

LUFF EXPLORATION CO.

IBLA 88-289

Decided jUNE 28, 1990

Appeal from a decision of the Deputy State Director, Montana State Office, Bureau of Land Management, upholding issuance of Notices of Incidents of Noncompliance Nos. DH-175, DH-176, and DH-177 (lease Nos. CA-NCR 368, CA-NRM 1011, and CA-NRM 782).

Affirmed as modified.

1. Oil and Gas Leases: Civil Assessments and Penalties--Oil and Gas Leases: Incidents of Noncompliance

As owner of the land and minerals, the Federal Government has an interest in being paid royalties based on accurate measurements. The regulation at 43 CFR 3162.7-3 contemplates that "the authorized officer" will issue orders and notices setting forth the methods and procedures for measuring gas production. The standards established by the American Gas Association Gas Measurement Committee are well recognized and are a reliable source from which to draw Federal requirements as to the method for accurately measuring gas for the purpose of Federal royalty payments.

2. Bureau of Land Management--Notice: Generally--Oil and Gas Leases: Civil Assessments and Penalties--Oil and Gas Leases: Incidents of Noncompliance

BLM may use the American Gas Association Gas Measurement Committee standards as the source for establishing a requirement as to the proper measurement of production, but a lessee is not in violation of that requirement until BLM has decided to impose it, has notified the lessee, and has given an opportunity to comply.

3. Appeals: Generally--Board of Land Appeals--Bureau of Land Management--Oil and Gas Leases: Civil Assessments and Penalties--Oil and Gas Leases: Incidents of Noncompliance

The regulations at 43 CFR 3162.1(a) and 43 CFR 3161.2 reflect BLM's broad authority to issue orders governing

operations at lease sites. Challenges to the scope of BLM's authority and the manner in which it is exercised are properly raised by a party adversely affected by appeal to the Board of Land Appeals, after administrative review by the State Director.

APPEARANCES: Larry A. Carrell, Vice President--Operations, for Luff Exploration Company, Denver, Colorado; John C. Chaffin, Esq., Office of the Field Solicitor, U.S. Department of the Interior, Billings, Montana, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE IRWIN

Luff Exploration Company (Luff) has appealed a decision of the Acting Deputy State Director, Montana State Office, Bureau of Land Management (BLM), dated March 2, 1988, finding that issuance of Notices of Incidents of Noncompliance (INC) Nos. DH-175, DH-176, and DH-177, issued respectively for Federal oil and gas leases CA-NCR 368, CA-NRM 1011, and CA-NRM 782, was correct. The INC's, dated January 25, 1988, each imposed an assessment of \$250 under 43 CFR 3163.1(a)(2) for failure to comply with a prior written order requiring the installation of thermometer wells. The State Director's decision upheld the issuance of the INC's but reduced the total assessment to \$250 because the instruction to install the equipment had been issued by a single order.

BLM's original order was issued by a letter dated October 23, 1987, from the Miles City District Office informing Luff that an inspection of seven wells had "revealed that the method of gas measurement is unacceptable because the flowing temperature of the gas is not being recorded at the well site." The letter ordered that thermometer wells be installed for this purpose within 30 days. It identified The American Gas Association (AGA) publication "Gas Measurement Committee Report No. 3," 2d ed. Sept. 1985, as the basis of BLM's "policy for gas measurement" and cited Chapter 6, "Instructions for Computing the Flow of Natural Gas and Other Related Hydrocarbon Fluids Through Orifice Meter," as stating under "Flowing Temperature Factor" that "[t]he temperature utilized should be the actual flowing temperature of the gas." The letter required the installation of the thermometer wells "per part 4.9" of the AGA report.

As explained in the request for State Director review, in accordance with 43 CFR 3165.3(b), prepared by Luff's Vice President of Operations Larry A. Carrell, the problem BLM's order posed for Luff was that the gas measurement equipment was not owned or operated by Luff but by the gas purchaser, True Oil Company (True), and could not be modified by Luff. Carrell states that, upon receipt of the order, he discussed the matter with BLM and with True and requested True to install the equipment. He further states that in a subsequent conversation he was advised by True that the equipment had been installed and that, based on this information, by a letter dated November 18, 1987, Luff advised BLM that "the gas purchaser has installed the necessary temperature measuring devices as required."

Shortly after receiving Luff's letter, BLM checked the wells and found that the devices had not been installed. Upon being informed of the fact by BLM, Carrell states that he called True and discovered that the equipment had not been received from the supplier. On November 25, 1987, BLM granted a 45-day extension for installation of the equipment. Within this time the required equipment was installed at four of the seven well sites. It was installed at the other three sites on January 29, 1988. Because the equipment had not been installed on these three wells when BLM again inspected them on January 22, 1988, it issued the INC's which are the subject of this appeal.

On appeal Luff presents five arguments. Summarized, they are: (1) the gas measurement methods which were employed did not result in a loss of royalty to the Federal government; (2) the gas measurement equipment is not owned or operated by Luff and Luff could not control the timing of the installation of the temperature measuring devices; (3) BLM did not consider the marginal economics of the low-producing wells in issuing the order; (4) BLM does not have authority to issue an order which negates rights established by arm's-length contracts; and (5) BLM's action was unjustified. BLM has responded to appellant's statement of reasons in a memorandum submitted through the Office of the Field Solicitor, Billings, Montana. ^{1/}

Because Luff's second and fourth points concern the history just described, we begin by considering them. The issue they raise is whether in the circumstances BLM had authority to order installation of the thermometer wells.

Until BLM issued its order of October 23, 1987, no regulation or order explicitly required the use of thermometer wells to measure the temperature of gas being produced. ^{2/} The applicable regulation provides:

All gas production shall be measured by orifice meters or other methods acceptable to the authorized officer on the lease pursuant to methods and procedures prescribed in applicable orders

^{1/} The Field Solicitor's Office also filed an answer, much of which discussed standards of review applied by the Federal courts established under Article 3 of the Constitution in reviewing agency decisions. The Interior Board of Land Appeals, a quasi-judicial administrative appeals board, is not such an Article 3 court but rather the "authorized representative of the Secretary" which may consider "as fully and finally as might the Secretary" the matters within its jurisdiction. 43 CFR 4.1. See Alvin R. Platz, 114 IBLA 8, 15 (1990). Its decisions are final for the Department, but are subject to judicial review. 43 CFR 4.1(a)(3), 4.403.

^{2/} Appellant notes that BLM's proposed revisions to the operating regulations acknowledge that BLM's "existing internal guidelines on the subject of gas measurement were never formalized in a Notice to Lessees and Operators." 53 FR 3168 (Feb. 3, 1988). The same statement appears in the final regulations. 54 FR 8100 (Feb. 24, 1989).

and notices. The measurement of the volume of all gas produced shall be adjusted by computation to the standard pressure and temperature of 14.73 psia and 60° F[ahrenheit] unless otherwise prescribed by the authorized officer, regardless of the pressure and temperature at which the gas is actually measured.

43 CFR 3162.7-3. Although the regulation does not expressly require the installation of any temperature measurement equipment, it does require that the gas volume measured be adjusted to 60° F. and this adjustment cannot be made unless the gas temperature is periodically measured by some means. Presumably, this could be done by spot measurement without the need for a permanently installed thermometer well. The record is not clear as to the method of temperature measurement previously used for Luff's wells for calculating royalty payments, but the essential language of the regulation has remained unchanged for a number of years and it seems that whatever method was used was considered satisfactory by BLM. See 47 FR 47758, 47771 (Oct. 27, 1982). 3/

[1] The situation changed, however, with BLM's order of October 23, 1987. It informed Luff that the current method of measurement was unacceptable and specified the method "acceptable to the authorized officer" by which gas production was to be measured in the future. As owner of the land and minerals, the Federal Government has an interest in being paid royalties based on accurate measurements. The regulation contemplates that "the authorized officer" will issue orders and notices setting forth the methods and procedures for measuring gas production. The standards established by the AGA Committee are recognized throughout the industry and are a reliable source from which to draw Federal requirements as to the method for accurately measuring gas for the purpose of Federal royalty payments. Thus, BLM's issuance of the order was within the scope of 43 CFR 3162.7-3 and the method of measurement selected was not arbitrary or unreasonable.

BLM's issuance of the order was also in accord with other provisions of the regulations. A Federal oil and gas lessee (which includes an operator, see 43 CFR 3160.05 (1987)) is required to comply with:

[A]pplicable laws and regulations; with the lease terms, Onshore Oil and Gas Orders, NTL's; and with other orders and instructions of the authorized officer. These include, but are not limited to, conducting all operations in a manner which ensures the proper handling, measurement, disposition, and site security of leasehold production; * * *. [Emphasis supplied.]

43 CFR 3162.1(a); see also 43 CFR 3161.2. Thus, 43 CFR 3162.1(a) required Luff to comply with BLM's order of October 23, 1987.

[2] BLM asserts in its reply to Luff's statement of reasons that "by not practicing acceptable industry standards for use of actual flowing

3/ The requirement that gas volume be computed at 60° F. for payment of Federal royalties is even older. See 7 FR 4132, 4136 (June 2, 1942).

temperature in calculations" as described in the AGA Committee standards Luff violated 43 CFR 3162.1(a). We do not agree. The contents of the AGA Gas Measurement Committee Report standards were not rules or regulations of the Department of the Interior. Nor does 43 CFR 3162.7-3 refer to them as defining methods for the proper measurement of production. As stated above, until BLM issued its order, no other regulation, order, or instruction from BLM required the installation of thermometer wells or otherwise notified Luff that compliance with the AGA Gas Measurement Committee Report was required. While BLM may use the AGA Committee standards as the source for establishing a requirement as to the proper measurement of production, a lessee is not in violation of that requirement until BLM has decided to impose it, has notified the lessee, and has given an opportunity to comply. The violation at issue in this case is Luff's failure to comply with BLM's order, not its failure to intuit what BLM might require.

[3] In the few instances in which this Board has had reason to address the scope of 43 CFR 3162.1(a) or similar general provisions of the oil and gas lease operating regulations at 43 CFR part 3160, it has regarded them as reflecting BLM's broad authority to issue orders governing operations at lease sites. See, e.g., William Perlman, 96 IBLA 181, 184 (1987). Broad authority, however, does not mean unlimited authority and challenges to the scope of BLM's authority and the manner in which it is exercised may be brought to this Board, after administrative review by the State Director. 43 CFR 3165.4(a); see San Juan Citizens Alliance, 104 IBLA 288 (1988).

In the present case Luff argues that BLM may have exceeded its authority by issuing an order which negates the terms of the gas purchase contracts. In support of this argument Luff has provided copies of the relevant provisions of the two contracts governing sales from the wells. Both require the amount of metered gas to be computed to a standard temperature of 60° F. One requires that "[t]he flowing temperature of the gas being delivered at each point of measurement shall be determined by spot thermometer readings made as often as found necessary by practice, but not more often than once each meter chart cycle." The other provides that "[t]he flowing temperature of the gas being delivered at any point of delivery shall be assumed to be 60° Fahrenheit" but also allows the purchaser the option of determining the actual temperature by making spot readings once each meter chart cycle.

Luff raised a similar argument in its request for State Director review. ("[W]e question the authority of the BLM to take the action they have in this matter where your demands contravene terms of the applicable arms-length contracts.") BLM's decision responded to the argument with the statement that Federal laws and regulations "have precedence over any contract terms" agreed to between Luff and True. But see National Railroad Passenger Corp. v. Atchinson, Topeka & Santa Fe Railway Co., 470 U.S. 451, 472 (1985). BLM's reply to appellant's statement of reasons states BLM's "opinion" that an "arms-length contract should be written and implemented based on provisions of acceptable industry standards and, by all means, in conformance with lease terms and applicable regulations, orders, etc.," and

that a lessee should "resist signing and being a part of an operation that may not conform to federal regulations." These contracts were signed many years before BLM issued its order, however, and there is no suggestion in the record that the provisions of the contracts were contrary to any regulation, order, or industry standard in effect at the time they were signed. ^{4/}

It is clear that the contract provisions call for the temperature of the produced gas to be measured differently than required by the order BLM issued on October 23, 1987. We do not believe, however, that the order negates the contract provisions. The contracts establish the manner in which the temperature of gas is calculated for the purpose of its sale. The regulation controls the manner the temperature is to be measured for the purpose of making Federal royalty payments. It appears that the provisions of appellant's sales contracts call for measurement of the flowing temperature of the gas by much looser standards than required by the BLM order. However, the standard temperature for gas volume measurement is 60° F. under the terms of both the sales contracts and the regulation. 43 CFR 3162.7-3. Appellant has made no showing that compliance with the BLM order will fail to generate an accurate measurement of the volume of gas produced and sold from the lease. Accordingly, we find no error in a requirement to accurately measure the volume of production from the lease.

Luff also argues that the assessment should not be imposed because under the contracts it was unable to control the timing of the installation of the equipment. The fact that Luff had to rely upon True to install the equipment presents an obvious problem. The record indicates, however, that BLM recognized the problem and granted an extension of time. The decision on appeal states that "you could have avoided the assessment by requesting a second extension from the Miles City District if there were difficulties encountered in securing the necessary equipment." From Luff's request for State Director review it appears that Luff did not seek a further extension because it believed none was needed. Its request states that, after being informed in early December by its personnel that True had been working on the gas measurement equipment, Luff checked with True and was "advised that they had installed the necessary temperature measurement devices." Thus, the assessment was imposed as a result of Luff's reliance on incorrect information from True and not because of BLM unreasonably refused to grant an extension. Cf. Yates Energy Corp., 89 IBLA 150, 153 (1985).

Next, we consider Luff's concern that economic considerations were not taken into account. Luff's request for State Director administrative review stated that on "an annualized average basis" the difference between the volumes calculated by "the methods employed by True Oil and those specified by BLM should not exceed one percent" and that Luff believed the "error which may occur will favor both the BLM and our interests." BLM's decision stated that it disagreed with these factual statements and that it

^{4/} See note 2, *supra*.

was BLM's policy "to assure that all measurement and calculations of leasehold production volumes be as accurate as recognized measurement standards will allow."

Luff has raised the point again on appeal, arguing that, having taken temperature measurements using the devices installed, the annualized average temperature at the wells exceeds 60° F., that a difference of 10° F., i.e. an actual average of 70° F., results in a volume calculation error of less than 1 percent, and that "as long as the actual temperature is greater than 60 degrees Fahrenheit, the result of our practice is slightly higher calculated volumes than actual" so "there is no loss of royalty to the Federal Government." Luff has also provided production and royalty payment figures to show that, based upon a 1-percent error, there was an overpayment of royalties of \$9.63. In addition Luff argues a broader point that BLM's issuance of orders should take into consideration the economics of low producing wells because such orders could lead to the termination of sales and premature abandonment of the wells.

BLM's reply to the statement of reasons refers to Luff's conclusion that there has been no loss of royalty as a "guess" and states that Luff has not provided "convincing evidence that their practice of using an assumed annualized temperature for volume computation is accurate." It also states that even with proper measurement equipment there are inaccuracies, but that proper equipment and accurate measurement of the flow-ing temperature is necessary "to ensure a volume measurement with as low a percentage of error as possible." BLM dismisses Luff's broader economic point with the statement that if it were true, "the contract in effect at the time of the BLM's actions would no longer be in effect."

In this context, Luff's arguments are not directed at BLM's authority to order installation of the thermometers but the wisdom of doing so in the case of the three wells at issue. We have no reason to doubt that Luff's numbers are accurate. ^{5/} Nor does BLM deny appellant's basic point that, over the course of a year, the difference between royalties paid based upon the prior method of calculation and royalties paid using temperature measurements from thermometer wells will be quite small and may even result in lower royalty payments. Similarly, it seems that Luff is correct that BLM did not pay attention to the possibly marginal economics of the three wells. BLM's response that the contracts are still in effect ignores Luff's concern that a gas purchaser considers a number of economic variables in making purchases, including the cost of complying with BLM's rules, regulations, and orders. The effect BLM points to would have occurred only if True had decided that the wells were so marginal that installing the equipment was the cost which made them uneconomic.

^{5/} BLM's reply attempted to show that Luff's figures for the royalties paid differed from those reported to the Minerals Management Service. In a further response Luff points out the difference in the two sets of numbers. One is royalties received by MMS in 1987; the other is royalties paid for gas sales made in 1987.

However, these concerns do not provide a proper basis for reversal of BLM's decision. BLM determined that the installation of temperature wells was necessary to ensure accurate measurement of gas volumes for the payment of Federal royalties and issued an order requiring their installation. We have found that BLM's determination had a reasonable basis and that BLM had authority to issue the order. Whatever the actual effect on the amount of royalties collected, and whatever the consequence as to the economic feasibility of continuing to operate the wells, the record does not indicate that BLM acted improperly in ordering installation of the thermometer wells.

Finally, we come to Luff's "major reason for [its] appeal in this case," namely, "to focus attention on the lack of justification for actions such as was taken in this case." Luff argues:

There are pertinent legal questions, debatable technical issues and economic considerations in this case. Economic considerations are, in our opinion, the most important. As taxpayers we are appalled at the gross inefficiency and profound ignorance that prevails in the bureaucratic process to even allow something as trivial as this case to occur. As businessmen we resent being forced to spend our valuable time on such a non-issue. As independent oil and gas exploration and production people who seek to serve all interests we represent with honesty and integrity and who clearly understand the economics of survival in our industry, we can only wish that the actions of the Federal Government in cases such as this had to be based upon economic justification and that some form of effective accountability for inefficient actions by the public sector existed. A reasonable degree of economic sensibility must, at some time, be forced into the Federal Government's logic process for dealing with issues such as this case. It is our contention that taking action in a robotic fashion purely for the sake of taking action, like procedures employed by the BLM in this case, is not in the public's best interest. It is our hope by calling attention to this case, we can encourage change by those who should be able to cause change. [6/] In the meantime, we request your objective consideration and decision to rescind penalties in this case.

We have dealt--we trust objectively--with Luff's arguments above, and it is our conclusion that BLM's imposition of a \$250 assessment for Luff's failure to timely comply with BLM's order is not improper. To Luff's charge that its actions were unjustified, BLM replied: "We feel that consistent [sic] use of industry standards which assure proper and accurate measurement of our natural resources for royalty purposes, is adequate justification for our action." It is of course not our function to establish priorities for BLM's enforcement activities. We note only that economic efficiency is not the only criterion of a fair and effective enforcement program.

We also note that BLM recently established rules that adopted the AGA Committee standards for all leases. These rules did not require wells

6/ Luff sent copies of its statement of reasons to the U.S. Senators from the States of Colorado, Montana, and Wyoming.

producing less than 200,000 cubic feet a day to comply until February 26, 1990, and provided for variances. 54 FR 8101, 8110 (Feb. 24, 1989). In issuing the rules, BLM was aware of the economic effect they would have. See 53 FR 3168 (Feb. 3, 1988) (proposed rules). Although these rules may benefit Luff in regard to other wells it operates, in this case BLM had authority to issue the order of October 23, 1987, and could properly require the installation of thermometer wells.

Therefore, in accordance with the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the Deputy State Director, Montana State Office, BLM, is affirmed as modified by our analysis.

Will A. Irwin
Administrative Judge

I concur:

C. Randall Grant, Jr.
Administrative Judge