ALASKA SUPREME COURT

ConocoPhillips Alaska, Inc. v. State, Department of Natural Resources

ConocoPhillips Alaska, Inc. v. State, Dep't of Nat. Res., 109 P.3d 914 (Alaska 2005) · Decided January 28, 2005

SUMMARY

The Alaska Supreme Court affirmed the Department of Natural Resources' denial of a discovery-royalty application for oil produced from the Midnight Sun Reservoir. The court held that the reservoir was part of the previously known Kuparuk C geologic structure and that the commissioner's decision was supported by substantial evidence and consistent with the lease and applicable regulations. The court also concluded that excluding the corporations' attorneys from participating in the administrative hearing was error, but harmless because the corporations failed to establish substantial prejudice.

CASE DETAILS

COURT	Alaska Supreme Court
WRITING FOR THE COURT	Bryner, Chief Justice; Bryner; Carpeneti; Eastaugh; Fabe; Matthews
JURISDICTION	Alaska
DECIDED	January 28, 2005
DISPOSITION	affirmed
PROCEDURAL POSTURE	The corporations appealed the Department of Natural Resources commissioner's denial of their application for a reduced discovery royalty rate. The superior court declined to conduct a trial de novo and affirmed the commissioner under deferential administrative-review standards. The corporations appealed to the Alaska Supreme Court.
STANDARD OF REVIEW	When reviewing an agency decision after the superior court acts as an intermediate appellate court, the Alaska Supreme Court directly reviews the merits. It applies substantial-evidence review to factual questions, the reasonable-basis test to legal questions involving agency expertise, the substitution-of-judgment test to legal questions not involving agency expertise, and a reasonable-and-not-arbitrary test to administrative regulations. Procedural due process issues are reviewed de novo.
PRECEDENTIAL VALUE	published; precedential Alaska Supreme Court opinion

PARTIES	ConocoPhillips Alaska, Inc., Exxon Mobil Corporation, ExxonMobil Alaska Production Inc., Forest Oil Corporation v. State of Alaska, Department of Natural Resources

TOPICS

judicial review of agency action · administrative law · oil and gas · mineral rights · procedural due process

PRACTICE AREAS

administrative law · oil and gas · mineral rights · contracts · constitutional law

QUESTIONS PRESENTED

1. Whether the commissioner's interpretation and application of the lease and former 11 AAC 505.741(b) correctly treated the Midnight Sun Reservoir as part of the known Kuparuk C geologic structure rather than as a new geologic structure qualifying for a discovery royalty.
2. What standard of review governed the commissioner's decision concerning the meaning and application of geologic structure.
3. Whether the commissioner's factual findings were supported by substantial evidence.
4. Whether the administrative hearing violated procedural due process by barring counsel from participating, prohibiting cross-examination, and denying post-hearing argument, and whether any error required a de novo hearing or reversal.
5. Whether the commissioner's decision constituted an unconstitutional impairment or modification of the corporations' lease rights.

HOLDINGS

1. The lease and former 11 AAC 505.741(b) permitted the Department of Natural Resources to apply a flexible, expertise-based standard for determining whether an oil discovery occurred in a new geologic structure. The commissioner properly considered physical separation, the existence of a structurally distinct entrapping mechanism, and commercial exploration risk, and correctly concluded that Midnight Sun was part of the known Kuparuk C geologic structure.
2. The commissioner's decision was subject to deferential administrative review rather than de novo judicial review because the lease made discovery royalty entitlement contingent on an agency determination involving agency expertise and discretion.
3. Substantial evidence supported the commissioner's finding that Midnight Sun was part of the Kuparuk C geologic structure, so the court was required to affirm that finding.
4. The commissioner improperly barred the corporations' counsel from participating in the administrative hearing, but the error was harmless because the corporations failed to show substantial prejudice.
5. The commissioner's decision did not constitute an unconstitutional legislative impairment of the lease because the lease itself authorized the Department to determine discovery royalty awards subject to the

governing regulations.

KEY QUOTATIONS

> *"We affirm the commissioner's decision, holding that it is supported by substantial evidence and correctly construes the terms of the lease according to the law in effect when the lease was signed."* (109 P.3d at 914)

> *"We also hold that the commissioner improperly barred the corporations' counsel from participating in the administrative hearing, but we conclude that this error was harmless because the corporations have failed to show substantial prejudice."* (109 P.3d at 914)

> *"The commissioner looked at three basic factors: whether the Midnight Sun Reservoir was a physically separate accumulation of oil; whether it had a structurally distinct entrapping mechanism; and whether its discovery entailed commercial risk."* (109 P.3d at 922)

> *"On this record, we conclude that the procedural error was harmless."* (109 P.3d at 924)

FACTUAL BACKGROUND

The corporations held a 1965 Alaska DL-1 oil-and-gas lease containing a discovery royalty clause for the first commercial discovery of oil or gas in a geologic structure. In 1997, the Sambuca No. 1 well discovered oil in the Midnight Sun Reservoir, a geographically discrete Kuparuk C sandstone accumulation north of the Prudhoe Bay bounding fault. The Department of Natural Resources concluded that Midnight Sun shared the entrapping mechanism and structural characteristics of the previously known Kuparuk C geologic structure and denied the requested reduced royalty. The commissioner also found that the well was drilled from an existing pad in a developed area, with Ivishak as its primary target, and therefore did not involve the type of commercial risk the discovery royalty program was intended to reward.

PROCEDURAL HISTORY

The Department of Natural Resources director denied certification of a discovery royalty for the Midnight Sun Reservoir. The corporations appealed to the commissioner, who affirmed after an administrative hearing in which counsel was barred from participating. The superior court treated the matter as an ordinary administrative appeal, declined a de novo hearing, and affirmed. The Alaska Supreme Court directly reviewed the agency decision and affirmed.

DISPOSITION

affirmed

CASES CITED

- Arkla Exploration Co. v. Texas Oil & Gas Corp., 734 F.2d 347 (8th Cir. 1984)
- Exxon Corp. v. State, 40 P.3d 786 (Alaska 2001)
- Alyeska Pipeline Serv. Co. v. DeShong, 77 P.3d 1227 (Alaska 2003)
- Jager v. State, 537 P.2d 1100 (Alaska 1975)

- Tesoro Alaska Petroleum Co. v. Kenai Pipe Line Co., 746 P.2d 896 (Alaska 1987)
- Pan Am. Petroleum Corp. v. Shell Oil Co., 455 P.2d 12 (Alaska 1969)
- Commercial Fisheries Entry Comm'n v. Baxter, 806 P.2d 1373 (Alaska 1991)
- Mathews v. Eldridge, 424 U.S. 319 (1976)