IN THE SUPREME COURT OF THE STATE OF ALASKA

DENALI CITIZENS COUNCIL, Appellant, vs. STATE OF ALASKA, DEPARTMENT OF NATURAL RESOURCES, and USIBELLI COAL MINE, INC., Appellees.	)	Supreme Court No. S-14896

Superior Court No. 3AN-10-12552CI

REPLY BRIEF OF APPELLANT DENALI CITIZENS COUNCIL

APPEAL FROM A FINAL JUDGMENT OF THE SUPERIOR COURT
THIRD JUDICIAL DISTRICT AT ANCHORAGE
THE HONORABLE ANDREW GUIDI, PRESIDING

FOR Peter Van Tuyn, AK Bar No. 8911086
Karen E. Schmidt, AK Bar No. 1211113
BESSENYEY & VAN TUYN, L.L.C.
310 K Street, Suite 200
Anchorage, AK 99501
(907) 278-2000 phone
(907) 278-2004 fax
peter@bvt-law.com
karen@bvt-law.com

Attorneys for Denali Citizens Council

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Deputy Clerk

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AS 38.05.035(e)

(e) Upon a written finding that the interests of the state will be best served, the director may, with the consent of the commissioner, approve contracts for the sale, lease, or other disposal of available land, resources, property, or interests in them. In approving a contract under this subsection, the director need only prepare a single written finding. In addition to the conditions and limitations imposed by law, the director may impose additional conditions or limitations in the contracts as the director determines, with the consent of the commissioner, will best serve the interests of the state. The preparation and issuance of the written finding by the director are subject to the following:

(1) with the consent of the commissioner and subject to the director's discretion, for a specific proposed disposal of available land, resources, or property, or of an interest in them, the director, in the written finding,

(A) shall establish the scope of the administrative review on which the director's determination is based, and the scope of the written finding supporting that determination; the scope of the administrative review and finding may address only reasonably foreseeable, significant effects of the uses proposed to be authorized by the disposal;

(B) may limit the scope of an administrative review and finding for a proposed disposal to

(i) applicable statutes and regulations;

(ii) the facts pertaining to the land, resources, or property, or interest in them, that the director finds are material to the determination and that are known to the director or knowledge of which is made available to the director during the administrative review; and

(iii) issues that, based on the statutes and regulations referred to in (i) of this subparagraph, on the facts as described in (ii) of this subparagraph, and on the nature of the uses sought to be authorized by the disposal, the director finds are material to the determination of whether the proposed disposal will best serve the interests of the state; and

(C) may, if the project for which the proposed disposal is sought is a multiphased development, limit the scope of an administrative review and finding for the proposed disposal to the applicable statutes and regulations, facts, and issues identified in (B)(i) -

(iii) of this paragraph that pertain solely to the disposal phase of the project when

(i) the only uses to be authorized by the proposed disposal are part of that phase;

(ii) the disposal is a disposal of oil and gas, or of gas only, and, before the next phase of the project may proceed, public notice and the opportunity to comment are provided under regulations adopted by the department;

(iii) the department's approval is required before the next phase of the project may proceed; and

(iv) the department describes its reasons for a decision to phase;

(2) the director shall discuss in the written finding prepared and issued under this subsection the reasons that each of the following was not material to the director's determination that the interests of the state will be best served:

(A) facts pertaining to the land, resources, or property, or an interest in them other than those that the director finds material under (1)(B)(ii) of this subsection; and

(B) issues based on the statutes and regulations referred to in (1)(B)(i) of this subsection and on the facts described in (1)(B)(ii) of this subsection;

(3) a written finding for an oil and gas lease sale or gas only lease sale under AS 38.05.180 is subject to (g) of this section;

(4) a contract for the sale, lease, or other disposal of available land or an interest in land is not legally binding on the state until the commissioner approves the contract, but if the appraised value is not greater than $50,000 in the case of the sale of land or an interest in land, or $5,000 in the case of the annual rental of land or interest in land, the director may execute the contract without the approval of the commissioner;

(5) public notice requirements relating to the sale, lease, or other disposal of available land or an interest in land for oil and gas, or for gas only, proposed to be scheduled in the five-year oil and gas leasing program under AS 38.05.180 (b), except for a sale under (6)(F) of this subsection, are as follows:

(A) before a public hearing, if held, or in any case not less than 180 days before the sale, lease, or other disposal of available land or an interest in land, the director shall make available to the public a preliminary written finding that states the scope of the review established under (1)(A) of this subsection and includes the applicable statutes and regulations, the material facts and issues in accordance with (1)(B) of this subsection, and information required by (g) of this section, upon which the determination that the sale, lease, or other disposal will serve the best interests of the state will be based; the director

shall provide opportunity for public comment on the preliminary written finding for a period of not less than 60 days;

(B) after the public comment period for the preliminary written finding and not less than 90 days before the sale, lease, or other disposal of available land or an interest in land for oil and gas or for gas only, the director shall make available to the public a final written finding that states the scope of the review established under (1)(A) of this subsection and includes the applicable statutes and regulations, the material facts and issues in accordance with (1) of this subsection, and information required by (g) of this section, upon which the determination that the sale, lease, or other disposal will serve the best interests of the state is based;

(6) before a public hearing, if held, or in any case not less than 21 days before the sale, lease, or other disposal of available land, property, resources, or interests in them other than a sale, lease, or other disposal of available land or an interest in land for oil and gas or for gas only under (5) of this subsection, the director shall make available to the public a written finding that, in accordance with (1) of this subsection, sets out the material facts and applicable statutes and regulations and any other information required by statute or regulation to be considered upon which the determination that the sale, lease, or other disposal will best serve the interests of the state was based; however, a written finding is not required before the approval of

(A) a contract for a negotiated sale authorized under AS 38.05.115 ;

(B) a lease of land for a shore fishery site under AS 38.05.082 ;

(C) a permit or other authorization revocable by the commissioner;

(D) a mineral claim located under AS 38.05.195 ;

(E) a mineral lease issued under AS 38.05.205 ;

(F) an exempt oil and gas lease sale or gas only lease sale under AS 38.05.180(d) of acreage subject to a best interest finding issued within the previous 10 years or a reoffer oil and gas lease sale or gas only lease sale under AS 38.05.180 (w) of acreage subject to a best interest finding issued within the previous 10 years, unless the commissioner determines that substantial new information has become available that justifies a supplement to the most recent best interest finding for the exempt oil and gas lease sale or gas only lease sale acreage and for the reoffer oil and gas lease sale or gas only lease sale acreage; however, for each oil and gas lease sale or gas only lease sale described in this subparagraph, the director shall call for comments from the public; the director's call for public comments must provide opportunity for public comment for a period of not less than 30 days; if the director determines that a supplement to the most recent best interest

finding for the acreage is required under this subparagraph,

(i) the director shall issue the supplement to the best interest finding not later than 90 days before the sale;

(ii) not later than 45 days before the sale, the director shall issue a notice describing the interests to be offered, the location and time of the sale, and the terms and conditions of the sale; and

(iii) the supplement has the status of a final written best interest finding for purposes of (i) and (l) of this section;

(G) a surface use lease under AS 38.05.255 ;

(H) a permit, right-of-way, or easement under AS 38.05.850 ;

(7) the director shall include in

(A) a preliminary written finding, if required, a summary of agency and public comments, if any, obtained as a result of contacts with other agencies concerning a proposed disposal or as a result of informal efforts undertaken by the department to solicit public response to a proposed disposal, and the department's preliminary responses to those comments; and

(B) the final written finding a summary of agency and public comments received and the department's responses to those comments.

AS 38.05.035(g)
(g) Notwithstanding (e)(1)(A) and (B) of this section, when the director prepares a written finding required under (e) of this section for an oil and gas lease sale or a gas only lease sale scheduled under AS 38.05.180, the director shall consider and discuss

(1) in a preliminary or final written finding facts that are known to the director at the time of preparation of the finding and that are

(A) material to issues that were raised during the period allowed for receipt of public comment, whether or not material to a matter set out in (B) of this paragraph, and within the scope of the administrative review established by the director under (e)(1) of this section; or

(B) material to the following matters:

(i) property descriptions and locations;

(ii) the petroleum potential of the sale area, in general terms;

(iii) fish and wildlife species and their habitats in the area;

(iv) the current and projected uses in the area, including uses and value of fish and wildlife;

(v) the governmental powers to regulate the exploration, development, production, and transportation of oil and gas or of gas only;

(vi) the reasonably foreseeable cumulative effects of exploration, development, production, and transportation for oil and gas or for gas only on the sale area, including effects on subsistence uses, fish and wildlife habitat and populations and their uses, and historic and cultural resources;

(vii) lease stipulations and mitigation measures, including any measures to prevent and mitigate releases of oil and hazardous substances, to be included in the leases, and a discussion of the protections offered by these measures;

(viii) the method or methods most likely to be used to transport oil or gas from the lease sale area, and the advantages, disadvantages, and relative risks of each;

(ix) the reasonably foreseeable fiscal effects of the lease sale and the subsequent activity on the state and affected municipalities and communities, including the explicit and implicit subsidies associated with the lease sale, if any;

(x) the reasonably foreseeable effects of exploration, development, production, and transportation involving oil and gas or gas only on municipalities and communities within or adjacent to the lease sale area; and

(xi) the bidding method or methods adopted by the commissioner under AS 38.05.180 ; and

(2) the basis for the director's preliminary or final finding, as applicable, that, on balance, leasing the area would be in the state's best interest.

AS 38.05.133
(a) The procedures in this section apply to the issuance of an exploration license under AS 38.05.132 .

(b) The licensing process is initiated by the commissioner preparing, or a prospective licensee submitting to the commissioner, a proposal that identifies a specific area to be subject to the exploration license, proposes specific minimum work commitments, and states the minimum qualifications for a licensee as established by regulations adopted by

the commissioner. A prospective licensee may initiate a proposal only in response to a call for proposals by the commissioner or during a period specified in regulations adopted by the commissioner. The regulations must provide for at least one period for that purpose during each calendar year.

(c) If the commissioner initiates the licensing process under (b) of this section, the commissioner shall publish notice of the commissioner's proposal in order to solicit comments and competing proposals.

(d) Within 30 days after receipt of a proposal from a prospective licensee under (b) of this section, the commissioner shall either reject it in a written decision or give public notice of the intent to evaluate the acceptability of the proposal. The commissioner shall solicit comments on a proposal for which public notice is given under this subsection, and shall request competing proposals.

(e) The commissioner may make a written request to a prospective licensee for additional information on the prospective licensee's proposal. The commissioner shall keep confidential information described in AS 38.05.035 (a)(8) that is voluntarily provided if the prospective licensee has made a written request that the information remain confidential.

(f) After considering proposals not rejected under (d) of this section and public comment on those proposals, the commissioner shall issue a written finding addressing all matters set out in AS 38.05.035(e) and (g), except for AS 38.05.035 (g)(1)(B)(xi). If the finding concludes that the state's best interests would be served by issuing an exploration license, the finding must (1) describe the limitations, stipulations, conditions, or changes from the initiating proposal or competing proposals that are required to make the issuance of the exploration license conform to the best interests of the state, and (2) if only one proposal was submitted, identify the prospective licensee whom the commissioner finds should be issued the exploration license. The commissioner shall attach to the finding a copy of the exploration license to be issued and the form of lease that will be used for any portion of the exploration license area subsequently converted to a lease under AS 38.05.134.

(g) If only one prospective licensee submits a proposal and the finding under (f) of this section concludes that an exploration license should be issued to that prospective licensee, the prospective licensee has 30 days after issuance of the finding within which to accept or reject the issuance of the exploration license, as limited or conditioned by the terms contained in the finding. The exploration license to be issued and the form of lease that will be used must be attached to that finding. The prospective licensee must accept or reject the issuance of the exploration license in writing.

(h) If competing proposals are submitted, and the commissioner's finding under (f) of this section concludes that an exploration license should be issued, the commissioner shall

issue a request for competitive sealed bids, under procedures adopted by the commissioner by regulation, to determine which prospective licensee should be issued the exploration license. The finding provided to the prospective licensees and the public under (f) of this section must contain notice that (1) the commissioner intends to request competitive sealed bids, (2) a prospective licensee who intends to participate in the bidding must notify the commissioner in writing by the date specified in the notice, and (3) a prospective licensee's notice of intent to participate in the bidding constitutes acceptance of issuance of the exploration license, as limited or conditioned by the terms contained in the finding and by the exploration license to be issued and the form of lease to be used that have been attached to that finding, if the prospective licensee is the successful bidder. The successful bidder is the prospective licensee who submits the highest bid in terms of the minimum work commitment dollar amount.

I. INTRODUCTION

In determining whether a particular land disposal serves the best interest of the State of Alaska, appellee Department of Natural Resources (DNR) has a procedural duty to take a "hard look" at all of the factors required by statute. These procedures are designed to ensure that the agency's ultimate substantive decision will be the result of "reasoned decisionmaking" and not "arbitrary" or "capricious." In addition, the factual findings that serve as the basis for DNR's decision must be supported by "substantial evidence" in the record. DNR's decision approving the Healy Basin Gas Only Exploration License fails to meet these procedural and substantive standards.

DNR acknowledges that, in order to properly analyze the statutory factor concerning "reasonably foreseeable fiscal effects" (AS 38.05.035(g)(1)(B)(ix)), the agency "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." Exc. 604-605. Despite its recognition that it must evaluate these issues, DNR failed to analyze the impact of the 'size of the license area' on the economic feasibility of the Healy Gas License for Usibelli Coal Mine (Usibelli). DNR's passing references in response to comments are insufficient to constitute an adequate analysis of this issue. Accordingly, DNR has failed to meet the "hard look" standard with respect to statutory factor (g)(1)(B)(ix). Moreover, DNR's substantive determination that the Healy Gas License serves the best interest of the State is arbitrary, capricious, and contrary to law because its decision was made without the benefit of an adequate evaluation of economic feasibility and without substantial evidence in the record on this issue.

Further, DNR originally committed to requiring strong mitigation measures in the Healy Gas License and, in its final decision, DNR relied on mitigation measures as a key mechanism to ensure that its decision serves the best interest of the State of Alaska. During the course of its review, however, DNR revised the mitigation measures to substantially weaken them without providing a rational explanation. The resulting mitigation measures are now among the weakest in the State. DNR's self-contradictory approach make its decision arbitrary and capricious.

Judicial review is essential for the protection of the public interest. Since DNR has failed to take a hard look at a required statutory factor and failed to explain a significant change in course with respect to mitigation, the agency has failed to engage in reasoned decisionmaking and its decision must be reversed as arbitrary and capricious.

II. STANDARD OF REVIEW

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). In order to withstand judicial scrutiny, the administrative record for a decision disposing of the public's interest in State lands must demonstrate that DNR took a "hard look at the salient problems" and engaged in "reasoned decisionmaking."[1] *Trustees for Alaska v. State, DNR*, 795 P.2d 805, 811

[1] It is the sufficiency of DNR's analysis that matters, not the quantity of paper generated. DNR and Usibelli attempt to dismiss Denali Citizen's claims as merely complaining about "one sentence out of a 256 page document." DNR Brief (Br.) at 1, 6, 9, 16, 17, 18; *see also* Usibelli Br. at 5. However, an agency cannot do with quantity what it is required to do substantively. *See Anderson v. Evans*, 314 F.3d 1006 (9th Cir. 2002) ("girth is not a measure of the analytical soundness of an environmental assessment").

(Alaska 1990). DNR's factual findings must be based on "substantial evidence." *Alaska Ctr for the Env't v. State,* 80 P.3d 231, 236 (Alaska 2003). Indeed, DNR and Usibelli agree that DNR's best interest finding must have a "reasonable basis" and not be "arbitrary" or "capricious." *See e.g.* DNR Br. at 8, note 11, Usibelli Br. at 3. These standards serve as an important check on DNR's ability to dispose of public lands, and the Court should apply them "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).

III. ARGUMENT

A. DNR HAS FAILED TO TAKE A "HARD LOOK" AT STATUTORY FACTOR (G)(1)(B)(IX) CONCERNING "REASONABLY FORESEEABLE FISCAL EFFECTS" BECAUSE DNR FAILED TO EVALUATE THE ECONOMIC FEASIBILITY OF THE PROPOSED GAS LICENSE.

DNR has failed to adequately analyze a required statutory factor, and this procedural failure renders its best interest finding for the Healy Gas License invalid. The Commissioner of DNR has emphasized that, in order for the agency to be able to conduct a proper evaluation of statutory factor AS 38.05.035(g)(1)(B)(ix) concerning the "reasonably foreseeable fiscal effects" of the Healy Gas License, it was essential for DNR to analyze the economic feasibility of the License to the licensee:

> In determining if an exploration license is in the best interest of the state, the Director is required to consider and discuss a wide range of matters ... . [O]ne of these factors is also "reasonably foreseeable fiscal effects" of the exploration license (AS 38.05.035(g)(1)(B)(ix)). *To consider this factor, the Director 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.

Exc. 604-605 (emphasis added). The Commissioner went on to conclude, erroneously, that because the Director had "appropriately considered feasibility of the exploration license" along with other required factors, the Director had "appropriately determined" that the Healy Gas License is "in the best interest of the state." *Id.* Unfortunately, the Commissioner is mistaken. Nowhere in the Director's Final Finding is there any meaningful analysis of the 'size of the license area' or its effect on the economic feasibility of the Healy Gas License.[2]

DNR's analysis of statutory factor (g)(1)(B)(ix) concerning the "reasonably foreseeable fiscal effects" of the project was set forth in the Final Finding Chapter 8. Exc. 371. In sections G and H of Chapter 8, DNR discusses the "Potential Fiscal Effects on the State," the "Fiscal Effects on Local Communities," and the "Potential Effects on the Denali Borough and Communities," including economic effects. Exc. 488-493. Given the Commissioner's view that, in order to fully evaluate the fiscal impact of the project, DNR 'must' evaluate the impact of the size of the license area on economic feasibility, one would expect Chapter 8 to include a section discussing this issue; but Chapter 8 makes no mention of this topic. Exc. 472-498. Instead, the Commissioner's conclusion that DNR had adequately addressed this issue was based on DNR's brief mention of the issue in response to comments.

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[2] Usibelli's brief raises a red herring by asserting that economic feasibility can only be determined after exploration. *See* Usibelli Br. at 9. DNR's best interest finding must be focused on an *exploration* license, and all of the statutory factors including economic feasibility are focused on the exploration stage of gas development. Exc. 604-05.

Despite this lack of analysis, the Director made, and the Commissioner affirmed, a finding that the Healy Gas License would be in the best interest of the State based on the mere assumption that gas exploration activities throughout the entire proposed area would be economically feasible, and based on the unsupported speculation that the exclusion of any areas west of the Nenana River "may make the project economically unfeasible." Exc. 515. *See* Exc. 513, 515-16, 523-25 (similar comments). This does not rise to the level of a hard look. In order to pass judicial muster, it is necessary for a meaningful analysis of the impact of the size of the license area on economic feasibility, supported by factual evidence, to be included in the Final Finding document itself. Since DNR failed to adequately analyze a required statutory factor, its decision is procedurally flawed and must be reversed.

B. DNR's Conclusion That a Reduction in the Size of the License Area Would Be Economically Infeasible Is Without Support in the Record and Therefore Arbitrary.

DNR has a duty to ensure that its land disposal decisions serve the best interest of the State and do not allow gas exploration activities to inflict excessive or unnecessary harm on fish, wildlife, water resources, the tourism industry, property values, and local communities. It was arbitrary for DNR to turn a blind eye to the possibility of excluding certain highly sensitive areas from the license area—a potentially powerful mechanism for protecting the public interest—based on the unsupported speculation that such a reduction would be economically infeasible.

1. Record Evidence Does Not Support DNR's Conclusion.

DNR and Usibelli erroneously assert that the economic infeasibility of a smaller

license area is supported by evidence in the record. *See* DNR Br. at 12-16; Usibelli Br., at 9. Usibelli, for instance, points to its own comments, which show at most that it raised "a number of economically-based concerns" about Denali Citizens' and others' comments on the proposed license. Usibelli Br. at 9-12.[3] Mere comments submitted by a project proponent, however, cannot substitute for an agency's analysis of a key issue. Moreover, Usibelli acknowledges that the portions of the record it cites do not directly support its assertions concerning the economic consequences of reducing the project area, noting repeatedly that such conclusions would have to be "reasonably infer[red]. *Id.* at 10-11. Usibelli is also wrong in suggesting that a *post hoc* justification presented by counsel during litigation can serve as a basis for upholding an agency decision in the absence of sufficient justification in the agency record. *Noey v. Dep't of Envtl. Conservation*, 737 P.2d 796, 806 (Alaska 1987) (failure of agency to ensure that record supports findings and conclusions is arbitrary and contrary to law); *Kelly v. Zamarello*, 486 P.2d 906, 918 (Alaska 1971) (agency finding needs "substantial support in the record").[4]

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[3] For example, in one such citation to its own public comments, Usibelli 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." Usibelli Br. at 11-12 *quoting* Exc. 339 (emphasis from Usibelli Brief); *see also* DNR Brief at 20 (same). This vague comment does not offer any fact-specific analysis and does not support DNR's generalizations and assumptions regarding the impact of the size and location of the license area on economic feasibility.

[4] *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)).

The administrative process leading up to DNR's approval of the Healy Gas License involved significant controversy concerning the appropriate size and location of the license area, particularly with respect to the Wolf Townships and other areas west of the Nenana River presenting the most conflicts with gas exploration activities. As discussed above, DNR responded to such comments by refusing to consider reducing the size of the license area as a means to avoid such conflicts based on the unsupported assumption that a smaller area "may make the project economically unfeasible." Exc. 515. *See* Exc. 513, 515-16, 523-25 (similar comments). Indeed, without any analysis, DNR relied on this assumption as the basis for its conclusion that a reduction in acreage was not a viable approach and that mitigation measures would serve as a better "tool for protecting fish, wildlife, the environment, and human enjoyment of land." DNR Br., at 31 (citing Exc. 598 and 605). DNR also stated, without any basis for comparison, that the "imposition of mitigation measures to avoid, minimize, or mitigate potential impacts is *preferable* to removing a large acreage from the license area." Usibelli Br. at 6 (citing Exc. 515) (emphasis added). *See* DNR Br. at 20, 25-28. These unfounded conclusions fly in the face of reasoned decisionmaking and render DNR's decision arbitrary, capricious, and contrary to law.

DNR and Usibelli have also made many other attempts to gloss over the gaps in the record and characterize DNR's poor reasoning as sound through a series of arguments meant to obfuscate the inherent simplicity of the situation. Some examples of these specious arguments are addressed below.

2. Meaningless Distinction Between Leases and Licenses

The record demonstrates that Usibelli had filed 15 exploration lease applications for an area nearly one-fifth the size of 208,000 acres ultimately covered by the DNR license. Exc. 8-47, Exc. 56-90. Contrary to DNR's arguments (DNR Br., at 2, 15-16), under the law in effect at the time, the original lease applications covered the same early stage in the exploration process as the present licensing process. Exc. 8-48, Exc. 56-90. Moreover, the per-acre fees for these original lease applications were *higher* than for the subsequent license granted by DNR because the law—H.B. 531—has since been changed to reduce the per acre costs. *Compare* Exc. 2-7, 8-47 and 56-90 *with* Exc. 140, 138, 684. *See* Appellant's Br. at 18.

Further, the record shows that Usibelli let stand its 15 original applications for a much smaller acreage, roughly 45,000 acres, during this time period, only letting them lapse after H.B. 531 became law. Exc. 772-775. This action only makes sense if Usibelli believed that the much smaller gas exploration area would have been economically feasible.[5] Nowhere in the record did DNR explain why, given the higher per-acre fees associated with Usibelli's original lease applications and the much smaller acreage of 45,000 acres, gas exploration activities now suddenly required a minimum of 208,000 acres in order to be economically viable and forced DNR to ignore the possibility of excluding certain sensitive areas and rely solely on mitigation measures instead.

In light of the Commissioner's emphasis on the critical importance of analyzing

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[5] Denali Citizens and others noted this point in objecting to the massive expansion of the area that would be open to gas activities. *See, e.g.*, Exc. 123-28; Appellant's Br. at 7.

the 'size of the license area' as part of the economic feasibility of the project under statutory factor (g)(1)(B)(ix), as well as the large number of public comments urging DNR to consider the exclusion of sensitive areas as a means to reduce impacts on fish, wildlife, water resources, property values, tourism, recreation, and other uses (*see* Appellant's Br. at 7), it was arbitrary and capricious for DNR to make a final decision favoring a mitigation approach based on the untested assumption that a reduction-in-acreage approach would not be economically viable.

Finally, it is disingenuous for DNR to assert that Usibelli had a choice between applying for a lease or a license:

> There are any number of reasons why a company might pursue one area by lease in a given year and later seek a different area by license. Nothing in this record tells us why Usibelli decided to seek a certain area by lease and later proposed a somewhat different area by license.

DNR Br., at 16. *See also* Usibelli Br. at 12. DNR is well aware that, when Usibelli filed applications for gas exploration licenses, the shallow gas leasing program had ceased to exist and Usibelli's only option was to proceed through the licensing program.

The relevant question is not whether a difference between leases and licenses might impact the economics of the project in general. Rather, the question is whether, in the face of comments raising legitimate concerns about the appropriate size and location of the proposed license area and having done no analysis, DNR can refuse to consider excluding sensitive areas on the mere speculation that such an exclusion might impact the economic feasibility of the project for Usibelli. Indeed, in the excerpt above, DNR admits that "nothing in this record" provides any answer to this question nor supports

DNR's arbitrary reliance on economic infeasibility as a justification for its refusal to consider the exclusion of areas facing the greatest adverse impacts from gas exploration activities.[6]

3. Meaningless Distinction Between Director's Finding and Commissioner's Reconsideration

DNR also suggests that the Director's finding and reasoning relating to the size of the license area are irrelevant since the Commissioner addressed the issue on reconsideration, and thus the Commissioner's reasoning is the only appropriate focus of judicial review. *See* DNR Br. at 7, 20-22. *See also* Usibelli Br., at 7-8. Yet DNR raises a distinction that has no difference. In his reconsideration decision, the Commissioner likewise found that the economic viability of the project for Usibelli was critical to the final finding, stating that "the Director had to consider the possibility that the project would not occur at all if it became economically infeasible for the licensee." Exc. 604-05. Much like the DNR Director, however, the Commissioner (1) did not point to any evidence in the record that supported the conclusion that the final 208,000-acre license size was the minimum necessary to be economically feasible for Usibelli; (2) did not attempt to reconcile DNR's assumption about this purported minimum license size with Usibelli's willingness to move forward with a much smaller acreage for early exploration activities under the now-defunct shallow gas leasing program; and (3) did not require

[6] While Usibelli's brief references the lease/license distinction, it offers no explanation as to why differing costs associated with leases and licenses would not be relevant to Usibelli's economic calculus for the exploration project. Usibelli Br., at 12. Likewise, the superior court merely recites the fact that there are differences between leases and licenses, and did not confront the consequences of that distinction to economics of Usibelli's exploration plans. Exc. 768.

DNR to supplement its analysis to fill such important gaps and correct faulty reasoning.

In a last ditch effort to sidestep this issue, DNR now asserts that the Commissioner had other grounds for affirming the Director's finding, and thus his language on economic feasibility has no bearing on the issue. DNR Br., at 21-22. DNR's argument ignores the Commissioner's own words, however, which provide that "in the case of deciding if the Healy exploration license is in the best interest of the state, the Director *must consider*" the size of the license area and its effect on the economic feasibility of the Healy Gas License for Usibelli. Exc. 604-05 (emphasis added). DNR cannot later distance itself from a mandate that it has acknowledged and emphasized as necessary for an adequate analysis and well-reasoned decision.

Consequently, throughout the entire process—up to and including the Commissioner's decision on reconsideration—DNR has handled the question of the size of the license area, and the potential for exclusion of areas with especially sensitive resources or areas that will have concentrated conflicts and impacts resulting from gas exploration, in an arbitrary manner.

C. DNR's Finding That the State's Best Interest Is Protected By Strong Mitigation Measures Is Not Supported In The Record.

DNR acknowledges that mitigation measures are critical to ensuring that the license is in the best interest of the State, and DNR has not said otherwise in its brief. *Compare* Appellant's Br. at 18-19 and cites therein *with* DNR Br. at 31-46.[7] Denali

[7] Because Usibelli defers to DNR for its entire response on whether DNR's stated commitment to strong mitigation measures has any legal meaning or effect (Usibelli Br. at 12), Denali Citizens does not separately reference Usibelli in its reply to this argument.

Citizens thus reiterates its contention that it was arbitrary and self-contradictory for DNR to acknowledge the need for mitigation measures that are "among the strongest and most detailed" in the State in order to protect the public interest, while in actuality imposing some of the weakest measures in the State. Furthermore, DNR's reasoning was illogical and arbitrary because it justified its changes by emphasizing that the initial strong measures might have been "unnecessarily restrictive" while paradoxically stating that it did not intend to make the measures weaker. Appellant's Br. at 18-25 (citing *inter alia* Exc. 599, 1682, 2184, 602). This confused logic is a classic illustration of arbitrary decision-making. *Trustees*, 795 P.2d at 811. *See also FCC v. Fox Television Stations*, 129 S. Ct. 1800, 1824 (2009) (Kennedy, J., concurring in part and concurring in the judgment) ("[A]n agency's decision to change course may be arbitrary and capricious if the agency ignores or countermands its earlier factual findings without reasoned explanation for doing so.").

If DNR had found that stringent mitigation measures were necessary and then made a decision consistent with that finding, such an approach would survive judicial review. Alternatively, if DNR had provide a well-reasoned explanation demonstrating that anticipated impacts would be minor and that only modest mitigation measures would be needed, that approach could likewise be rational and worthy of deference. DNR's self-contradictory approach, however, renders its decision arbitrary and capricious.

1. Ripeness

As it did in the superior court, DNR mischaracterizes Denali Citizens' argument as one that challenges "the adequacy of the [mitigation] measures," DNR Br., at 32. It then

asserts that such a challenge is not ripe (*see* DNR Br. at 32-33). Denali Citizens reiterates that is *not* challenging the adequacy of the mitigation measures. The *Trustees for Alaska v. State, Department of Natural Resources* case cited by DNR is thus inapposite. *See* DNR Br. at 32-33 (citing *Trustees v. State*, 851 P.2d 1340, 1346-47 (Alaska 1993)). Denali Citizens is arguing instead that DNR failed to provide a rational and well-reasoned explanation for the discrepancy between its finding that protection of the State's best interest required strong mitigation measures and its imposition of some of the weakest measures in the State. DNR has failed to identify any new information or findings that would justify its change in position.

This case is ripe for judicial review because DNR has made a final best interest finding concerning a disposal of public lands, and it has imposed mitigation measures as part of that decision. The court has an obligation to ensure that decisions affecting important public interests are well-reasoned and supported by the record.

2. The Blanket Exception

One of Denali Citizens' points is that DNR has broadened the blanket exception that it can apply to any and all mitigation measures, undermining the applicability of such measures. Appellant's Br., at 22 and Ex. 1 (comparing Healy blanket exception to other State of Alaska licenses and leases). Since DNR has not provided any rationale or factual findings supporting this dramatic change, nor addressed the inconsistency it raises with DNR's starting premise that strong mitigation measures are needed, it illustrates the agency's self-contradictory approach.

DNR first argues that there is no such thing as a "blanket exception," but then

immediately admits that DNR has broad authority to grant exceptions to mitigation measures. DNR Br. at 34. Whether this authority is called a blanket exception or some other term, the fact is that it exists. DNR then asserts that it "is under no obligation to explain every edit it makes between drafts." DNR Br., at 34. That may be true, but what DNR cannot do is say one thing (mitigation measures are "critical" to ensuring that the State's best interest is met, and its Healy license measures are "among the strongest" in the State) and then do something completely different (impose standards as weak as exist in the State) without providing a rational explanation supported by evidence in the record. Again, this is the very essence of arbitrary decision-making. *FCC*, 129 S. Ct. at 1824. *See also*, *Kelly*, 486 P.2d at 918 (agency finding needs "substantial basis in the record").

DNR then tries to justify the change by saying that the standards at issue— in which DNR could grant an exception to any measure so long as Usibelli shows that compliance with the measure is "not feasible and prudent" versus "not practicable"— have exactly the same meaning. DNR Br., at 34-40. Yet DNR admits that this change was meant to make it easier for Usibelli to claim an exception. *See* Exc. 539-40 (Usibelli comment seeking more consideration of economics in mitigation measures, with DNR responding that it had changed "feasible and prudent" standard to the "not practicable" standard, which specifically includes cost consideration). And, if DNR counsel's view were accurate, DNR's explanation that the original measures were "unnecessarily restrictive" (Exc. 602) would be nonsensical.

DNR's attempt to distinguish Denali Citizens' points about the Alaska Coastal Management Program (ACMP), the *Citizen's to Preserve Overton Park* precedents, and

the use of the terms in four recent oil and gas lease sale findings, all ignore the evidence that appears in this record.[8] In the end, DNR counsel's claim is nothing but an improper attempt to rewrite the record. *Oregon Natural*, 531 F.3d at 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 also attacks as inapposite Denali Citizens' comparison of this standard to that used in the Clean Water Act. DNR Br., at 37 and note 62. 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]

In a last ditch effort to obtain blind deference from this Court, DNR asserts that

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[8] DNR's points about the ACMP influencing the Healy license, DNR Brief at 37-38, are particularly out of place as the Healy license area is not situated in the State's coastal zone and the ACMP thus did not apply. Regardless, this justification appears nowhere in the record.

[9] DNR's counsel refers to a case discussing the "practicable" and "feasible and prudent" standards and claims that this case supports its position that these standards are synonymous. DNR Br., at 37 note 62 (citing *Conservation Law Found'n v. FHWA*, 24 F.3d 1465, 1467 [*sic*] (1st Cir. 1994)). No analysis in that case, however, supports DNR's point. The court nowhere stated that these two standards were the same nor analyzed the similarities or differences between the two. It simply found that the agency findings were supported in the record of that case. *See id.* at 1476.

"when it comes time to applying [*sic*] the exception, it will be DNR that interprets its own words." DNR Br., at 35. DNR further argues that, since "DNR has been stating throughout this appeal process that it does not interpret the terms differently" and since the courts "give deference to an agency's interpretation of its own words," then "how would a different standard ever end up applying?" *Id.* This point from DNR evidences a startling misunderstanding of the nature of judicial review and deference to agency decisions. Nowhere is there deference for arguments that DNR's counsel makes in the context of an appeal of an agency decision.

3. Specific Measures

DNR's treatment of specific mitigation measures suffers from similar deficiencies. DNR mischaracterizes Denali Citizens' argument as attacking those specific measures. Instead, Denali Citizens is relying on them as evidence of DNR's self-contradiction with respect to its own findings. *See* DNR Br. at 40-46. DNR irrationally found that the measures needed to be strong while at the same gutting specific standards in the exploration license and postponing many measures until later stages.

In order for its decision to have a rational basis in the record, DNR needed to explain why the measures were unnecessarily restrictive when Usibelli had stated in the record that only measures "more onerous" than the original measures would significantly impact its operations. Exc. 337. Notably, DNR does not address this core issue in its brief. Rather, with respect to setbacks in residential neighborhoods, DNR's brief focuses on the experience of oil and gas projects in other residential areas, such as the Kenai Peninsula. DNR Br., at 41 (citing Exc. 602). Given the evidence in the record showing

the measures set out in the preliminary finding would help reduce residential impacts and were not too restrictive for Usibelli (*e.g.*, Exc. 337), what happens in other areas is not relevant. DNR's conclusion that the measures were unnecessarily restrictive thus contradicts the record, lacks a reasonable basis, and is arbitrary and capricious.

Trying to sidestep the issue, DNR also argues that the measures are protective of landowners. DNR Br., at 40. Yet 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. For every other mitigation measure, including those referenced by DNR in its brief (DNR Br., at 40-41), DNR has postponed until later phases of development a determination of what measures to apply. A subdivision exclusion would have been more protective than a small setback, with all related critical issues put off until later. DNR's conclusion that its landowner protection measures are strong and protective of the State's best interest thus contradicts the record, lacks a reasonable basis, and is arbitrary and capricious.

DNR's weakening of mitigation measures is even starker with respect to caribou and noise measures. With respect to caribou, the final finding provides that DNR "may impose" restrictions on subsequent activities. Exc. 505. DNR urges the Court to interpret this to mean that DNR has imposed a meaningful restriction on exploration activities. DNR Br., at 45. Yet there is no limit placed on any specific activity and the measure is wholly discretionary. Exc. 505. *See* also DNR Br., at 45. With respect to noise, 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. Exc. 116-17, 589). *See also* Exc. 95 (Usibelli comment on draft standards that Mat-Su standards would apply in Healy area); Exc. 123-24 (Denali Citizens noting similar understanding). DNR provided instead that such measures "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 argues that the elimination of specific sound levels is of no consequence, and that landowners can advocate for specific noise limits at later phases and appeal them if desired. DNR Br., at 44. DNR then concludes by asserting that these "measures are policy determinations within DNR's area of expertise," *id.*, thus apparently seeking complete deference from the Court on this issue.

Again, however, DNR mischaracterizes the issue. Denali Citizens does not challenge DNR's ability to impose or alter specific measures. Instead, Denali Citizens contends 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 and weakening of critical mitigation measures. If DNR had presented a rational basis in the record for these changes, its conclusion might not be arbitrary, but DNR's stated 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.

D. JUDICIAL REVIEW MUST BE MEANINGFUL, NOT BLINDLY DEFERENTIAL.

DNR mischaracterizes Denali Citizens' various arguments as an attack on "DNR's policy determination that the license best serves the State's interest." DNR Br. at 11-12. *See id.* 23-28. Rather than accepting judicial review of whether DNR adequately addressed an important statutory factor based on evidence in the record and reached a well-reasoned decision, DNR seeks blind deference through which the Court would grant unfettered discretion to DNR so long as it provides at least lip service to statutory factors without regard to the content or rationality of that response. DNR Br. at 11-12. To give this argument merit would be to eviscerate judicial review of best interest findings. Granting DNR the unfettered discretion it seeks, and upholding its decision despite glaring gaps in the record and faulty reasoning, would mean decisions involving large-scale disposals of State land and other important public interests could proceed without a meaningful judicial check on arbitrary agency action.

Denali Citizens is not asserting that DNR lacks authority and discretion regarding land disposal. Rather, what DNR must do in its decision is take a hard look at required statutory factors and offer a well-reasoned justification for the decisions it does make. This is where DNR has failed. DNR's conclusory findings—which have no basis in the record and are in fact contrary to the information in the record—are procedurally defective and arbitrary and cannot stand. *Trustees*, 795 P.2d at 811. *See also Kelly*, 486 P.2d at 918 (agency finding needs "substantial support in the record").

IV. CONCLUSION

With respect to the Healy Basin Gas Exploration License, DNR had a duty to take a hard look at required statutory factors, and then make a well-reasoned decision supported by the record. DNR failed to adequately analyze statutory factor (g)(1)(B)(ix) by failing to address the size of the license area and its effect on economic feasibility. Moreover, DNR's refusal to consider excluding certain sensitive areas was arbitrary because it depended on pure speculation that such exclusion would render the license area economically infeasible. Additionally, it was arbitrary for DNR to make a finding that strong mitigation measures were needed, while simultaneously weakening key measures and deferring consideration of others to later phases of development. For these reasons, the Court should set aside DNR's best interest finding and require DNR to prepare a new best interest finding should Usibelli choose to proceed with the project.

Dated: June 7, 2013

Respectfully submitted,

FOR 

Peter Van Tuyn, AK Bar No. 8911086

Attorney for Denali Citizens Council

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I hereby certify that this Brief is formatted pursuant to Appellate Rule 513.5(c) in 13-point Times New Roman typeface.

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Respectfully submitted,

FOR

Peter Van Tuyn, AK Bar No. 8911086
BESSENYEY & VAN TUYN, L.L.C.
310 K Street, Suite 200
Anchorage, AK 99501
(907) 278-2000 phone
(907) 278-2004 fax
peter@bvt-law.com

Attorneys for Denali Citizens Council

IN THE SUPREME COURT OF THE STATE OF ALASKA

DENALI CITIZENS COUNCIL, Appellant, vs. STATE OF ALASKA, DEPARTMENT OF NATURAL RESOURCES, and USIBELLI COAL MINE, INC., Appellees.	)	Supreme Court No. S-14896
Superior Ct Case No. 3AN-10-12552CI	)	

CERTIFICATE OF SERVICE

I hereby certify that Appellant's REPLY BRIEF, SUPPLEMENTAL EXCERPTS OF RECORD, AND REQUEST FOR ORAL ARGUMENT were served by electronic and first class mail on the following parties:

Rebecca Kruse
Assistant Attorney General
Alaska Department of Law
1031 W. 4th Avenue, Suite 200
Anchorage, AK 99501-1994
direct: (907) 269-3036
fax: (907) 269-8644
becky.kruse@alaska.gov
Attorney for Appellee Alaska Department of Natural Resources

Kyle Parker
David Mayberry
Crowell & Moring LLP
1029 W. Third Ave., Suite 550
Anchorage, AK 99501
telephone: (907) 865-2600
fax: (907) 865-2680
kparker@crowell.com
dmayberry@crowell.com
Attorneys for Appellee Usibelli Coal Mine, Inc.

Dated: June 7, 2013

Karen E. Schmidt