5. *Beaver Creek National Wild River (segment of main stem from confluence of Bear and Champion Creeks downstream to its exit from the NE corner of T12 N, R 6 E, Fairbanks meridian within White Mountains National Recreation Area and Yukon Flats Refuge)
6. *Birch Creek National Wild River (segment of main stem from south side of Steese Highway in T 7 N, R 10 E, Fairbanks meridian, downstream to south side of Steese Highway in T 10 N, R 16 E)
7. Charley National Wild River (entire river, including its major tributaries, Copper Creek, Bonanza Creek, Hosford Creek, Derwent Creek, Flat-Orthmer Creek, Crescent Creek, and Moraine Creek, within Yukon-Charley Rivers Preserve)
8. Chilikadrotna National Wild River (portion within Lake Clark Park and Preserve)
9. *Delta National Wild and Recreational River (segment from and including all of Tangle Lakes to a point one-half mile north of Black Rapids)
10. *Fortymile National Wild, Scenic, and Recreational River (main stem, O'Brien Creek, South Fork, Napoleon Creek, Franklin Creek, Uhler Creek, Walker Fork downstream from the confluence with Liberty Creek, Wade Creek, Mosquito Fork downstream from the vicinity of Kechumstuk, West Fork Dennison Fork downstream from the confluence of Logging Cabin Creek, Dennison Fork downstream from confluence of West Fork Dennison Fork, Logging Cabin Creek, North Fork, Hutchison Creek, Champion Creek, Middle Fork downstream from confluence of Joseph Creek, and Joseph Creek)
11. *Gulkana National Wild River (main stem from outlet of Paxson Lake in T 12 N, R 2 W, Copper R meridian to confluence with Sourdough Creek, south branch of west fork from outlet of unnamed lake in sections 10 and 15, T 10 N, R 7 W, Copper R meridian to confluence with West Fork, north branch from outlet of two unnamed lakes, one in sections 24 and 25, second in sections 9 and 10, T 11 N, R 8 W, Copper R meridian to confluence with West Fork, West Fork from confluence with north and south branches downstream to its confluence with main stem, Middle Fork from outlet of Dickey Lake in T 13 N, R 5 W, Copper R meridian to confluence with main stem)
12. Ivishak National Wild River (that portion from its source, including all headwaters and unnamed tributary from Porcupine Lake within Arctic Refuge)
13. John National Wild River (portion within Gates of the Arctic Park)
14. Kobuk National Wild River (portion within Gates of the Arctic Park and Preserve)
15. Mulchatna National Wild River (portion within Lake Clark Park and Preserve)

16. Noatak National Wild River (from its source in Gates of the Arctic Park to its confluence with Kelly River in Noatak Preserve)
 17. North Fork of the Koyukuk National Wild River (portion within Gates of the Arctic Park)
 18. Nowitna National Wild River (portion from where river crosses the west limit of T 18 S, R 22 E, Kateel River meridian, to its confluence with Yukon River within Nowitna Refuge)
 19. Salmon National Wild River (portion within Kobuk Valley Park)
 20. Selawik National Wild River (portion from fork of the headwaters in T 12 N, R 10 E, Kateel R meridian to confluence of Kugarak River, within Selawik Refuge)
 21. Sheenjek National Wild River (segment within Arctic Refuge)
 22. Tinayguk National Wild River (portion within Gates of the Arctic Park)
 23. Tlikakila National Wild River (portion within Lake Clark Park)
 24. *Unalakleet National Wild River (segment of main stem from headwaters in T 12 S, R 3 W, Kateel R meridian extending downstream 65 miles to western boundary of T 18 S, R 8 W)
 25. Wind National Wild River (portion from its source, including all headwaters and one unnamed tributary in T 13 S, within Arctic Refuge)
- [*all or a portion that is outside of a refuge or park CSU is designated as wild & scenic river]

"any unit in Alaska of the . . . National Trails System"

1. Iditarod National Historic Trail

"any unit in Alaska of the . . . National Wilderness Preservation System"; includes those encompassed within refuges and parks above and forest monuments below; thus, the following are those additional wilderness designations within the Tongass National Forest:

1. Chuck River Wilderness
2. Coronation Island Wilderness
3. Endicott River Wilderness
4. Karta River Wilderness
5. Kuiu Wilderness
6. Maurille Islands Wilderness
7. Petersburg Creek-Duncan Salt Chuck Wilderness
8. Pleasant, Lemusurier and Inian Islands
9. Russell Fjord Wilderness
10. South Baranof Island Wilderness
11. South Etolin Island Wilderness
12. South Prince of Wales Wilderness
13. Stikine-LeConte Wilderness
14. Tebenkof Bay Wilderness
15. Tracy Arm-Fords Terror Wilderness
16. Warren Island Wilderness
17. West Chichagof-Yakobi Wilderness

"any unit in Alaska of . . . a National Forest Monument":

1. Misty Fjords National Monument (encompasses Misty Fjords National Monument Wilderness)
2. Admiralty Island National Monument (encompasses Kootznoowoo Wilderness)

Select State Tools for Managing State Land/Water and Related Public Activities Involving Fish and Wildlife Resources

January 2004 DRAFT #6

The following is a brief compilation of the land and resource management tools that the state and municipal governments may apply to public activities involving state land, water, and related use of fish and wildlife resources.

State Administrative Authorities

Most state land management authorities for general state-owned lands are found in Title 38 of the Alaska Statutes. Most fish and game management authorities are found in Title 16 of the Alaska Statutes. Title 38 provides the Alaska Department of Natural Resources (DNR) and Title 16 provides the Alaska Department of Fish and Game (ADF&G) with general administrative authorities provided by the legislature. These administrative management tools include the following.¹

DNR Administrative Authorities

Special Use Land Designations – Under 11 AAC 96.014, DNR may designate state land² “Special Use Land.” The process for developing this designation always includes public notice and involvement and may be part of a DNR planning process under AS 38.04.065. Special Use Land designations that call for public use restrictions must be promulgated as regulations before they become effective. Such designations have been used to establish guidelines for activities such as camping, limiting motorized access, and resource extraction. This designation has also been used to require authorizations for activities where they were not formerly required. Restrictions on public access can be made administratively only if within the limits of AS 38.04.200 (see *Access Restrictions* below).

This designation has been applied to state-owned land and water, providing an administrative and regulatory means for limiting public uses that are “Generally Allowed Uses.”³ For example, the Marmot Island area has restrictions placed on off-road vehicles, boating, and camping, among other uses. Another example is the proposed Kashwitna Special Use Land, which will include restrictions on off-road vehicle use. The State’s Togiak Special Use Land was established as part of a coordinated management strategy with the U. S. Fish and Wildlife Service. The designation established camping limits on state-owned shorelands within and adjacent to the Togiak National Wildlife Refuge.

¹ Some of these management tools are provided in more than one statute and/or regulation, so the citations may not be complete.

² “Land” or “State Land” means all land, including shore, tide and submerged land, or resources belonging to or acquired by the state (AS 38.05.965(20)).

³ “Generally Allowed Uses” are listed under 11 AAC 96.010 which describes which uses on land managed by the DNR Division of Mining, Land and Water do not require a permit or other written authorization.

Land Planning – Several statutes, including AS 38.05.300, require or allow DNR to adopt land use plans to provide for the use and management of state-owned land. DNR uses a system of multiple use classifications, which identify primary uses for any given parcel of land within a planning area. Any given parcel can have up to three primary use classifications. There are numerous classifications established by regulation, including ones for public recreation and wildlife habitat. A map of completed plans can be viewed at the DNR website: <http://www.dnr.state.ak.us/mlw/images/plan.gif>

Plans have been used to recommend the establishment of Special Use Areas (the Kashwitna Special Use Area was proposed by the Kashwitna Management Plan) and as the basis for establishment of Special Use Areas. For example, the Lake Clark, Kenai Fjords, Resurrection Bay, and Exit Glacier Road Special Use Land designations were adopted concurrently with the Kenai Area Plan.

Development and Management of Parks – AS 38.05.295 gives the Commissioner of the Department of Natural Resources the authority to establish a policy and adopt regulations by which parks and recreation areas can be developed and managed, and it gives the authority to classify public land as parks and recreation areas. This statute works in conjunction with AS 38.05.300, and, therefore, any parks or recreation areas created under this statute are limited to 640 acres. Many of the smaller units of the State Park System located around the state were established by this method. Units over 640 acres can be added to the State Park System only through legislation (see "*Legislative Authorities*" section below).

Cooperative Resource Management Agreements – Under AS 38.05.027, the state can cooperate with federal agencies through mutual agreement. Under these agreements, management objectives and practices are explicitly addressed on specifically identified parcels of land. Memoranda of Understanding have also been used. For instance, the U. S. Fish and Wildlife Service, Alaska Department of Fish and Game, and Alaska Department of Natural Resources signed a memorandum to cooperatively manage the lands and waters of the Chickaloon Flats in the vicinity of Kenai National Wildlife Refuge.

Access Restrictions – The DNR Commissioner can regulate access on state lands, but state law restricts that authority regarding traditional means of access for traditional outdoor activities on state lands and waters. Specifically, 38.04.200 states:

The commissioner may not manage state land, water, or land and water so that a traditional means of access for traditional outdoor activities is restricted for the purpose of protecting aesthetic values of the land, water or land and water or is prohibited unless the restriction or prohibition meets one or more of the following criteria:

- (1) for an area of land and water that encompasses 640 contiguous acres or less;
- (2) temporary in nature and effective cumulatively less than eight months in a three year period;
- (3) for the protection of public safety and public or private property;

- (4) for the development of natural resources and a reasonable alternative for the traditional means of access across the land, water, or land and water for traditional outdoor activities on other land, water, or land and water is available and approved by the commissioner;
- (5) authorized by the legislature

State land is required to be managed for multiple use. Alaska Statute 38.05.300 states that land and water may not be closed to multiple purpose use if the area involved is more than 640 acres (one square mile), except by act of the legislature or under specific criteria. In addition, while theoretically DNR can administratively create a non-motorized area, as a practical matter, to effect such restrictions through enforcement is limited by available staff and the provisions of Title 38.

ADF&G Administrative Authorities

In conjunction with the regulatory authorities of the Alaska Boards of Fisheries and Game, ADF&G's general mandate is to manage, protect, maintain, improve, and extend the fish, game, and aquatic plant resources of the state in the interest of the economy and general well-being of the state. The combined authorities of the Boards and ADF&G include the establishment of seasons, quotas, bag limits, and harvest levels and regulation of commercial, recreational, guided, subsistence, and personal uses of fish and wildlife through fishing, hunting, trapping and other activities. The ADF&G and Boards of Fisheries and Game are empowered to establish the means and methods employed in the pursuit, capture, transport, and related uses of fish and wildlife. Restrictions on methods and means may include types of access, vessel types, size of motors, and establishment of areas with particular public restrictions such as non-motorized areas for hunting and limiting fishing to catch and release only. Except in emergencies or on legislated lands managed by ADF&G, such restrictions can only be effected through regulations adopted after an extensive public process.

State Legislative Authorities

The power to establish policy for managing public uses of state natural resources resides with the legislature. Although the legislature is not limited regarding what types of designation it can create for any area of state land and water, several designations have consistently been used under Titles 41 and 16, described below.

Alaska Statutes, Title 41

Designations legislated under Title 41 include: State Parks, Recreation Areas, Special Management Areas, Public Use Areas, and Recreational Rivers. For any of these designations, the legislature identifies in statute the public purposes meriting the designation, the lead management agency, specific guidance regarding incompatible activities and allowable uses, the specific powers to adopt and enforce a management plan and regulations, and provides funding. The legislation also can provide specific directions to state agencies regarding joint management with federal agencies.

Management of these areas is usually legislatively assigned to DNR and frequently to the Division of Parks and Outdoor Recreation (State Parks). ADF&G has responsibilities for management of fish and game resources on all lands in the State of Alaska, and this responsibility remains unchanged by these legislative designations. Typically, DNR implements the statutory purposes of the land designation by developing management plans and promulgating regulations in consultation with ADF&G. Given an area's statutory purposes, these plans and regulations identify incompatible uses, restrict certain uses, and require that guides and other commercial operators obtain special permits to operate in these areas. In state park units established under Title 41, Chapter 21, a person who violates a provision of the statute or regulations is guilty of a misdemeanor, and a citation may be issued to the offender by DNR.

State Park – The statutory purposes for individual parks vary. Examples include "park area" for Denali State Park; water supply, recreational opportunities, scenic value, wildlife, and wilderness for Chugach State Park; and recreational and scenic resources, fish and wildlife habitat, sport and subsistence hunting and fishing, personal use fishing, trapping, and commercial fishing for Afognak Island State Park.

State Recreation Area (SRA) – These are created for "public recreation." Examples include Captain Cook SRA, Cairnes Head SRA, and Chena River SRA.

Special Management Area (SMA) – The general intent is to protect and perpetuate fishery and wildlife resources and habitat and to manage recreational uses and development activities. There currently are only two: Kenai River SMA and Business Park Wetlands SMA.

Public Use Area – The statutory purposes vary but may include protection of fish and wildlife habitat, public enjoyment of fish and wildlife and their habitat, public recreation, traditional public uses, personal use woodcutting, fishing, hunting, grazing, trapping, protection of water quality, and scenic resources. Typically the legislature provides very detailed policy guidance (much more so than for a state park), including delineating incompatible uses and specifying uses which may not be restricted. Such policy guidance expresses legislative intent regarding any limitation of public uses. To illustrate how such legislation can be tailored to specific areas, the Nelchina Public Use Area statutes specify that the DNR will obtain the concurrence of ADF&G on land plans for the central caribou calving area.

Recreation River – The statutory purposes for the Susitna Basin Recreation Rivers include protection of fish and wildlife populations and habitat, recreation and economic use, multiple use management of upland activities, and accommodation of access for resource uses. As with Public Use Areas, the legislature provides very detailed guidance on management and compatible activities. Recreation Rivers are not part of the State Park system, and instead are managed primarily by the DNR Division of Mining, Land, and Water. The division has limited field staff and does not have the statutory authority to issue citations for infractions of the regulations.

Alaska Statutes, Title 16

In certain areas where conservation and protection of wildlife and fish is emphasized, the Alaska Legislature under Title 16 created refuges, sanctuaries, and critical habitat areas. As with other types of legislative designation, unit-specific policy guidance regarding allowable uses and incompatible activities is common. Generally, the legislature does not specifically direct ADF&G to restrict fishing or hunting, although there are exceptions, and ADF&G has general statutory authority to issue citations and to arrest violators. DNR also has authorities that vary between designated areas such as the right to issue leases, rights of way, mining claims, and oil and gas leases.

Title 16 authority for managing fish and wildlife resources is delegated to the Commissioner of Fish and Game, with certain responsibilities assigned to the Board of Fisheries and the Board of Game. This division of powers can seem complex, especially in regard to the "special areas" discussed below. For simplification, the combined authorities are referred to as belonging to ADF&G, recognizing that within the responsibility for conservation and development of the resources, the allocation of resource utilization rests with the Boards.

Sanctuaries – Three such areas have been designated and were created to protect a specific species and associated public uses: walrus at Walrus Island State Game Sanctuary and brown bear at Stan Price and McNeil River State Game Sanctuaries. ADF&G manages the fish and wildlife resources and most land use activities. The DNR manages mineral entry and leasing (except at McNeil River, which is closed to mineral entry and leasing by statute). Hunting and trapping within McNeil River Sanctuary are statutorily prohibited. At Stan Price Sanctuary, ADF&G is legislative directed to manage state owned tidelands compatibly with the U. S. Forest Service's management of the adjacent uplands.

Refuges – The generic purpose of the state's refuge designation is to protect and preserve natural habitat and wildlife populations in certain areas of the state, and some refuges have more specific statutory purposes. ADF&G and DNR retain their respective management authorities in refuges. ADF&G manages the fish and wildlife and is responsible for developing a management plan for the refuge in consultation with DNR. An example of site-specific policy guidance is found at the Yakataga State Game Refuge, where timber harvest activities in certain areas are provided for and commercial, recreational, and subsistence fishing and hunting are specifically allowed.

Critical Habitat Areas – The purpose of these areas is to protect and preserve habitat especially crucial to the perpetuation of fish and wildlife and to restrict other uses not compatible with that primary purpose. ADF&G is specifically directed to adopt regulations it considers advisable for conservation and protection purposes governing the taking of fish and game in these areas. Similar to Refuges and Sanctuaries, ADF&G and DNR retain their other respective management authorities. There is sometimes a

provision for establishing a citizens advisory committee. At Dude Creek Critical Habitat Area, allowable public uses are listed.

Public Trust Doctrine

The Alaska Constitution and Statutes accepts the authority and responsibility for management of its public trust doctrine resources. The doctrine provides that public trust lands (those below Mean High Tide and within Ordinary High Water boundaries), waters, and living resources are held by the state in trust for the benefit of all of the people and establishes the right of the public to fully utilize these lands, waters, and resources for a wide variety of public uses. The public has a right to use all waterways in Alaska regardless of ownership of the underlying land. State law permits members of the public to touch the bed of a waterway to the extent reasonably necessary to participate in public trust activities, such as boating, hunting, fishing, and trapping. The state manages all waterways for public uses in the state except where specifically limited by Congressional legislation or Court actions. Attached are most public trust doctrine provisions in Alaska's Constitution and statutes. These lands/waters are managed as general state lands by DNR except where modified by legislative designations or administrative actions.

Designation of waters as special areas – One option for state management of public uses on waters, shorelands, tidelands, and submerged lands may be to adopt legislation utilizing one of the existing designations discussed above or to create a new designation. The legislation would need to identify the purposes for the designation, lead management agency, specific guidance regarding incompatible activities and allowable uses, specific powers the resource agencies have to adopt and enforce a management plan and regulations, and provide funding. The legislation could also provide a specific change to state agencies regarding joint management with federal agencies, if appropriate.

Enforcement Issues

Adequate law enforcement is a concern statewide. Some resource and land management concerns could be alleviated through enforcement of existing state regulations. Strict enforcement of the existing state regulations could reduce impacts of illegal public use and curb unethical commercial operators. The Alaska Department of Public Safety's Division of Fish and Wildlife Protection enforcement efforts are spread out statewide over all lands, focused on the subsistence, recreational, and commercial fisheries and hunting, during the periods of seasonally high public use on state lands and waters. Citations may also be issued for violations under Title 16 (regulations which apply to ADF&G) and Title 11 sections 09-21 (regulations which apply to Alaska State Parks). Unfortunately, Title 11 (sections 51-98) regulations that apply to general state lands may only be enforced by civil action. While Alaska State Troopers can enforce some nuisance activities such as trespass and littering under the Alaska Criminal Code, many of the nuisance activities that occur on state land are not covered under this code.

Trespass

Trespass concerns generally takes one of two forms. The first is trespass onto private uplands, and the second is trespass that occurs on conveyed lands below the ordinary high water mark (shorelands). The first form of trespass often occurs because the private lands are not marked or the parcel has recently been conveyed into private ownership. The second form occurs in cases where shorelands under waterways (which the state asserts are navigable, thus state owned) were conveyed to the private upland owner in error by the Bureau of Land Management. Regardless of ownership, the private landowner is usually unaware that the public is allowed full use of the waterway. The Alaska State Troopers will enforce trespass on private and state lands where sufficient evidence of land ownership is available. Oftentimes, trespass enforcement falls upon appointees of the upland owner to file civil complaints if ownership is in question. Alaska State Troopers will not issue citations for trespass where the land ownership is in dispute.

Trespass could be reduced through educational efforts of land managers, such as maps and brochures that describe land ownership boundaries, the ordinary high water mark, Public Trust Doctrine rights, and the location of public trails, rights-of-way, or easements.

Water quality

All waste not disposed of in accordance with State of Alaska waste water disposal regulations or General Permit issued by the Department of Environmental Conservation, must be hauled to a permitted solid waste facility per 18 AAC 72.020(b). Regulations require a minimum separation of 100 feet between the mean annual high water level of a lake, river, stream, spring, or slough, or the mean higher high water level of coastal waters and the disposal of human waste.

Other Relevant State Regulations

DNR Permits

All commercial recreation businesses that use state uplands, shorelands, tidelands, and fresh water bodies must register. At this time, day use commercial recreation businesses that exclusively operate on salt water, without taking clients ashore on state-owned tidelands or uplands, are not required to register. Air or water taxi services that drop clients off on state tidelands for guided or unguided recreation must register. Air or water taxi services are not required to register the transportation of non-recreation oriented passengers or business services such as delivering supplies to commercial fisherman or transporting people to their remote cabin site. Commercial recreation businesses that occasionally use state land must also register.

Those commercial recreation businesses with a camp or facility, whether occupied or unoccupied, that remains overnight on state land must first obtain a land use permit or

lease from DNR. These permits are issued on a non-competitive basis and cost \$500/year. A \$2.00 per overnight client fee is also charged.

Those commercial recreation businesses that already have permits or leases to operate on state land are required to register any commercial recreation day use regardless of whether it is directly related to the permits or leases.

Guide Registration

(1) **Sport Fishing.** Under 5 AAC 75.075, all sport fish guides and sport fish service providers must register annually with the Alaska Department of Fish and Game. In addition, all registered sport fish service providers are required to annually register any powered water crafts and non-powered boats 10 feet or greater in length with the Department of Motor Vehicles. All sport charter vessels used in the guided recreational taking of fish must also be licensed with the Commercial Fishing Entries Commission (CFEC). Under 5 AAC 75.076, all fishing services operating charter vessels in saltwater must obtain and complete a marine logbook for all charter vessels they operate in marine waters.

Fish guiding regulations in various areas of the state, including Cook Inlet, provide specific area and seasonal stipulations that make it illegal for a guide to fish while a client is present or within a guide's control or responsibility, unless the guide is providing assistance to a client with a disability. This prevents the guide from harvesting a bag limit for themselves or more commonly for their clients.

Important Definitions:

"Fishing service" means the indirect provision of assistance for compensation or with the intent to receive compensation, to an angler engaged in sport fishing in the taking or attempt to take fish or shellfish by a business that employs or contracts with a fishing guide for fishing guide services during any portion of the angler's fishing trip; "fishing service" does not include booking or ancillary services provided by a tour broker or agent to a business that conducts fishing services.

"Fishing guide services" means the direct provision of assistance, for compensation or with the intent to receive compensation, to an angler engaged in sport fishing in the taking or attempting to take fish or shellfish by accompanying or personally directing the angler in fishing activities during any portion of the angler's fishing trip; however, the term does not include services provided by assistants, deckhands, or persons similarly employed who work directly under the supervision of, and on the same vessel as, a fishing guide.

"Charter vessel" means a vessel licensed under AS 16.05.490, used for hire in the sport, personal use, or subsistence taking of fish or shellfish, and not used on the same day for any other commercial fishing purpose; a charter vessel does not include a vessel or skiff without a charter operator.

(2) **Wildlife Guiding.** Big game guides and transporters are regulated by the Alaska Department of Community and Economic Development under Alaska Statutes Title 8. The Big Game Commercial Services Board (commonly referred to as the Guide Board) was eliminated several years ago, replaced by limited controls and monitoring through the Division of Occupational Licensing. While there is a limit on the number of areas a game guide can operate in, there is no limit on the number of guides than

can operate in any given area unless restricted by the federal or private land manager. Alaska Statute 08 Chapter 54 contains the state's rules for game guides and related definitions can be found as follows: AS 08.54.610 defines⁴ a registered guide⁵; AS 08.54.620 Class A assistant guide; 08.54.630 Assistant guide, and 08.54.650 Transporter.

Under AS 08.54.720(17) and (18), big game guides are prohibited from taking big game while accompanying a client or taking the species a client has contracted for while the client is still in the field (excluding defense-of-life-and-property situations):

AS 08.54.720. Unlawful acts.

(a) It is unlawful for a

(17) registered guide, except in the defense of life or property, to knowingly personally take

(A) big game while accompanying a client in the field; or

(B) a species of big game if the registered guide is under contract with a client to provide a guided hunt for that species of big game and the client is in the field;

(18) person who is licensed as a registered guide, a class-A assistant guide, or an assistant guide, except in the defense of life or property, to knowingly personally take big game while a client of the registered guide by whom the person is employed is in the field unless the person is not participating in, supporting, or otherwise assisting in providing big game hunting services to a client of the registered guide by whom the person is employed; or

(19) person who is licensed as a transporter, or who provides transportation services under a transporter license, to knowingly accompany or remain in the field with a big game hunter who is a client of the person except as necessary to perform the specific duties of embarking or disembarking big game hunters, their equipment, or big game animals harvested by hunters; this paragraph does not apply to a person who holds both a transporter license and any class of guide license issued under this chapter.

Alaska Statute 16.05.790 prohibits obstruction or hindrance of lawful hunting, fishing, trapping, or viewing of fish or game.

Alaska Statute 16.05.940(33) defines "take" to mean taking, pursuing, hunting, fishing, trapping, or in any manner disturbing, capturing, or killing or attempting to take, pursue, hunt, fish, trap, or in any manner capture or kill fish or game. The phrase "or in any manner disturbing ..." may theoretically provide authority to cite those who "disturb" wildlife or fish out of season with the same force as someone who kills those critters; this has not been tested in court.

Attracting Wildlife

⁴ Beginning in 1932, the Alaska Game Commission required nonresident photographers to hire a registered guide to photograph brown, grizzly, or polar bear. The regulation was retained by the State of Alaska until 1967.

⁵ Through the early 1970s, the definition of guiding was, "Guiding as herein used means accompanying, guiding, or assisting another person to take or photograph game with the intent of receiving monetary or material remuneration for such services..."

Feeding of wildlife or leaving garbage that attracts them is prohibited by regulation (5 AAC 92.230) except under an ADF&G permit:

A person may not intentionally feed a moose (except under terms of a permit issued by the department), bear, wolf, coyote, fox, or wolverine, or negligently leave human food, pet food, or garbage in a manner that attracts these animals. However, this prohibition does not apply to use of bait for trapping fur bearers or hunting black bears under 5 AAC 84 – 5 AAC 92.

The guidelines for taking a bear in defense of life and property are set forth in regulation 5 AAC 92.410. Provocation of the animal and negligent storage of food are not justifications for shooting a bear. Brochures and other means are used to advise traveling public to avoid using well-worn bear trails and avoid camping near food sources such as salmon streams or berry patches. The brochure, "Bear Facts," from the Alaska Department of Fish and Game offices around the state addresses these issues.

Other Government Tools

Boroughs (municipal governments) have authority to adopt planning, zoning, or municipal land use regulations that can address recreational development. Some boroughs have used planning and zoning powers to address certain types of recreational use, such as motorboats on lakes in the Mat-Su Borough, but generally do not restrict recreational uses unless there is a public health or safety issue (such as snowmachines on residential streets). Municipalities can adopt Coastal Management Plans that apply to state, municipal, and private lands; these plans provide general guidance over development activities. The Coastal Management Plans generally do not address recreational use. Boroughs may also own land, most of which is land transferred from the state under the municipal entitlement program.

Fact Sheet

Recordable Disclaimers of Interest: State Owned Navigable Waters



July 2003

Frequently Asked Questions:

What is a Recordable Disclaimer of Interest?

A Recordable Disclaimer of Interest is a legal document through which the United States disavows ownership of specified land. The State of Alaska is asking the Bureau of Land Management to disclaim ownership of the beds of some navigable waters that the state acquired at statehood.

Is the federal government conveying federal lands through these disclaimers?

No. If a waterbody meets the federal legal requirements for navigability for title purposes, the state already owns the underlying lands. The state acquired title to the submerged lands at statehood, so when the federal government issues a recordable disclaimer of interest, it is simply acknowledging that it does not own the identified land.

Why is the state asking for disclaimers on navigable waters?

A Recordable Disclaimer of Interest for submerged lands will lift the cloud on the state's title. The state's title to submerged lands is somewhat clouded because it took ownership without any written documentation. Alaska owns the lands underlying navigable waters not because the United States conveyed them, but rather by virtue of the equal footing doctrine. Under the equal footing doctrine, new states are admitted to the Union with all of the powers of sovereignty and jurisdiction that pertained to the original states, and ownership of lands underlying navigable waters is an essential attribute of state sovereignty. When Alaska became a state, title to lands underlying navigable waters within its boundaries passed to it automatically, as a matter of constitutional grace. But whether a waterway meets the technical criteria for navigability is not always clear. While ideally the state would like to verify ownership of all lands underlying waterways in Alaska, recordable disclaimers of interest provide finality for at least

those waterways that the state and the United States agree are clearly navigable.

Under what authority does the federal government issue these disclaimers?

The disclaimers are issued by the federal government's primary land manager, the Bureau of Land Management (BLM). The federal law authorizing these disclaimers is section 315 of Federal Land Policy and Management Act, 43 U.S.C. 1745. BLM regulations spell out the requirements and procedures for filing and approving the disclaimers, in 43 C.F.R. 1864. In early 2003, BLM revised the regulations to allow states to apply for disclaimers for submerged lands.

What is required for the state to apply for a Recordable Disclaimer?

The federal regulations specify the filing requirements. The state must submit an application letter to the State Director of the BLM, along with a filing fee. The application must include a legal description of the lands, the reasons the applicant believes the federal government does not own the specified land, documents or title evidence to support the application, and names and addresses of any others who may claim title to the lands. BLM's State Director can waive requirements if necessary.

How does BLM process an application?

When BLM receives an application, it will take the following actions:

- BLM will review the application to ensure that it meets all filing requirements. Pre-application meetings may be held to ensure that the applications are complete before filing.
- BLM must publish a notice in the Federal Register at least 90 days before it issues a disclaimer, and also must publish a notice in

local newspapers. The purpose of the notice is to allow adjacent property owners an opportunity to assert a competing claim or to provide evidence of federal ownership.

- BLM must also offer an opportunity to review and comment on the application to adjacent federal landowners such as the National Park Service, the U.S. Fish and Wildlife Service, the Department of Defense, or the U.S. Forest Service.

Which rivers will the state file applications on?

The state's initial filings are for rivers that BLM has previously determined to be navigable for title purposes.

The state filed its first application in February 2003 for the Black River, a tributary of the Porcupine River in Northeast Alaska. The state will file five additional applications in July 2003. These five include:

- * The Porcupine River in Northeast Alaska;
- * The Klutina River and Klutina Lake, in the Copper River Basin;
- * The Tazlina River and Tazlina Lake, in the Copper River Basin;
- * The Kvichak River and Lake Iliamna; and
- * The Wood River and lake system, within Wood Tikchik State Park.

Within the next several months, the state intends to file applications for additional rivers that BLM has already found to be navigable. Not all navigable waters in Alaska are as well documented as these, of course. For waterways that require more research, the state and federal agencies will establish a process to gather information about the waterways from the public and other sources.

Various interest groups have claimed that the state plans to file applications for 20,000 rivers and a million lakes. Is this true?

While neither the state nor the federal government knows how many waterbodies in Alaska are navigable, hundreds of waterways certainly qualify, based on the legal standard for navigability. The state has no intention of filing applications for 20,000 rivers and a million lakes.

Why did the state file on the Black River first?

The state selected part of the Black River for its initial application for several reasons. First, BLM has previously determined this segment of the river to be navigable. In addition, in 1993 the state filed an action to quiet title to the riverbed, and the United States Court of Appeals for the Ninth Circuit acknowledged that the submerged land was probably state-owned, although it could not enter judgment for jurisdictional reasons. Finally, the river has a long history of use for navigation that precedes statehood.

How does the state's ownership impact allocation of fisheries?

State title to submerged land has no impact on allocation of fish or game. The federal subsistence priority granted by Title VIII of the Alaska National Interest Lands Conservation Act applies to all waterways in which the federal government has reserved water rights, generally in federal reservations such as National Parks and National Wildlife Refuges. Thus, the federal subsistence priority applies to waters within and adjacent to reserved federal lands regardless of the ownership of the land underlying the waters. The state manages fish and wildlife and provides for harvest on all lands in Alaska, regardless of ownership. On federal lands and in waters where the United States has a federal reserved water right, the Federal Subsistence Board may limit harvests by people ineligible for the federal subsistence priority. Thus, the ownership of land under navigable waters is not a factor in allocation of fish and wildlife among users.

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AGRIUM

4/19/06

Agrium



phase 2 summary



Photo Courtesy of Eagle Eye Helicopter, Inc.

The Cook Inlet region of Alaska has a variety of established industries that were built around an abundance of low cost natural gas. The natural gas supply is vanishing, forcing industry to cease operations and raising the cost of fuel to utilities and consumers. Kenai Blue Sky employs commercially proven technology and capitalizes on unique market conditions, strategic partnerships and alliances to provide a long-term commercial alternative to natural gas reliance.

The diversity and synergies offered by Kenai Blue Sky are immense. Kenai Blue Sky will retain the annual production of over 2 million tonnes of ammonia and urea. It provides an opportunity for Railbelt utilities to make available reliable, competitively priced power in a region with aging and expensive generation. It reduces environmental emissions through proven technology and provides excess CO₂ to recover up to 300 million barrels of oil through enhanced oil recovery in Cook Inlet. This project anchors the development of the Beluga coalfield and would result in the retention and creation of over 500 long-term Alaskan jobs.

Privileged and Confidential

The Project

Kenai Blue Sky employs developed technology and capitalizes on unique market conditions, strategic partnerships and alliances to provide a long-term commercial alternative to natural gas reliance within Alaska. The objective is to site a world class gasifier and traditional pulverized coal power plant adjacent to Agrium's Kenai facility to begin production in 2011. Two gasifier trains would produce the H₂, N₂, steam and CO₂ required by the nitrogen facility and strategically positioned companies in Cook Inlet. Environmental emission concerns are addressed through proven technology.

The diversity and synergies offered by Kenai Blue Sky are immense. Kenai Blue Sky could retain the annual production of 0.8 million tonnes of ammonia and 1.3 million tonnes of urea, along with associated jobs, community support and business opportunities for Alaska companies. The project could also provide low cost power for sale into the Railbelt, excess CO₂ to recover up to 300 million barrels of oil through enhanced oil recovery, the anchor demand required to develop another Alaskan coal mine, and assist in the economics of other Alaskan communities and companies by supplying an economic alternative for by products and demand for services.

With almost 40 years of Alaska experience, the Kenai nitrogen facility has been able to successfully compete in the export fertilizer market. However, declining

***With almost 40 years of
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the Kenai nitrogen facility
has been able to successfully
compete in the export
fertilizer market.***

natural gas supplies and lack of further development will force the facility to cease operations in the near future. Based on an abundant Alaska resource, coal, this project will effectively mitigate the volatility associated with the traditional natural gas based fertilizer producers. Nearby coal reserves are projected to provide well in excess of 100 years of economic development. This enables Alaska to retain a value-added facility, continues to diversify the state portfolio and capitalizes on the operations experience of one of the world's leading fertilizer companies.



Kenai Blue Sky could also significantly improve the Railbelt energy mix by decreasing natural gas power production from 73% to 39%. Cook Inlet natural gas now uses national benchmark pricing resulting in significantly higher prices and volatility. The stability offered through long-term coal contracts offers a stable low cost solution. By leveraging an existing multi-billion dollar fertilizer plant, development and operations of Kenai Blue Sky significantly enhance the value proposition of the power generation. These synergies extend into the enhanced oil recovery opportunities and other benefits currently being explored. Further, the existing highly skilled employment base and support industries of the Kenai enhance the project's credibility and sustainability.

The Market and Industry

The ten-year average growth in global nitrogen demand was 1.9% per annum and is expected to continue to grow at this rate.

By 2011, the global nitrogen demand is expected to be 100 million nutrient tonnes. There has been a pronounced shift to urea within this market as urea growth has averaged 3.5% over the past ten years and is expected to grow at 2-3% per annum.

The production portfolio is shifting toward the low cost trapped gas of the Middle East and other regions. This shift is coming at the expense of the older production in the higher gas cost markets such as North America and Europe.

Kenai Blue Sky will target the Pacific Rim market. This market is currently served by product sourced out of

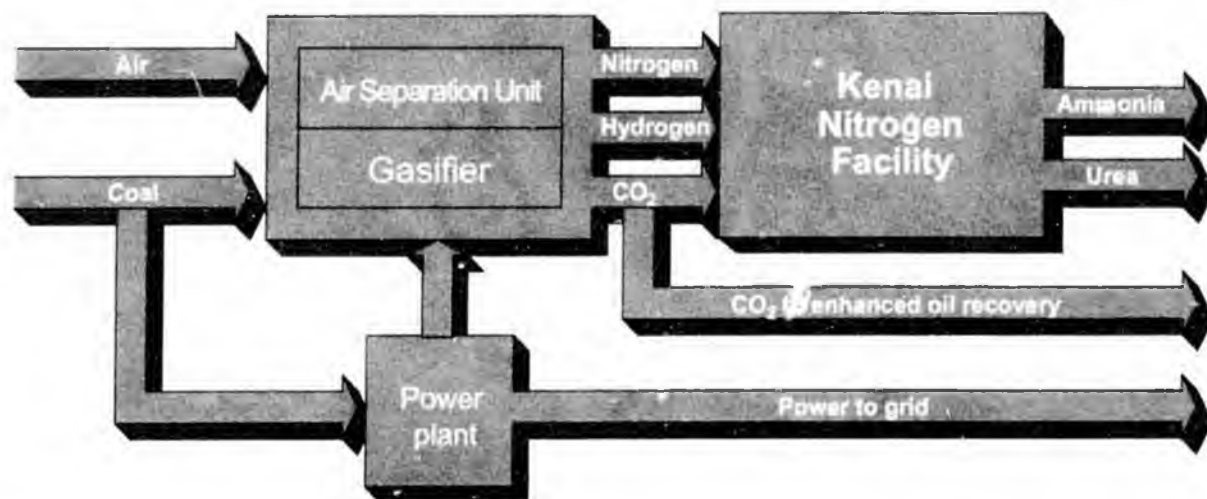
the Middle East, the former Soviet Union, Malaysia and Kenai. Within this market, Kenai continues to enjoy a strategic advantage with its location and proximity to market. With a significant savings in shipping costs Kenai has been able to compete in the Asian markets, with strong relationships with Korea, Mexico and as far south as eastern Australia. The current outlook continues to support these market fundamentals. With high cost power production in Alaska, the Railbelt is well positioned to accept a new source of low cost, environmentally friendly, coal fired power production. The high decline rates on the natural gas supply are forcing prices higher and are limiting the availability of new natural gas power production. Coal based production addresses this concern and offers an economic alternative to the higher cost alternative.

Kenai Blue Sky Business Model/Strategy

The basis of the Kenai Blue Sky business model is predicated on the long-term viability of the strategic partnerships and alliances required to make this project successful. The project derives significant synergies from the integration of the nitrogen facility, power plant, air separation unit, coal mine, other feedstock alternatives and gasifier.

Given the cost and magnitude of Kenai Blue Sky, the current view is that the ultimate structure will include several strategic partners with an interest in the overall structure or perhaps individual components with strong

contractual ties. Agrium could bring nitrogen production experience and use its existing marketing capacity and network to market the product. Usibelli Coal Mine Inc. (UCM) brings to the project over 60 years of experience as the only operating Alaskan coal mining company. The proven experience of Agrium and UCM combined with the excellent operating performance of the Kenai Nitrogen Operations team is a strong foundation on which to build Kenai Blue Sky. The partners will be strategically integrated to enhance this foundation into a long-term viable partnership.



Kenai Blue Sky Project Components

All components of this project utilize existing, proven technology in a unique configuration to produce multiple benefits to the State of Alaska.

Coal Supply

Kenai Blue Sky could utilize up to four million tons of coal per year. The long-term nature, volume and location support the development of new coal opportunities in Alaska. UCM is evaluating options associated with utilization of coal from Beluga, Healy, and other coalfields. UCM is also evaluating the transportation of coal to the Kenai Blue Sky facility. A draft report is expected by early summer 2006. Phase 2 of the project will continue to develop on this and will narrow the scope to identify the most viable strategic option.

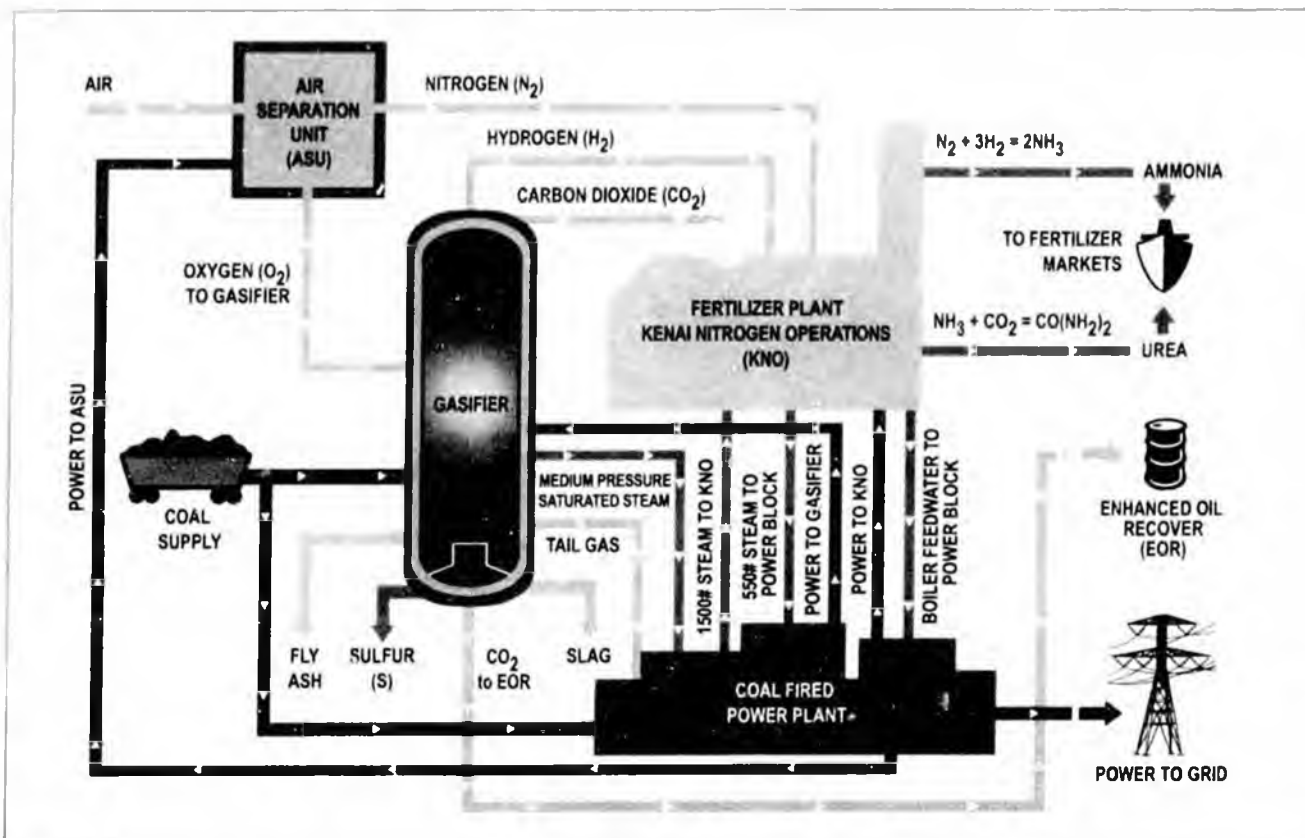
Gasifier Block

Two coal gasification trains could utilize Alaskan coal to produce the hydrogen, nitrogen, steam and carbon dioxide required by KNO. The process dries and pulverizes delivered coal conveying it to the gasifier

where the coal reacts with sub-stoichiometric amounts of pure oxygen to form a gas stream rich in carbon monoxide and hydrogen (syngas). This gas is reacted with water in shift converters where the carbon monoxide (CO) is shifted into carbon dioxide (CO₂) and hydrogen (H₂). The CO₂ is then removed from the syngas along with sulfur and other impurities. Finally a pure hydrogen stream is supplied to the KNO nitrogen plant where it will be combined with pure nitrogen from the air separation unit and then be converted into ammonia (NH₃).

Air Separation Unit

The air separation unit (ASU) processes air directly from the atmosphere to generate the nearly pure oxygen required by the gasification block. The air separation unit is the largest power consumer in the envisioned complex due to the large compressors required to liquefy and separate pure oxygen and nitrogen from the air. The gasifier block requires pure oxygen to process the coal, all of which is supplied by the air separation unit.



Kenai Blue Sky Project Components continued

Power Block

Southcentral Alaska and the entire Railbelt grid are in need of low cost reliable power. The current natural gas generators continue to age and the prices continue to escalate. Kenai Blue Sky envisions building two traditional coal fired boilers supplying power to the Kenai Blue Sky project and potentially the Railbelt grid. Kenai Blue Sky could require approximately 100 MW of power. This leaves the potential to generate additional power for sale into the grid. The project will use BACT for emissions control and consider the application of proven technology that could demonstrate emissions control beyond current BACT levels.

KNO Nitrogen Plant

Agrium's Kenai Nitrogen Operations (KNO) is the second largest nitrogen fertilizer production facility in North America. Agrium supplies fertilizer (urea) to Alaskan customers that include farmers, greenhouse operators, and State airports. This world-class facility is scheduled to permanently shut down on October 31, 2006 due to a lack of natural gas feedstock. KNO takes pure hydrogen from the gasifier and pure

nitrogen from the air separation unit and combines them in a high-pressure converter to form ammonia (NH_3). Ammonia produced in the ammonia converter is refrigerated and sold and is also combined with carbon dioxide (CO_2) in a high-pressure reactor to form urea (NH_2CONH_2). The urea is sold as the highest grade of solid nitrogen fertilizer.

Enhanced Oil Recovery

Excess CO_2 could be injected into the aging Cook Inlet oil fields to produce an estimated 300 million barrels of additional crude oil from these fields. The potential daily oil production increase is estimated to be as much as 25,000 barrels per day. The use of CO_2 to enhance the recovery of oil from existing fields has been proven in many fields across North America. The unique properties of CO_2 allow this gas to dissolve into the remaining heavy oil in the reservoir and change the oil's flow characteristics. The result is that more oil is able to flow from the reservoir and be recovered. The Department of Energy has sponsored two studies that have identified the high potential for recovery in the Cook Inlet fields.

Kenai Blue Sky Project Phase 2

Following the final determination of project feasibility, Kenai Blue Sky will move into a more detailed engineering analysis that will better define the project. The goal of Phase 2 will be to develop a Front End Engineering Design (FEED) package. The FEED package will establish engineering definition sufficient to support a Lump Sum Turn Key (LSTK) offering for the final design and construction of the project. Phase 2 will also begin the environmental permitting and establish the corporate structure and commercial agreements to advance the project.



Phase 2 Deliverables

Develop Front End Engineering Design (FEED) Package

The engineering deliverable for Phase 2 will be developed in conjunction with Black & Veatch/Uhde who have been integral to the design from the beginning. In Phase 2, the design will be honed to the final design case and the level of detail in the estimate will be greatly increased over the feasibility investigations. This level of work is often referred to as a

Front End Engineering Design (FEED) package. The detail of this design is highly specific and allows for a greater definition of the project, but not sufficient for the final design and construction of a facility. The FEED reduces the uncertainty around final project cost and allows for a better overall design by providing greater definition.

The Major Parts of the FEED are:

- A scope of work and supply document that will form the basis for the final lump sum turnkey (LSTK) offer during Phase 3.
- A Class 3 capital cost estimate as defined by the Association for the Advancement of Cost Engineering International. The capital cost estimate shall also include a confidence level analysis. The intention of this analysis is to quantify the uncertainty around the cost estimate.
- Detailed engineered process and utility equipment lists.
- The following drawings, developed during Phase 1, will be refined and enhanced:
 - Basic process units block flow diagrams.
 - Process flow diagrams for all process systems.
 - Plot plan for all project facilities.
 - Electrical Single Line Diagram for generation facilities and electrical connection to the Gasification Plant and KNO.
 - Preliminary Piping and Instrument Diagrams (P&IDs) for all process facilities.
- Detailed estimates for the following categories:
 - Operating costs (other than coal).
 - Operations and Maintenance Manpower requirements.
 - Anticipated Maintenance costs.
 - Estimate of the availability for the major pieces of equipment.
- Evaluation of Feedstock and suitability for intended application.
- Detailed Project Implementation Plan.
- Estimated plant emissions, discharges and waste products.
- Detailed Schedule for Phase 3.
 - Based on a start of Phase 2 in summer 2006, estimated completion date of January 2008.

Perform Environmental Permitting

The environmental work required in Phase 2 is dependent on the results from the feasibility investigations in Phase 1. If it is determined that there are any requirements for baseline data collection, this work will commence in Phase 2.

The goal of this work will be to develop any data collection and modeling required to support the project

and begin the permitting process. It is envisioned that the permitting and National Environmental Policy Act (NEPA) process work, if it is required, will begin in Phase 2. Some engineering will need to be completed in order to begin the permitting process.

Phase 2 Deliverables continued

Produce Bankable Documents to Secure Financing for Phase 3 and Phase 4

The Kenai Blue Sky Project offers a number of potential commercial opportunities. A major focus of Phase 2 will be to define the commercial opportunity and establish a corporate structure to execute Kenai Blue Sky. This could also require the development and execution of raw material supply and product offtake agreements. The

development and execution of these agreements could lead to secured financing for Phase 3 and Phase 4. The current estimated cost for Phase 2 is \$28 million. This estimate will continue to be refined as Phase 1 is completed. The funding will be a mix of private and public funding.

Phase 2 Costs

Phase 2 will further define the value proposition for Kenai Blue Sky and set the stage for participation in the subsequent stages. To facilitate this process the participants are being chosen for their strategic alignment with project. This maintains focus and will optimize the outcome of this process.

The anticipated breakdown of spending is as follows:

Front End Engineering Design	\$ 13.4 million
Environmental Permitting	\$ 4.3 million
Commercial Development	\$ 5.4 million
G&A	\$ 4.6 million
Total	\$ 27.7 million

Phase 2 Participants

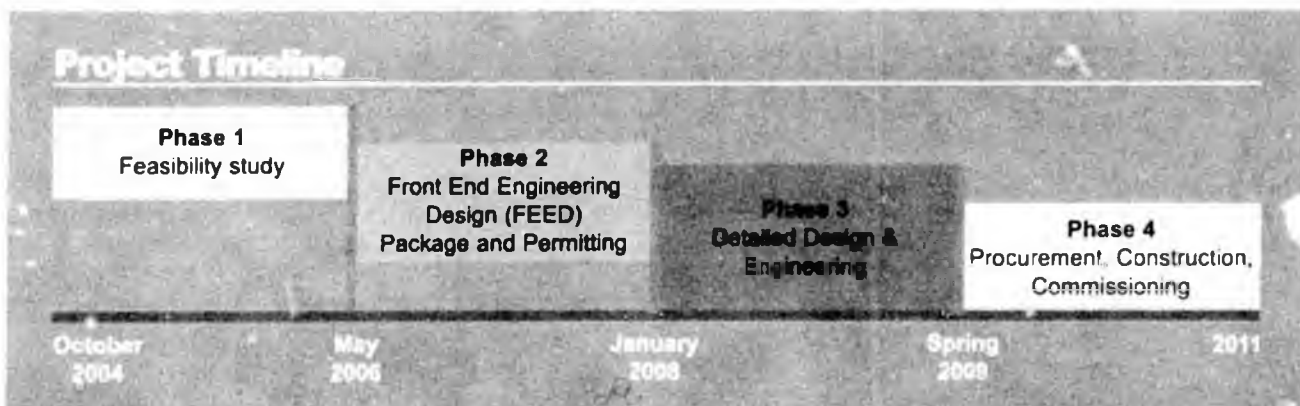
Current indications are that the Kenai Blue Sky has solid financial fundamentals. Sensitivity analysis shows that Kenai Blue Sky maintains a positive economic

feasibility over a broad range of scenarios. Strategic partners will be engaged in the development of this opportunity.

Phase 2 Summary of Economics

The Kenai Blue Sky concept has been underway since October of 2004. Phase 1, the feasibility assessment, is nearing completion and continues to show strong promise and presents an economic opportunity. To date the dollars invested in commercial, environmental, and engineering studies have documented the viability of

the project. The final product of Phase 1 will set the basis for the Front End Engineering Design (FEED) package to be developed in Phase 2. A "Go" decision from Phase 2 will lead into the detailed design and engineering in Phase 3 followed by procurement, construction and commission in Phase 4.





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**ANS
(ALASKA
NORTH
SLOPE)
LESSEES,
4/20/05**

*JOINT WORK SESSION 4-20-05
Sen. RES. E. LIB. & A*

**FIVE COMMON
MISCONCEPTIONS ABOUT
PRODUCER "CONTROL" OF
ANS GAS AND ITS RELATION
TO THE PIPELINE**

**TESTIMONY BEFORE THE
ALASKA LEGISLATIVE BUDGET
AND AUDIT COMMITTEE**

APRIL 20, 2005

**BY: W. Mark Cotham
Mark C. Harwell
Cotham, Harwell & Evans
Houston, Texas**

INTRODUCTION

My name is Mark Cotham and I am appearing today with my law partner, Mark Harwell. We are attorneys with the Houston law firm of Cotham, Harwell & Evans. Our firm has been engaged by the Alaska Gasline Port Authority (the "Port Authority") to testify on issues surrounding the obligations of leaseholders of gas properties.

We have been practicing oil and gas law for a combined over forty-three years. Biographical information about us and our firm is attached to these remarks. Our firm specializes in representing royalty owners in development and marketing disputes with oil and gas producers. The circumstances surrounding Alaska's stranded gas reserves and the history of attempts to have a gas pipeline built to them are unique. However, the obligations that producers have to develop and market natural gas are established and familiar in the lower forty-eight states.

We have been asked by the Port Authority to review with you the legal duties and obligations that the Alaska North Slope ("ANS") producers have to develop and market this stranded gas. Reviewing the Alaska natural gas discourse, I have been struck by the absence of much, if any, public discussion about the producers' duties. There has, and rightly so, been a lot of discussion about the Federal Government's loan guarantee and why it was important in getting the pipeline built. The producers have likewise been very outspoken about concessions as far as royalty and the taxes that they have said "must" be made by the State.

It is a *misconception*, however, to believe that the oil companies enter discussions about Alaska's gas reserves without their own specific duties. In fact, the authors of Alaska's leases have provided clear duties and responsibilities for which the ANS producers *are* accountable. Furthermore, the State is in an excellent position, if it so chooses, to require the ANS producers to promptly and diligently market that gas.

While I am here today in my capacity as counsel for the Port Authority, it is important for me to emphasize that the viewpoints I am going to share are *not*, from an oil and gas law perspective, contentious or an attempt to advocate debatable legal propositions. The body of law that we'll be discussing today is settled and scholars agree, to an extent uncommon in most areas of the law, on what is required.

In order to insist upon the performance that is due to the people of Alaska, it is important to have a firm grasp on what is due from the oil companies under their leases and the law generally. Unfortunately, that subject has sometimes been the subject of misconceptions.

The five misconceptions that I would like to address with you today are:

- **MISCONCEPTION NUMBER 1:** The oil companies "own" the ANS gas.
- **MISCONCEPTION NUMBER 2:** The oil companies have complete legal control over *if* and *when* the ANS gas is marketed.
- **MISCONCEPTION NUMBER 3:** The oil companies can choose how much profit they want and not market the ANS gas until their profit goals, through State concessions or otherwise, are met.
- **MISCONCEPTION NUMBER 4:** The oil companies, by virtue of owning the ANS leases, have the legal right to dictate the location, ownership and structure of the pipeline.
- **MISCONCEPTION NUMBER 5:** The State is in a relatively weak negotiating position with the oil companies.

I hope by reviewing these issues that I can help to bring the discussion away from the false issue of what Alaska "has" to do by way of concessions to get the producers to agree to market Alaska's stranded gas. And, instead, assist the discussions to focus on which pipeline proposal offers the most benefit to the Alaskan people. This is *the* critical inquiry for good stewardship of Alaska's resources.

Because this is a discussion about the legal duties that the ANS producers have to the State, it is necessarily based on the myriad of cases and treatises that have addressed these oil and gas law issues. For the most part, these are collected in the end notes to avoid the discussion becoming bogged down in legal detail.

Terminology and Background

Because there are a variety of terms used to describe relations in an oil and gas lease context, it is helpful to address this subject first. The **lessor** here is obviously the State of Alaska. It owns the minerals. In return for a **royalty** (and a competitive bid bonus payment), the State has leased the subject ANS acreage to **lessees**.

The lessees are oil companies. The interests they own, which bear the costs of drilling and operating, are known as **working interests**. This is to be distinguished from a **royalty interest** which bears none of the costs of drilling or producing oil or gas. The **operator** is a working interest owner who assumes managerial duties on behalf of all of the working interest owners. Almost always, the operator owns the largest share of the working interest.

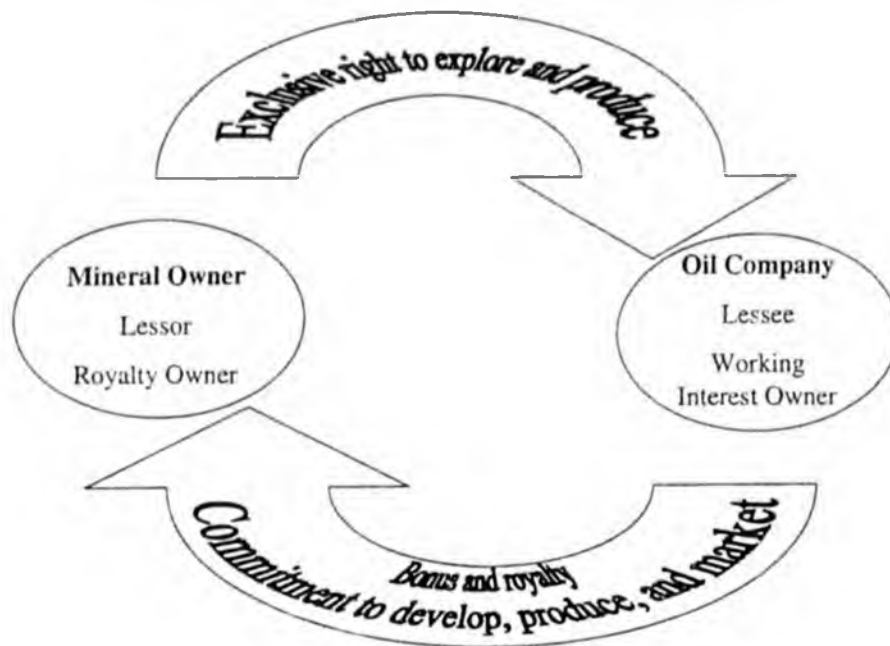
Throughout this report, the phrase **producers** is often used. This is meant to generically encompass the operator and all of the other working interest owners who each assume the same basic obligations. In this regard, it is worth noting that while lessees' duties are almost universally phrased in terms of the "*operator's*" duties, the same duties extend to all of the producers who are subject to the same forms of lease.

A **unit** is a collection of leases, or parts of leases, that are combined to more efficiently explore and develop the combined acreage. The Prudhoe Bay Unit is an example of a unit. Units are subject to approval by the Department of Natural Resources as well as the Alaska Oil and Gas Conservation Commission. Inside of the oil and gas units are **participating areas** which include that portion of the leases in a unit that cover a known or estimated accumulation of oil and gas and to which production is allocated by a unit agreement.

Development plans are periodic plans submitted by producers in which they are required to address "long range proposed development activities for the unit, including plans to delineate all underlying oil or gas reservoirs, bring the reservoirs into production, and maintain and enhance production once established" and the "details of the proposed operations for at least one year following submission of the plan." These plans are reviewed by the Commissioner of the Department of Natural Resources who must approve them.

Graphically, the basic rights and responsibilities that exist between the State as lessor and the ANS oil companies as lessees appear as follows:

What is conveyed by an oil and gas lease?



MISCONCEPTION NUMBER 1: The oil companies "own" the ANS gas.

Reality: The oil companies have the right to develop and market gas; however, that right has corresponding responsibilities. *If the producers do not meet their responsibilities, 100% of their rights to the ANS gas can be cancelled.*

There have been many references in discussions about the gas pipeline to the fact that the producers own or control the gas. The one I particularly like and sympathize with was former Chairman Ogan's question last Fall, "How [does] one get past the [reality] that the guys with the gas make the rules."¹ While I understand the sentiment, the fact is that the producers *do not own*, or for that matter entirely control the ANS gas, as a matter of law.

One normal incident of ownership is that an owner can decide to use or not use the property that they own.² For instance, an owner can decide to develop his or her property or not. Another incident of ownership is that an owner can choose to sell or not sell their property.³ Unless the State changes ownership, through for example exercising its condemnation powers, an owner's legal use of and decision to sell all or none of that property is *solely* up to the owner.

The producers do *not*, however, have a legal choice about whether or not to develop, produce and market the ANS gas reserves. Instead, under the oil and gas leases that we'll discuss momentarily, the producers are *expressly* required to reasonably develop and produce the ANS gas.⁴ Further, they must, in accordance with the common interpretation of oil and gas leases, market the ANS gas with reasonable diligence.⁵ Finally, and this is very important, *if* the producers breach their leases, they are subject to having their interests forfeited.⁶ That is expressly provided in the ANS producers' leases and will be discussed later in detail.

Now, what difference does all of this make? First, appreciating the limits on the producers' rights in ANS gas is necessary to understanding why the producers' decisions *are* the State's business. After all, if the producers really *owned* the gas, in a traditional sense, then how they use it would, as a matter of respect for property rights, *not* be the State's business. Second, because the producers' rights in this gas are conditioned upon them being diligent in their development, production and marketing, the State has every legal right to insist upon this as a means to further its interests as a royalty owner.

A good analogy to illustrate this difference between absolute ownership and more limited legal rights is a comparison of someone who owns their own business, say a hamburger stand, versus someone who owns say a McDonald's franchise. By comparing the attributes of these two different circumstances you get a good understanding of the difference between ownership of the ANS gas on the one hand and the far more limited rights that the producers possess here. Comparing these two circumstances, you find:

**Single Owner
Hamburger Stand**

McDonald's franchise

The owner holds 100%.

Many incidents of ownership, all *subject* to a franchise agreement.

Owner runs it however he or she pleases.

Must run it according to standards established in a franchise agreement.

No matter how it is run, the owner will remain *the owner*.

Failure to meet the franchise agreement standards will lead to *forfeiture* of the franchise.

As I hope throughout this testimony to illustrate, the ANS producers cannot fairly be portrayed as an owner in the same sense as our single hamburger stand owner. Instead, their rights are far more analogous to a McDonald's franchise. The ANS producers, like a franchise, have to meet standards and failing that the producers can totally lose their rights.

So, in summary on this point, the State, as mineral owner, has not fully conveyed its mineral interests. To the contrary, it has conveyed only the right to explore and produce, subject to requirements, including the possibility of forfeiture in the event of breach of the leases. In legal parlance, this more limited interest is generally known as a "fee simple determinable."⁷

With an appreciation of the fact that the ANS producers are not true owners of the gas, we can now turn to what extent the producers nonetheless can legally "control" *if and when* the ANS gas is produced and marketed.

MISCONCEPTION NUMBER 2: The oil companies have complete legal control over *if* and *when* the ANS gas is produced and marketed.

REALITY: The oil companies are subject to very specific duties to develop and market the ANS gas. The duties that the oil companies have include:

- (1) the duty to reasonably develop this acreage;
and
- (2) the duty to market the gas with reasonable prudence and diligence.

The violation of these duties would entail extraordinary financial consequences.

The duties to which I am referring are, as the end notes make clear, *very* well established in the American common law. In circumstances, such as the case here, where Alaskan courts have not addressed an issue, Alaska's rules of decision indicate that it will follow this law.⁸

While the duties to develop, produce and market are complementary, they are worth discussing separately since they have different origins and may have different remedies.

The ANS producers' development and production duties are expressly recognized in the leases and unit agreements. The standard modern form State of Alaska lease,⁹ provides in pertinent part:

13. DILIGENCE AND PREVENTION OF WASTE.

(a) The lessee *shall exercise reasonable diligence* in drilling, producing, and operating wells on the leased area unless consent to suspend operations temporarily is granted by the state.

(b) Upon discovery of oil or gas on the leased area in quantities that would appear to a reasonable and prudent operator to be sufficient to recover ordinary costs of

drilling, completing, and producing an additional well in the same geologic structure at another location with a *reasonable profit to the operator*, the lessee must drill those wells as a *reasonable and prudent operator* would drill, having due regard for the interest of the state as well as the interest of the lessee.

(c) The lessee shall perform all operations under this lease in a good and workmanlike manner in accordance with the methods and practices set out in the approved plan of operations and plan of development...

(Emphasis supplied.) Our review of other earlier State leases suggests each have functionally equivalent requirements.¹⁰ Furthermore, even in the absence of express requirements, courts have implied a duty to diligently develop.¹¹

In contrast to these development obligations, the Alaskan leases that we have reviewed do not provide for any *express* obligations to *market* production. This is not at all uncommon for oil and gas leases. In such circumstances, courts and commentators have long recognized that an *implied* duty to market exists.¹²

The duty to market obviously lies at the heart of the parties' purpose since without it the lessor (the State here) does not receive any royalty. As the New Mexico Supreme Court explained in *Darr v. Eldridge*,¹³:

Obviously production without disposition of the product is futile. Thus the courts have developed the implied covenant 'to make diligent efforts to market the production in order that the lessor may realize on his royalty interest.'

Courts, in cases involving leases similar to the State of Alaska leases, have found the existence of other requirements in leases – such as to “produce” or “develop,” further support an implied duty to market. In *Cole Petroleum Co. v. United States Gas & Oil Co.*,¹⁴ for example, the Texas Supreme Court explained:

Under the ordinary oil and gas lease, the lessee is not required to market the yield of the leased land at any certain time for any certain price. When the lease is silent on the subject, the lessee's duty is to exercise

ordinary or reasonable care. The assignment before us explicitly fixed the degree of care to be used by the assignee in proceeding to develop the lease to the normal stage of production as such care 'as is reasonably necessary'...Without the exercise of reasonable care to market the gas, there could be no compliance with the assignee's obligations to proceed with the development reasonable and necessary to bring the lease to a normal stage of production.

Similarly, other courts have reasoned that without the exercise of reasonable care in the marketing of gas, there could be no compliance with a lessee's obligations to proceed with reasonable development.¹⁵

The standard against which a producer's marketing efforts must be measured has been summarized by Professor Kramer¹⁶ as follows:

[M]odern courts, in reviewing the lessee's marketing efforts, have generally applied the reasonably prudent operator standard. Absent an express agreement altering the marketing duty, neither the lessee nor the lessor determine the duties owed under the marketing covenant. Instead, the decision turns on the facts, circumstances, and practical considerations presented in each case. Therefore, the lessee in any given case is compared to a hypothetical reasonable person engaged in oil and gas operations. Under such an objective standard, the lessee cannot justify his wrongful act or omission on the grounds that his course of action was reasonable based on circumstances peculiar to himself. Rather, the lessee's marketing activities are compared to those that would have been carried on by a reasonably prudent operator under similar circumstances. Where it is found that the lessee failed to meet this standard of conduct he will be liable for breach of the implied marketing covenant.

Ultimately therefore, the duties to develop and market turn on what a "reasonably prudent operator" would do in the same circumstances.¹⁷ In this case, the relevant circumstances would certainly include the fact that the reserves are

enormous, certain to exist (indeed gas is being produced daily), and the existence of a market.

Several cases address whether or not an operator was "reasonably prudent" in securing or failing to secure pipeline connections for gas. The most prominent and relevant case in this regard is *Cole Petroleum Co. v. United States Gas & Oil Co.*¹⁸ There, a lessor alleged that the producer had not used reasonable care to market the gas. The jury found for the lessor and specifically concluded that for over two years the producer had not sold and delivered gas to an available pipeline.¹⁹ The lease terms in *Cole* were very similar to the State leases here and the Texas Supreme Court found they supported an implied covenant to "exercise ordinary or reasonable care" in marketing.²⁰ The Texas Supreme Court also found that the producer's breach of the marketing covenant supported lease forfeiture where the lease provided as much upon the operator's failure "to fulfill any of the covenants of this agreement."²¹ The *Cole* case remains good law and has been repeatedly cited by courts across the land. It is *the* case that is the most on-point to the circumstances presented by the ANS leases.

Other cases have, like the *Cole* case, found that a lack of diligence in securing a pipeline connection or negotiating gas contracts is a breach of the producer's duty to market which renders a producer liable.²² Even in the cases where the courts have found the implied covenant to market was not breached, they have nevertheless emphasized the diligence that operators showed with respect to trying to secure, and in some cases actually securing, pipeline connections.²³ In each of these cases the courts recognized that the producers' attempts to and actually contracting with a pipeline were central to the issue of whether reasonable diligence in marketing had been shown.

A final factual issue that is key to how a reasonably prudent operator would interact with a pipeline (prospective or nearby) is the recognized need of such pipelines to secure long-term commitments from producers. Case law and legal commentators have repeatedly recognized this fact as an economic reality of the industry.²⁴

While Alaska oil and gas law is not well developed concerning the responsibilities of a lessee to a lessor, Alaska *does* have a body of law that is consistent with and complementary to the principles embodied in the other states' oil and gas law. Alaska law recognizes that in *every* contract there is an implied covenant of good faith and fair dealing that neither party will do anything which will injure the right of the other to receive the benefits of the agreement.²⁵ This

general requirement finds specific application when one party's obligations are subject to a condition precedent. In this case, a condition precedent to the ANS oil companies' duty to produce and sell the ANS gas is the existence of a market for that gas.

Alaska law makes clear that *if* a party such as the ANS oil companies take steps to impede the condition from occurring, or even fails to cooperate in helping the condition to occur, then the oil companies can be liable as though the condition had occurred.²⁶ It is worth emphasizing that the duty imposed under this doctrine is not only to avoid "hindering" a condition, but also to "cooperate" and actually take affirmative steps to cause its occurrence.²⁷

One final point should be made with respect to what is and what is *not* required from producers. There is strong authority supporting the position that a producer is not itself required to build a pipeline.²⁸

MISCONCEPTION NUMBER 3: The oil companies can choose how much profit that they want and delay developing or marketing the ANS gas until their profit goals, through State concessions or otherwise, are met.

REALITY: The terms of the leases and the common law more generally require the oil companies to develop and market the ANS gas if and when they have a "reasonable expectation of profit." That unquestionably *now* exists for ANS gas.

An important corollary to the "reasonably prudent operator" standard is that such an operator *will* act if and when there is a "reasonable expectation of profit."²⁹ As the Colorado Court of Appeals in *Whitman Farms v. City of Longmont*,³⁰ recently explained:

When, as here, there is a proven field of oil or gas, courts have held that a lessee is required to further develop the lease when there is a reasonable expectation that one or more new wells would generate enough revenue to cover the cost of development and return a reasonable profit. Thus, when a prudent operator would have a reasonable expectation of such economic viability and a lessee is not developing the field, it is proper to conclude that the lessee has breached the covenant of reasonable development and to grant an equitable termination to the lessor.

In light of this description of the law, it is worthwhile to examine the oil company decision-making process that may be associated with any proposed gas pipeline. This Committee last Fall heard testimony from the ANS producers as well as a former ARCO executive describing how oil companies generally approach big projects from a capital budgeting perspective.³¹ One aspect of that budgeting process involved oil companies deciding whether capital projects were "discretionary" or "nondiscretionary."³²

By way of illustration, an oil company divides the items that it considers for inclusion in its capital budget as falling into two basic categories:

Non-Discretionary

1. Mandatory health, safety and environmental investments.
2. Projects where concessions will disappear; leases will be lost.

Discretionary

1. Project #1.
 2. Project #2.
 3. Project #3.
- Etc.

How does this discretionary/non-discretionary distinction relate to the development and marketing obligations these producers have with respect to ANS gas? We know – given that more than thirty years have passed since discovery of the ANS gas reserves *without* a pipeline – that the ANS gas pipeline has been seen as “discretionary.” Whereas, for instance, Qatar, Venezuela, Nigeria, etc. have set firm deadlines making their projects “non-discretionary”, the oil companies evidently perceive no such urgency in Alaska. I like the analogy I recently heard that the Alaska gas pipeline project has been viewed like a grocery product with no “expiration date” whereas other projects evidently do have expiration dates.

There is, however, good news in that circumstances now exist that should move the development of ANS gas from the discretionary category to the non-discretionary category of projects. The ANS producers now have enormous reserves, a market and therefore a more than reasonable expectation of profit. Graphically, the equation is:

$$\begin{array}{ccccccc} \text{Extraordinary} & + & \text{Minimal} & + & \text{Strong} & = & \text{More Than a} \\ \text{Reserves} & & \text{Production} & & \text{Market} & & \text{Reasonable} \\ & & \text{Expense} & & & & \text{Expectation} \\ & & & & & & \text{of Profit} \end{array}$$

These combined facts mean that it should no longer be “discretionary” for the oil companies to market the gas – instead they *must* diligently market the gas.

A second aspect of the way that oil companies decide when and where to invest is the distinction between “non-commercial,” “commercial” and “competitive” projects. This categorization of projects by oil companies was likewise the subject of testimony before this committee last Fall.³³ “Non-commercial” projects are projects that are *not* calculated to return their costs,

including the costs of capital. "Commercial" projects return their costs, including capital costs plus something. "Competitive" projects, are projects with high enough returns to rank at the top of the oil companies' capital budgets.

Historically, development of the ANS gas has been perceived as either non-commercial, or commercial but *not* competitive. Obviously, the project has *never* been seen as competitive. The law, however, requires that the project be pursued *if* it is *commercial* to the extent of involving "a reasonable expectation of profit."³⁴ Here, after only relatively minor infrastructure adjustments, the producers would be paid a billion or more dollars a year for thirty years. That level of profit is simply extraordinary.

If the ANS oil companies themselves were being asked to shoulder the burden of building a pipeline, then the risks involved in building that pipeline might have relevance. When, however, other parties are ready, willing and able to construct a pipeline, the profit that the oil companies are looking at is simply "off the charts" and risk free.

In summary on this issue, doing nothing in the face of an available market is not an alternative that the law affords to the oil companies. Warehousing reserves, or as the courts have typically described this behavior, holding leases for "speculative" purposes, is uniformly regarded as unacceptable.³⁵ "Leases of this kind contemplate exploration and development, and not the bottling up of land for speculative or other purposes or the postponement of reasonable development..."³⁶

MISCONCEPTION NUMBER 4: The oil companies, by owning the ANS leases, have the legal right to dictate the location and ownership of the pipeline.

REALITY: The oil companies have a duty to prudently develop and market the ANS gas, independent of any profit-making plans they have concerning the pipeline or *other* projects.

Further, under the antitrust laws, the oil companies *cannot* use their monopoly over the ANS gas to monopolize the pipeline or impede competition. To do so, would mean that the oil companies were engaged in "monopoly leveraging" a practice in direct violation of the antitrust laws.

The law does not allow the ANS oil companies to compromise their performance under the ANS leases to serve separate corporate profit objectives. To the contrary, the oil companies must consider what a reasonably prudent operator holding *just this lease(s)* would do, not how that oil company can overall make money by using these leases to leverage their way into, for instance, the pipeline project.³⁷ This aspect of a producer's duty has most frequently been declared by the courts in the context of producers sacrificing one property for the benefit of another; for example, where one property was produced less so that another could produce more. Not surprisingly, this has been held to violate the reasonably prudent operator standard.³⁸ The same principle has also been used to declare invalid a producer's attempt to use gas to satisfy other corporate obligations.³⁹

Independent of their obligations as lessees under the ANS leases, the producers are also prohibited by federal⁴⁰ and Alaska⁴¹ antitrust laws from using any monopoly over ANS gas to establish a monopoly over the pipeline. The federal courts have recognized that the Sherman Antitrust Act § 2 (monopolization) is violated when a party possessing a monopoly, or market power, seeks to use that market power to gain a competitive advantage in another market. "Leveraging" is a monopolist's use of power in one market to gain an advantage in a related market, or power held in one time period to gain advantage in a later period. Often, the leveraging occurs in a vertical context, as when an upstream producer with monopoly power uses that power to gain advantage in a downstream market.⁴²

Section 2 of the Sherman Act focuses on the wrongful wielding or maintenance of monopoly power, or attempts to monopolize. A monopoly

involves action by a single entity. A joint venture is such an entity. Alaska has a well established definition of a joint venture.⁴³

Here, a combination of the producers clearly possesses monopoly power over the sale of gas from the North Slope. This group controls roughly 90% of the ANS gas, excluding the royalty. If this upstream monopoly were to be used as leverage to discourage competition for a pipeline, and to thereby extend monopoly power into the downstream market for the transportation of the gas, this would violate the anti-trust laws. Such leveraging would injure the State by preventing it from receiving royalty as well as severance taxes.

The anti-trust laws obviously exist to protect competition in the transportation of ANS gas. This is precisely the kind of relevant market that the antitrust laws were intended to protect as the court in *Woods Exploration Producing Co. v. Aluminum Co.*,⁴⁴ explained:

When one must "look" for a monopoly, determining a relevant market in which to look and in which to evaluate competitive effects is obviously an essential first step. But when, with an illegal practice such as is present here in mind, one can look at an area and see the existence of monopoly power, not by inference from market share, but by determining actual ability to exclude competition and control prices, there appears no real need to go further.

Section 1 of the Sherman Act deals with combinations in restraint of trade, a subject that will be more fully discussed in the last section of this presentation. The point to note here is that absent a joint venture, the same acts can also be characterized as a combination in restraint of trade which is a § 1 violation.

MISCONCEPTION NUMBER 5: The State is in a relatively weak negotiating position with the oil companies.

REALITY: Precisely the opposite is true. The State is in an extraordinarily strong position to insist on diligent marketing of ANS gas for three reasons:

1. The State can insist on diligent marketing of the ANS gas and if the oil companies refuse the leases can be cancelled.;
2. *If* the oil companies insist on *not* marketing Alaska's stranded gas, the damages would be measured by the amount of royalty that *should* have been, but was not paid. This would amount to *many* billions of dollars.; and
3. A concerted "refusal to deal" in the sense of refusing to sell the Alaskan gas into an available market is anticompetitive and actionable under the antitrust laws. These laws provide mandatory treble damages and injunctive relief.

Let me address each of these three points in order.

First, as noted, the State leases provide what in the oil and gas legal world is a very strong and uncommon remedy. If the oil companies breach their lease, the Commissioner of the Department of Natural Resources, can cancel them. In this regard, the Alaska standard form of lease provides:

20. DEFAULT AND TERMINATION; CANCELLATION. (a) The failure of the lessee to perform timely its obligations under this lease, or the failure of the lessee otherwise to abide by all express and implied provisions of this lease, is a default of the lessee's obligations under this lease. Whenever the lessee fails to comply with any of the provisions of this lease...and fails within 60 days after written notice of that default to begin and diligently prosecute operations to remedy that default, the state may terminate this lease if at the time

of termination there is no well on the leased area capable of producing oil or gas in paying quantities. If there is a well on the leased area capable of producing oil or gas in paying quantities, this lease may be terminated by an appropriate judicial proceeding....⁴⁵

This remedy is recognized as being available by legal scholars, including Professor W.L. Summers, who sees no doubt as to the entitlement to cancellation as a remedy for breach of the covenant to market:

*If the lease contains an express provision for forfeiture of the lease for breach of all covenants thereof, which, either by express terms, or by construction of the court, includes implied covenants, and has the effect of making them conditions, there would seem to be no doubt that the lessor is entitled to declare a forfeiture for breach of the implied covenant to market and recover in an action to quiet title or cancel the lease.*⁴⁶

It is hard to convey how extraordinary and significant this remedy is in the context of getting the Alaskan gas reserves developed. It is extraordinary in the sense that I would estimate that *far less than one percent* of all leases between private royalty owners and producers contain such a remedy. It is *significant* in the sense that *if* the ANS producers breach their duties, they can legally lose the entirety – 100% of their interests which reverts back to the State of Alaska.

A second aspect of the strength of the State's position is that the oil companies could, if they neglect to market Alaska's stranded gas, face very large damage claims. In cases where producers have breached their duties to develop or market oil or gas, producers have been held responsible by courts for all of the royalty that would have been paid *if* the producer had acted prudently.⁴⁷ Professor Kuntz summarized the damages remedy as follows:

Damages are recoverable for breach of the implied duty to market the product. It has been held that...damages may be recovered concurrently with cancellation of the lease....The measure of damages for breach of the implied duty to market the product is the royalty which the lessor would have received if the product had been marketed.⁴⁸

The losses that the State might seek to recover would not be fanciful. The fact is that *every day* that is lost in the development of this gas means that 3-4 billion cubic feet or so of gas effectively goes to the end of a 20-30 year line, perhaps worse. What do I mean by "going to the end of the line?" The gas, of course does not go away. But if the pipeline is delayed a year then that means that Alaska instead of receiving royalty and taxes in year one, only replaces *that* royalty and taxes, *if ever*, when the pipeline delivers its last gas. To make matters worse, if there is even a small percentage of the reserves projected as probable to be found in Northern Alaska, it is likely that the first year, or however long, effectively never gets made up.

Thirdly, the State's negotiating position is strong because the antitrust laws are very powerful means to preserve competition. As noted earlier, if the producers combine to refuse to sell ANS gas, then they may be liable under § 1 of the Sherman Antitrust Act.

Generally speaking, every company has the right to choose to do business with someone else or not. That is a basic tenet of our civil liberty. But when two or more persons agree not to do business with another, the potential for a combination in restraint of trade violating § 1 of the Sherman Act arises. An early example of this concerned a group of retail lumber dealers who agreed to boycott the business of a lumber wholesaler who also sold direct to consumers.⁴⁹ In another case, the Supreme Court found a § 1 violation when the NYSE and its member traders agreed to remove private phone lines to non-member traders, effectively denying them access to the market.⁵⁰

Normally, concerted refusals to deal, or boycotts, are reviewed by the courts using a *per se* analysis. The *per se* rule means that any concerted refusal to deal is presumed to have anticompetitive effects warranting § 1 liability. In 1985, the Supreme Court modified this analysis slightly in the context of a business cooperative that excluded one of its members, which thereby deprived the excluded member of a pricing advantage. In that context, the Supreme Court held that the *per se* analysis is not correctly applied unless there is a showing that the business cooperative has "market power or unique access to a business element necessary for effective competition."⁵¹ To the extent, if any, that this modification to a *per se* analysis applies to the present circumstances, which is doubtful, it is nevertheless clear that the requisite market power exists here and, could be exercised to control the ANS gas, which is essential to effective competition.

A "concerted refusal to deal" can also involve anticompetitive conduct by a monopolist creating a § 2 violation. An example is *Consolidated Gas Co. of Florida, Inc. v. City Gas Co. of Florida, Inc.*,⁵² which has some similarities to the present circumstances. Consolidated was a small retail distributor of propane. City Gas held a monopoly on retail gas distribution over a large area of Florida, fully enveloping Consolidated's customers. The price differentials between propane and natural gas made it essential that Consolidated convert to natural gas, but it could only economically do so by purchasing the gas from City Gas. City Gas refused to sell gas at a reasonable price, offered to buy-out Consolidated at a low price, and simultaneously embarked on a marketing campaign to take away Consolidated's customers. The court held that the refusal to sell was an anticompetitive attempt to maintain a monopoly in violation of § 2 of the Sherman Act. Among other things, the court enjoined City Gas to sell Consolidated gas at reasonable prices (which at that time and place was regulated by a state agency).

Similarly a monopolist unlawfully maintains its monopoly in violation of § 2 of the Sherman Act when the monopolist controls a scarce facility, to which it refuses its competitors reasonable access. This is sometimes referred to as the "essential facilities" doctrine. In the seminal case of *Otter Tail Power Co. v. United States*,⁵³ Otter Tail controlled an electric power distribution system, access to which it denied to new municipal systems. The distribution system was an essential facility to any "would be" competitor. The Supreme Court affirmed the finding of a § 2 violation and the district court's injunction that Otter Tail sell wholesale electricity to the municipal systems. As for the present circumstances, the North Slope production facility is quite arguably an essential facility to any gas marketer or transporter. Depending on the characterization of the producers' combination as either a joint venture or an agreement, the producers' refusal to sell the ANS gas, or to allow access to the gas, could be either a § 1 or a § 2 violation.

The damages awardable under the antitrust laws are automatically trebled.⁵⁴ In addition, 15 U.S.C. § 26 provides that any person may obtain injunctive relief "against threatened loss or damage by a violation of the antitrust laws." In a request for injunctive relief there is no necessity to prove actual damages, but only a threatened loss or damage.

CONCLUSION

It is a *misconception* that the State of Alaska cannot insist on the oil companies complying with their established duties to develop and market the ANS gas. The same oil and gas leases under which the ANS producers have benefited from the production of over 14 billion barrels of oil, also have burdens.

I think it is hard to overstate the importance of the Port Authority's being ready, willing and able to build a pipeline and buy ANS gas to the subject under discussion. In light of this market, the development of ANS gas can absolutely no longer be characterized as "discretionary." In fact, as of the Port Authority's offer, it can fairly be said the ANS gas is no longer stranded.

Unquestionably, Alaska has the power to compel the development and marketing of ANS gas reserves. If, how and when it exercises that power is up to Alaska's stewards, including this body as well as the Executive branch.

Endnotes

¹ Legislature Budget and Audit Committee, Stranded Gas Hearings, [Port Authority Testimony] June 16, 2004, p. 3.

² *Joseph M. Jackovich Revocable Trust v. State of Alaska*, 54 P.3d 294, 299 (Alaska 2002), quoting, *Lange v. State*, 86 Wash.2d 585, 547 P.2d 282, 288 (Wash. 1976) ("Thus appellants were deprived of the most important incidents of ownership, the rights to use an alienate property.")

³ *Id.*

⁴ See notes 9-11 and accompanying text, *supra*.

⁵ See notes 12-16 and accompanying text, *supra*.

⁶ See notes 48-49 and accompanying text, *supra*.

⁷ *Jupiter Oil Co. v. Gene M. Snow*, 819 S.W.2d 466, 468 (Tex. 1991) ("The common oil and gas lease is a fee simple determinable estate in the realty.... A possibility of reverter is the interest left in a grantor after the grant of a fee simple determinable. ...The grantor's possibility of reverter in the mineral interest only upon the termination of the lease. ...Thus, upon the termination of the lease, the mineral estate ordinarily reverts to the grantors of the lease, their heirs or assigns."). There is a distinction that I want to draw from a very strict legal standpoint, lest there be later confusion about my point. There is a raging academic (in both senses of the word) debate in oil and gas law about the fundamental nature of oil and gas rights. Bennett, Jared C., *Ownership of Transmigratory Minerals, Utah and Zebras. Proof that Oil and Gas Ownership Law Needs Reform*, 21 J. Land Resources & Environmental L. 349, 349 (2001) ("some scholars contend that the debate over theories of ownership are about as useful as arguing over whether a zebra is a black horse with white stripes or a white horse with black stripes.") Some states, such as Texas, consider a mineral owner as owning the minerals in the ground and are referred to as "ownership-in-place" jurisdictions. *Id.* at 351-2. Other jurisdictions, including the United States Supreme Court, have rejected that ownership characterization and are referred to as "non-ownership in place" jurisdictions, or in some cases "qualified ownership in place" jurisdictions. *Id.* pp. 359-60. Because all states recognize that until produced an owner is subject to the "rule of capture," there is for the most part no practical difference in the two theories. Wherever Alaska might fall in this debate, and its courts have not yet weighed in, the fundamental restrictions on the producers' ownership interests discussed herein remain.

⁸ In circumstances where Alaska has yet to decide an issue of law, it looks to the common law as established by other states. See ALASKA STAT. § 0.10.010 (2004) ("So much of the common law not inconsistent with the Constitution of the State of Alaska or the Constitution of the United States or with any law passed by the legislature of the State of Alaska is the rule of decision in this state"). This approach has been specifically endorsed by Alaska's Supreme Court in the

absence of prior Alaskan case law. *Guin v. Young*, 591 P.2d 1281, 1284 n. 6 (Alaska 1979) ("Our duty is to adopt the rule of law that is most persuasive in light of precedent, reason and policy.").

⁹ State of Alaska, Department of Natural Resources, Competitive Oil and Gas Lease Form #DOG200204 (re. 10/2003), p. 6.

¹⁰ See e.g., State of Alaska, Department of Natural Resources, Competitive Oil and Gas Lease Form #DOG 9609 (Revised 6/97) § 13, p. 5; State of Alaska, Department of Natural Resources, Competitive Oil and Gas Lease Form #DO&G-24-84 (Royalty)(Revised 8/84) DNR 10-1185 § 13, p. 4; State of Alaska, Department of Natural Resources, Division of Minerals and Energy Management, Competitive Oil and Gas Lease Form No. DMEM-1-79A (Net Profit Share) (Revised November 5, 1979) § 21, p. 4; State of Alaska, Department of Natural Resources, Division of Lands, Competitive Oil and Gas Lease Form No. DL-1 (Revised Oct. 1963) § 20, p. 2.

¹¹ The status of the common law concerning the implied duty to develop was summarized by Professor Richard W. Hemingway in *THE LAW OF OIL AND GAS* § 8.3, p. 544 (3d Ed. 1991) as follows:

All jurisdictions impose a prudent operator rule to determine whether lease development satisfies the implied covenant of further development. This rule requires that operations be mutually profitable to both lessor and lessee and be diligently prosecuted in relation to the circumstances in each case. Within such relationship the lessee has an implied duty, after production is acquired, to develop the lease to its fullest extent.

See also, *Sauder v. Mid-Continent Petroleum Corp.*, 292 U.S. 272, 280 (1934) ("Whatever, in the circumstances, would be reasonably expected of operators of ordinary prudence, having regard to the interests of both lessor and lessee, is what is required."); *Mize v. Exxon Corp.*, 640 F.2d 637, 641 (5th Cir. 1981)(collecting cases)("The rule imposing a duty of reasonable development is widely recognized."); *Chenoweth v. Pan American Petroleum Corp.*, 314 F.2d 63, 65-6 (10th Cir. 1963)("In cases questioning the development done by an operator under the prudent operator rule, the actions of the operator are examined item by item. This is essentially a comparison of his acts with standards or practices then prevailing in the area all in the context of economics."); *Meaher v. Getty Oil Co.*, 450 So.2d 443, 446 (Ala. 1984)("implied covenants to reasonably develop the leased lands, recognized to exist in every oil and gas lease, continue to obligate the lessee to develop all the leased lands, both within and without the producing unit."); *Byrd v. Bradham*, 280 Ark. 11, 14, 655 S.W. 2d 366, 367 (1983)("In oil and gas leases where royalties constitute the chief consideration, an implied covenant exists that the lessee will explore and develop the property with reasonable diligence."); *Olson v. Schwartz*, 345 N.W.2d 33, 38 (N.Dak. 1984)("It is well settled that the lessee of an oil and gas lease has an implied obligation to the lessor to do everything that a reasonably prudent operator would do in operating, developing, and protecting the property, with due consideration being given to the interests of

both the lessor and the lessee, if there is no express clause in the lease relieving the lessee of this implied duty."); *Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*, 925 S.W.2d 565, 572 (Tex. 1996) ("to fulfill its obligations to lessors [under the 'implied covenant to reasonably develop'] a gas producer must drill additional wells as would a reasonably prudent operator"); *Sonat Exploration Co. v. Superior Oil Co.*, 710 P.2d 221, 224 (Wyo. 1985)("It is well established that oil and gas leases such as that with which we are concerned contain an implied covenant of development."). The Alaska Supreme Court, in passing on other issues, noted the existence of an implied covenant to develop in *Baxley v. State of Alaska*, 958 P.2d 422, 427 (1998)(All of the State's oil and gas leases contain an implied covenant for lessees to "diligently explore and develop their leases.")

It is worth noting that cases addressing the implied covenant to develop are often referred to in analyzing express provisions requiring "reasonable developments." See e.g., *Atlantic Richfield Co. v. Gruy*, 720 S.W.2d 121 (Tex. App. – San Antonio 1986, writ ref'd n.r.e.)(a lessor who asserted a breach of an express covenant to develop where lease required development with "due diligence" must show a reasonable probability of profit from the additional drilling).

¹² An established statement of the implied covenant to market is found in W.L. SUMMERS, 2 THE LAW OF OIL AND GAS § 400, pp. 582-3 (1959 and 2004 Supp.)(collecting cases):

In the absence of such a duty [to market expressed in a lease], the courts, on the same theory that they imply covenants to test and develop, imply a covenant on part of the lessee to market the oil and gas produced. It would be of little benefit to the lessor to have express or implied covenants on part of the lessee to test, develop, and protect the land by drilling wells, if the lessee might cap them and refuse to market the product.

See also, RICHARD W. HEMINGWAY, THE LAW OF OIL AND GAS, § 8.9(c), p. 577 (3d Ed. 1991) ("As in the case of the covenant to produce, the lessee is also under an implied obligation to market with due diligence the products produced. Obviously, without marketing the lessor will not realize any benefit from the lease.").

The case law supporting the implied duty to market is legion. See e.g., *Wolfe v. Texas Co.*, 83 F.2d 425, 432 (10th Cir.), *cert. denied*, 299 U.S. 553 (1936)("In the absence of an express provision in an oil and gas lease with respect to marketing the production there is an implied duty on the part of the lessee to make diligent efforts to market the production in order that the lessor may realize on his royalty interest."); *Craig v. Champlin Petroleum Co.*, 300 F.Supp. 119, 125 (W.D. Okla. 1969), *aff'd*, 421 F.2d 236 (10th Cir. 1970)(a "lessee under oil and gas leases involved in this case has implied duty and obligation in the exercise of reasonable diligence, as a prudent operator...to obtain a market for gas...at the prevailing market price therefore. [citations omitted] A failure to comply with such duty...renders the defendants liable to the plaintiffs for any resulting loss."); *Davis v. Cramer*, 808 P.2d 358, 361 (Col. 1991)(*en banc*)("Embodied in the covenant to operate diligently and prudently is the implied covenant to market."); *Daughetee v. Ohio Oil Co.*, 263 Ill. 518, 523, 105 N.E. 308 (1914)(there is an implied obligation upon the

lessee "to fully develop the premises and market the oil or gas found."); *Gilmore v. Superior Oil Co.*, 192 Kan. 388, 392, 388 P.2d 602, 606 (Kansas 1964) ("Kansas has always recognized the duty of the lessee under an oil and gas lease not only to find if there is oil and gas, but to use reasonable diligence in finding a market for the product, or run the risk of causing the lease to lapse...in the absence of an express provision of the lease creating such duty, the lessee is under an implied obligation to exercise reasonable diligence in marketing the gas produced."); *Caskey v. Kelly Oil Co.*, 737 So.2d 1257, 1261 (La. 1999)(Louisiana recognizes "the obligation to diligently market the minerals discovered and capable of production in paying quantities."); *Severson v. Barstow*, 103 Mont. 526, 63 P.2d 1022, 1024 (Mont. 1936)("Where, as here, the principal consideration for a lease is the payment of royalty, the lease carries an implied covenant to use reasonable diligence to market the product when produced, although the lease is silent on the subject, and whatever is implied in a contract is as effectual as what is expressed..."); *Townsend v. Creekmore-Rooney Co.*, 358 P.2d 1103, 1104 (Okla. 1960)("Where the oil and gas lease does not, in express terms, provide for the marketing of production discovered under the lease, the lessee is under an implied covenant only to market production within a reasonable time. In complying with said covenant the lessee must exercise due diligence in securing a market or a new market, if the one secured proves unsatisfactory. The matter of whether the lessee exercised due diligence in obtaining a satisfactory market within a reasonable time depends upon the facts of each case."); *Berry Energy Consultants v. Bennett*, 175 W.Va. 92, 97 33 S.E.2d 823, 828 (W. Va. 1985)("the lessees in this action had an obligation to be reasonably diligent in marketing the gas. As indicated above, the parties entered into the lease for the purpose of 'exploring and operating for' and 'producing and marketing' oil and gas"); *Tuna Oil & Gas Corp. v. Bates*, 978 S.W.2d 735, 739 (Tex. App. 1998)("Oil and gas law in Texas recognizes an implied covenant in gas leases such that a lessee must use due diligence to market the oil or gas produced within a reasonable time and at a reasonable price...[t]he behavior of a lessee in this regard must conform to the standard of a reasonably prudent operator.").

¹³ 66 N.M. 260, 263, 346 P.2d 1041 (N.Mex. 1959).

¹⁴ 41 S.W.2d 414, 121 Tex. 59 (1931).

¹⁵ See also, *Eggleston v. McCasland*, 98 F.Supp. 693, 695 (Okla. 1951)("Generally, even in the absence of an express covenant to produce and market, there is an implied covenant that the lessee will do so. * * * In this lease, there is an express covenant to produce, and the covenant to market will be implied."); *Carroll Gas & Oil Co. v. Skaggs*, 231 Ky. 284, 21 S.W.2d 445, 447 (Ky. Ct. App. 1929)(a "lessee is under a duty to market the oil or gas found in the land," and there is a "necessary inference" from the lease clause providing for payment of royalty "that the gas was to be marketed within a reasonable time."); *Molter v. Lewis*, 156 Kan. 544, 549, 134 P.2d 404 (Kan. 1943)("It would be of little benefit to the lessor to have express or implied covenants on the part of the lessee to test, develop, and protect the land by drilling wells, if the lessee might cap them and refuse to market the product.").

¹⁶ Bruce M. Kramer and Chris Pearson, *The Implied Marketing Covenant in Oil and Gas Leases: Some Needed Changes for the 80's*, 46 LA. L.REV. 787, 810-11 (1986)(notes omitted).

¹⁷ As in a typical tort situation, the "reasonable prudence" of an operator is determined in light of all of the pertinent circumstances. The Colorado Supreme Court explained this in *Davis v. Cramer*, 808 P.2d 358, 363 (Colo. 1991):

The covenant to market requires that the lessees exercise reasonable diligence to market the products. Reasonable diligence is whatever, in the circumstances, would be reasonably expected of all operators of ordinary prudence, having regard to the interests of both lessor and lessee. . . .The existence of reasonable diligence is primarily a question of fact.

¹⁸ 121 Tex. 59, 41 S.W.2d 414 (Tex. 1931).

¹⁹ 41 S.W.2d at 415-6.

²⁰ 41 S.W.2d at 416.

²¹ 41 S.W.2d at 417.

²² One case applying the implied covenant to market in a failure to secure pipeline connection situation is *Crain v. Hill Resources, Inc.*, 972 P.2d 1179, 1181 (Okla. Ct. App. 1998). In *Crain*, the "wells were never hooked up to a pipeline," and the court found that therefore the "lessees failed to comply with the implied covenant to market the gas and cancelled the lease." Another case presents an analogous circumstance concerning a producer's failure to prudently market gas. The Colorado Court of Appeals in *Davis v. Cramer*, 837 P.2d 218, (Colo. Ct. App. - 1992) upheld the trial court's determination that the implied covenant to market had been breached during the primary term of the oil and gas lease; the well was completed in 1972 and the pipeline was completed near the well in 1975, but product was not marketed until 1978. The court found lease cancellation to be an appropriate remedy. In *Barby v. Cabot Corp.*, 550 F.Supp. 188, 190 (W.D. Okla. 1981) the court found "[d]efendant was dilatory in renegotiating" expired gas contracts. Given this conclusion, the court found that damages were appropriate for "Defendant's breach of its duty to diligently market the gas produced."

²³ See e.g., *Christianson v. Champlin Refining Co.*, 169 F.2d 207, 210 (10th Cir. 1948)(In determining whether an operator had "exercise[d] due diligence" the court emphasized the defendants "secure[d] within a year the construction of an expensive pipe line and made it possible to market the gas which was an inferior quality, which in itself, entailed additional difficulty, and were actually marketing the gas from the well within fifteen months from the date of completion."); *Tate v. Stanolind Oil Co.*, 172 Kan. 351, 358 240 P.2d 465, 470-71 (Kan. 1952)(In deciding whether marketing had occurred "within a reasonable time," the court considered that the pipeline "refused to take the gas," and the producer "proceeded before the commission to compel" the pipeline to take it and the pipeline "then agreed to do so."); *Fey v.*

A.A. Oil Corp., 129 Mont. 300, 320 285 P.2d 578, 588 (Mon. 1955) (In determining "[w]hether due diligence [in marketing] has been exercised," the court emphasized that "[t]he record is replete with the efforts of defendants to procure a pipe line company that would take the gas at the profit to lessors and lessees."); *Commissioners of the Land Office v. Carter Oil Co. of W. Va.*, 336 P.2d 1086, 1096 (Okla. 1958) (In determining whether "due diligence was exercised in the seeking and obtaining of a market" the court considered the fact that "[c]ontinued negotiations were carried on with other [potential buyers] and the operator found a buyer "taking the gas from the well head.").

²⁴ Holliman, *Exxon Corp. v. Middleton: Some Answers but Additional Confusion in the Volatile Area of Market Value Gas Royalty Litigation*, 13 St. Mary's L.J. 1, 6 (1981).

Unlike liquid hydrocarbons, gas cannot be stored in surface containers, nor can it be transported by truck. Rather, gas normally is marketable only when the reserves in the field where the lease is situated justify the sizeable capital expenditure necessary to construct and lay a pipeline capable of transporting the gas to its market destination. Pipeline systems, of course, are complex creatures and are quite expensive to construct. Investors traditionally have not been willing to build pipelines unless gas is available in a sufficient quantity and has been committed to the pipeline for an adequately long period, thereby providing the investors with reasonable assurance that they will make a profit on their investment. Thus, the justification for the capital expenditure necessary to construct the pipeline usually comes in the form of long-term gas sale contracts which effectively commit the volume of gas to be sold to the purchaser who will transport the gas through its pipeline to the point of consumption.

See also, *Panhandle Eastern Pipe Line Co. v. The United States*, 187 Ct. Cl. 129, 170 408 F.2d 690 (Ct. Cl. 1969)("Since pipelines are expensive to construct, pipeline companies have been required to insure for themselves long-term supplies of natural gas in order to amortize their investments..."); *The Superior Oil Co. v. Western Slope Gas Co.*, 549 F.Supp. 463, 469 (D. Colo. 1982)("Because gas purchasers must make substantial capital outlays in order to move the gas product to the retail consumer, they require same assurance that sufficient long-term supplies of gas will be available to them.").

The Oklahoma Supreme Court recognized the connection between the duty to market and such long-term commitments in *Tara Petroleum Corp. v. Hughey*, 630 P.2d 1269, 1273 (Okla. 1981), (footnotes omitted) when it stated:

Once a producing well is drilled, a producer has a duty to market the gas. In order to market gas it is usually necessary to enter into a gas purchase contract – frequently a long term one...We have

recognized this necessity of the market, and we believe that lessors and lessees know and consider it when they negotiate oil and gas leases.

See also, Hillard v. Stephens, 276 Ark. 545, 550, 637 S.W.2d 581, 583-4 (Ark. 1982) ("Once the lessee-producer drills a well resulting in the commercial production of natural gas on the leased premises, the lessee-producer has the immediate duty to market the gas. In order to market such gas effectively, it is the custom in the industry and is usually necessary for the lessee-producer to sell the gas under a long-term gas purchase contract.").

²⁵ Alaskan law concerning the duty of good faith and fair dealing in contracts was summarized by the court in *Guin v. Ha*, 591 P.2d 1281, 1291 (Alaska 1979):

In every contract, including policies of insurance, there is an implied covenant of good faith and fair dealing that neither party will do anything which will injure the right of the other to receive the benefits of the agreement.

²⁶ The Alaska Supreme Court explained in *Mitford v. de Lasala*, 666 P.2d 1000, 1006 (1983):

Restatement (Second) of Contracts § 205 (1981) provides:

Every contract imposes upon each party a duty of good faith and fair dealing in its performance or its enforcement.

The prevention doctrine is subsumed in this duty under the view of the new Restatement. *Id.* comment d (among judicially recognized types of bad faith is "interference with or failure to cooperate in the other party's performance.").

²⁷ As the court in *Casey v. Semco Energy, Inc.*, 92 P.3d 379, 384-5 (Alaska 2004) (internal quotes omitted) explained:

The covenant of good faith and fair dealing is implied in all contracts in Alaska. Where a party has promised to attempt to satisfy a condition, the attempt must be made in good faith. A party must act in subjective good faith, meaning that it cannot act to deprive the other party of the explicit benefits of the contract, and in objective good faith, which consists of acting in a manner that a reasonable person would regard as fair. Where a duty of one party is subject to the occurrence of a condition, the additional duty of good faith and fair dealing . . . may require . . . refraining from conduct that will prevent or hinder the occurrence of that condition or . . . taking affirmative steps to cause its occurrence.

See also, *Aronoff v. The Linkin Co.*, 618 A.2d 669, 682 (D.C. Cir. 1992)("There is an implied covenant in each contract that the parties will 'extend reasonable cooperation' in clearing the way for performance.").

²⁸ Notwithstanding the general implied duty to market, substantial authority can be mustered for the proposition that lessees, in discharging this duty, are not required to undertake expensive projects and risks in constructing a pipeline to take oil or gas to market. *Kretzi Development Co. v. Consolidated Oil Corp.*, 74 F.2d 497, 500 (10th Cir. 1934)("It may be conceded for the purpose of this case that a lessee is obligated to put forward a reasonable effort to market gas produced on the leased premises, but certainly that duty does not extend to the point of providing pipe line facilities ninety miles in length at a large outlay of money with an attending financial hazard due to possible exhaustion of the supply and other frequently encountered factors, in order to reach a market at which the product may be sold."); *Matzen v. Hugoton Production Co.*, 321 P.2d 576, 581, 182 Kan. 456 (1958)(a lessee's duty to market gas "did not extend to providing a gathering system to transport and process the gas off the leases at a large capital outlay with attending financial hazards in order to obtain a market at which the gas might be sold."); Richard W. Hemingway, *THE LAW OF OIL AND GAS*, (3d Ed. 1991)("Although the lessee has an obligation to market the products from the wells, it has been repeatedly held that he does not have to stand the expense of a long and costly gathering system to transport the products to the nearest market.").

²⁹ *Texas Pacific Coal and Oil Co. v. Barker*, 117 Tex. 418, 6 S.W.2d 1031, 1036 (1928)("The court's charge should make plain that it was the duty of the lessee to drill an offset or additional well, if, considering the cost of the same and the probable profit therefrom, he would have been doing what an ordinarily prudent person would have done under the circumstances."); *Temple v. Continental Oil Co.*, 182 Kan. 213, 320 P.2d 1039, 1056 (Kan. 1958)("A lessor is entitled to the benefit of oil produced from the lease at the time it should be produced and not some remote period of time in the future. The lessee is not the sole judge of what constitutes prudent development of the tract. The test is what would be expected of an operator of reasonable prudence, in the furtherance of the interests of both the *lessor* and the *lessee*."); Eugene Kuntz, 5 *A Treatise on the Law of Oil and Gas*, § 58.3, p. 79 (1991 and 2004 Supp.)("The factor most frequently considered is the factor of profitability of drilling. This is on the assumption that a prudent operator will drill on additional development well if it would be profitable to do so and will not drill if the proposed well would be unprofitable. Thus, profitability is a common measure of prudence in drilling.").

It is important to note that there is a distinction between "reasonable expectation" and probability of profit. This distinction was explained in Vander Ploeg, Claude L., *The Implied Covenant of Reasonable Development - A Delicate Balance*, 3 *EASTERN MIN. L. INST.* 181-3 (1982):

Actually, very few cases require the lessor to prove that the proposed well will be profitable. Instead the courts speak in terms of "reasonable expectation" of profit or "reasonable probability"

of profit.

There is a difference between proving a reasonable expectation of profit and proving by a preponderance of the evidence that the proposed well will be profitable.

The object of the court's inquiry in these cases is to determine whether the proposed well would be drilled by a prudent operator. The modern operator is a risk taker. Both exploration and development wells are proposed and drilled on the basis of risk analysis. The risk of a dry hole is balanced against the potential reward of a producer. Even development wells are drilled by extremely prudent operators when a dry hole is more probable than a producer. A successful well may pay out in a short period of time. A two-to-one risk of a dry hole is more than balanced by a ten-to-one recovery of capital ratio. It could be argued that an operator should be required to drill a development well in that situation.

³⁰ 97 P.3d 135, 137-8 (Colo. Ct. App. 2003)

³¹ Legislative Budget and Audit Committee, Stranded Gas Hearings, October 14, 2004. *See e.g.*, testimony of Ken Thompson, Past Executive Vice-President of ARCO and Joe Marushark, Vice-President of Alaska Gas Development, ConocoPhillips Alaska.

³² Thompson, Ken, *Making Oil and Gas Upstream/Midstream Investment Decisions*, Presentation to the Senate Resources Committee, Legislative Budget and Audit Committee Hearings: Alaska Natural Gas Pipeline Issues, October 14, 2004, pp. 7-8, 12.

³³ *Id.* at p. 18.

³⁴ See note 30 and accompanying text, *supra*.

³⁵ 5 H. Williams & C. Myers, OIL AND GAS LAW, § 842.1, at 266.10 (1986); *Carter v. United States Smelting, Refining and Mining Co.*, 485 P.2d 748, 752 (Okla. 1971)(condemning holding a lease for "sheer speculation and without any purpose for further development."); *Garcia v. King*, 139 Tex. 578, 164 S.W.2d 509 (1942)("The lessors should not be required to suffer a continuation of the lease after the expiration of the primary period merely for speculation purposes on the part of the lessess.").

³⁶ *Amoco Production Co. v. Douglas Energy Co.*, 613 F.Supp. 730, 733 (D.Kan. 1985).

³⁷ WILLIAMS & MEYERS, 8 OIL AND GAS LAW, § 806.3 (2003), *citing Shelton v. Exxon Corp.*, 719 F. Supp at 549 (S.D. Tex. 1989), *aff'd in part, and rev'd in part, on other grounds*, 921 F.2d 595 (5th Cir. 1991), explains in this regard:

This analogy to the reasonable man of tort law also helps to explain the meaning of the prudent-operator standard. The prudent operator is a reasonable man engaged in oil and gas operations. He is a hypothetical operator who does what he ought to do not what he ought to do with respect to operations on his leasehold. Since the standard of conduct is objective, a defendant cannot justify his act or omission on personal grounds or by reference to his particular circumstances. *It is no excuse that defendant failed to drill the offset well a prudent operator would have drilled because defendant is short of cash, over-committed on drilling programs, has no need for more production or prefers to spend his money on other things.* In short, the question is not what was meet and proper for this defendant to do, given his particular circumstances, but what a hypothetical operator acting reasonably would have done, given circumstances generally obtained in the locality.

(Emphasis supplied.)

³⁸ *Newell v. Phillips Petroleum Co.*, 144 F.2d 338, 739 (10th Cir. 1944)("It was the duty of Phillips to operate this well prudently and with reasonable diligence... Its duty in that respect was not affected in any manner by its ownership of other wells in the vicinity. And its failure to discharge that duty, whether motivated by its interest in wells located lower on the structure, or otherwise, would render it liable in damages for any injury suffered by the owner of the royalty interest."); *Smith v. Amoco Production Co.*, 272 Kan. 58, 31 P.3d 255, 272 (Kan. 2001)("Amoco admits that its obligations as lessee apply independently to each lease. The independent duty principle is applied to prevent Amoco from making the management of a given lease dependent upon the management of another lease."); *Amoco Production Co. v. Alexander*, 622 S.W.2d 563, 569 (Tex. 1981)("The reasonably prudent operator standard is not to be reduced to the Alexanders because Amoco has other lessors in the same field. Amoco's status as a common lessee does not affect its liability to the Alexanders."); Pearson and Dancy, "Negotiating and Renegotiating the Gas Contract: Producer Duties to Third Parties," 56 Okla. B.J. 2181 at 2182 (1985)("lessee cannot justify his actions merely on the grounds that his course of action was reasonably based on circumstances peculiar to himself.").

³⁹ *Shelton v. Exxon Corporation*, 719 F.Supp. 537, 549 (S.D.Tex. 1989)("In its simplest form the holding of *Alexander* was that the lessee's duty was to do that which would be done by a reasonably prudent operator holding only the lease in question."), *aff'd, in part, and rev'd, in part, on other grounds*, 921 F.2d 595 (5th Cir. 1991).

⁴⁰ 15 U.S.C. § 1 *et. seq.*

⁴¹ ALASKA STAT. § 45.50.562 *et. seq.*

⁴² L. SULLIVAN & W. GRIMES, *THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK* at 106 (West 2000).

⁴³ Alaska has approved Professor Williston's formulation of the requirements of a joint venture. According to Williston the requirements are: (a) A contribution by the parties of money, property, effort, knowledge, skill, or other asset to a common undertaking; (b) A joint property interest in the subject matter of the venture; (c) A right of mutual control or management of the enterprise; (d) Expectation of profit, or the presence of "adventure," as it is sometimes called; (e) A right to participate in the profits; (f) Most usually, limitation of the objective to a single undertaking or ad hoc enterprise.

Basel v. Westward Trawlers, 869 P.2d 1185, 1190-1191 (Alaska 1994)

⁴⁴ 438 F.2d 1286, 1306 (5th Cir. 1971). Among the relevant factors often employed to define market power are: (1) defining the product; (2) defining the geographic market; (3) considering the barriers to entry into the market; and (4) measuring industry concentration. *See e.g.*, SULLIVAN & GRIMES at 60-68. Here the product is natural gas, for which there is no viable substitute. The geographic location is the ANS. The barriers to producing the product and entering the market are enormous. Finally, the producers have an oligopoly. The interdependence of oligopolies is a well-documented economic reality.

⁴⁵ State of Alaska, Department of Natural Resources, Competitive Oil and Gas Lease Form No. DOG 200204 (Revised 10/2003).

⁴⁶ THE LAW OF OIL AND GAS, § 400 at p. 594 (1959 and 2004 Supp.) (Emphasis supplied). *See also*, *Cole Petroleum Co. v. United States Gas & Oil Company*, 121 Tex. 59, 41 S.W.2d 414, 416 (Tex. 1931); *Deadwood-Osage Co. v. Walker*, 28 P.2d 428, 443, 46 Wyo. 482 (Wyo. 1934).

⁴⁷ The common law has established that the damages for a producer's failure to perform an express or implied covenant to develop or market are measured by the royalties that would have resulted if the producer had reasonably developed the lease or unit. RICHARD H. HEMINGWAY, *THE LAW OF OIL AND GAS* (3d Ed. 1991) ("Breach of implied covenants that result in undue loss of production may be compensated by the royalty that the lessor would have received had the wells been properly operated or drilled."); *ANR Western Coal Development Co. v. Basin Electric Power Cooperative*, 276 F.3d 957, 969-970 (8th Cir. 2002) (adopting the "royalty rule" and rejecting argument that "plaintiff still has the mining property" as the basis for a deduction from royalty due); *Gold Min. & Water Co. v. Swinerton*, 23 Cal.2d 19, 29 142 P.2d 22 (1943) ("The majority rule relating to oil and gas leases appears to be that where a lessee fails to perform...the lessor may recover the full amount of the royalty to which he would have been entitled had the lessee fully performed."); *Fisher v. Hampton*, 44 Cal. App. 3d 471, 118 Cal. Rptr. 811, 814 (1975) (reaffirming California's adherence to the royalty rule); *Cawood v. Hall*

Land & Mining Co., 293 Ky. 23, 168 S.W.2d 366, 369-70 (1943) ("To sustain this contention ["since the coal is still there...the only loss...is the use of money"] might result in the indefinite postponement of the payment of royalties...The lessor did not contract for indefinite investment of his royalties at interest but for the royalties themselves."); *Carroll Gas & Oil Co.*, 21 S.W.2d at 291 ("If it can be shown with reasonable certainty that the land covered by the lease would have produced a certain quantity of gas, and that the lessor was entitled to a certain portion of the proceeds, the proper measure of damages is the value of the royalty of the lessor which he did not receive and which he would have received if the production had been marketed."); *Macon v. Trowbridge*, 38 Colo. 330, 87 P. 1147 (1906) ("The amount of such recovery, if any, [for lessee's failure to "work and develop the property"] would depend upon the amount of ore that could have been mined, if reasonable diligence had been exercised."); *Gilmore v. Ontario Iron Co.*, 86 N.Y. 455, 459-60 (Ct. App. 1881) (rejecting argument "the ore may remain and not be lost" as justifying deduction from royalty due); *Daughetee*, 263 Ill. 518 at 527 ("It is no answer to a suit of this character to say that the oil or gas is still on the premises and may be extracted at some point in the future. The point is [the lessee]...agreed to do this in order that the lessor could realize upon the value of these products."). See also, Maxwell, Richard C., *Appropriate Damages for Breach of Implied Covenants in Oil and Gas Leases*, 42 SW Legal Fdn. Oil & Gas Inst. 7-20 - 7-24 (1991) ("So many uncertainties exist as to what the future development of a tract subject to litigation may be that the solution of placing a sum in the hands of the lessor equaling, so far as the limits of proof will allow, the royalties that would have been paid if development had been prudent seems appropriate. This approach puts the risk of future development on the defaulting lessee."); *Texas Pacific Coal & Oil Co.*, 6 S.W.2d at 1031 ("Under sound fundamental principals, no deduction should be made from the value of the lessor's ryalty on account of the value of unmined minerals which the lessee was entitled to remove from the leased premises."); *Freeport Sulphur Co. v. American Sulphur Royalty Co.*, 117 Tex. 439, 6 S.W.2d 1039, 1045 ("the royalty company should be allowed to recover as the damage suffered by it the amount which the jury finds the appellant (the royalty company) would have received in royalties if the mines had been operated during the time they found operation was unreasonably suspended, with interest at 6 per cent from the date such royalty would have accrued.")

⁴⁸ 5 EUGENE A. KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS, § 60.5(d), p. 143 (1991 and 2004 Supp.).

⁴⁹ *Eastern States Retail Lumber Dealers Ass'n. v. United States*, 234 U.S. 600 (1914).

⁵⁰ *Silver v. NYSE*, 373 U.S. 341 (1963).

⁵¹ *Northwest Wholesale Stationers, Inc. v. Pacific Stationers & Printing Co.*, 472 U.S. 284, 298 (1985).

⁵² 665 F. Supp. 1493 (S.D. Fla. 1987) *aff'd*, 880 F.2d 297 (11th Cir.), vacated, 889 F.2d 264 (11th Cir. 1989), *reh'g granted*, 912 F.2d 1262 (11th Cir. 1990), *rev'd per curiam on non-antitrust grounds*, 499 U.S. 915 (1991) (finding that a natural gas pipeline was essential and duplication was possible, though expensive and unnecessary, because the defendant's pipeline could easily carry gas for the plaintiff as well as the defendant.).

⁵³ 410 U.S. 366 (1973).

⁵⁴ 15 U.S.C. § 15 (a).