February 29, 1996

The Honorable John T. Shively, Commissioner
Department of Natural Resources
P.O. Box 107005
Anchorage, Alaska 99510-7005

RE: DNR's Duty To Collect Erroneously Granted Exploration Incentive Credits
A.G. file no: 661-95-0231
1996 Op. Att'y Gen. No. 6

Dear Commissioner Shively:

I. INTRODUCTION

Former Commissioner Noah asked whether the Department of Natural Resources (DNR) is legally obligated to pursue the recovery of funds that several years ago it mistakenly credited to certain oil and gas lessees under the exploration incentive credit (EIC) program established by AS 38.05.180(i). In our opinion, DNR must attempt to recover the funds erroneously credited to the lessees.

II. FACTS

AS 38.05.180(i) authorizes the commissioner to use exploration incentive credits to encourage oil and gas exploration on state leases. Under that authority, the commissioner promulgated regulations setting forth the standards for the award of an EIC. In essence, the regulations permit an EIC award for an exploratory well that either: (1) is more than three miles from

any other well (distance criterion); or (2) if within three miles of any other well, tests a potential hydrocarbon trap that the commissioner determines to be a "distinctly separate exploration target" (separateness criterion). 11 AAC 83.820(2)(A)&(B).

Between 1985 and 1987 several wells were drilled in the Colville Delta area. The first was the Texaco Colville Delta No.1 well (Texaco No.1), which was completed in April of 1985. The No.1 well discovered the Nuiqsut sandstone. A "side track" well (Texaco No.1A) was drilled using a portion of the Texaco No.1 well and was also completed in April of 1986. The Texaco No.1A well was drilled to acquire additional geologic and engineering data, not to reach the original bottom-hole location.

In May of 1986, Texaco, Inc. (Texaco) on behalf of itself and its partners, submitted a brief application for an EIC credit for the Texaco No.1 well. The application included the costs of drilling the side track well, but did not disclose that a side track well had been drilled. The EIC regulations do not allow an EIC credit for side track wells to acquire additional data. *See* 11 AAC 83.820(7). On July 9, 1987, the then commissioner issued a two-sentence "Certification of Exploration Credit Grant" in the amount of $2,810,357, which included $449,700 of side track well costs. The certification does not contain any discussion of whether the Texaco No.1 well, or the Texaco No.1A well for that matter, qualifies for an EIC award under the regulations. Moreover, according to the Division of Oil & Gas (Division), there is no written record that the question of whether the requirements of the regulations were met was ever formally considered by DNR. The certification stated that credit was "subject to adjustment through audit of the . . . [Texaco] No.1 exploratory well costs . . . ."

The year after the discovery of the Nuiqsut sandstones in the Texaco No.1 well, Amerada Hess Corporation (Amerada Hess) drilled the AHC Colville Delta 25-13-6 No.1 well (AHC No.1) to confirm the discovery of the Nuiqsut sandstones. The AHC No.1 well was located 2.6 miles from the Texaco No.1 well. It was completed in March of 1986.

During the same time frame, Texaco drilled two other wells in the Colville Delta. The Texaco No.2 well was drilled to delineate and determine the commercial viability of the Nuiquist sandstones discovered earlier in the Texaco No.1 well. Likewise, the Texaco No.3 well was drilled to establish the aerial extent and commerciality of the previously discovered Nuiqsut sandstones. The Texaco No.2 well was located 2.999 miles from the No.1 well. The Texaco No.3 well was located more than three miles from the Texaco No.1 well, but only 2.802 miles from the Texaco No.2 well, which was spudded, cored, and logged before the Texaco No.3 well was spudded.

In 1987, perfunctory EIC award applications were submitted by Amerada Hess and Texaco for the AHC No.1, Texaco No.2, and Texaco No.3 wells. The amount of the credits were $1,807,607, $2,080,277, and $1,427,083, respectively. The applications did not disclose any particular well's location in relation to any other well. Nor did they disclose the targets of any of the wells. Indeed, no geologic data was submitted with the applications.

Nevertheless, in October of 1987, the then commissioner issued two-sentence award certificates granting an EIC award for each of the three wells. Again, there is no written record of any formal determination of whether any of the wells qualified for an award under the EIC regulations. Like the earlier certification for the Texaco No.1 well, each of these certifications stated that the credit was "subject to adjustment of the . . . well costs . . . ."

Several years later in April and May of 1993, DNR initiated compliance and cost audits of the four wells. During the course of the audits, the auditor discovered a document which suggested that the companies applied for the EIC awards knowing, or at least suspecting, that they did not qualify for an award on some of the wells. Specifically, Texaco's files contained a letter from it to Amerada Hess discussing whether EIC applications should be filed for the later drilled wells. The letter stated:

> Pursuant to your May 2, 1986 request, **we** have reviewed the locations of the wells drilled this past winter in view of requesting Exploration Incentive Credits and **concur with your view that only the Texaco Colville Delta #2 Well qualifies for such credits.**
>
> **Although our #3 Well is not at least three miles from our #2 Well, we are planning to file for credits on both wells prior to year end.**

(Emphasis added.) DNR asked for a copy of the May 2, 1986, request, but neither company could (or would) provide it.

As a result of the auditor's concern, DNR informed the companies that it believed that some of the Colville Delta wells may not qualify for an award and requested additional information including pre-drill prospect maps, prospect risk assessments, and other relevant documents. DNR met with Amerada Hess and Texaco at various times to discuss the matter and the companies submitted some additional information. After a complete technical review, the Division has concluded that at least some of the wells do not meet the requirements of the regulations for an EIC award.

Moreover, the additional information submitted by the companies confirms that they knew or suspected that some of the wells did not qualify and that the companies were debating

internally what to do. A July 28, 1986, Diamond Shamrock, a partner in some of the Colville wells, internal memorandum stated:

> **Out of all the exploratory drilling this past winter it appears that only the Texaco Colville #3 well will qualify for E.I.C.** We should request that Texaco make application for credit on this well and ice road. Amerada Hess has already requested that Texaco apply for credit on the #2 well, which if certified will preempt credit for the #3. Since our percentage in the #3 is twice the amount of the #2 and Amerada's is vice versa, our positions on the credits are obvious.

(Emphasis added.)

On November 15, 1993, Texaco supplied the Division with information attempting to explain why it submitted EIC applications for the Texaco No.2 and No.3 wells when it knew that these wells did not meet the distance criterion (and clearly did not meet the separateness criterion). The material included a 1985 Texaco internal memorandum. It relates a conversation between the then director of the Division and Ms. Nelson of Texaco in which, according to Texaco, they discussed the possibility of whether the distance and separateness criteria could be waived. Ms. Nelson stated:

> I have reviewed the well spacing restrictions relative to qualifying for credit under incentive credit provisions of the regulations.
>
> The regulations are clear that each well must either be 1) three or more miles apart; or 2) within three miles, if the well is to test hydrocarbons which constitute a distinctly separate exploration target.
>
> I spoke to [the director] regarding the possibility of a variance or waiver of this restriction. She said there are none to date and she would not be inclined to consider one at this point.

This memorandum demonstrates that Texaco was well aware of the EIC restrictions before it drilled the Texaco Nos. 2 and 3 wells, and before it applied for EIC awards.

Texaco concluded its 1993 presentation with the statement that "after discussing with the appropriate parties the fact that we weren't in compliance with the EIC regulations, Texaco. . . submitted the applications and left the granting or denial of the credits up to the discretionary powers of the Director." As discussed below, however, neither the commissioner nor the director had the discretionary authority to grant an EIC award (to give away state assets) if the wells did not meet the requirements set forth in the regulations.

III. ANALYSIS

A. DNR Is Legally Obligated to Collect All Funds Owed to the State under Programs Administered by DNR.

Title 38 charges DNR with the administration of Alaska's oil and gas resources including the leasing of state land and the collection of oil and gas royalties, bonus bids, and rentals.[1] Through AS 38.05.180(i), the legislature granted the DNR commissioner the authority to establish an EIC program under which an oil and gas lessee could earn credits to be applied against the lessee's royalty and rental payments, and certain taxes owed to the state.

Generally, DNR is legally obligated to ensure that lessees pay the correct amount owed to the state.[2] In addition, DNR is authorized and required to demand and enforce payment of monies owned to the state and which are committed to the agency for collection.[3]

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[1] AS 38.05.035(a)(10). *See* Alaska Department of Natural Resources, *Historical and Projected Oil and Gas Consumption* 1 & 33 (1994); Alaska Department of Natural Resources, *Five-year Oil and Gas Leasing Program* 1-4 (1993).

[2] *See California Co. v. Udall*, 296 F.2d 384, 388 (D.C. Cir. 1961) (purpose of federal leasing program was "to obtain for the public a reasonable financial return on assets that 'belong' to the public. The Secretary of the Interior is the statutory guardian of this public interest."); *Marathon Oil Co. v. United States*, 604 F. Supp. 1375, 1384 & 1386 (D. Alaska 1995) (the Minerals Management Service, the federal counterpart of the Division of Oil & Gas, has "ongoing responsibility to ensure

B. Paying or Refraining from Collecting Public Monies Pursuant to a Policy Decision without a Legal Basis Would Violate the Alaska Constitution.

Commissioner Noah's letter suggests that it may be good policy to refrain from collecting the EIC funds. The Alaska Constitution prohibits a payment of public monies which is not authorized by law or lacks a public purpose.[4] No "[c]ommissioner . . . or anyone else in state government, [has the authority] to give [public] money away, regardless of whether it is done under the guise of a policy decision or an outright gift . . . .Good intentions or a moral basis do not authorize disbursement of money from the state treasury."[5] Refraining from collecting funds owed to the state would constitute an unauthorized payment of public funds.

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collection of all royalties due" and "is charged with managing these natural resources and insuring that full royalties are levied and collected."); *State v. Arctic Slope Regional Corp.*, 834 P.2d 134, 135 (Alaska 1991) (DNR has the duty "to ensure that the financial . . . terms of the leases are met.").

[3] *See* 84 C.J.S. *Taxation* § 657, at 1340 (1954) (a "collector is authorized and required to demand and enforce payment.") (footnotes omitted).

[4] Article IX, Sections 6 and 13, of the Alaska Constitution prohibit gifts or payments without appropriation.

> Article IX, Section 6 (the Public Purpose Clause), states:
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> Public Purpose. No tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose.
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> Article IX, Section 13 (the Appropriation Clause), provides:
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> Expenditures. No money shall be withdrawn from the treasury except in accordance with appropriations made by law. No obligation for the payment of money shall be incurred except as authorized by law. Unobligated appropriations outstanding at the end of the period of time specified by law shall be void.

[5] Appellee's Brief at 10 (Fischer Brief), *Dick Fischer Development No. 2 Inc. v. Department*

Our statements here that a commissioner cannot pay out public monies just because the commissioner thinks it would be good policy are consistent with the position we advocated in *Dick Fischer Development No. 2 Inc. v. Department of Administration*, 838 P.2d 263 (Alaska 1992). There, the state planned to construct a large office building in downtown Anchorage. The state solicited bids and identified Fischer as the low bidder. The state awarded the project to Fischer as the low bidder. The unsuccessful bidders, however, filed bid protests. Before the bid protests could be resolved, the state canceled the project.

Fischer claimed that he had incurred significant bid preparation costs. In an effort to settle adverse claims and retain good will in the construction industry, the then commissioner of the Department of Administration, Eleanor Andrews, issued a written decision in which the state agreed to pay Fischer and other claimants reasonable bid preparation costs. She cited the project's long and unfortunate history and noted that this was the third unsuccessful solicitation of bids for the project. Since the bidders spent considerable time and money preparing their bids, Commissioner Andrews felt that it was "fundamentally unfair" to ask them to bear the full costs of the state's indecisiveness. *Id.* at 265. Her decision to pay the bid costs was not based on legal liability, but on "sound public policy considerations." *Id. See Fischer Brief, supra* at 4-5.

When Fischer sued the state for breach of contract, the state counterclaimed for reimbursement of the bid preparation costs that Commissioner Andrews awarded to Fischer arguing that the award was illegal under Public Purpose Clause of the Alaska Constitution. *Fischer Brief, supra* at 6 & 10-11. The state argued that the commissioner had violated her authority when she

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of Administration, 838 P.2d 263 (Alaska 1992).

authorized the payment without authorization of law just because she felt that it was good policy. *Id.* at 11-12. The superior court ruled that no public purpose was served by the payment of the bid cost and ordered the monies repaid to the state. *Id.* at 7.[6]

Our position and the superior court's decision in *Dick Fischer* stand for the proposition that neither a commissioner nor any other state official has the authority to deprive the state treasury of public monies unless authorized by law. Even if good policy reasons exist to either award public monies or refrain from collecting public monies owed to the state, such actions would be unconstitutional without a legal basis.[7] Thus, DNR cannot refrain from collecting funds legally owed to the state merely because a commissioner thinks that refraining would be good policy.

C. DNR Is Legally Obligated to Pursue the Recovery of Improperly or Mistakenly Paid Public Monies.

Dick Fischer demonstrates not only that a commissioner cannot give away public monies unless authorized, but also that the state can recover public funds which were erroneously

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[6] *Dick Fischer Development No. 2, Inc. v. Department of Administration*, No. 3AN-86-10666 Civil (Alaska Super., October 2, 1990). *Accord Pan-Alaska Construction v. State*, No. 3AN-87-6318 Civil at 4-6 (Alaska Super., May 12, 1988) (payment of bid preparation costs would violate the Public Purpose Clause). On appeal, the Alaska Supreme Court found that there was no legal basis for the award of bid preparation costs to Fischer. *Dick Fischer*, 838 P.2d at 266-67. The court also rejected Fischer's argument that it should not have to repay the money because the state promised to pay the undisputed claims for bid preparation costs. *Id.* at 268. The court, however, did not rely upon the state's constitutional argument. Rather, it held that Fischer did not give any consideration for the promise and that Fischer did not detrimentally rely upon the promise. Accordingly, the Alaska Supreme Court affirmed the superior court's order that Fischer repay the funds tendered by the state for bid preparation costs. *Id.* at 268.

[7] *See also Orange County v. Irvine Co.*, 188 Cal. Rptr. 552, 555 (Cal. App. 1983) (where consideration for a payment of funds by the state to settle a lawsuit is utterly lacking, the expenditure violates the Public Purpose Clause of the California Constitution).

or illegally paid.[8] "Public monies are trust funds belonging to the people, and must be reimbursed by the recipient if they are paid out illegally by a public official, *even though in good faith*." (Emphasis added.)[9] This rule applies whether the erroneous or illegal payment was made based on a mistake of law or fact.[10] Indeed, the legislature has specifically authorized the attorney general to institute legal actions to recover funds which are "illegally paid or are diverted for an illegal purpose, or paid to a person not authorized by law to receive them." AS 37.10.090.

The question raised, however, is whether DNR must, as oppose to can, attempt to recover funds which were previously erroneously or illegally paid. If DNR were to waive the collection of funds erroneously paid, it would in effect be acquiescing in the withdrawal of monies from the state treasury without statutory authorization. This action would be unconstitutional under the Appropriation Clause of the Alaska Constitution.

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[8] The Alaska Supreme Court has noted that actions for "money had and received" to recover money in the hands of another "have been successfully brought for the recovery of public monies paid in violation of the law." *Municipality of Anchorage v. Sisters of Providence*, 628 P.2d 22, 34 (Alaska 1981). *See LTV Education Systems, Inc. v. Bell*, 862 F.2d 1168, 1175 (5th Cir. 1989) (it is "well established that the government may recover money it mistakenly, erroneously, or illegally paid."); *National Rifle Ass'n v. Young*, 134 F.2d 524, 526 (D.C. Cir. 1943) ("anytime within the statute of limitations the Commissioner of Internal Revenue may cancel, retroactively, an exemption or deduction which he has erroneously allowed."); *K.O. Lee Company v. United States*, 279 F. Supp. 146, 148 (N.D. S.D. 1968) (within the statutory period of limitations and in the absence of a binding settlement, the commissioner had authority to re-examine and re-determine petitioners' tax liability); *Jackson v. State*, 407 So.2d 416, 417-18 (La. App. 1981) (government is not barred from recovering funds paid because of its negligence through error or mistake); *Amerada Hess Corp. v. Conrad*, 410 N.W. 2d 124, 134 (N.D. 1987) ("tax authority may modify past practices to disadvantage of a taxpayer if it is determined that the former practice was incorrect.").

[9] *State v. Axtell*, 393 P.2d 451, 455 (N.M. 1964) (emphasis added).

[10] *See Maricopa County v. Cities & Towns of Avondale*, 467 P.2d 949, 952 (Ariz. 1970); *Axtell*, 393 P.2d at 455; *State v. Continental Baking Co.*, 431 P.2d 993, 996 (Wash. 1967).

A very similar question was previously raised by a former commissioner of the Department of Revenue (DOR) to this office. 1963 Op. Att'y. Gen. No. 20 (Alaska, June 20, 1963). There, DOR "inquired whether [it] was legally obligated to recover funds it ha[d] paid by error to municipalities." *Id.* at 1. DOR had refunded liquor license proceeds over several years to a municipality under the mistaken belief that the establishment from which the license fees were collected was located within the city limits, and therefore the city was statutorily entitled to the license proceeds.

This office noted that monies collected by the state for liquor licenses were required to be deposited in the state general fund. Relying on the Appropriation Clause, we reasoned that:

> If the Department of Revenue waived the collection of amounts erroneously paid from the state general fund, it would in effect be acquiescing in the withdrawal of moneys from the state treasury without appropriation having been made by law, and without any other statutory authorization having been given.

Id. at 2. We concluded that DOR "must take whatever steps are necessary to recover such amounts erroneously paid . . . and cannot legally waive the state's claim to the funds involved." *Id.* at 1. We note that the Washington Supreme Court has held that the state not only has the right to recover overpayments made by it, but "[i]ndeed, it has a duty to do so." *State v. Adams*, 732 P.2d 149, 153 (Wash. 1987).

The situation presented here is analogous. The credits were awarded under a mistaken factual belief that the wells qualified for a credit under the EIC program. If the wells did not qualify, then the award of the credits lacked statutory authorization. If DNR were to waive the collection of the amounts erroneously paid from the state treasury, it "would in effect be acquiescing

in the withdrawal of moneys from the state treasury without appropriation having been made by law." 1963 Op. Att'y. Gen. No. 20 (Alaska, June 20, 1963). Accordingly, it is our opinion that DNR is legally obligated to pursue recovery of the funds that were erroneously credited against the lessees' obligations to the state unless some legal doctrine precludes the state from collecting the funds.[11]

D. There Are No Legal Doctrines Which Prevent the State from Collecting the Erroneously Granted EIC Credits.

There are several legal doctrines -- estoppel, res judicata, and the statute of limitations -- which could possibly preclude the state from collecting the erroneously credited EIC funds. We have determined, however, that none of these doctrines would more likely than not bar the state's collection of the erroneously credited funds.

IV. CONCLUSION

DNR is legally obligated to initiate an action to recover funds if they were mistakenly credited to certain oil and gas lessees under the EIC program established by AS 38.05.180(i). DNR cannot waive the state's claim to such funds or give such funds away under the guise of a policy decision or an outright gift. Such conduct would run afoul of the Alaska Constitution which prohibits (1) the expenditure of public money except for a public purpose and (2) appropriations unless made by legislative act. Furthermore, we see no legal doctrine which would likely bar the

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[11] Although we conclude that DNR is legally obligated to pursue recovery of the funds, we do not mean to suggest that the attorney general's statutory authority to initiate or compromise and settle any actions involving the state is infringed. *See* AS 44.23.020. *See Public Defender Agency v. Superior Court*, 534 P.2d 947, 950 (Alaska 1982) (the attorney general's "discretionary control over the legal business of the state, both civil and criminal, includes the initiation, prosecution and disposition of cases.").

state's collection of the erroneously credited funds. Therefore, it is our opinion that DNR must attempt to recover those funds erroneously credited to the lessees.

Very truly yours,

Bruce M. Botelho
Attorney General

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