determine to be necessary for timely development and proper conservation of the oil and gas resources of the unitized area." [R. 1260] As discussed above, this court has found that this provision of the contract accords to DNR the administrative authority to reject proposed plans of development. But rejection of a proposed plan of development does not result in automatic termination under the PTUA. Rather, a separate administrative determination as to the appropriate remedy is required in such instance. To the extent Section 336 would permit the automatic termination of the PTUA whenever a POD was rejected by the State, it is inconsistent with the PTUA and inapplicable to this unit.

E. The Appellants' Right to Due Process

The right to due process, under both the state and federal constitutions, prohibits the State from depriving any person of "life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1; Alaska Const. Art. I, §7. The State acknowledges that the Appellants are entitled to due process with respect to their interests at Point Thomson. [State's Br. at 99]

The Appellants assert that their due process rights were violated when the Commissioner terminated the PTU on appeal from the Director's Decision. They assert that the only issues over which the Commissioner had jurisdiction were whether the Director had properly rejected the 22nd POD and whether the modified POD should be approved. [Exxon Br. at 47] The Appellants maintain that the Director's Decision, which stated simply that "[f]ailure to submit an acceptable plan of development is grounds for termination of the PTU," was

inadequate to notify the Appellants that the Commissioner would terminate the PTU in the administrative appeal. [*Id.* at 50]

The State maintains that the Appellants were accorded adequate notice and an opportunity to be heard. It notes that the Commissioner indicated to the Lessees that his review would "cover both the appeal from the October 27, 2005 decision and the proposed cure." [R. 664; State's Br. at 101] It asserts that the Appellants "knew that a rejection of the POD and an affirmation of the default finding could lead to the determination of what remedy was appropriate as a result of the affirmation." [State's Br. at 101] And yet the State has also acknowledged that termination of the unit is only "one possible remedy" when a proposed POD is not acceptable to the Director. [*Id.* at 105]

The State also asserts that any alleged due process violations in connection with the unit termination decision were cured by the reconsideration process before the Commissioner that was pursued by two of the Appellants, ExxonMobil and ConocoPhillips. In support of this argument, the State cites to *State, Dept. of Natural Res. v. Greenpeace*, 96 P.3d 1056 (Alaska 2004), in which the Alaska Supreme Court held that any alleged procedural due process violations in that case were cured by according the objecting party an opportunity to be heard on reconsideration. Yet as Appellants note, BPXA and Chevron did not seek reconsideration before the Commissioner. [Jt. Reply at 19]. And, unlike the situation in *Greenpeace*, the Appellants here were not accorded an opportunity to fully contest the challenged decision on reconsideration. [*Id.* at 20]

Instead, the reconsideration motion and decision were primarily focused on the decertification issue, not the termination decision. [*See* R. 9288, 9291]

The Alaska Supreme Court's decision in *White v. State, Dept. of Natural Resources*, 984 P.2d 1122 (Alaska 1999)(*White I*) is instructive on these issues. In that case, White had requested a hearing before DNR on a disputed factual issue with respect to an oil and gas lease. DNR refused to grant him a hearing on the issue. The Supreme Court reversed and remanded, and held that the due process clause accorded to White the opportunity for a hearing on that issue before an agency determination was made that precluded the automatic extension of the lease. 984 P.2d at 1128.

Likewise, albeit in a quite different context, the Supreme Court found that a trial court had violated a parent's right to due process when the trial court entered a *permanent* child custody order after conducting a hearing that had been scheduled to determine *interim* custody. *Cushing v. Painter*, 666 P. 2d 1044, 1046 (Alaska 1983). Due process requires that parties are accorded "sufficient written notice, specifying the nature of the dispute and the relief requested." *Hickel v. Halford*, 872 P.2d 171,180 (Alaska 1994).

Here, the State did not seek termination under Section 20(c) of the PTUA. Rather, it sought to terminate the unit after it rejected the Appellants' proposed Plan of Development. Nothing in the PTUA nor the regulatory framework in place in 1977 mandated or authorized automatic termination of the unit when DNR rejected the proposed POD. And while this court has concluded that the

PTUA and then-existing regulations did not preclude DNR from pursuing termination at the administrative level, the Appellants were constitutionally entitled to a clear written notice that DNR was considering this remedy when it rejected the POD, and should have been accorded the opportunity to be heard with respect to the appropriate remedy when the modified 22nd POD was rejected. *See generally* former 11 AAC 88.155. The Director's statement that "[f]ailure to submit an acceptable plan of development is grounds for termination of the PTU" is not constitutionally adequate notice that a termination would be administratively declared by the Commissioner on appeal of the Director's Decision rejecting the 22nd POD.

Accordingly, this matter is remanded to the DNR for the purpose of according to the Appellants a hearing on the appropriate remedy to the State upon DNR's rejection of the proposed 22nd Plan of Development. On remand, the agency should also consider the import of Section 21 of the PTUA, as amended in 1985, in determining the appropriate remedy.

III. The Expansion Leases

A separate component of the administrative determinations focused on the Expansion Agreement entered into in 2001 between the Appellants and the State. That agreement expanded the PTU on the condition that the PTU Lessees performed certain work at the PTU and put the unit into production with at least seven development wells by 2008. [R. 5678] The agreement also provided that

if the Lessees failed to perform the work in a timely manner, the expansion leases would automatically contract out of the unit and the Lessees would owe DNR certain sums of money. [*Id.*]

The Appellants did not complete the work contemplated under the Expansion Agreement. Instead, in October 2006, ExxonMobil proposed a modification of the Expansion Agreement. DNR characterized the proposed modification as allowing it "to retain the most valuable portions of the Expansion Acreage without putting the unit into production." [R. 5680]

In the Commissioner's November 2006 decision, the Lessees' request to modify the Expansion Agreement was denied. The Commissioner's decision also stated that "the state is entitled to have the Expansion Leases back and to receive payment." [R. 5688-89]

The Appellants originally appealed this aspect of the Commissioner's decision, but later abandoned this particular claim and in June 2007 paid the State the $20,000,000 payment plus interest then due as specified in the Expansion Agreement. On October 19, 2007, the Appellants filed a motion to dismiss the claims on appeal with respect to the Expansion Agreement. The State filed a partial opposition to the motion, disputing the language in the proposed order on these claims. Specifically, the Appellants' proposed order simply provided that all claims regarding the Expansion Agreement "are hereby dismissed as expressly abandoned by all Appellants and, in the alternative, as moot." The State's proposed order was broader, and sought to affirm a final

agency decision, effectively returning the expansion leases to the State. In reply, the Appellants asserted that the language from the Commissioner's decision that "the state is entitled to have the Expansion Leases back" should be considered dicta, and not a final agency determination with respect to the underlying leases in the expansion acreage. [R. 5689]

This court agrees with the Appellants that the validity of the leases encompassed within the expansion acreage was not directly before the Commissioner in this administrative proceeding, and thus is not properly before this court on appeal. With respect to mootness, this court agrees with the State's position that the claims related to the Expansion Agreement are more properly characterized as dismissed rather than moot.

Accordingly, with respect to the Expansion Agreement claims, all of the Appellants' claims concerning the Expansion Agreement are hereby dismissed as they have been expressly abandoned by all Appellants.

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Conclusion

DNR's rejection of the Lessees' proposed modified 22nd Plan of Development, including DNR's interpretation of Section 10 of the Point Thomson Unit Agreement, is affirmed.

DNR's determination as set forth in the Commissioner's Decision and the Decision on Reconsideration that terminated the Point Thomson Unit is reversed and remanded, so as to accord to the Appellants notice and an opportunity to be heard before the agency as to the appropriate remedy when the Department has rejected the proposed modified 22nd Plan of Development for the Point Thomson Unit.

All of the Appellants' claims concerning the Expansion Agreement are dismissed as they have been expressly abandoned by all Appellants.

Dated this 26th day of December, 2007.

Sharon Gleason
Judge of the Superior Court

I certify that on 12-26-07 a copy of the above was mailed/faxed to each of the following at their addresses of record

Judicial Assistant

AG-Todd
Ashburn / crosby
Orlansky
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Serdahely
Rozell

Dawn
Ellis
Bailey / Ashley /
Haynes / Phillips
Sneed

IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT AT ANCHORAGE

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

BRIEF OF APPELLEE

APPEAL FROM THE DEPARTMENT OF NATURAL RESOURCES

FINAL DECISION OF THE COMMISSIONER DATED NOVEMBER 27, 2006 & COMMISSIONER'S DECISION ON RECONSIDERATION DATED DECEMBER 27, 2006

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STATEMENT OF THE CASE

I. INTRODUCTION

This appeal arises from the termination of the Point Thomson Unit (PTU or Unit). The termination is the nadir of a hotly-contested, decades-long struggle by the Appellee, the Alaska Department of Natural Resources (DNR), to achieve oil and gas production from this 30-year-old Unit. Appellants British Petroleum (BP), Chevron, ConocoPhillips (CPA) and ExxonMobil (Exxon), as the Unit Lessees, held the right to explore and produce the Unit. But for more than 20 years, they refused DNR's requests to adequately explore and develop the PTU and produce its known oil and gas deposits.

The dispute came to a head over Lessees' proposed 22nd Plan of Development (22nd POD). Lessees have long insisted that the only way to develop the Unit was to await construction of a gas pipeline, tap the main gas reservoir (the Thomson Sand), and then produce oil, gas condensate (gas liquids) and dry gas together with no effort to maintain reservoir pressure – this is known as a gas blow down project.[1] [R. 5674 n.2] In a high pressure gas reservoir, like the PTU's Thomson Sand, this approach poses a high risk that liquids suspended in the gas will fall out and become unrecoverable as pressure decreases. This means the potential loss of millions of barrels of liquid hydrocarbons.

[1] Citations to the record, indicated as "[R.]," refer to the record assembled by DNR for this appeal and labeled by DNR as "PTUREC_."

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By contrast, phased production starting with gas cycling avoids much of the waste inherent in a gas blow down project. In a gas cycling project, dry gas, gas liquids and oil are all produced together, liquids are stripped, and enough dry gas is re-injected into the reservoir to maintain sufficient pressure to keep the liquids producible. [R. 631]

In addition to the potential loss of liquids, Lessees' gas blow down approach meant an indefinite delay of unit production. There is no certainty about when a gas pipeline will be built, but the existing Trans Alaska Pipeline System (TAPS) can transport gas liquids and oil.

Both the Alaska Oil and Gas Conservation Commission (AOGCC) and DNR[2] are responsible for preventing wasteful oil and gas development.[3] Because Lessees wanted to pursue a gas blow down project, DNR asked them to apply to the AOGCC for approval of unit pool rules and a depletion plan. [R. 1960] The AOGCC asked for geologic and other data, but Lessees did not cooperate with the request for information. They did not provide sufficient information to enable the AOGCC to conclude that the PTU is primarily a gas unit or to conclude that a gas blow down project was an appropriate approach to PTU development. [R. 5606-08]

Early in the 22nd POD review process, the Lessees provided DNR with a draft POD for comment. They proposed more studies (not production or exploration) while

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[2] AS 31.05.030; AS 38.05.020; 11 AAC 83.303(a)(2).

[3] Waste includes "the inefficient, excessive, or improper use of, or unnecessary dissipation of, reservoir energy . . . and the . . . operating or producing of any oil or gas well in a manner which results . . . in reducing the quantity of oil or gas to be recovered from a pool . . . ." AS 31.05.170(15)(A).

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awaiting gas pipeline construction. [R. 207-14, 12217-25] In response, DNR asked the Lessees to drill an exploratory well to resolve reservoir uncertainties that Lessees were asserting precluded them from producing gas and oil liquids, neither one of which require a gas pipeline to produce. If Lessees had agreed to drill the well, DNR would have approved the POD and extended other drilling deadlines set out in a 2001 Unit expansion. DNR also stated that it would support a gas blow down project if new data generated by the exploratory well supported it. [R. 1958-60]

The Lessees refused to drill. [R. 12190] In the proposed 22nd POD, the Lessees stated that they could find no viable way to develop the PTU in the absence of a gas pipeline. [R. 628] The DNR Director of the Division of Oil and Gas (Director) issued a decision defaulting the PTU, provided an opportunity to cure by filing a POD that committed to development, and notified Lessees that Unit termination could result from their failure to cure the default. [R. 648]

The Lessees appealed to the Commissioner and continued to insist that development of the PTU must await a gas pipeline. Commissioner Menge upheld the default and terminated the unit. Commissioner Rutherford affirmed these decisions on reconsideration.

II. UNIT HISTORY

Generally, an oil and gas unit is formed when DNR approves the joint development and operation of two or more oil and gas leases under a written

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agreement.[4] The primary term of a lease is normally extended by production. Inclusion in a unit also extends the lease term.[5]

The PTU was formed in 1977. [R. 1253–72] It was located on the North Slope with a western boundary approximately three miles east of the Badami Unit, which is connected to TAPS, and 30 miles east of the Prudhoe Bay Unit. [R. 629]

In the early 1980s, exploration of the PTU confirmed the presence of significant oil and gas – at least eight trillion cubic feet of gas (TCF), 200 million barrels of gas liquids, an unknown quantity of oil in the Thomson Sand reservoir, and 200 million barrels of oil in Brookian reservoirs. Nearly 30 years later, the Lessees have not produced any oil or gas from the PTU. [R. 640]

A. Well Drilling, Certification, and Abandonment

The PTU Agreement (PTUA or Agreement) required Lessees to annually drill a well until the discovery of reserves capable of being produced in paying quantities. [R. 1259] By 1982, DNR had certified six Unit wells as capable of producing in paying quantities.[6] According to AOGCC records, Exxon petitioned the AOGCC to change the status of five of the wells from suspended to abandoned in 1986, thereby effectively

[4] "A unit agreement is a contract between the department and lessees that allows for the efficient development of a reservoir that underlies multiple leases owned by different lessees. The various lessees join together in exploration and drilling, and allocate costs and production." *Exxon Corp. v. State*, 40 P.3d 786, 788 (Alaska 2001); AS 38.05.180(p).

[5] AS 38.05.180(m).

[6] Under 20 AAC 25.170, an operator abandoning a well must remove the wellhead equipment and some casing, install a well abandonment marker, and remove all materials, supplies, structures, and installations.

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abandoning operations.[7] [R. 5047] These wells also received location clearances from the AOGCC.[8] [R. 5047] DNR certified a seventh well, Sourdough #2, on April 26, 1994 [R. 26200] and Lessees abandoned it the following day.[9] [R. 5759]

Lessees have admitted that the wells are no longer capable of production. In 1983, Lessees told DNR that the plugged and suspended wells were inappropriate for production. [R. 296-98] In 1988, Exxon stated "[w]ells drilled far in advance of commencement of sustained gas production would not be used for development purposes due to concerns over potential well bore degradation associated with prolonged shut-in." [R. 11530] CPA has stated that "[s]everal of the ConocoPhillips certified wells were certified after the wells had been plugged and suspended or abandoned and are no longer physically capable of production." [R. 5804-05]

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[7] 20 AAC 25.105.

[8] AOGCC's website reflects abandonment of the sixth well in November 1986.

[9] (1) PTU Well No. 1 on ADL 47560 was certified under Article 9 of the PTUA. [R. 4078 – November 4, 1977, State decision]; (2) Alaska State Well No. F-1 on ADL 312862 was certified under the terms of the lease, but a lease POD was required by December 1982 to keep the lease in good standing. [R. 25366 – June 1982, State decision]; (3) Alaska State C-1 Well on ADL 38382 was certified under the lease and 11 AAC 83.105. [R. 20298 – July 22, 1981, State decision]; (4) Exxon No. 1 Alaska State "A" Well on ADL 47556 was certified. [R. 21012 – December 15, 1977, State decision]; (5) Point Thomson Unit No. 2 Well on ADL 47567 was certified under 11 AAC 83.105. [R. 23421 – January 5, 1979, State decision]; (6) Staines River State No. 1 Well on ADL 47573 was certified under the lease and 11 AAC 83.105. [R. 24521 – January 7, 1980, State decision]; and (7) Sourdough Well # 2 on ADL 343112 was certified under 11 AAC 83.361 and .395 and sections 4(d) and 30(6) of the lease. [R. 26200 – April 26, 1994, State decision: 629 – October 27, 2005, Director's Decision].

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Similarly, BP admitted it would take at least three to four years to put a production well into operation in the PTU. [R. 871–72]

B. Amendment to the Unit Agreement Section 20(c)

Section 20(c) of the Agreement provided that the PTU would automatically terminate five years from formation unless certain conditions were met, such as inclusion of a well capable of production in a participating area (PA). [R. 1267-8] A PA must be formed before production commences, and thus continuation past the primary five-year term required production in the PTU. [R. 9467, 9469] To avoid automatic termination, DNR agreed with Lessees' request to amend the Agreement to eliminate the PA requirement. [R. 9452] This amendment, allowing Lessees to avoid automatic Unit termination for lack of production was made effective in 1985. [R. 9448]

C. Unit Expansions

Lessees applied to expand the PTU three times. DNR approved an expansion application in March 1984, on the condition that Lessees drill two wells – one by 1985, and another by 1990. [R. 630] Lessees led DNR to believe that the approved expansion and promised drilling would lead to production by 1992. [R. 1172–73] Lessees did not comply with the drilling requirement. [R. 10025, 383–91, 630]

DNR denied a 1998 PTU expansion application partly due to lack of Unit development and exploration. [R. 630] It cautiously approved a 2001 application for expansion based on commitments to bring the unit into production. [R. 12757–66,

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12736–42, 26404–10, 1520–48] But Lessees did not perform the work commitments, which included an exploration well by 2003, a production well by 2006, and seven production wells by 2008. Specifically, when the Lessees failed to drill in 2003, two leases reverted to the State and Lessees paid $950,000. [R. 377–78, 380, 632, 26404–10] In 2005, DNR denied Lessees' request to substitute the Stranded Gas Development Act (SGDA) negotiations for the remaining drilling and other work commitments. [R. 200-03, 1958-60]

Despite this rejection, Lessees made the same request to substitute SGDA negotiations for the work commitments when they appealed the Director's decision in 2006. They also offered to pay $20,000,000 and return 20,000 acres of PTU leases to the State. [R. 682–84] But Lessees proposed to return less and different acreage, i.e., acreage with no or marginal hydrocarbon prospects. [R. 5756-58, 5766] The Commissioner found that Lessees owed the State $20,000,000 and the return of the remaining expansion leases. [R. 5756–58, 5766]

D. Plans of Development

1. Requirement for Plans of Development

From the PTU's inception, Lessees have acknowledged that statute, regulation and the PTUA requires them to submit a POD for DNR's approval as a condition of unitization. At the time of PTU formation, AS 38.05.180(m) provided "that DNR may require the operator of an oil or gas unit to operate in accordance with a 'reasonable' unit plan of operation, and that the plan must 'adequately protect all parties in interest,

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including the state.'" [R. 880] Lessees understood that "the regulations in effect at the time the Unit Agreement was signed required annual updates to Plans of Further Development and Operation." [R. 11233]

In 1983, DNR amended its regulations to further define the requirements of a POD. Lessees have acknowledged that the PTU was subject to these amendments:

> Exxon has received your letter dated October 14, 1985 requesting an update to the Seventh Plan of Further Development and Operation for the Point Thomson Unit. Your letter states that, pursuant to 11 AAC 83.343(c) and the terms of the Point Thomson Unit Agreement, an update to the 7th Plan was due in your office on October 1, 1985.
>
> . . . .
>
> Exxon's interpretation of the provisions of 11 AAC 83.343(c) and 11 AAC 83.343(d) as they relate to the 7th Plan is as follows. . . . Section 11 AAC 83.343(c) requires that a plan 'be updated and submitted . . . for approval at least 90 days before the expiration date of the previously approved plan.' Exxon, therefore, intends to submit an update for your approval on or before October 1, 1988.[10]

The unit regulations adopted in 1983 are consistent with PTUA Section 10, which requires Lessees to submit a POD for DNR's approval. [R. 1259-60] Lessees' PODs confirmed their understanding of the requirement that they submit a POD that is acceptable to DNR. For example, the 2004 21st POD included the following language:

> ExxonMobil, as Point Thomson Unit (PTU) Operator and on behalf of the PTU Working Interest Owners (Owners), hereby submits the enclosed Twenty-first Plan of Further Development and Operation (POD 21) for your review and approval. POD 21 is submitted in accordance with

[10] [R. 11232 – October 31, 1985 7th POD Progress Report]. Another example of Lessees' admission that the amended regulations apply to the PTU is Lessees' 1991 9th POD, which states: "[t]his Ninth Plan of Development is submitted . . . pursuant to Article 10 of the . . . Unit Agreement and 11 AAC 83.343." [R. 11453]

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Article 10 of the Point Thomson Unit Agreement (PTUA) and all other applicable regulations.[11]

2. PODs 1 Through 5 – 1978 to 1982 Exploration Period

PODs 1 through 5 focused on drilling PTU exploration wells. Lessees also conducted some unit studies and stated that if oil was discovered, it would be piped to Prudhoe Bay. [R. 11360-70, R. 11340-41, R. 11306-07, R. 11292-95, R. 11272-74]

3. PODs 6 Through 22 – 1983 to 2005 Study Period

Well drilling stopped with the 1982 6th POD, in which Lessees proposed environmental studies. [R. 296-98, 11261-68] DNR was concerned about the lack of drilling, inadequate reservoir delineation, and the need for production, but reluctantly approved the POD:

> I have reviewed your request for approval of the Sixth Plan of Further Development and Operation . . . the Department feels that the activities proposed for the time period covered . . . do not significantly contribute to the further delineation and understanding of the reservoir(s) and unit area as required by 11 AAC 83.343(a)(1), and in the Unit Agreement.
>
> The primary interests of the department in reviewing and approving unit plans of development and operation are to ensure that the engineering and geologic studies characterizing the underlying reservoir(s) are progressing, and that orderly and timely development of commercial hydrocarbon reservoirs occurs. [R. 11258]

[11] [R. 419–24 – August 31, 2004 21st POD Application]. For additional similar documents see [R. 206–14 – July 1, 2005 22nd POD Application, R. 316 – October 30, 1995, 13th POD Application, R. 383–91 – August 5, 2002 19th POD Application, R. 11340–01 – September 13, 1978 2nd POD Application, R. 11360–70 – November 18, 1977 1st POD Application, R. 11306–07 – October 18, 1979 3rd POD Application].

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The resulting studies indicated that the PTU had some oil and a large gas field, but Lessees did not propose to put the unit into production. Instead, in the 1983 7th POD, Lessees contended they were entitled to an additional five-year study period on the following grounds: (1) Lessees wanted credit for 700 million dollars they claimed to have already spent on PTU lease acquisition and drilling; (2) Exxon claimed credit for an alleged 15 years of diligent PTU development studies; (3) Lessees believed that development before construction of a gas pipeline would be waste; and (4) they did not think PTU wells were appropriate for production. [R. 296–98]

DNR approved the 7th POD for the period January 1984 through December 1988. However, the approval was made against the backdrop of ongoing negotiations between Lessees and DNR to expand the Unit, which involved a requirement to drill additional wells. The POD approval did not relieve Lessees of expansion drilling commitments. [R. 299]

Shortly after DNR approved the 7th POD, it also approved the expansion of the Unit based on Lessees' commitment to drill two unit wells. [R. 630, 1033] Lessees told DNR the commitments would lead to a gas cycling development by 1992:

> To reiterate, Exxon as the Point Thomson Unit Operator, is making preparations to be in a position to commence a well in the 1985/1986 winter drilling season. The purpose of this well would be to confirm reserves sufficient to prove commerciality of the reservoir (additional delineation wells may be required) . . . .
>
> Further, should the well satisfy the February 1, 1990 obligation, the lessees of these leases would be obligated to drill another well on lands covered by those leases prior to February 1, 1995. This second well

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should be drilled at a location to be determined jointly by the State and the lessees.

> As discussed with you, current plans call for establishment of a participating area and start-up of production for a gas cycling / condensate recovery development as early as 1992. . . . A drilling obligation date of February 1, 1995 would provide owners the opportunity to gather additional data to better determine the need and location for further exploratory drilling outside of the established participating area. [R. 10023–24]

Because Lessees did not drill the first promised well, two expansion leases contracted out of the Unit in 1985. [R. 630, 10025]

In the 1988 8th POD, Lessees asked for three more years of study. [R. 11529–34] They committed to drilling the second 1984 expansion decision well by 1990, but after DNR approved the POD, Lessees refused to drill saying that "we have conducted further economic analysis and decided not to drill . . . Unit Well No. 5." [R. 11463]

In the 1991 9th POD [R. 11452–54a], Lessees proposed to finish the incomplete reservoir mapping project, which DNR had approved in the 8th POD. [R. 11469] DNR expressed the following concerns:

> [T]he Eighth Plan of Development for the PTU, approved by the division on October 6, 1988 for a three year period, anticipated the preparation of unit consensus maps for each of the currently known reservoirs (Pre-Mississippian, Thomson, and Flaxman). The consensus maps were to be prepared during the period of the Eighth Plan and were to assist in the assessment of the unit's development potential and contribute to the further delineation and understanding of the reservoir(s) and unit area as required in 11 AAC 83.343(a)(1), and in the Unit Agreement.
>
> The consensus mapping by the unit owners was not accomplished as proposed during the term of the Eighth Plan, and the division remains concerned with some of the rational [sic] given for delaying consensus mapping program. (see September 25, 1991 correspondence). The

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> division is further concerned with the length of time to accomplish the mapping program and the adverse impacts of this delay for making the detailed technical analysis for the orderly and timely development of the hydrocarbons in the Point Thomson Area.
>
> . . . .
>
> [T]he division feels that it is essential that the working interest owners expedite the consensus mapping efforts in order to evaluate all Point Thomson development opportunities.
>
> . . . .
>
> At the conclusion of the Ninth Plan period, Exxon should be prepared to convene a joint meeting of all working interest owners . . . to discuss . . . potential development options and schedules. [R. 11404–05]

But by 1992, the reservoir mapping was still incomplete and Lessees proposed to finish it as part of the 10th POD. [R. 11386–96] Lessees also proposed initiation of a multi-year "Consensus Reservoir Characterization Study" and a "Conceptual Planning Schedule." [R. 88, 11387]

The 1993 11th POD proposed to continue Reservoir Characterization and other studies. [R. 317, 11738–43] DNR reluctantly approved the POD, but expressed dissatisfaction with the lack of Unit exploration and development work; DNR also stated its intent to contract leases from the PTU:

> I am informing Exxon, the PTU operator, of my intent to contract the unit boundary effective January 1, 1995 . . .
>
> Little exploration work has been conducted on tracts within the unit boundary in the past few years. No explicit exploration work was conducted under the tenth plan nor is any contemplated under the eleventh plan. . . . Absent significant and actual on-the-ground exploratory activity on the tracts identified in Attachment # 1 on or before December 31, 1994, pursuant to 11 AAC 83.356(e) and 11 AAC

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83.343(b), I plan at this time to contract the unit boundary effective January 1, 1995. [R. 11735]

In the 1994 12th POD, the Lessees proposed to continue a reservoir description study (first proposed in the 10th POD) and other studies. [R. 1064] DNR requested the Lessees to report all efforts Lessees had made to market PTU hydrocarbons. [R. 336–37] Instead of providing the marketing information, Exxon asserted that no markets existed justifying production. [R. 339–40]

The 1995 13th POD reported that PTU development was uneconomic and proposed more studies. [R. 314-18] In its approval, DNR asked for Unit development:

> The division remains concerned about the lack of exploration and development work that has been conducted in the PTU. The division has stepped back from its intent to contract the unit to allow the partners to find new opportunities, including farm-in agreements, to evaluate the area outside the known Pt. Thomson sands accumulation. The division wants the acreage within or immediate adjacent to the unit explored and evaluated. To that end, the division wants the working interest owners to share data pertaining to the acreage within or immediately adjacent to the unit. The division wants the unit to function as a unit rather than as separate leases. Most importantly the division wants a fair and honest attempt to get this acreage explored and to be appraised of efforts to develop and produce the Pt. Thomson sands accumulation itself. [R. 321]

In the 1996 14th POD, Lessees proposed yet more studies. [R. 11648–52] They also reported that BP and Chevron had drilled a well not previously proposed in a POD [R. 11650] In reporting on the 14th POD, Lessees stated that they were instrumental in passage of the SGDA. [R. 348–50]

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In 1997, Lessees filed the 15th POD. [R. 11633–38] Then-Division-Director Ken Boyd (who filed an affidavit in this appeal on the Lessees' behalf) rejected the 1997 15th POD as noncompliant with 11 AAC 83.343(a). [R. 323–25] DNR believed that the POD should include comprehensive plans for unit exploration, delineation and development:

> . . . The 15th POD must also include an evaluation of the oil rim component . . . Exxon must estimate the volume of oil in place and the volume of recoverable oil and formulate a plan to further delineate and develop the oil component. . . .
>
> . . . BP and Chevron publicly announced a discovery with an estimated 100 mmb of recoverable oil from the Sourdough prospect within the . . . unit . . . Exxon's A-1 well discovered the Flaxman oil accumulation . . . . The proposed POD did not include plans for developing either of these known prospects or exploration for additional reservoirs within the unit . . . The unit Plan of Development must include a schedule to evaluate the geology of the multiple reservoirs in the entire unit area and perform an integrated economic analysis of the unit. This evaluation should at a minimum incorporate the Thomson condensate, oil rim, Upper Cretaceous through Eocene turbidites, and fractured basement potential. [R. 324]

DNR requested that Lessees drill an exploration well in the Unit by 1999. Lessees responded that: (1) DNR should approve the POD as submitted; (2) they would not drill the well; and (3) they would not provide the studies. [R. 332–34] DNR threatened Unit default. [R. 327–30] Then-Director Boyd wrote: "[t]he division remains concerned about the lack of exploration and development work . . . the division wants a fair and honest attempt to get this acreage explored and to be appraised of efforts to develop and produce . . . ." [R. 321]

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Despite these warnings, in the 16th and 17th PODs, Lessees only proposed additional studies – a reservoir consensus map project, continuation of engineering and geological studies, and data sharing. [R. 365–72, 640–41]

The 2001 18th POD proposed to drill the exploration well Lessees had committed to in the 2001 Unit expansion and to undertake related work for a gas cycling project. [R. 365–72, 641] But after DNR approved the 18th POD, Lessees refused to drill the well. [R. 374–75, 377–78]

In the 2002 19th POD, the Lessees proposed additional studies and permitting, and they refused to drill the well upon which the 18th POD was based. [R. 383–91] DNR nevertheless found that the proposed studies would facilitate development and approved the POD. [R. 393–94]

DNR approved the 2003 20th POD [R. 396–400] because it advanced the 2001 expansion development commitments. [R. 414-17] But after DNR approved the POD, Lessees stopped much of this work, including development permitting and investigation of the Pre-Mississippian formation reservoir. On December 18, 2003, Lessees notified DNR that, in their opinion, a gas cycling project was uneconomic and that they intended to change their development focus to a gas blow down project. [R. 632–33]

In the 2004 21st POD, Lessees continued to focus on a gas cycling project and the 2001 expansion work but conveyed that "the Owners have not been able to identify an economically viable Gas Injection Project under current fiscal terms." [R. 419–24]

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DNR requested copies of reservoir data and the various PTU studies. It asked Lessees to work on all production options including liquids:

> The Division must determine if the proposed 21st POD is in the public interest. The 21st POD focuses on gas sales, which may not be the best alternative, especially considering the unknown timing of a gas sales pipeline. A prudent unit operator should evaluate all alternatives to develop the unitized substances including: gas injection followed by gas sales, gas sales followed by gas injection, simultaneous gas sales and gas injection projects, and the combined economics of developing gas and oil from the Thomson Reservoir along with oil from the Pre-Mississippian and Brookian reservoirs within the PTU. The Division cannot adequately review the proposed plan without the technical data, assumptions, and interpretations that went into the PTU Owners' evaluation of the Gas Injection Project. Article 10 of the PTU Agreement, Plan of Further Development and Operations, supports the Division's data request as follows:
>
> Any plan submitted pursuant to this section shall provide for the exploration of the unitized area and for the diligent drilling necessary for determination of the area or areas thereof capable of producing unitized substances in paying quantities in each and every productive formation and shall be as complete and adequate as the Director may determine to be necessary for timely development and proper conservation of the oil and gas resources of the unitized area . . . . [R. 427]

Lessees balked at providing the information, so the Director conditioned POD approval on disclosure of the information within 30 days or the Unit would default. [R. 428] Lessees appealed, but the Commissioner affirmed the Director's decision. The Commissioner's decision also notified Lessees that the expansion drilling commitments were part of the POD and that the 22nd POD must address the expansion drilling commitments. [R. 12278-79] Ultimately Lessees provided enough information to avoid unit default. [R. 12268–80]

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The 2005 22nd POD proposed more studies and an extension of the 2001 expansion drilling commitments pending the SGDA negotiations. [R. 206–14] DNR offered to approve the POD and extend the drilling commitments if Lessees committed to drill an exploratory well and other delineation work. Moreover, if results indicated a gas blow down project was the best way to develop, DNR agreed to focus PTU development on a gas blow down project:

> While first and foremost, the Division would like to see PTU development commence today, we would accept an extension of the existing development drilling commitments if the PTU Owners agree to acquire additional technical data to delineate the Thomson Reservoir. The Division believes there is considerable uncertainty in ExxonMobil's interpretation of the available PTU geological and geophysical data, which makes it difficult to assess the connectivity of the reservoir, fluid contacts, and the hydrocarbon properties of the oil rim. An exploration/delineation well could provide significant information pertinent for appropriate development of the Thomson Reservoir.
>
> ExxonMobil should begin development drilling within the PTU by June 15, 2006, as set forth in the Expansion Agreement, or if the PTU Owners concur that the geologic uncertainty is too great, ExxonMobil should drill a well to help resolve those uncertainties. The Division proposes modifications which, if accepted by the unit operator, would qualify the proposed 22nd POD for approval. [R. 1958–60]
>
> Lessees refused to drill. [R. 636]

III. THE OCTOBER 27, 2005, UNIT DEFAULT DECISION

The Director rejected the 22nd POD, defaulted the PTU, and gave Lessees 90 days to avoid Unit termination by submitting a POD that committed to develop the Unit – he warned Lessees that "[f]ailure to submit an acceptable plan of development is grounds for termination of the PTU." [R. 627–50]

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Lessees' record of broken development promises, refusal to invest in needed exploration wells, refusal to commit to production of known commercial hydrocarbon deposits, and insistence on a gas blow down project, which risked the loss of millions of barrels of gas liquids and oil and indefinitely delayed PTU development, left the Director with no choice but to default the Unit:

> The premise that the PTU can only be developed if a North Slope gas pipeline is built is inappropriate. In addition to dry gas, the unit contains 100s of millions of barrels of hydrocarbon liquids. These hydrocarbon liquids could be produced using mostly existing oil pipelines without construction of a North Slope gas pipeline. Therefore, potential PTU development is not, in fact, limited to dry gas production. In addition, the PTU Agreement, which requires timely exploration, delineation, development, and production of unitized substances, does not guarantee the lessees' commercial success or provide for indefinite extension of the leases. [R. 628]

The Director expressly rejected any linkage between the then pending SGDA negotiations and Lessees' PTU development obligations.

> The Sponsor Group consists of only three of the Major PTU Owners: Exxon, BPXA, and CPAI, and does not officially represent the PTU lessees. The State is also negotiating with two other applicants that submitted proposals to build a North Slope gas pipeline. Depending on the progress of the negotiations, it is unlikely that a North Slope gas pipeline will be in operation before 2012, and the Sponsor Group has not yet made a public commitment to ever build a North Slope gas pipeline. However, regardless of the status of those negotiations, the PTU Owners have an obligation to diligently explore, delineate, and develop the hydrocarbon resources underlying the unit area.
>
> The 22nd POD states that field activities associated with development drilling should begin three to three and one-half years before field startup, but it does not indicate when, if ever, an open season might occur or when, if ever, Exxon anticipates the commencement of development or production. At this point in time, the PTU Owners do not control if or when a North Slope gas pipeline will ever be operational. Reliance on

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third parties, beyond the control of the PTU Owners, is not grounds for the delay of PTU development and production. [R. 642]

IV. THE NOVEMBER 27, 2006, TERMINATION DECISION

DNR granted Lessees' request to extend their time to appeal the Director's default decision so that the cure and appeal were ultimately due October 20, 2006, and November 3, 2006, respectively. [R. 651–65]

On October 18, 2006, Exxon submitted a revised 22nd POD as the cure. It was very similar to the initial 22nd POD, but it was for five years rather than one, and offered an exploratory well by 2010 and $40 million if the well was not drilled due to circumstances not within Lessees' control.[12]

Lessees, and a number of other interested parties, submitted their November 3, 2006, filings amounting to approximately 5,500 pages.[13] They argued that the 22nd POD cure appropriately stayed development pending successful SGDA negotiations and construction of a gas pipeline because a reasonably prudent operator (RPO) would not develop until then. [R. 701–854, 873–77] Lessees never suggested that DNR had already approved this development delay. To the contrary, Lessees acknowledged the

[12] [R. 665–81] BP and Chevron supported the cure, and DNR staff opposed it. [R. 688–93, 700, 685–87]

[13] AOGCC [R. 5605], BP [R. 855–3715], Exxon [R. 701–854], Vic Fischer and Jack Coghill [R. 5614–17], Alaska Gasline Port Authority (Port) [R. 3716–5604], and Governor Hickel [R. 694–99]. Lessees were served with the Port and AOGCC filings. [R. 5654]

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Unit termination and contended that DNR did not have the power to terminate the PTU because it contained certified wells.[14] [R. 701–854]

The AOGCC supported the default decision, stating that Lessees had not cooperated with requests for information needed to establish PTU pool rules. AOGCC was concerned that a gas blow down project would cause waste of gas liquids. Lessees had also refused AOGCC requests for PTU gas cycling documents. [R. 5605–13]

The AOGCC explained that it needed significant additional information to decide pool rules:

> This is a significant hydrocarbon reservoir, the largest proven accumulation of oil and gas in the State that is still undeveloped. The Commission's sole objective in providing these comments to the DNR is to ensure that we will receive, in a timely manner, the information we need to establish appropriate Pool Rules for the Thomson Sand Reservoir. Toward this end, there are several items in the proposed POD that we believe must be completed prior to submission of a Pool Rule application to the Commission. These include:
>
> (i) Completion of the revised geological, engineering, and economic models necessary to evaluate the gas sales and alternative development scenarios as outlined in section 3 of the POD.
>
> (ii) Completion of the evaluation of alternative development scenarios as described in section 3.2 of the POD.
>
> (iii) Completion of drilling of the well proposed in section 4 of the POD. Selection of the drilling location for this well should be done in consultation with the DNR and the Commission to help ensure that it will answer the questions that must be answered and, that can only be answered by drilling a well or wells.

[14] The SGDA findings also acknowledged that DNR had provided notice of the PTU termination. Specifically, the findings required DNR to ". . . suspend[] action to terminate the PTU." [R. 824]

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(iv) Resumption and timely completion of the process established between the Commission and the PTU owners that is described in section 5.1 of the POD.

In conclusion the Commission does not believe that the uncertainty that still exists about the potential development of the PTU can be used as justification for a decision that may promote waste of tens to hundreds of millions of barrels of oil and condensate. This is especially true in light of the fact that much of this uncertainty could have been eliminated already had the PTU owners adhered to the work commitments specified in previous PODs and agreements. [R. 5608-09]

In briefing to DNR, the Port argued that the PTU did not contain wells capable of producing in paying quantities because all the wells that DNR had certified were plugged and abandoned, and that DNR should terminate the Unit for failure to meet development and drilling obligations. [R. 3716–24]

On November 20, 2007, Commissioner Menge held a hearing. [R. 9299–409] AOGCC, BP, Chevron, Conoco, Exxon, the Port, Vic Fischer, and Governor Hickel made presentations. BP, Chevron and Exxon asked the Commissioner to approve the 22nd POD. The Port argued that the PTU did not contain wells capable of producing in paying quantities and that it should be terminated. [R. 33–37, 85, 9316–17,] The AOGCC criticized Lessees' gas blow down project and failure to adequately delineate the Unit. [R. 33–37, 85, 9314–17] After these presentations, and despite the Commissioner's express invitation, Lessees declined to respond. [R. 9385]

On November 27, 2006, the Commissioner issued his decision rejecting the proposed POD cure, declining to modify the 2001 expansion terms, and terminating the

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PTU. The Commissioner affirmed the Director's default decision, except on certified wells. [R. 5759-60, 5765]

Lessees' contention that DNR had agreed to the gas blow down project is not supported by the record. [R. 5763] Instead, they repeatedly ignored DNR's requests to further explore and delineate the unit:[15]

> DNR has repeatedly requested that Lessees drill an exploratory well to, among other things, better delineate the various hydrocarbon deposits and to firm up the potential of liquids production. A pure gas blow down project will result in the loss of millions of barrels of gas condensate. Neither DNR nor AOGCC are prepared to allow a pure gas blow down project in the face of such a potential hydrocarbon loss without more data indicating it is appropriate. Lessees contend the data indicate uncertainties which prevent them from engaging in liquids production, yet they refuse to obtain more data to reduce the uncertainties. [R. 5753]

The proposed cure did not meet the requirements of the Director's decision, DNR's unit regulations, or the PTUA. [R. 5765] Lessees made no commitment to develop or to adequately explore and delineate the Unit. [R. 5755–56] Instead, the Lessees wanted to further delay unit exploration, development and production until a gas pipeline was constructed and the State granted Lessees royalty and tax breaks.

[15] Lessees insisted that the contract negotiated under the SGDA provide for construction of a gas pipeline before PTU was developed. This was essentially the same position they had taken with DNR on PTU PODs. The Murkowski administration sponsored the resulting proposed contract and submitted it to the legislature for approval, but the legislature did not approve the contract. In the absence of legislative approval of the limited production obligations set out in the contract, DNR was bound to follow existing, law regulations, and agreements which authorize the extension of lease terms by unitization only where Lessees comply with the POD requirements of Article 10 of the PTUA and 11 AAC 83.343, and DNR was also bound to follow the criteria for evaluating PODs set out in 11 AAC 82.303.

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[R. 5755-56]

Lessees' offer to drill a well by 2010 or pay $40,000,000 was not a firm commitment to drill, and money was not an adequate substitute for the required exploratory well. Further, the five-year term did not protect the public interest. Lessees' profit concerns were simply not a valid basis for failing to develop the Unit. [R. 61, 5756]

Commissioner Menge also rejected Lessees' request to modify the 2001 expansion commitments. Lessees' proposed modification relinquished fewer leases, less area, and less valuable acreage than the State was entitled to for breach of the 2001 expansion commitments. Thus, the Commissioner found Lessees were required to relinquish the expansion leases and pay the State $20,000,000 for failure to drill the well due in 2006. [R. 66, 5757–58]

In his decision, the Commissioner addressed the unit wells previously certified as capable of producing in paying quantities. The Lessees had plugged and abandoned the wells many years ago, and they were incapable of production. [R. 5759–60] The Commissioner found that the policy of treating plugged and abandoned wells as capable of production was poor policy – it was inconsistent with the law, unit regulations and the PTUA. He revoked the certifications, and set a new policy that a well must actually be capable of production to be certified. [R. 65–66, 5759–60]

The Commissioner also rejected Lessees' contention that the acceptability of the 22nd POD turned on the RPO standard, noting:

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> The Lessees' appeal is based on the premise that they do not have to produce because they contend a reasonably prudent operator [RPO] would not produce. This position comes from Section 10 of the unit agreement regarding PODs which states that the Lessees' covenant to develop the unit as a [RPO]. But section 10 says much more.
>
> It requires the Lessees to submit PODs to DNR for approval. Section 10 includes specific requirements about the type and scope of work an acceptable POD must contain. The Director's Decision set out requirements for a PTU default cure which are consistent with the statutes, regulations, unit agreement and leases. The Lessees' proposed cure was not responsive. It did not include a commitment to produce any of the known PTU hydrocarbon reserves – oil, gas liquids or gas. The proposed POD did not make a firm commitment to further delineate the PTU hydrocarbon reservoirs notwithstanding DNR's repeated requests. [R. 5762]

Finally, the Commissioner specifically found that the decision did not turn on Lessees' economics:

> Lessees' economics, adequate returns, and risk might be appropriate considerations in some situations. But they play no role here where the unit has been in existence since 1977, massive hydrocarbon deposits were discovered in the early 1980s, the unit has never been put into production, and the Lessees say it may never be put into production until a gas pipeline is constructed and the state compromises its taxes and royalties. Against this backdrop, the state oil and gas leasing system is not intended to require DNR to engage in a murky subjective contest about a Lessees' internal economics, development risk, or view of the difficulty of developing the unit. One of the state's primary interests is production. If production is not in the plan, the state's remedy is to terminate the unit and find another means to develop the unit. [R. 5763-64]

V. THE DECEMBER 27, 2006, RECONSIDERATION DECISION

The Lessees filed approximately 3,000 pages of material in their requests for reconsideration of the PTU termination decision. [R. 5819–9298] They did not assert

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that the wells that had been previously certified were still capable of production. In fact, CPA admitted they were not and argued that proper policy was to certify a reservoir rather than a well. [R. 5797–813] Exxon argued that DNR had not noticed the potential unit termination; lacked the authority to terminate because there were certified wells in the Unit; was estopped because requiring a certified well to actually be capable of production changed long-standing DNR policy of recognizing plugged and abandoned wells as capable of production; and had breached the covenant of good faith and fair dealing. [R. 5819–33]

Then-Acting Commissioner Rutherford affirmed Commissioner Menge's termination decision. [R. 9286–98] Lessees were not entitled to hold the Unit based on speculation that circumstances may eventually change enough to make development more profitable:

> . . . [T]he PTU is among the largest oil reserves on the North Slope, and it also contains hundreds of millions of barrels of gas condensate. Neither the oil nor the gas condensate require a gas pipeline to produce. Lessees' statements that more tax and royalty concessions will be needed before production can occur and refusal to drill exploratory wells to further delineate the unit, also provide grounds for unit termination, but the primary basis of the decision is the unequivocal statement that the Lessees cannot find a way to put the unit into production and their refusal to submit and acceptable POD. [R. 9290-91]

She also affirmed Commissioner Menge's certified well findings. Lessees had not contended the plugged and abandoned wells were actually capable of production. Thus, she concluded, that Commissioner Menge's decision had conformed the status of the wells to the facts. [R. 9292–93]

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Commissioner Rutherford declined to stay the decision and refused Lessees' requests to conduct discovery intended to show that DNR had a long-standing policy of treating plugged and abandoned wells as capable of production because DNR had already admitted as much. [R. 9295-96] She also found that Lessees had notice and an opportunity to be heard on the issues of Unit termination and certified wells because Lessees and the Port raised those issues on appeal. [R. 9286–98] Finally, she determined that even if the PTU contained certified wells, issuance of the termination decision was proper because in all unit terminations, the Commissioner needed to make default, cure and, termination findings. [R. 92[illegible]1–92]

STANDARD OF REVIEW

I. Applicable Standard of Review

Below, the State identifies the standard of review that the court should apply to the issues in this appeal.

A. Rejection of the POD

To decide whether the circumstances justified DNR's rejection of the initial and modified PODs, the court should apply the reasonable basis test because the agency's decision is best characterized as a mixed question of fact and law. For example, in *Tarbox v. State, Alaska Transp. Com'n*,[16] the Alaska Supreme Court applied the

[16] 687 P.2d 916, 919 (Alaska 1984).

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IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT AT ANCHORAGE

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

ORDER RE MOTION FOR STAY PENDING APPEAL

This case is before the superior court in its capacity as an appellate court upon appeal from administrative determinations by the Department of Natural Resources (DNR) which terminated the Point Thomson Unit Agreement. See AS 22.10.020(d). This Agreement was entered into between the Appellants and the State in 1977 for the purpose of facilitating the production of oil and gas at Point Thomson.

On March 15, 2007, Chevron U.S.A. Inc. (Chevron) filed a Motion to Stay the Commissioner's Decision on Appeal from the Director's October 27, 2005 Decision Denying the Proposed Plans for Development of the Point Thomson Unit (PTU) issued November 27, 2006, and the Commissioner's Decision on Reconsideration of the Point Thomson Unit Termination Decision issued December 27, 2006. Chevron asserts that pursuant to Appellate Rule 603(a)(2) and the Supreme Court's ruling in Keane v. Local Boundary Comm'n, 893 P.2d 1239 (Alaska 1995), this Court should stay these

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administrative decisions pending the resolution of this appeal. Subsequently, all of the other Appellants have joined in Chevron's motion.

On April 5, 2007, the State filed its Opposition to Chevron's Motion to Stay. The State asserts that a st .y of the Commissioner's unit termination decisions would impede the public's overriding interest in the development of the PTU oil and gas reserves. The State also asserts that a stay would adversely impact pending administrative proceedings with respect to leases within the PTU. And the State argues that the motion for stay should be denied because the Appellants have failed to meet the requirements of Appellate Rule 603. Finally, the State notes that the Appellants have not filed a supersedeas bond as required by the appellate rules with respect to the Commissioner's finding that the Appellants had breached the unit expansion agreement.

On April 5, 2007, the Alaska Gasline Port Authority (AGPA) and Jim Whitaker filed an Opposition to the Motion to Stay. They, too, assert that a stay of the Commissioner's unit termination decision would improperly impact pending administrative appeals of the Director's lease termination decisions. Further, AGPA and Mr. Whitaker argue that a stay would delay a gas pipeline and cause undue hardship to Alaska. Still pending before this court is the issue of whether AGPA and Mr. Whitaker should be permitted to participate as parties in this appeal (and the related motion to strike their opposition to the stay motion) which issue will be addressed by separate order of this Court.

Oral argument was heard on the motion on April 17, 2007. Thereafter, the parties designated additional portions of the administrative record that relate to this motion.

The legal standard for considering motions to stay administrative decisions pending appeal.

Appellate Rule 603(a)(2)(a) provides:

> When an appeal is taken, the appellant may obtain a stay of proceedings to enforce the judgment by filing a supersedeas bond. The stay is effective when the supersedeas bond is approved. The filing of a supersedeas bond does not prohibit the court from considering the public interest in deciding whether to impose or continue a stay on that portion of an administrative or district court judgment which is not limited to monetary relief.

The Appellants seek primarily to stay the non-monetary portions of the administrative determinations. In Keane v. Local Boundary Comm'n, 893 P.2d 1239, 1249 (Alaska 1995), the Alaska Supreme Court discussed the appropriate legal analysis to apply when a party seeks to stay a non-monetary administrative decision pending appeal. Whether to grant such a stay is a discretionary determination for the court, which is to be "guided by the public interest." Id.

In addition to consideration of the public interest, the two alternative tests presented in A.J. Industries, Inc. v. Alaska Public Service Commission, 470 P.2d 537 (Alaska 1970) apply to motions for stays of non-monetary administrative decisions sought under Appellate Rule 603(a)(2). Keane v. Local Boundary Comm'n, 893 P.2d 1239, 1249-1250 (Alaska 1995). Under one approach, an appellant may be entitled to a stay upon a "clear showing of probable success on the merits." Id. Upon such a showing, a stay may be granted even where the party seeking the stay does not stand

to suffer irreparable harm in the absence of the stay, or where the party against whom the stay is sought would be harmed if the stay is issued. Id. Alternatively, if the appellant does not demonstrate a clear showing of probable success on the merits, but does raise "serious and substantial questions going to the merits of the case," a stay may be granted, but in such circumstances the moving party must also demonstrate that it is faced with irreparable harm in the absence of the stay and that the party opposing the stay can be adequately protected. Id. See also Keystone v. Alaska Transportation Comm'n, 568 P.2d 952, 954 (Alaska 1977). This second approach is termed the "balance of hardships" approach, as it requires weighing the moving party's potential injury in the absence of the stay against the harm that would be imposed on the non-moving party if the stay is granted. 568 P.2d at 954.

Discussion.

Of primary contention between the parties at this initial stage of the appeal is the appropriate interpretation to accord to two subparts of a DNR regulation, 11 AAC 83.374(c) and (d), and also the applicability of a separate regulation, 11 AAC 83.361.

11 AAC 83.374(c) and (d) provide:

> (c) If a default occurs with respect to a unit in which there is no well capable of producing oil or gas in paying quantities and the default is not cured by the date indicated in the demand, the commissioner will, in his discretion, and after giving the unit operator and defaulting party (if other than the unit operator) reasonable notice and opportunity to be heard, terminate the unit agreement by mailing notice of the termination to the unit operator and the defaulting party. Termination is effective upon mailing the notice.
>
> (d) If a default occurs with respect to a unit in which there is a well capable of producing oil or gas in paying quantities and the default is not

cured by the date indicated on the demand, the commissioner will, in his discretion, seek to terminate the unit agreement by judicial proceedings.

11 AAC 83.361 provides in pertinent part:

> **Certification of well test results.** For the purposes of 11 AAC 83.301 – 11 AAC 83.395, a well will be considered capable of producing hydrocarbons in paying quantities, as defined in 11 AAC 83.395, when so certified by the commissioner following application by the lessee or unit operator. . .

The applicable portion of 11 AAC 83.395 cited above is subsection (4), which provides as follows:

> "paying quantities" means quantities sufficient to yield a return in excess of operating costs, even if drilling and equipment costs may never be repaid and the undertaking considered as a whole may ultimately result in a loss; quantities are insufficient to yield a return in excess of operating costs unless those quantities, not considering the costs of transportation and marketing, will produce sufficient revenue to induce a prudent operator to produce those quantities.

It is undisputed that there are wells within the Point Thomson Unit that had been certified by DNR pursuant to 11 AAC 83.361 as "capable of producing hydrocarbons in paying quantities." Because of those certifications, the Appellants assert that subsection (d) of 11 AAC 83.374 applies, which requires that the Commissioner must "seek to terminate the unit agreement by judicial proceedings" as opposed to what occurred in this case – termination of the unit agreement at the administrative level. The Appellants also assert that their constitutional rights to due process and equal protection were violated at the administrative level.[1] In the Appellants' view, they have

[1] One concern of the Appellants in this regard is their assertion that the AGPA had submitted extensive materials it delineated as "confidential" to DNR setting forth AGPA's legal analysis of the State's ability to terminate the PTU Agreement, which materials were not served on the Appellants during the course of the administrative proceedings. See also State's Notice of Supplemental Record Citation at fn. 1.

demonstrated a clear probability of success on these issues such that this court should stay DNR's determinations during the pendency of this appeal. They also assert that the public interest warrants granting the stay, because the Appellants will be able to continue development of the PTU if the unit agreement is reinstated and because other potential lessees would discount their bids if leases were reoffered while this appeal is pending.

The State asserts that "what appellants actually want is a stay of the lease termination appeal proceedings now pending before the DNR Commissioner." State Opp. at 2. It asserts that staying the agency's PTU termination decisions would preclude DNR from concluding the related lease termination proceedings at the administrative level, which would not result in an ordered determination of the legal issues associated with the Point Thomson reserves.

In the termination decision of November 2006, the DNR Commissioner found that:

> DNR Oil and Gas Directors have certified seven exploration wells drilled into the PTU as capable of producing in paying quantities. With one exception, all of the certifications were issued in the 1970s and 1980s. All of the wells which were certified have been plugged and abandoned
>
> . . .
>
> There is no existing certified PTU well capable of producing in paying quantities. A PTU production well has never been drilled. No certified PTU well exists today.

[Ex. E to Chevron's Memo. at 12, 13.] In the December 2006 reconsideration decision, the Commissioner found that "the primary basis of the [unit termination] decision is the unequivocal statement that the Lessees cannot find a way to put the unit into production and their refusal to submit an acceptable POD." [Ex. F to Chevron's Memo at 6.]

Relying on 11 AAC 83.361, the Appellants assert that the plugged and abandoned wells in the unit that had been certified must still be "considered capable of producing hydrocarbons in paying quantities" pursuant to the Department's own regulations, such that judicial proceedings to seek unit termination are required under 11 AAC 83.374(d). The Appellants assert that the purported "decertification" of the wells at the administrative level was an invalid attempt to make subsection (d)'s requirement of judicial proceedings unnecessary. The Appellants have also submitted affidavits from a number of technical experts regarding well suspension practices that assert that the wells could be successfully reentered as production or injection wells.

Yet at the same time that the Appellants assert the wells should be considered as capable of producing hydrocarbons for purposes of default proceedings under 11 AAC 83.374, for purposes of actual production at Point Thomson, the Appellants appear to assert that the wells that were certified are in fact not currently capable of producing hydrocarbons in paying quantities. According to DNR's Director of the Division of Oil and Gas, the Appellants' proposed 22nd Plan of Development for the Unit "states that PTU development is not possible without modifying the laws regarding the State's right to taxes and royalties on oil and gas production and on construction of a North Slope gas pipeline." [Ex. C to Chevron's Memo. at 2].

But irrespective of the current actual ability of the plugged and abandoned wells to produce hydrocarbons in paying quantities, the undisputed fact remains that the Department certified these wells pursuant to 11 AAC 83.361 and that as a result of these certifications, the wells "will be considered capable of producing hydrocarbons in paying quantities" for purposes of 11 AAC 83.374. Although the State asserts that this

Court should look past the alleged procedural infirmities given the current actual status of the wells, parties appearing before an agency are entitled to relief when an agency has substantially failed to follow its own procedural regulations. Under the established precedent of the Alaska Supreme Court, "[an] agency is bound by the regulations it promulgates . . . An agency has not acted in the manner required by law if its actions are not in compliance with its own regulations." Trustees for Alaska v. Gorsuch, 835 P.2d 1239, 1244 (Alaska 1992)(citation omitted).

Upon review of the applicable regulations, this Court finds that the Appellants have made the requisite "clear showing of probable success on the merits" with respect to the procedures employed by DNR to terminate the Point Thomson Unit, and particularly whether 11 AAC 83.374(d) should have been applied to this unit termination proceeding. Of course, it is certainly possible that upon further briefing of the many complex and unprecedented legal issues presented in this case, this Court may be persuaded by the State that the Department's decisions should be affirmed. But upon consideration of the submissions of the parties to date and the representations of counsel at oral argument, this Court finds that at this initial stage of the appeal, the Appellants have made a clear showing of probable success with respect to the procedural challenges the Appellants have raised, and specifically with respect to DNR's apparent violation of its own procedural regulations.

But the determination of whether to grant a stay on appeal is to be "guided by the public interest." Keane, 893 P.2d at 1249. Fundamentally, the public interest with respect to the Point Thomson reserves is the production of oil and gas. "It is the policy of the State to encourage the . . . development of its resources by making them

available for maximum use consistent with the public interest." Ak. Const. Art. VIII, §1. See also §§ 11, 12. The Appellants assert that the public interest warrants the stay because if the decisions are stayed they will be able to continue development of the PTU. But this argument is not persuasive, as it is somewhat at odds with the Appellants' own proposed 22nd POD, which did not propose to put the unit into production. See, e.g., PTU REC 000871.

In addition, the State has persuasively demonstrated that it is in the public interest to accord to DNR a reasonable opportunity to address the related lease termination proceedings at the administrative level at this time. Over the course of the appeal, the public interest could be adversely affected by DNR's decertification action to the extent that that action generates uncertainty and instability among lessees or potential lessees throughout the state with respect to their rights in the state's oil and gas reserves. See, e.g., PTU REC 005743. But at this stage of the proceedings, the public interest warrants that DNR continue to be accorded a reasonable opportunity in the first instance to address the legal status of the Point Thomson leases. Allowing the agency that opportunity is consistent with the doctrine requiring exhaustion of administrative remedies. In explaining the reasons underlying that doctrine, the Alaska Supreme Court quoted the United States Supreme Court as follows:

> Judicial review may be hindered by the failure of the litigant to allow the agency to make a factual record, or to exercise its discretion or apply its expertise. . . A complaining party may be successful in vindicating his rights in the administrative process. . . And notions of administrative autonomy require that the agency be given a chance to discover and correct its own errors. Finally, it is possible that frequent and deliberate flouting of the administrative processes could weaken the effectiveness of an agency by encouraging people to ignore its procedures.

Eidelson v. Archer, 645 P.2d 171, 176 (Alaska 1982) *quoting* McKart v. United States, 395 U.S. 185, 194-195 (1969). Cf. Matanuska Electric Association v. Chugach Electric Association, 99 P.3d 553, 559 (Alaska 2004)(discussion of primary jurisdiction doctrine).

This court does find merit in the Appellants' argument that the public interest could be adversely affected in the absence of a stay because potential lessees would discount their bids if leases were reoffered to the public while this appeal is pending. But should DNR seek to reoffer oil and gas leases to the public at Point Thomson during the pendency of this appeal, the State has acknowledged that it will accord at least 60 days notice. See AS 38.05.035(e). That timeframe accords to the Appellants sufficient time to renew their stay motion with this Court as warranted.

Accordingly, the Appellants' motion for a stay of the non-monetary components of the PTU termination decisions is denied at this time, without prejudice to the Appellants' right to renew the motion during the pendency of this appeal, and particularly if DNR seeks to reoffer oil and gas leases at Point Thomson to the public.

With respect to the Commissioner's finding that the Appellants owe the State $20,000,000 for breach of the 2001 Expansion Agreement, the Appellants are entitled to a stay of that monetary portion of the Commissioner's Decision upon posting a supersedeas bond with this court in the amount of $25,000,000.

Dated this 1st day of May, 2007.

Sharon Gleason
Sharon Gleason
Judge of the Superior Court

I certify that on 5-1-07 a copy of the above was mailed/faxed to each of the following at their addresses of record
[signature]
Judicial Assistant

ellis
AG-todd
ashburn/crosby
orlansky
keithley
serdahely
rozell
dawson
ballew
brecht
walker

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State wins ruling over Slope field - POINT THOMSON: Alaska had right to reject Exxon's plan.

Anchorage Daily News (AK) - December 28, 2007

Author: *WESLEY LOY wloy@adn.com ; Staff*

The state has landed a sharp blow against oil titan Exxon Mobil with a judge's ruling that officials had the right to reject the company's noncommittal development plan for a giant North Slope oil and gas field. But whether the ruling is a knockout punch in the struggle for control of the Point Thomson field remains to be seen.

Exxon and other oil companies with a stake in the field still have legal options. And at a minimum, state Superior Court Judge Sharon Gleason ruled that the companies are entitled to a hearing before the state decides what to do next.

The ruling, which Gleason issued the day after Christmas, is a victory for Gov. Sarah Palin and her predecessor, Frank Murkowski, whose administration in 2005 made the first move to snub Exxon's development plan -- the 22nd offered by the company over the years -- for lack of a promise to start producing from the field, which has lain fallow for 30 years.

Weary of waiting, state officials since have suggested it's time to wrench the Point Thomson acreage away from Exxon and other leaseholders and offer it for sale to companies more eager to develop the field, which would create jobs and big tax dollars for the state.

Located just west of the Arctic National Wildlife Refuge, Point Thomson is believed to hold huge reserves of natural gas -- supplies considered critical for supporting a proposed natural gas pipeline.

Despite its riches, Exxon hasn't developed the field, citing technical challenges and the lack of a multibillion-dollar pipeline to carry the gas to the Lower 48 or Asian markets.

State officials counter Exxon has had plenty of time to exploit at least Point Thomson's considerable oil reserves plus its liquid gas, both of which could be shipped down the trans-Alaska oil pipeline.

The judge ruled state officials had the right, and substantial justification, to reject Exxon's development plan.

But Gleason also held the state was too hasty in breaking up the unit binding together Point Thomson leases covering 106,000 acres. Before state officials did that, the companies had a constitutional right to a written notice plus a hearing before the Department of Natural Resources, she ruled.

Exxon spokeswoman Kimberly Brasington said the ruling "confirms" that the state "was wrong" in dissolving the unit. Exxon and the other companies will keep working with the state to settle the conflict, she said.

Nan Thompson, a manager with the department, said Thursday state officials are "quite pleased" with Gleason's ruling overall.

She wouldn't say definitively, however, whether the state is hellbent on regaining control of the Point Thomson land and leasing it again.

"The state is eager to see this land developed," she said. "That's about as close as I can get to answering your question."

Exxon controls Point Thomson with a 53 percent stake. Other leaseholders include BP, Chevron and Conoco Phillips.

Outside of court, however, the state has moved to revoke the leases. The companies have appealed.

Find Wesley Loy online at adn.com/contact/wloy or call 257-4590.

Caption: Illustrated by Ron Engstrom ILLUSTRATION SHOWS MAP Photo by Bruce Webb, Alaska Department of Natural Resources

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TRANS-CANADA WITHDRAWN PARTNERS

STATE OF ALASKA

SARAH PALIN, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES & DEPARTMENT OF REVENUE

ALASKA GASLINE INDUCEMENT ACT

January 16, 2008

Anthony (Tony) M. Palmer
Vice-President Alaska Development
TransCanada PipeLines Limited
450 – 1st Street S.W.
Calgary, AB, T2P 5H1
Canada

Re: Request for information relating to ANNGTC agreements.

Dear Mr. Palmer:

This letter requests additional clarifying information related to the original partnership agreements of Alaska Northwest Natural Gas Transportation Company ("ANNGTC") and the Co-Applicants' Alaska Gasline Inducements Act ("AGIA") Application.

In accordance with Section 1.17 of the RFA, the Commissioners request that Co-Applicants (TransCanada Alaska Company, LLC and Foothills Pipe Lines Ltd., jointly) provide the information addressed in the attachment to this letter to assist the Commissioners in obtaining a clear and complete understanding of all aspects of the Co-Applicants' Application. The Commissioners request that Co-Applicants provide the requested information within five working days from the date of this letter. However, where possible, earlier responses to any of the questions by e-mail will facilitate the review.

Please submit the additional clarifying information, in writing and signed by an official with authority to bind the Co-Applicants, at the address below by 5:00 PM AST on January 24, 2008.

Paper copies must be submitted to:
AGIA License Office
State of Alaska, Dept of Revenue
550 West 7th Ave. Suite 1820
Anchorage, AK 99501

E-mails or Fax copies must be submitted to:
Mr. Chris Rutz
E-mail: crutz@aidea.org
Facsimile: 907-771-3930

Information submitted by e-mail or facsimile must be followed with a paper copy mailed or delivered to the address above. Please contact me at 907-771-3015, to confirm timely receipt of the information or if you have other questions concerning this request.

Sincerely,

Christopher Rutz C.P.M.
Procurement Manager

WRITTEN REQUESTS FOR ADDITIONAL DATA OR FOR CLARIFICATION
RFA Section 1.17

Confidentiality:

Co-Applicants may request that Proprietary or Trade Secret information submitted in response to this request for additional information be kept confidential. As set out in RFA Section 13.6, Co-Applicants must mark each page containing information that they request to be kept confidential, include a copy of the page with the Proprietary or Trade Secret information redacted, and provide a brief non-confidential summary for each section for which the Co-Applicants seek confidentiality (AS 43.90.160(b)).

The State understands that the original partnership agreements of Alaska Northwest Natural Gas Transportation Company ("ANNGTC") contained provisions under which the capital account of a withdrawing partner would be reclassified to "subordinated debt" of the partnership and payable by the partnership to the withdrawn partners after the Alaskan Natural Gas Transportation System became operational. The State further understands that such payments are required to be made when the partnership determines that they can be made without undue hardship. According to the April 12, 2007 "Financial Report to the Board of Partners of the Alaskan Northwest Natural Gas Transportation Company, Year 2006" filed with the Federal Energy Regulatory Commission "Obligations to Withdrawn Partners" is approximately $8.9 billion.

1. Please provide copies of the ANNGTC partnership agreement and any ancillary agreement(s) relating to the obligations of the partners of ANNGTC as the same have been amended or modified, and please identify the ultimate parent company for each withdrawn partner from that partnership.

2. Please provide an organizational chart that shows the relationship between TransCanada Corporation and the following entities: (1) TransCanada Alaska Company, LLC (one of the Co-applicants for the AGIA license); (2) Foothills Pipe Lines Ltd. (the other Co-Applicant for the AGIA license); (3) United Alaska Fuels Corporation (partner in) and (4) TransCanada PipeLine USA Ltd. (partner in ANNGTC).

3. Please identify the "applicable Canadian subsidiaries" of Foothills Pipe Lines Ltd. that are, "identified in the *Northern Pipeline Act* ('NPA') as having responsibility for the various zones of the Project in Canada" (Application at Section 1.3, Page 1-1) and describe what responsibility each entity has for each zone of the project in Canada.

4. Please state whether the ANNGTC holds any authorizations under the Northern Pipeline Act or otherwise for any facilities in Canada.

5. Please state whether Foothills Pipe Lines Ltd. or any of its subsidiaries holds any authorizations for facilities in the U.S. under the Alaska Natural Gas Transportation Act ("ANGTA").

6. Please provide all documentation whereby any of the withdrawn partners of the ANNGTC have acknowledged or agreed:

   (i) that there will be no obligation to withdrawn partners if the project proposed in the November 30, 2007, AGIA application is placed into service; or

(ii) that any partner withdrawing from that partnership forfeits all ownership rights, including past capital contributions.

7. Please provide all memoranda (internal or otherwise) and opinion letters from inside or outside counsel that TransCanada has received or commissioned evaluating TransCanada's obligations to withdrawn partners of the ANNGTC if the project proposed in the November 30, 2007, AGIA application is placed into service.

8. Please identify any obligations that the Co-Applicants, and their successors and assigns, would have to the partners of ANNGTC with respect to the AGIA project.

9. Assuming that the project proposed in the November 30 application is completed at the cost and on the schedule contained in the application.

   (i) Please state what the Co-Applicants would do with respect to rates for the project if either of the Co-Applicants or affiliates or subsidiaries of the Co-Applicants are ultimately required to pay any obligations to withdrawn partners of the ANNGTC. Would the Co-Applicants commit not to include any such payments in the rates for their proposed project?

   (ii) If the answer to (i) is yes, please confirm that such a commitment would be binding on the Co-Applicants if awarded the AGIA License.

TransCanada
In business to deliver

January 24, 2008

TransCanada PipeLines Limited
450 - 1st Street S.W.
Calgary, Alberta, Canada T2P 5H1

tel 403.920.2035
fax 403.920.2318
email tony_palmer@transcanada.com
web www.transcanada.com

AGIA License Office
State of Alaska, Dept of Revenue
550 West 7th Ave. Suite 1820
Anchorage, AK 99501

Attention: Mr. Christopher Rutz
AGIA License Office

Subject: Alaska Gasline Inducement Act
TransCanada Application for License
Additional Clarifying Information

Dear Mr. Rutz:

TransCanada acknowledges receipt of your correspondence dated January 16, 2008 in which TransCanada is asked to provide additional clarifying information to its November 30, 2007 Application for License. In that regard, please find attached our responses to the nine requests you forwarded.

We are submitting this reply document to the State by two means:

- we are today e-mailing an electronic copy to the attention of Mr Chris Rutz at crutz@aidea.org; and
- we are today forwarding the originally signed document by courier to the AGIA License Office, attention Chris Rutz.

Thank you for your ongoing consideration of our Application and I remain available to provide further information or participate in discussions that the State may wish to initiate.

Sincerely,

A. M. (Tony) Palmer
Vice President, Alaska Development

This response to the State's January 16, 2008 letter asking for additional information regarding Alaskan Northwest Natural Gas Transportation Company ("ANNGTC" or "the Partnership") is being submitted by TransCanada Alaska Company, LLC and Foothills Pipe Lines Ltd. (the "TransCanada AGIA Applicants" or "we"). We do not request confidential treatment for any of the information included in this response.

Before responding to the specific questions the State has asked, we believe that the following background information regarding ANNGTC will be helpful.

Background Information Regarding ANNGTC (Voluntarily Provided by the TransCanada AGIA Applicants)

ANNGTC was formed as a New York general partnership in 1978 to construct and operate the Alaska Natural Gas Transportation System ("ANGTS") pursuant to the Alaska Natural Gas Transportation Act of 1976 ("ANGTA"). The ANNGTC General Partnership Agreement (a copy of which is attached as Exhibit 1-A) anticipated that the pipeline would be built relatively promptly; thus, Section 3.3 of the Partnership Agreement, which sets forth the purpose of the Partnership, provides that the "Line" (defined in the Partnership Agreement as the "Gas pipeline to be owned and operated by the Partnership," extending from Prudhoe Bay to an interconnection with the Canadian pipeline) was to be put in operation by January 1, 1983 or "as soon thereafter as practicable." Each partner in ANNGTC was required to make an initial capital contribution equal to its pro rata share of up to $24 million and then to make annual capital contributions in the amount set by ANNGTC's Board of Partners each year. Partners who did not wish to continue contributing had the option of withdrawing, subject to a continuing obligation on the part of partners who joined later than others, to make equalizing payments to true up their capital contributions to the amount of the original partners' contributions.

The Partnership Agreement significantly limits the rights of partners that withdraw from the Partnership. Section 15.9 of the Partnership Agreement expressly provides that withdrawal "terminates the Withdrawing Partner's status as a Partner" and that a Withdrawn Partner "shall have those rights stated in Section 4.4.4 and no others." Section 4.4.4 provides that Withdrawn Partners are not entitled to any return of their capital contributions, except that they "shall be entitled to receive, after the Line becomes operational and at a time when the Executive Committee determines payment may be made without undue hardship to the Partnership" an amount equal to their respective capital contributions. If their right to payment is triggered, the Withdrawn Partners are also entitled to a return on their capital contributions, from the date of the withdrawal to the date of payment, "calculated at the rate permitted by the FERC to the Partnership as the Partnership's allowance for such funds during construction." Section 4.4.4 provides that the amounts due to Withdrawn Partners "shall be recorded as a contingent liability of the Partnership, and not as a Partner's Capital Account" and that their right to reimbursement is subordinate to the rights of the Partnership's other creditors. In FERC Order No. 31, issued in June 1979, the FERC preliminarily set the Partnership's AFUDC rate at 14% per annum.

There were originally eleven partners in ANNGTC. Partners began withdrawing in 1981; the last partner not affiliated with TransCanada withdrew more than a decade ago, in 1994.[1] The only remaining ANNGTC partners are TransCanada PipeLine USA Ltd. and United Alaska Fuels Corporation, both of which are indirect, wholly owned subsidiaries of TransCanada Corporation.

In accordance with the terms of the ANNGTC General Partnership Agreement, ANNGTC has recorded the amounts due to Withdrawn Partners under the Partnership Agreement as contingent liabilities on its financial statements. Those liabilities had grown to approximately $8.9 billion as of December 31, 2006.

Before the deadline for submitting applications under the Alaska Gasline Inducement Act ("AGIA"), the Partnership considered whether it could or should submit an application for the AGIA license. Ultimately, the Partnership concluded that the uncertainties created by ANNGTC's historical contingent liabilities would preclude it from making a viable proposal to be the AGIA licensee. Accordingly, ANNGTC has not made any application and has played no role in the AGIA application filed by the TransCanada AGIA Applicants.

It should be emphasized that the TransCanada AGIA Applicants are not, and have never been, partners in ANNGTC. They are entirely separate legal entities that have no obligations under the Partnership Agreement. Furthermore, their AGIA application does not contemplate the use of any assets owned by the Partnership (such as the certificate ANNGTC obtained from FERC under ANGTA or proprietary intellectual property licensed to or developed by the Partnership).

The State's January 16, 2008 request for information asks whether the TransCanada AGIA Applicants would have any liability to ANNGTC's Withdrawn Partners if the TransCanada AGIA Applicants were selected as the AGIA licensee and succeeded in constructing the pipeline. The answer to that question is "no"; the TransCanada AGIA Applicants would have no such liability. As noted above, the TransCanada AGIA Applicants are not, and have never been, partners in ANNGTC, and, their November 30, 2007 AGIA application does not contemplate the use of any Partnership assets. Moreover, they would have no liability for the same reasons that no other TransCanada entity, including the remaining partners in the Partnership, would have no such liability. Under the Partnership Agreement, contingent liabilities to Withdrawn Partners are triggered only if (among other things) the Partnership itself builds the Line contemplated by the Partnership Agreement—namely, the pipeline authorized under ANGTA. The remaining partners in the Partnership have no obligation under the terms of the Partnership Agreement to pursue that project (which, in any event, is no longer viable due to the contingent obligations of the Partnership) and owe no duties to their former partners who have withdrawn from the venture. Furthermore, the Partnership Agreement does not contain any provision that purports to limit the ability of a partner or former partner—let alone their respective affiliates—to pursue a

[1] The original partners in ANNGTC and their withdrawal dates are as follows: Texas Gas Alaska Corporation (1981), American Natural Alaskan Company (1982), Northern Arctic Gas Company (1984), Columbia Alaskan Gas Transmission Corporation (1984), Pan Alaskan Gas Company (1984), Pacific Interstate Transmission Company (Arctic) (1985), TETCO Four, Inc. (1989), Calaska Energy Company (1993), and Northwest Alaskan Pipeline Company (1994). Until its withdrawal in 1994, Northwest Alaskan Pipeline Company was the Operator of the Partnership.

separate pipeline project. Accordingly, neither the TransCanada AGIA Applicants nor any other TransCanada entity will have any obligation to the Withdrawn Partners if the TC AGIA Applicants succeed in building the pipeline proposed in their November 30, 2007 AGIA application.