IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT AT ANCHORAGE

DENALI CITIZENS COUNCIL, Appellant, v. ALASKA DEPARTMENT OF NATURAL RESOURCES, USIBELLI COAL, INC Appellees.	) Case No. 3AN-10-12552 CI

REPLY BRIEF OF APPELLANT DENALI CITIZENS COUNCIL

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I. INTRODUCTION

The dispute in this case is simpler than appellee Department of Natural Resources (DNR) makes it out to be.[1] The administrative record in this case demonstrates that DNR founded its "best interest" finding on its conclusion that a smaller leasing area would not be economically feasible and its statement that the mitigation measures are "among the strongest and most detailed" in the State. Yet in its primary defense, DNR asserts that Denali Citizens Council (Denali Citizens) cannot challenge the best interest finding based on these points. The record, however, reveals that these points go to significant issues, and that DNR's treatment of them is not supported in the record. Consequently, to agree with DNR's argument is to render meaningless judicial review of the best interest finding. The law does not sanction that result.

Arguing in the alternative, DNR then defends its economic feasibility and mitigation measure statements, asserting that they are supported in the record. This is not so. Indeed, if DNR were correct that a record as weak on these points as the one is here, DNR would be free to make any statement with impunity in support of its best interest findings, no matter how baseless or illogical.

II. STANDARD OF REVIEW

DNR does not take issue with the standard of review set forth by Denali Citizens: that judicial review is focused on whether DNR's best interest finding has a "reasonable basis" and is not "arbitrary" or "capricious." *Compare* DNR Brief at 5-6 *with* Denali

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[1] License holder Usibelli Coal Mine (UCM) chose not to defend DNR's decision with its own brief in this appeal; rather it joined in DNR's brief.

Citizens Brief at 3-4. This standard requires that DNR factual findings be based on "substantial evidence," *Alaska Ctr for the Env't v. State,* 80 P.3d 231, 236 (Alaska 2003) and that the record demonstrate that DNR took a "hard look at the salient problems" and engaged in "reasoned decisionmaking." *Trustees for Alaska v. State, DNR*, 795 P.2d 805, 811 (Alaska 1990).

III. ARGUMENT

A. DNR's Finding Must Be Supported In The Record

DNR asserts that its responses to public comments are not relevant to the judicial task of determining whether DNR's decision is arbitrary. DNR Brief at 9-12. According to DNR, the "arbitrary and capricious" standard of review does not apply to public comments and so long as DNR "considered, summarized and responded" to public comments, it has met its legal burden.

DNR's argument is misplaced. Denali Citizens does not challenge the response to public comment, but rather supports its claim that DNR's decision to grant the exploration license is arbitrary with statements that DNR made in response to public comments. This is what is meant by the "reasonable basis" standard of review – the record must demonstrate that DNR engaged in "reasoned decisionmaking" and took a "hard look at the salient problems." *Trustees*, 795 P.2d at 811.

That the issue of the size of the license area and the mitigation measures imposed on the license are salient issues is addressed in the opening brief and below. That is the only threshold that Denali Citizens must cross before relying on those issues to demonstrate that DNR's decision is not supported in the record.

Indeed, to find otherwise is to declare meaningless the public review and comment process. If DNR's position were to stand, its response to public comment could be conclusory and still pass legal muster, which is not true. *See Alaska Ctr for the Env't,* 80 P.3d at 236 (fact findings must be based on "substantial evidence); *see also Seattle Audubon Society v. Moseley*, 798 F. Supp. 1473, 1479 (W.D. Wash. 1992), *aff'd* 998 F.2d (9th Cir. 1993).

If DNR's position were to stand, its response to comments could also be complete nonsense and still pass legal muster. Suppose for the sake of illustration that DNR had decided to lease the downtown area of Anchorage for oil and gas activities. The downtown community submits comments to DNR and opposes the decision on the grounds that homes and business will be negatively impacted by the oil and gas activities, and documents to DNR several factors that make this likely to be true. DNR considers the comment, summarizes it in the record, and responds with the statement that "no, homes and business will not be impacted because the sky is blue." According to DNR's argument in this case, this response could not form the basis of a successful challenge to DNR's decision to lease the downtown area; if DNR met its duty to consider, summarize and respond, the logic of the response has no bearing on the legality of DNR's decision. This cannot be true if there is to be meaningful judicial review of DNR's best interest finding; the deference ends where ignorance or illogic begins.

Kachemak Bay, which DNR cites in support of its argument, DNR Brief at 12, is inapposite to DNR's point. That case dealt with a challenge to a best interest finding for an oil and gas lease sale in Cook Inlet. *Kachemak Bay Conservation Soc'y v. State, DNR*,

6 P.3d 270 (Alaska 2000). The appellants in that case argued, among other things, that DNR's finding was arbitrary because DNR had not taken a hard look at transportation methods and risks, or at potential sociological impacts. *Id.* at 284-85. In its analysis of appellants' claims, the Alaska Supreme Court conducted a thorough review of the finding and record in that case on those specific issues, and did not simply defer to DNR's treatment of public comment, *id.*, as DNR's counsel would have the court do here.

Consequently, DNR's contention that the merits of its responses to public comments are somehow outside the realm of judicial review is wrong.

B. DNR's "Best Interest" Finding Is Arbitrary

1. The Size Of The Lease Area And The Terms Of The Lease Are Salient Issues

Appellants must meet the threshold in an arbitrary and capricious challenge that the issues it raises are salient, i.e. significant. *Trustees*, 795 P.2d at 811. The issues of lease sale size and adequacy of mitigation measures to support DNR's core reliance in the best interest finding on such measures are significant issues.

The issue of the geographic scope of the license area implicates area residents, the Healy residential community, and the wildlife and recreation-rich Wolf Townships. *See e.g.,* Denali Citizens Brief at 8 and record cites therein. DNR is also required by law to consider fiscal issues in its decision, *see* AS 38.05.035(g)(1)(B)(ix), and DNR applied this authority to find that the economic feasibility of licensing a smaller area is a mandatory consideration. *See* Exc. 604-05 (DNR "must consider whether or not the project will be economically feasible…"). DNR also recognizes that the State's interest

allows it to delineate exploration license areas that are smaller than those requested by the applicant, *see* DNR Brief at 13, and thus whether that authority exists is not at issue in this lawsuit.[2] Whether mitigation measures exist and operate in a manner that fulfills DNR's commitment is also important to finding the appropriate balance of the State's interest. *See* Denali Citizens Brief at 8-11 and record cites therein. Both of these issues were also the source of significant controversy in the administrative decision-making process, which also illustrates their significance. *See e.g. id.* and record cites therein.

Consequently, it cannot reasonably be argued that these are not salient issues, and DNR does not do so.

2. DNR's Reasoning For The Size Of The Lease Area Is Not Supported In The Record

DNR spends significant effort refuting an argument that Denali Citizens does not make. Denali Citizens is not asserting that DNR lacks authority and discretion to issue a license as geographically large as it did. Consequently, DNR's arguments that it was not

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[2] DNR in its brief takes a narrow view of the state's interest. DNR Brief at 13. In the record, DNR interpreted this interest and applied it to the Healy gas license decision in a manner that highlighted the need to be especially sensitive to local interests. *See* Exc. 148 ("the revenue stream to the state from the proposed exploration license and any downstream production is not expected to significantly impact the overall oil and gas revenue of the state of Alaska. *The best interests of local residents is therefore of critical importance to the best interest decision.*") (emphasis added). This interpretation and application are consistent with the statutory best interest factors.

Consequently, DNR cannot argue that the concerns raised by Denali Citizens about the size of the license area are somehow not relevant to the DNR decision. Since DNR acknowledges that it has the authority to limit the size of the license area its suggestion that the relevant interests may be narrow is an unnecessary distraction. The Court can thus remain focused on the logic and support for DNR's decision not to limit the size of the license area.

necessary to reduce the license area for the license to be in the State's best interest, DNR Brief at 13-22, are simply irrelevant.[3]

What DNR must do in its decision is provide a rational basis for the decision it does make, and that is where DNR fails. In other words, Denali Citizens is not asking the Court to second guess DNR's decision and determine of its own accord the appropriate geographic scope of the license; rather Denali Citizens is asking the Court to hold DNR to the deferential, but not blindly so, arbitrary and capricious standard for its decision.

In reviewing a DNR decision, a court should analyze whether DNR has given reasoned consideration to all materials facts and issues "with particular vigilance if it 'becomes aware, especially from a combination of danger signals, that the agency has not really taken a hard look at the salient problems and has not genuinely engaged in reasoned decision making.'" *Trustees,* 795 P.2d at 809 (citations omitted). Those "danger signals" exist here with respect to DNR's rejection of a smaller license area on the ground that doing so "may make the project economically infeasible," Exc. 515, in the form of the following facts:

* UCM previously filed 15 exploration applications for an area less than one fifth the size of the area ultimately covered by the DNR license. Exc. 8-47, Exc. 56-90.

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[3] DNR also appears to suggest that Denali Citizens argues that the burden of proof in this lawsuit is upon DNR. *See e.g.*, DNR Brief at 9. That is not true. Denali Citizens knows that it must demonstrate that DNR's decision is arbitrary and that it has no rational basis in the record. Still, DNR's record must have that rational basis on salient issues, or it cannot stand.

* The financial hurdles for these original applications were higher than for the subsequent license granted by DNR because the law – H.B. 531 -- had been changed to significantly lower the up-front financial hurdle. *Compare* Exc. 2-7, 8-47 and 56-90 *with* Exc. 140, 138, 684.

* UCM requested that its 208,000 acre application be delayed until it was clear whether or not H.B. 531 would pass, and let stand its 15 original applications in this time period, only letting them lapse after H.B. 531 became law. Exc. 612-15.

These facts strongly suggest, if not outright prove, that a Healy gas exploration license area smaller than 208,000 acres would be economically feasible for UCM in the Healy area; otherwise there would have been no reason for UCM to have filed the 15 applications and hedge its bets as it did during legislative consideration of H.B. 531.

DNR provides no discussion in the record of the prior lease applications and their relevance to the economic feasibility of the final agency approval. DNR's sole point raised in its brief about the prior lease application is that

> the existence of a prior *lease application* unrelated to the proposal before DNR here demonstrates nothing about whether DNR's consideration and approval of *this exploration license* had a reasonable basis.

DNR Brief at 21, note 2 (emphasis in original). Because DNR does not defend the decision on these grounds, it in essence admits that it did not factor this issue into its conclusion that a smaller area "may make the project economically infeasible." Exc. 515.

Rather, DNR's counsel now defends DNR's statement by asserting that its "economic infeasibility" statement was not focused on the exploration license itself, but rather is only relevant to the question of whether development and production take place.

DNR Brief at 24. This shift, from looking at the economic feasibility of the decision before the agency – whether to grant an exploration license to UCM – to a decision made by the developer at a later stage – whether a discovery is economically viable to develop and bring into production, opens the door for DNR to now assert that

> [t]here were several factors before DNR that indicated that eliminating the area west of the Nenana River could result in economic unfeasibility at the development stage.

DNR Brief at 24.

As an initial matter, that the viability of a license to encourage exploration is a relevant consideration is evident from the record. As DNR's Commissioner stated in the record, DNR emphasized exploration in its decision and stood to gain "valuable" information regardless of what happens after that exploration:

> In determining if *an exploration license* is in the best interest of the state, [DNR] is required to consider and discuss a wide range of matters [including the] "reasonably foreseeable fiscal effects" of *the exploration license* (AS 38.05.035(g)((1)(B)(ix)). To consider this factor, [DNR] must consider whether or not the project will be economically feasible to the licensee, given the size of the license area, the mitigation measures, and other regulatory requirements. .... The intent of *exploration licensing* is to encourage exploration in areas far from existing infrastructure, with relatively low or unknown hydrocarbon potential, where there is a higher investment risk to the operator; *the state also receives valuable subsurface geologic information from the exploration of new areas. If an exploration project does not occur because it is not economically feasible for the licensee*, the state will not realize these benefits.

Exc. 604-05 (emphasis added). Consequently, DNR's argument that development should be the sole focus of the Court's inquiry into whether there is a rational basis in the record for DNR's "economic feasibility" statement is simply wrong.[4]

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[4] This conclusion, while not needing further support, is nevertheless consistent with DNR counsel's arguments in this appeal. Such counsel takes great pains to point out in

In any event, DNR's points about development are not supported in the record. In its brief (and not in any analysis in the record), DNR focuses on four record citations to three documents to support its view that development may not be economically feasible (which, again, is too limited a question): a letter from UCM to the Denali Borough, and the preliminary and final best interest findings. DNR Brief at 25. None of these citations rebut directly the factual "danger signals" relayed above. The UCM letter does not explain why UCM thought exploration on a ~40,000 acre area was so worthwhile as to ensure that UCM hedged its bets with a series of 15 applications costing $5,000 each, which it variously activated and put on hold in case H.B. 531 did not pass.[5] It thus should not be considered part of a reasonable basis for DNR's decision.

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an argument section entitled "The Written Finding Grants Only The Right To Explore, Not The Ability To Exercise That Right Or To Progress To Development" that DNR's decision focused on exploration:

> while DNR's assessment of whether this Exploration License best serves the State's interest looks forward to what may develop in the future, it is important to bear in mind that this decision itself does not authorize any such activity. This Healy Final Written Finding approves an exploration license and nothing more.

DNR Brief at 6.

[5] Indeed, in a later letter to the Borough, UCM references its attempts to gain exploration approval in both the pre and post H.B. 531 contexts, and states that it "has been very open and candid in discussing its desire to develop potential gas resources that may exist in the Denali Borough." Exc. 1069. This provides yet another record basis for the conclusion that UCM's decision to place its 15 applications on hold pending resolution of H.B. 531 should be taken at face value; i.e. that UCM was planning on moving forward with its effort to gain authorization for exploration on ~40,000 acres. And UCM itself – which chose not to file a brief in this appeal and rather joined in DNR's brief – bypassed the opportunity to enlighten the Court with reference to evidence in the record on its intent or economic feasibility assessment.

DNR's argument based on UCM's comment in the preliminary finding is also misplaced. DNR's counsel argues that "[i]f a mere setback along the east and west shores of the river threatens the economic viability of the project, then it stands to reason that excluding the entire area west of the river would as well." DNR Brief at 25. This *post-hoc* rationalization is improper as a matter of administrative law, as an agency decision can only stand on DNR's record, and not DNR counsel's later rationalizations.[6] Moreover, this argument misrepresents what UCM actually stated. In the relevant comment, UCM states that "[s]ignificant topographical contrasts and features exist along the Nenana River Corridor that further inhibits operational, economic and environmental practicality and prudence in compliance with [the] setback." Exc. 339. Such a fact-specific point cannot reasonably be used to support DNR's vast economic feasibility generalization.

Finally, DNR refers the Court to the final finding and a discussion of the importance of "proximity to existing transportation, storage, and processing facilities" as a "major consideration" in development, especially of "marginally economic" fields. DNR Brief at 25, *citing and quoting* Exc. 440, 492. DNR intends this reference to support its assertion that development without greater than 200,000 acres available for exploration may not be economically feasible. DNR Brief at 25. Yet, UCM itself states

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[6] *See Oregon Natural Desert Ass'n v. Bureau of Land Mgmt.*, 531 F.3d 1114 (9th Cir. 2008) ("[T]he courts may not accept appellate counsel's post-hoc rationalizations for agency action . . . . It is well established that an agency's action must be upheld, if at all, on the basis articulated by the agency itself.") (citing *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 50 (1983)); *see also Fort Funston Dog Walkers v. Babbitt*, 96 F. Supp. 2d 1021, 1032-33 (N.D. Cal. 2000) (justification of decision must be contemporaneous with the decision and not supplied after the fact).

that its primary goal for exploration is "to find and produce gas to power its mining operations" and only if "larger quantities are discovered" would it consider distributing the gas to "Southcentral utilities." Exc. 359. And, as DNR states:

> UCM has ... DNR-issued coal leases in the license area. These include four permitted mine sites. Extensive infrastructure and facilities exist in support of these operations including numerous roads and trails, maintenance and office facilities, crushing and load out facilities, and related power plants, power lines and interties, railroad lines and spurs.

Exc. 380. Therefore, DNR's reference to the "major consideration" of "proximity to existing transportation, storage, and processing facilities" actually supports the view that this area has low transportation and facility-related infrastructure costs.

Consequently, there is no reasonable basis in the record for DNR's statement that a smaller license area "may make the project economically infeasible." Because the geographic scope of the license area is a salient issue, and DNR's reasoning to reject consideration of a smaller scope is not supported in the record, DNR's finding is arbitrary. *Trustees*, 795 P.2d at 809.

3. DNR's Reasoning That The State's Interest Is Protected By Mitigation Measures Is Not Supported By The Record

DNR mischaracterizes Denali Citizens argument on mitigation measures as an attack on those measures, and then claims that Denali Citizens cannot attack DNR's decision whether to impose specific mitigation measures as arbitrary and capricious. DNR Brief at 26. DNR sidesteps the point. DNR stated during the administrative process, including in the final best interest finding, that the mitigation measures in the Healy exploration license "are among the strongest" in the State. *See e.g.* Exc. 599, R.

1682, 2184. Yet DNR significantly watered down the applicable mitigation measures during the administrative process, stating that the original measures might be "unnecessarily restrictive" and paradoxically stating that it did not intend to make the protections weaker. *See e.g.* Exc. 602. It is this paradox, and the failure of the record to support DNR's statements, that demonstrates that DNR's final finding is arbitrary and capricious.

DNR seeks to avoid the entire issue by asserting that "[m]itigation measures are not findings that a disposal is in the best interest of the State," DNR Brief at 26, and that "the sufficiency of mitigation measures is not part of DNR's determination that an exploration license best serves the State's interest." *Id.* at 28. While mitigation measures are not findings, DNR cannot reasonably claim that mitigation measures are irrelevant to the finding; indeed the very first sentence of the mitigation measure chapter in the final finding contradicts DNR's point. *See* Exc. 500 (addressing DNR authority and discretion to impose conditions "to ensure that a resource disposal is in the state's best interest").

DNR's administrative practice also supports this point. In the Nenana Basin exploration license best interest finding, for example, DNR stated that mitigation measures are the key to ensuring that the state's best interest will be served:

> ADNR is conditioning this best interest determination, and any licenses issued under it, with a number of mitigation measures designed to reduce or eliminate possible adverse effects, and to ensure that future exploration, development, production, and transportation activities will serve the best interests of the state.

Nenana Basin Final Best Interest Finding at 1-8, *available at* http://dog.dnr.alaska.gov/programs/ExplorationLicenseAreas.htm#nenana (visited

January 16, 2012).[7] DNR took the same approach in its Susitna exploration license best interest finding. *See* Susitna Final Best Interest Finding at 1-8, http://dog.dnr.alaska.gov/programs/ExplorationLicenseAreas.htm#susitna (visited January 16, 2012).

As this language unequivocally demonstrates, DNR has specifically used mitigation measures to ensure that the State's best interests will be served in an exploration license decision; indeed in the Nenana and Susitna contexts they were a critical part of the foundation for DNR's best interest determinations. To be sure, DNR retains the discretion to impose additional measures on the subsequent activities of license holders. *See e.g.* Nenana Basin finding at 7-1 (measures may be imposed at later phases). But as demonstrated above DNR can and does set the minimum measures in the initial best interest finding in order to protect the state's interest.

a. The Blanket Exception

Notably, the treatment of exceptions to the mitigation measures in the Nenana, Susitna and other DNR decisions are, by their plain language, stricter than those applied in the Healy Basin decision. *See* Denali Citizens Brief at Attachment A (comparative presentation of blanket exception to mitigation measures). DNR's counsel tries to obfuscate this point by claiming that the change in language in the blanket exception is meaningless; that the terms "practicable" and "feasible and prudent" are "synonyms."

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[7] The Court may take judicial notice of these government documents. Alaska R. Evid. 201(b); *see also Greeson v. Imperial Irr. Dist.*, 59 F.2d 529 (9th Cir. 1932) ("[w]e may take judicial notice of records and reports of administrative bodies).

DNR Brief at 30-37. Yet DNR admits in the record that this change was intended to make gaining an exception easier on UCM. *See* Exc. 539-40 (UCM comment seeking more consideration of economics in mitigation measures; DNR responding that it had changed "feasible and prudent" standard to the "not practicable" standard, which specifically includes cost consideration).[8] And if DNR counsel's view was truly the case, DNR's explanation that the original measures were "unnecessarily restrictive," Exc. 602, would be nonsensical. There is simply no possible interpretation of the "unnecessarily restrictive" phrase in the context of the Healy Basin decision than that DNR had loosened the measures. DNR counsel's claim is thus nothing but an improper attempt to rewrite the record. *Oregon Natural*, 531 F.3d 1114 ("[T]he courts may not accept appellate counsel's post-hoc rationalizations for agency action . . . . It is well established that an agency's action must be upheld, if at all, on the basis articulated by the agency itself.") (citing *Motor Vehicle.* 463 U.S. at 50 (1983)); *see also Fort Funston,* 96 F. Supp. 2d at 1032-33 (agency decision stands or falls on the record, not on post-hoc arguments).

DNR attacks as inapposite Denali Citizens' comparison of this standard to that used in the Clean Water Act, stating that the Clean Water Act example "calls for a vastly different inquiry into whether there is any practicable alternative to a proposed activity,"

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[8] DNR also argues that the change was made to align the best interest finding with the Alaska Coastal Management Program. DNR Brief at 31-32. Nowhere in the record is this explained. Such *post hoc* rationalizations are improper. *Oregon Natural*, 531 F.3d 1114 (*citing Motor Vehicle,* 463 U.S. at 50); *see also Fort Funston*, 96 F. Supp. 2d at 1032-33. And, regardless, this argument is specifically rebutted by evidence that is in the record, i.e. that the new standard allows for greater consideration of economics, Exc. 539-40, and by DNR counsel's own admission that the ACMP does not apply in the Healy Basin. DNR Brief at 35.

while in the Healy Basin context the issue is "whether a licensee has demonstrated that compliance with an existing requirement is not practicable." DNR Brief at 36-37. DNR misses the point. In the relevant context, through its use of the lower "practicable alternative " standard, the Clean Water Act *encourages* the identification of less environmentally-damaging alternatives to the placement of fill in waters of the U.S. *See* 40 C.F.R. 230.10(a). DNR, on the other hand, changed its finding to use this lower standard in a context where alternatives to strict application of the mitigation should be *discouraged.*[9]

b. Specific Mitigation Measures

As an initial matter, DNR never supports with any Healy-specific analysis its statement that the mitigation measures might somehow be "unnecessarily restrictive" on UCM and, by not filing a brief, UCM itself bypassed the opportunity to point to any such evidence in the record. Evidence that is in the record on the potential impact of the measures on UCM includes the following statement from UCM on the mitigation measures in the preliminary finding:

> The operational practicalities and economics would be significantly affected if DNR were to impose any more onerous mitigation measures.

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[9] DNR's counsel refers the Court to a case that had claims dealing with both the "practicable" and "feasible and prudent" standards in support of its position that these standards are synonymous. DNR Brief at 36, *citing Conservation Law Found'n v. FHWA*, 24 F.3d 1465, 1467 (1st Cir. 1994) [sic, pinpoint likely should be 1476]. Denali Citizens finds no statement or analysis in that case that support this point. The court did address simultaneously the application of the laws in which these standards were found (the Clean Water Act and Transportation Act), but focused its analysis on the Clean Water Act standard and nowhere stated that they were the same, or analyzed the similarities or differences between the two; rather it simply found that the agency findings were supported in the record of that case. *See id.* at 1476.

Exc. 337.

Consequently, the following evidence exists related to the mitigation measures:

* UCM statement that its project would only be "significantly affected" if DNR imposed "more onerous" measures than those in the preliminary finding. Exc. 337.

* DNR's statements that the measures are "among the strongest in the State." Exc. 599.

* DNR's commitment that the Mat-Su coal bed methane standards would apply. Exc. 123-24, 589, 95.

In order for its decision to have a rational basis in the record, DNR would have needed to explain why the measures were unnecessarily restrictive on a company that had stated in that record that only "more onerous" measures would significantly impact its operations. Notably, DNR does not address this core issue in its brief. Rather, with respect to setbacks in residential neighborhoods, DNR focuses on the experience of oil and gas projects in other residential areas. DNR Brief at 39, *citing* Exc. 602. Given the evidence in the record in this case that the measures as set out in the preliminary finding are not too restrictive for the specific applicant here, Exc. 337, what does or does not happen outside the area is not relevant. Further, the Healy area does not have a large population, and residential areas are small and concentrated on the west side of the Nenana River, while the vast majority of the license area is east of the river. *See* R.234, 236, 156, Exc.329. These factors support the view that setback requirements would not be unnecessarily restrictive, and further differentiate the Healy area from the Kenai Peninsula.

Trying to sidestep the issue, DNR also argues that the measures are protective of landowners. DNR Brief at 40. DNR eliminated the small lot subdivision exclusion, leaving only a setback requirement for inhabited lots of 500 feet for drill pads and 1,500 feet for compressor stations. Exc. 524, 502. This latter standard is the only one related to activities in residential areas that is set in the final finding; every other one, including those referenced by DNR in its brief, DNR Brief at 40-41, puts off until later phases what measures may apply. An exclusion is more protective than a small setback with all related critical issues put off until later.

The unfounded nature of DNR's approach is even starker with respect to noise and caribou measures. DNR eliminated specific sound limits that were present in the preliminary finding, Exc. 254 (and which were similar to the Mat-Su coalbed methane standards, see Exc. 116-17), providing instead that they "will be considered on a site-specific basis." Exc. 502-03. In making the change, DNR stated that its "intent ... was not to weaken protections, but to ensure flexibility while not unnecessarily restricting the licensee's activities." Exc. 602.

DNR's counsel claims that the elimination of specific sound levels is of no matter; that landowners can advocate for specific noise limits at later phases, and appeal them if desired. DNR Brief at 42. Counsel concludes by asserting that DNR is "entitled to deference on these mitigation measures." DNR Brief at 43.

Again, DNR's counsel mischaracterizes the issue. Denali Citizens does not challenge DNR's ability to impose specific measures. What Denali Citizens does argue is that DNR's statement that the license is in the best interest of the State because, among

other things, the standards are strong, is completely undercut by the elimination or minimization of critical mitigation measures. If DNR has a rational basis in the record for this change, its finding might not be arbitrary, but DNR's reasons for doing so – that the original measures were "unnecessarily restrictive" and that the new measures are not weaker than the original measures -- are not supported by the record.[10]

With respect to impacts on caribou, the final finding provides that DNR "may impose" restrictions on subsequent activities. Exc. 505. DNR's counsel urges the Court to interpret this to mean that DNR somehow has imposed a restriction on activities. DNR Brief at 44. Yet not only is there is no limit placed on any specific activity, the promise of future restrictions is illusory, as the measure is wholly discretionary. This is shown by the use of the phrase "may impose," as opposed to something mandatory such as "will impose." Exc. 505.

That this is not a meaningful standard is demonstrated not only by its plain meaning, but also through the fact that DNR in other measures clearly knows how to write declarative mitigation measures, and has done so at the final finding decision point. *See e.g.*, Exc. 504-05 (Healy Basin mitigation measure 2f – seasonal restriction on

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[10] DNR counsel's point that Denali Citizens is somehow protected because it retains the right to challenge mitigation measures at later phases, while strictly irrelevant to the claim here, is telling of the shell game that DNR plays with parties challenging its decisions. Once the disposal decision is made – which is the reason for and focus of this license decision – there is no standard by which to judge DNR's decision whether or not to impose a specific mitigation measure. To be sure, if DNR mis-applies a standard, i.e. by allowing a structure 10' as opposed to 500' feet from an inhabited house, and doesn't apply the blanket exception or otherwise adequately explain its decision, a challenge may stand. But that is a far different question than whether a disposal that DNR claims is strictly conditioned by strong mitigation measures is in the state's best interest. This latter question is the focus here, and DNR does not revisit it later.

exploration within ½ mile of bear dens); Susitna Basin Final Best Interest Finding at 7-3, mitigation measure 10 (same); Nenana Basin Final Finding at 7-6, mitigation measure 20 (same).

In the end, DNR's own words in its brief condemn its defense:

> [b]ecause there is no specific Plan of Operation or proposed activity for DNR to assess at this point, *these mitigation measures* ***must be*** *generalized* to apply to a broad spectrum of activities that could be proposed throughout the life of the Exploration License and potential lease.

DNR Brief 45 (emphasis added). DNR's statement that it has no discretion to impose more stringent or specific measures is belied by the agency's own practice, both in terms of specific mitigation measures that it imposes on exploration licenses and by its own conditioning of other exploration license best interest findings on stringent mitigation measures. The Court should thus reject DNR's attempt to rewrite history, and find that its statement that the existence of strong mitigation measures supports its finding has no rational basis, and thus its best interest finding is arbitrary.

III. CONCLUSION

Even under the deferential "arbitrary and capricious" standard of review, DNR's finding must have a rational basis and be supported by the record. In the context of the record in this case, it is not rational for DNR to assume that a smaller lease sale area – whatever that may be – is not economically feasible. In the context of the record in this case and as seen in DNR's own agency practice, it is not rational for DNR to state that its finding is proper because the mitigation measures are among the strongest in the State and they will be strictly applied.

The law requires that DNR objectively determine the best interests of the state and ensure that its land disposal decisions serve those interests. *State. DNR v. Arctic Slope Regional Corp.*, 834 P.2d 134, 143 (Alaska 1991). The public appropriately defers to the state in making those assessments, but the check on the state's actions is that its best interest decision must have a reasonable basis in the record before the agency. In the case at hand, that reasonable basis does not exist.

For these reasons, the Court should set aside the finding and require a new best interest finding should UCM choose to proceed with the project.

Dated: January 23 2012

Respectfully submitted,

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