

MOBIL OIL CORP.
v.
MINERALS MANAGEMENT SERVICE

IBLA 91-424

Decided August 15, 1995

Appeal from a decision of District Chief Administrative Law Judge John R. Rampton, Jr., upholding orders of the Tulsa Regional Compliance Office, Minerals Management Service, requiring payment of additional royalty on gas produced from an Outer Continental Shelf oil and gas lease and a late payment charge. MMS-86-0182-OCS and MMS-86-0419-OCS.

Reversed.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties—Oil and Gas Leases: Royalties: Generally—Outer Continental Shelf Lands Act: Oil and Gas Leases

The regulated ceiling price for natural gas produced from an Outer Continental Shelf lease is one of the factors to be considered in valuing the gas for royalty purposes. Gas may be valued at the applicable ceiling price regardless of the fact it was sold at a lesser price where there was no reasonable basis for the lessee to believe the gas did not qualify for that regulated price.

2. Federal Oil and Gas Royalty Management Act of 1982: Royalties—Oil and Gas Leases: Royalties: Generally—Outer Continental Shelf Lands Act: Oil and Gas Leases

In the absence of a successful production test, gas produced from a reservoir penetrated by a well drilled before July 27, 1976, did not qualify for the higher natural gas ceiling price under sec. 102(d) of the Natural Gas Policy Act when evidence of production capability meeting the requirements of OCS Order No. 4 demonstrated that the reservoir was capable of production in paying quantities or when certain evidence (including sidewall cores and core analysis) indicated the reservoir was commercially producible.

3. Federal Oil and Gas Royalty Management Act of 1982: Royalties—Oil and Gas Leases: Royalties: Generally—Outer Continental Shelf Lands Act: Oil and Gas Leases

A finding of a reservoir capable of production in paying quantities under sec. 102(d)(2)(B)(ii) of the Natural Gas Policy Act requires evidence of production capability meeting the requirements of OCS Order No. 4. A sidewall core analysis showing a certain stratum to be productive of gas did not establish a reservoir capable of production in paying quantities under OCS Order No. 4 when a contemporaneous electric log for the well showed less than 15 feet of producible sand.

4. Administrative Procedure: Rulemaking—Federal Oil and Gas Royalty Management Act of 1982: Royalties—Oil and Gas Leases: Royalties: Generally—Outer Continental Shelf Lands Act: Oil and Gas Leases

In a case in which the evidence of record establishes that a producing reservoir penetrated by a well prior to July 1976 was reasonably believed by the operator to be commercially producible under sec. 102(d)(2)(B)(iii) of the Natural Gas Policy Act on the basis of sidewall cores and core analysis showing the reservoir to be productive of gas, a finding that the reservoir was not discovered before July 1976 based on an induction-electric well log which did not show a minimum of 15 feet of producible sand in one section will be reversed in the absence of a regulation promulgating this requirement under the language of sec. 102(d)(2)(B)(iii).

APPEARANCES: Jane J. Boleware, Esq., George J. Domas, Esq., New Orleans, Louisiana, for appellant; Howard W. Chalker, Esq., Peter J. Schaumburg, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE GRANT

The Mobil Oil Corporation (Mobil) has appealed from a July 11, 1991, decision of District Chief Administrative Law Judge John R. Rampton, Jr., issued after a hearing. Judge Rampton upheld the propriety of orders of the Tulsa Regional Compliance Office (TRCO), Minerals Management Service (MMS), requiring payment of additional royalties on gas produced from an Outer Continental Shelf (OCS) oil and gas lease and a late payment charge.

The instant case originated with the issuance of two orders by TRCO, dated March 3 and July 1, 1986. In the first order, TRCO required Mobil

to pay \$360,167.18 in additional royalties with respect to natural gas produced, during the period from December 1978 through October 1984, from well No. A-12B. 1/ That well was completed in September 1977 on OCS oil and gas lease 054-002559 (also identified as OCS-G-2559), issued effective May 1, 1974, situated in the West Cameron Block 617, off the coast of Louisiana in the Gulf of Mexico. TRCO concluded that Mobil had underpaid royalties by valuing the gas for royalty computation purposes according to the ceiling price established by section 104 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3314 (1988) (repealed effective Jan. 1, 1993), 2/ which was the price received on sale of the gas. TRCO contended that the gas should have been priced under the higher ceiling price established by section 102(d) of NGPA, 15 U.S.C. § 3312(d) (1988) (repealed effective Jan. 1, 1993), for which the gas assertedly qualified, and which price, hence, should have been invoked under Mobil's sales contract. 3/ Indeed, TRCO noted that Mobil later sought (by letter dated October 31, 1984) and obtained the approval of MMS to value gas from well No. A-12B according to the higher section 102(d) ceiling price, and began paying royalties based on that price in November 1984. In the second order under appeal, TRCO required Mobil to pay a late payment charge of \$271,989.01, based on interest computed with respect to the underpayment of royalties until the date of payment (under protest) on April 11, 1986. 4/

1/ MMS later recomputed the amount due to be \$359,130.60, taking into account (as noted by Mobil) an allowance for compressor fuel adjustments.

2/ Section 2(b) of the Natural Gas Wellhead Decontrol Act of 1989, P.L. No. 101-60, 103 Stat. 158. This statutory provision repealed the wellhead price control provisions of the NGPA, 15 U.S.C. §§ 3311-3333, effective Jan. 1, 1993.

3/ Mobil's July 19, 1976, "Gas Sales Contract" with the Northern Natural Gas Company provided that the purchase price would be \$1.75 per thousand cubic feet of gas (subject to regular increases), but stated that

"[i]f the Federal Power Commission, or any successor governmental agency having jurisdiction in the premises, acting under any section of the Natural Gas Act or other regulatory authority, or any other governmental authority, shall now or at any time hereafter prescribe, permit, or establish * * * a national ceiling * * * for rates and charges for the sale * * * of natural gas that is higher than the price herein provided to be paid for gas * * * and that is applicable to the gas produced from Seller's properties, then the price provided under this contract to be paid by Buyer to Seller for all such gas delivered * * * shall be increased to equal

such higher ceiling rate * * *, effective the date such higher rate is prescribed, permitted or established by law."

(Gas Sales Contract at 27-28).

4/ Interest computed on the actual amount of the underpayment (\$359,130.60) was \$273,025.59. However, this was reduced by \$1,036.58 in order to account for the overpayment in royalties deemed to be due in the March 1986 TRCO order.

Appeals (MMS-86-0182-OCS and MMS-86-0419-OCS) were duly taken to the Director, MMS, from the two TRCO orders. The Director affirmed the orders in a November 27, 1987, decision, concluding that Mobil was required to value the gas produced from well No. A-12B, from the time the NGPA became effective (December 1978) through October 1984, according to the higher section 102(d) ceiling price. This holding was based on a finding that production from that well had qualified for such price from the date of first production following the effective date of NGPA, and, further, that Mobil could and should have obtained the appropriate section 102(d) classification. MMS held that Mobil was required by statute and regulation to pay royalty on the basis of the fair market value of production, regardless of whether this was the price actually received on the sale of the gas. Thus, MMS rejected Mobil's contention that it was entitled to value the gas according to the lower section 104 ceiling price because it had believed in good faith that the gas did not qualify for the higher price. Mobil appealed this decision to the Board.

In our prior decision in this case, Mobil Oil Corp., 115 IBLA 304 (1990), we concluded that the proper value for the gas produced from well No. A-12B for royalty purposes, during the period from December 1978 through October 1984, depended on whether Mobil had, in fact, breached its duty to market the gas at the best price obtainable by failing to seek classification of the gas under section 102(d) of NGPA at an earlier date. 115 IBLA at 310-11. Finding that this presented a question of material fact which was not answered by the existing record, we referred the case for an evidentiary hearing.

A hearing was held in New Orleans, Louisiana, on March 19, 1991. At the conclusion of the hearing, after reviewing the testimony and documentary evidence presented, Judge Rampton affirmed both TRCO's March 1986 order requiring Mobil to pay additional royalties and its July 1986 order to pay late payment charges. Mobil appealed this decision to the Board.

[1] The Secretary of the Interior has considerable discretion (now delegated to MMS) to value natural gas produced from Federal oil and gas leases for royalty computation purposes. See Mobil Oil Corp., 115 IBLA at 308, and cases cited therein. One of the factors that may properly be considered in valuing gas is the regulated price at which the gas may be sold. Id. at 309-10, 310 n.7. Further, we have held that, where a Federal lessee is receiving less than the regulated price (i.e., the maximum ceiling price to which it is entitled under NGPA and its implementing regulations), the gas sales contract authorizes sales at the regulated price, and the lessee has thus failed to satisfy its obligation to the royalty owner to obtain the best possible sales price (consistent with reasonable business judgment), MMS is entitled to require that the gas be valued for royalty computation purposes on the basis of the higher price. See FMP Operating Co., 121 IBLA 328, 331-32 (1991).

[2] During the period from December 1978 through October 1984, section 102(d) of NGPA provided that gas would qualify for a higher "new

natural gas ceiling price" if it was produced from a lease entered into prior to April 20, 1977 (i.e., an "old lease," as defined in 15 U.S.C. § 3301(10) (1994)), and came from a "reservoir which was not discovered before July 27, 1976" (referred to both by MMS and Mobil as a "new reservoir"). 15 U.S.C. § 3312(d) (1988). This higher price was designed to provide an incentive to exploration and development of new reservoirs.

See Pennzoil Co. v. Federal Energy Regulatory Commission, 645 F.2d 360, 367 (5th Cir. 1981), cert. denied, 454 U.S. 1142 (1982). Since the reservoir at issue in this case was penetrated by a well (although not produced) prior to July 27, 1976, the issue raised by this appeal is whether the reservoir was "discovered" before that date.

In the absence of a successful production test, a reservoir is considered to have been "discovered before July 27, 1976," if it was penetrated by a well before that date and with respect to such well:

(ii) any production capability evidence meeting the requirements of OCS Order No. 4 demonstrates that, as of the time such evidence is obtained, the reservoir is capable of producing in paying quantities (within the meaning of such Order); or

(iii) subject to paragraph (3), [5/] an induction-electric log, sidewall cores and core analysis, or a wire line formation test indicates that, as of the time of such test, the reservoir is commercially producible. [Emphasis added.]

15 U.S.C. § 3312(d)(2)(B) (1988). OCS Order No. 4 (effective August 28, 1969) provides, in pertinent part, with respect to evidence of production capability:

The following may be considered as acceptable evidence that a well is capable of producing in paying quantities:

5/ Section 102(d)(3) provided:

"(3) Effect of negative production capability tests

"For purposes of paragraph (1), a reservoir shall not be considered as having been discovered before July 27, 1976, by the penetration of such reservoir by a well before July 27, 1976, if, with respect to such well—

"(A) a production test meeting the requirements of OCS Order No. 4 was performed and the results of such test failed to demonstrate that, as of the time of such test, such reservoir was capable of producing in paying quantities (within the meaning of such Order); and

"(B) production capability evidence meeting the requirements of OCS Order No. 4 does not exist or, if existing, does not demonstrate that, as of the date such evidence was obtained, such reservoir was capable of producing in paying quantities (within the meaning of such Order)."

15 U.S.C. § 3312(d)(3) (1988) (emphasis added).

- A. An induction-electric log of the well, clearly showing a minimum of 15 feet of producible sand in one section
which does not include an interval which appears to be water saturated. * * *
- B. Sidewall cores and core analysis which indicates that the section is producible.
- C. A wire line formation test or evidence that an attempt was made to obtain such test. The test results must indicate that the section is producible.
- D. All logs run must support other evidence that the section is producible.

The natural gas at issue here was clearly produced from a lease entered into prior to April 20, 1977. Thus, the question regarding whether the gas qualified for the section 102(d) ceiling price at the time of sale hinges on whether it was "produced from a reservoir which was not discovered before July 27, 1976." 15 U.S.C. § 3312(d)(1) (1988). In the case of gas produced from well No. A-12B, the reservoir in question is the EH-1. It is acknowledged that well No. 1 in the West Cameron Block 617 penetrated that reservoir before July 27, 1976. See Tr. 9-10, 36-37; Statement of Reasons for Appeal (SOR), dated Aug. 11, 1991, at 4. Thus, the issue is whether the evidence obtained in the drilling of well No. 1 prior to July 27, 1976, either supported a belief that the EH-1 reservoir was capable of production in paying quantities within the meaning of section 102(d)(2)(B)(ii) and OCS Order No. 4 or indicated that the reservoir was commercially producible under one of the criteria listed in section 102(d)(2)(B)(iii).

Mobil contends that, prior to filing the application for reclassification of the A-12B well, it reasonably believed that the EH-1 reservoir had in fact been discovered with the drilling of well No. 1 in July 1974, based on the results of a sidewall core analysis (Exh. Mobil-1) taken from that well in July and August 1974. ^{6/} As proof that it reasonably believed at the time of drilling the well that the reservoir was capable of production in paying quantities, Mobil offered the testimony of Kenneth Trocquet, a senior reservoir engineer. While Trocquet had not been responsible for

^{6/} Mobil initially explained its change regarding its assessment of the productive capability of well No. 1 on the basis simply of "re-analyz[ing]" the original logs taken from that well (SOR, dated Mar. 9, 1988, at 2). However, Mobil now indicates that the change was caused by the fact that it became aware in 1984 that MMS did not consider the sidewall core analysis sufficient to conclude that the reservoir was capable of production in paying quantities. See SOR, dated Aug. 11, 1991, at 22.

analyzing the results of the initial drilling efforts with respect to the well in 1974, he gave his interpretation of the results of the sidewall core analysis. He explained that, on the basis of the core analysis report three of four samples at the depth of the EH-1 reservoir were shown to be productive of gas (Tr. 39). An induction-electric log analysis of well No. 1 was also performed in 1974 which indicated that the reservoir included 12.5 feet of producible sand, less than the 15 feet required under paragraph 2.A. of OCS Order No. 4 (Mobil Answer at 19 n.7; see Tr. 62).

Trocquet also testified that, in his opinion, the EH-1 reservoir in No. 1 well was capable of producing natural gas in paying quantities. See Tr. 41. Asked to provide the basis for his opinion, he replied: "Personally, on the sidewall core analysis, and the properties in the zone from which they were taken." See Tr. 41. 7/

At the hearing, the focus of the dispute was whether the 1974 sidewall core analysis from the No. 1 well showing the EH-1 reservoir to be productive of gas is sufficient to establish a discovery well, i.e., that the reservoir was capable of production in paying quantities, within the meaning of section 102(d)(2)(ii) and OCS Order No. 4. Mobil contends that with respect to a pre-1976 well the terms of section 102(d)(2)(ii) indicate that "any" evidence of production capability meeting the requirements of OCS Order No. 4 would establish that the reservoir was "discovered" prior to 1976. Thus, Mobil argues that the sidewall core analysis constituted evidence meeting one of the standards for finding a producible well enumerated in OCS Order No. 4, and that it reasonably believed that evidence to be sufficient to disqualify the reservoir for section 102(d) pricing. MMS, on the other hand, asserts that in order to establish a reservoir capable of production in paying quantities in the absence of a production test (which was not performed on the EH-1 reservoir in the No. 1 well), OCS Order No. 4 requires evidence fulfilling all (not just one) of the listed criteria. Further, MMS contends that its interpretation of this requirement has been consistent over time. 8/

At the hearing, MMS provided the testimony of William A. Capers, Jr., a petroleum geologist with MMS extensively involved in the NGPA classification process since 1979. Capers testified that, in the absence of an

7/ In his testimony, Trocquet also cited other grounds not related to whether Mobil reasonably believed the EH-1 reservoir was discovered by the No. 1 well. These factors included actual production from the reservoir through a different well (A-12B) and a production test in well No. 1 in a different reservoir (Tr. 41-42).

8/ Prior to the hearing, Mobil asserted that MMS had changed its interpretation of OCS Order No. 4 in that only one of the criteria for evidence of production capability was required in the late 1970's, whereas satisfaction of all the criteria was required in the mid 1980's. See Respondent's Post-Hearing Brief at 12 (quoting Mobil's Answer to Interrogatory No. 7).

induction-electric log showing 15 feet of producible sand, MMS has always regarded sidewall cores and core analysis and/or a wire line formation test to be insufficient to show that a reservoir is producible in paying quantities. Mobil's evidence had indicated less than 15 feet of producible sand. See Tr. 59. Capers asserted that MMS has consistently required compliance with all 4 criteria in OCS Order No. 4 to establish a discovery well disclosing a reservoir capable of production in paying quantities (Tr. 57). MMS introduced an application for section 102(d) classification submitted by Mobil in 1981 for another Gulf of Mexico OCS well in which it asserted that penetration of the reservoir by a 1974 well did not establish a capability of production in paying quantities under OCS Order No. 4, even though core analysis showed certain strata to be productive of oil, because only 9.5 feet of producible sand was disclosed (MMS Exh. 2 at 4; Tr. 70-71). Also introduced was an application for section 102(d) classification by another operator filed in September 1979 and approved in 1980 involving a reservoir which had been penetrated by a 1974 well which the sidewall core analysis showed as productive of gas condensate but which (like the instant well) had less than 15 feet of producible sand (MMS Exh. 4; Tr. 73-74).

Capers stated that MMS has never rejected a reservoir classification under section 102(d) of the NGPA when sidewall core analysis indicated productive potential but less than 15 feet of producible sand was shown (Tr. 92-93, 96; see Tr. 109). Capers explained that sidewall core analysis indicating a producible stratum, one of the criteria under OCS Order No. 4, may disclose a potential for production, but compliance with all the criteria is required by MMS to establish the presence of a reservoir capable of production in paying quantities under OCS Order No. 4, which is required by the terms of section 102(d).

[3] We find that a careful reading of the language of section 102(d) of the NGPA fails to support the interpretation of OCS Order No. 4 offered by Mobil. With respect to reservoirs penetrated prior to July 27, 1976, the statute provides that the reservoir shall be considered as discovered if "any production capability evidence meeting the requirements of OCS Order No. 4 demonstrates" that the reservoir is capable of production in paying quantities as of the time the evidence is obtained. 15 U.S.C. § 3312(d)(2)(B)(ii) (1988) (emphasis added). Thus, the evidence must meet the requirements of OCS Order No. 4. This is not the same as stating that meeting any part of the standards set forth in the order will suffice.

A fair reading of the terms of OCS Order No. 4, incorporated by reference in the statute, will not sustain an interpretation that a reservoir may be deemed capable of production in paying quantities solely on the basis of a sidewall core analysis indicating the stratum is producible where the well log shows less than 15 feet of producible sand. An induction-electric log showing a minimum of 15 feet of producible sand is required by OCS Order

No. 4. ^{9/} The terms of the order clearly require that "all logs run" must support other evidence that the section is producible. Mobil's induction-electric log did not qualify under the terms of OCS Order No. 4 since it showed only 12.5 feet of producible sand in the EH-1 horizon as penetrated by the No. 1 well.

[4] Evidence of production capability meeting the requirements of OCS Order No. 4 is not, however, the sole criterion of whether the reservoir was "discovered" by the 1974 well. Under the alternative standard of discovery set forth at section 102(d)(2)(B)(iii), "sidewall cores and core analysis" constitute one of the forms of evidence set forth in the disjunctive (by the term "or") which may indicate ^{10/} that a "reservoir is commercially producible" and, hence, "discovered" by a pre-1976 well. 15 U.S.C. § 3312(d)(2)(B)(iii) (1988).

This section (B)(iii) standard was expressly made subject to the terms of section 102(d)(3). Capers testified to his (MMS') interpretation that the cross reference to this latter section, which in turn referred to evidence of production capability "meeting the requirements of OCS Order No. 4," invoked those same standards as the measure of a commercially producible well (Tr. 59). The Administrative Law Judge similarly held in his decision that this proviso barred a finding of a discovery where production capability evidence meeting the requirements of OCS Order No. 4 does not exist (Administrative Law Judge Decision at 7-8). ^{11/} However,

^{9/} Trocquet testified that the induction-electric log is the "primary tool" to determine whether a reservoir contains gas (Tr. 115; 120-21).

^{10/} Unlike production capability evidence meeting the requirements of OCS Order No. 4 which must "demonstrate" that the reservoir is capable of production in paying quantities under section (B)(ii), evidence under section (B)(iii) need only "indicate" that a well is commercially producible. The verb "demonstrate" is defined in terms of "to show clearly" or "to prove or make clear by reasoning or evidence." Webster's New Collegiate Dictionary 299 (1979). By contrast, the verb "indicate" is defined as

"to point out or point to" or "to be a sign, symptom, or index of." *Id.* at 580.

^{11/} In a similar case subsequently referred by the Board for a hearing, the Administrative Law Judge analyzed the section (B)(iii) standard differently. In a recently released decision the Administrative Law Judge concluded that the provision of section (d)(3) requiring evidence of capability of production in paying quantities meeting the requirements of OCS Order No. 4 applies only when there has been a negative production test. *Arco Oil & Gas Co. v. Minerals Management Service*, IBLA 90-4 (Mar. 15, 1994), appeal docketed, IBLA 94-381 (Apr. 7, 1994). As a result of this different opinion in a second case where the parties were represented by the same counsel, the Board requested the parties by order of Apr. 14, 1994, to file a supplemental brief addressing this question.

the proviso at section 102(d)(3) (quoted at note 5, *supra*) actually consists of two qualifying requirements: the existence of a production test meeting the requirements of OCS Order No. 4 which failed to demonstrate that the reservoir was capable of production in paying quantities (negative production test) and the lack of evidence of production capability "meeting the requirements of OCS Order No. 4."

We cannot ignore the fact that section (d)(3) is entitled "Effect of negative production capability tests" and that paragraphs (A) and (B) are stated in the conjunctive. Thus, the terms of section 102(d)(2)(B)(iii) may be reasonably construed to condition the necessity of evidence of production capability meeting the requirements of OCS Order No. 4 upon the existence of a negative production test meeting the requirements of paragraph 1 of OCS Order No. 4. No such test was performed in this case. Under this construction of the statutory language, a sidewall core analysis indicating that a section is commercially producible may support a finding that the reservoir was "discovered" under section 102(d)(2)(B)(iii). ^{12/} We find this construction of the statutory language is, if anything, more consistent with the statutory language than the MMS interpretation which Capers related in his testimony.

Reviewing the evidence in light of this standard, we note that Trocquet, petroleum engineer and senior staff reservoir engineer with

^{12/} The terms "commercially producible" and "capable of production in paying quantities" as used with respect to a reservoir are currently defined in the regulations in similar terms. Thus, both require "a well completed therein [which] can reasonably be expected to produce natural

gas in quantities sufficient to yield revenues in excess of operating costs." Further, "operating costs include those out-of-pocket cash expenses necessary to operate and maintain a well." See 18 CFR 271.204(b) and (c). The definition of commercially producible was initially tied to the term "production in commercial quantities" defined as production of gas from a reservoir which is either sold and delivered or retained by the operator for beneficial economic use. See 18 CFR 270.102(b)(4), 271.204(c), 43 FR 56546, 56556 (Dec. 1, 1978) (interim regulations). When the regulations were republished, the response to comments indicated that: "The Commission continues to believe that the new production test for new onshore and new OCS reservoirs should be the same unless factors such as the applicability of OCS Order No. 4 require a different standard." 44 FR 48182 (Aug. 17, 1979). However, promptly thereafter the rulemakers were persuaded otherwise as the definition of commercially producible was changed to match the definition of capable of production in paying quantities. 18 CFR 271.204(c), 44 FR 69646-47 (Dec. 4, 1979). Appellant asserts the initial position of FERC in this matter supports a finding that both Congress and FERC, which had responsibility for promulgating regulations implementing the NGPA, intended "commercially producible" to mean something different than "capable of production in paying quantities" as set forth in OCS Order No. 4.

Mobil, testified that in his opinion the EH-1 reservoir was capable of production in paying quantities based on the sidewall core analysis of samples taken from the EH-1 zone and the properties disclosed in the zone from which the core samples were taken (Exh. Mobil-1; Tr. 38-42). Trocquet indicated that he "looked at the petrophysicist's evaluation of where the EH-1 zone was located, selected those depths and correlated them to the depths indicated on this core report [Exh. Mobil-1]" (Tr. 39). He testified that three of the samples at the appropriate depth are listed under the "interpretation column in the report as being gas productive" (Exh. Mobil-1 at 2; Tr. 39). Further, Trocquet indicated that four core samples at the depth of the EH-1 reservoir taken on the second run on July 24, 1974, were interpreted as being gas productive (Exh. Mobil-1 at 6; Tr. 40). Asked his opinion regarding whether the "EH-1 reservoir in the Number 1 well was capable of producing natural gas in paying quantities," Trocquet responded "yes" (Tr. 41). In response to the inquiry on the basis of his opinion, Trocquet replied: "Personally, on the sidewall core analysis, and the properties in the zone from which they were taken" (Tr. 41). Additional grounds were also given by Trocquet for his opinion as noted by the dissent in this case. Thus, he also referred to actual production from the EH-1 reservoir through a different well not at issue here (Tr. 41). ^{13/} Also cited by Trocquet was a production test in the No. 1 well in another zone (the EH-2) (Tr. 41). The fact that Trocquet also mentioned later transpiring events in giving his opinion that the EH-1 reservoir penetrated by well No. 1 was commercially producible should not be held against Mobil where the hearing is held long after subsequent events confirmed the initial basis for the conclusion (the sidewall core analysis).

The MMS petroleum geologist, Capers, testified to the MMS interpretation of the requirements for a commercially producible well: "MMS has always regarded, in the absence of 15 feet of producible sand, that a wire line formation test and/or cores and core analysis, is not sufficient to indicate that a reservoir is producible in paying quantities" (Tr. 53). This was based on the MMS "interpretation" that the reference in section 102(d)(2)(B)(iii) to section 102(d)(3) invoked the standard of OCS Order No. 4 requiring 15 feet of producible sand (Tr. 59).

^{13/} Trocquet testified that the EH-1 reservoir was never produced from well No. 1 as this exploration well was an "expendable well" drilled to ascertain "the aerial extent of the reservoir" and the optimum producing well location before investing in an expensive production platform and development wells (Tr. 40-41). He explained that well No. 1 was not optimally located for this purpose (Tr. 41). The fact that the well was not in the best location for setting up a platform for production from the EH-1 reservoir is properly distinguished from the issue of whether the reservoir was reasonably believed to be commercially producible on the basis of evidence obtained in the No. 1 well.

Contrary to the MMS interpretation of section (B)(iii) as incorporating by reference the requirement of evidence of a commercially producible reservoir complying with OCS Order No. 4 even in the absence of a negative production test, it is clear that appellant relied upon a construction of the statute under which a commercially producible well may be indicated by sidewall cores and core analysis. As set forth above, we find appellant's construction of section (B)(iii) to be at least as reasonable as that of MMS. Cf. Amoco Production Co., 129 IBLA 186, 203-05 (1994). To the extent that appellant's evidence of discovery of a commercially producible reservoir based on the sidewall core analysis under section (B)(iii) was disregarded because the induction-electric log discloses less than 15 feet of producible sand (as required by OCS Order No. 4), the MMS interpretation of section (B)(iii) becomes a rule binding on operators. A rule, whether it be deemed substantive or procedural, must be promulgated pursuant to the notice and comment provisions of the Administrative Procedure Act, 5 U.S.C. § 553 (1994), in order to have the "force and effect of law." Union Oil Company of California, 110 IBLA 62, 64 (1989); Shell Offshore, Inc., 96 IBLA 149, 171-72, 94 I.D. 69, 82 (1987); ^{14/} see Chrysler Corp. v. Brown, 441 U.S. 281 (1979); Phillips Petroleum Co. v. Johnson, 22 F.3d 616, 619-20 (5th Cir. 1994), rev'g Conoco, Inc., 110 IBLA 232 (1989). ^{15/} A party may not be adversely affected by a rule promulgated without complying with these requirements. Phillips Petroleum Co. v. Johnson, supra at 621; see 5 U.S.C. §§ 552(a)(1), 553 (1994). Accordingly, we find that the fact that the induction-electric log disclosed less than 15 feet of producible sand did not preclude a finding that this reservoir was reasonably believed to be commercially producible from this well. Capers' testimony was clearly based on this predicate. The testimony of Trocquet, on the other hand, is that the reservoir was properly considered on the basis of the sidewall core analysis to be commercially producible. Since appellant's interpretation of section 102(d)(2)(B)(iii) was, as noted above, reasonable, its failure to apply sooner for section 102 pricing cannot, under the facts of this case, be said to constitute a breach in its duty to market gas at the highest available price. Consequently, the decision of the Administrative Law Judge is reversed as inconsistent with the law and the evidence.

^{14/} Aff'd, 923 F.2d 830 (Fed. Cir. 1991), cert. denied sub nom. Pennzoil Co. v. United States, 112 S. Ct. 167 (1991).

^{15/} The court in Phillips reversed a Board decision finding that the natural gas liquid products procedure paper was an interpretation of

the royalty valuation regulations which did not require use of rulemaking procedures under the APA. Rather, the court found that procedure paper's reliance on spot market prices for valuation was a rule requiring publication, notice, and comment in accordance with the APA.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is reversed.

C. Randall Grant, Jr.
Administrative Judge

I concur.

James L. Burski
Administrative Judge

ADMINISTRATIVE JUDGE HUGHES DISSENTING:

The issue in this case is not how section 102(d) of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3312(d) (1988), ^{1/} applies to gas produced from the A-12B well. That question is not within our authority to decide and the agency having that authority has already made its determination. The question is instead whether Mobil Oil Corporation (Mobil) could reasonably have believed that it was not entitled to charge purchasers the higher price authorized by section 102, and thus was justified in paying royalty on that basis during the relevant time period.

The statutory language is couched in terms of what a producer must show in order for Outer Continental Shelf (OCS) gas to qualify for the higher section 3312(d) price. Under section 102(d)(1), gas produced from an "old lease" on the OCS shall qualify for the higher price if the gas is produced from a reservoir not discovered before July 27, 1976. It is undisputed that Mobil must have known that the gas was produced from an "old lease": Lease 054-002559 was issued effective May 1, 1974. The critical question is whether Mobil reasonably believed at the time of production and sale that the reservoir from which the gas came had been discovered before July 27, 1976.

Under section 3312(d)(2), a reservoir that was penetrated before July 27, 1976, "shall be considered as having been discovered before July 27, 1976," if two main conditions are met: that reservoir must have been penetrated by a well before July 27, 1976 (15 U.S.C. § 3312(d)(2)(A) (1988)), and any one of three sub-conditions must have been met. 15 U.S.C. § 3312(d)(2)(B) (1988).

It is undisputed that the reservoir was penetrated by a well before July 27, 1976: Reservoir EH-1 was penetrated by well No. 1 in 1974. It remains to determine whether Mobil could reasonably have believed that any of three sub-conditions specified in section 3312(d)(2)(B) was met. If so, it could reasonably have believed that the reservoir was discovered before July 26, 1976, so that the gas produced from that reservoir did not qualify for the new, higher price, and that royalty was properly calculated on the old, lower price.

The first sub-condition (15 U.S.C. § 3312(d)(2)(B)(i) (1988)) appears to apply only where there was a production test meeting the requirements of OCS Order No. 4. I agree with the majority that the record contains no indication that such test was completed. Thus, Mobil could not reasonably have believed that the first sub-condition was met.

The second sub-condition (15 U.S.C. § 3312(d)(2)(B)(ii) (1988)) appears to apply where any production capability evidence meeting the

^{1/} Repealed effective Jan. 1, 1993.

requirements of OCS Order No. 4 demonstrated that the reservoir was capable of production in paying quantities as of the time such evidence was obtained. Mobil has pointed to no such evidence. Mobil could not reasonably have believed that the second sub-condition was met.

The third sub-condition (15 U.S.C. § 3312(d)(2)(B)(iii) (1988)) appears to apply, subject to section 3312(d)(3), where an induction-electric log, sidewall cores and core analysis, or a wire line formation test indicates that, as of the time of such test, the reservoir is commercially producible. I agree with the majority that the reference to section 3312(d)(3) does not reasonably appear to invoke the requirement that the listed tests comply with the requirements of OCS Order No. 4. The third sub-condition could be reasonably seen as satisfied where any of the listed tests indicated that, at the time of such test, the reservoir was commercially producible.

The majority relies on the fact that Mobil pointed to a sidewall core and core analysis, one of the permissible tests. I do not believe that Mobil proved that it reasonably believed that the sidewall core and core analysis indicated that, at the time of that test, the reservoir was commercially producible.

Mobil's evidence was in the form of testimony by Kenneth Trocquet, Senior Staff Reservoir Engineer. He testified that he believed (as of the time of the hearing) that the EH! 1 reservoir was "capable of production in paying quantities," based on

the sidewall core analysis, and the properties in the zone from which they were taken. And second, on the basis of actual production from this reservoir through the A! 12 well bore, and third, on the basis of a production test in the Number 1, not in the EH! 1 zone, but in the EH! 2 zone below it. That sustained good production, certainly beyond, I guess what would be called, "commercial production."

(Tr. 41-42). Thus, he based his conclusion that the EH! 1 reservoir (zone) was capable of production in paying quantities on three things, taken together: (1) a 1974 sidewall core analysis using the core from well No. 1; (2) actual production from this reservoir through the A! 12 bore; and (3) a production test in the EH! 2 zone below it. 2/ He did not

2/ It is unclear how the third factor, a production test in the EH-2 zone, could be relevant to whether the EH-1 was commercially producible, as it concerns a different reservoir. In the absence of an adequate explanation by Mobil as to how data from a different reservoir could have affected its beliefs on this question, this testimony must be discounted.

state that the sidewall core analysis, by itself, would support a commercially producible determination, either now or at the time the analysis was made.

Trocquet's testimony actually indicates that Mobil did not regard the sidewall core analysis as establishing that the reservoir was commercially producible. Trocquet acknowledged that commercial producibility could be established only by further reference to the amount of gas later produced from well No. A-12B. That evidence was plainly not available "as of the time of" the sidewall core analysis in 1974.

Actual production volume data from well No. A-12B, which was completed in September 1977, might have contributed to a belief that the gas did not qualify for the higher price as of the time Mobil marketed the gas. However, such data could not show that discovery predated July 27, 1976. In any event, the Act is clear that the critical point is "the time of" a specified test, that is (in this case), in 1974 at the time of the sidewall core analysis.

Viewed objectively, the 1974 sidewall core analysis (the only recognized test under the statute that Mobil actually did before July 27, 1976) falls short of what was necessary to indicate that, at the time of that test, the reservoir was commercially producible. That evidence consists of two sections, one covering 3 feet (5,685-5,688 feet) in Run #1 and one covering 54 feet (5,687-5,741 feet) in Run #2, that were interpreted as bearing gas. The latter is not continuous, with an area of low permeability and no analysis at 5,736.5 and 5,738.5 feet, respectively. Of course, evidence under section 102(d)(2)(B)(iii) had to reveal not only that there was a reservoir, but that it was "commercially producible," that is, "capable of generating revenues in excess of operating costs." See 18 CFR 270.102(b)(4) and 271.204(c) (1978). This sketchy data falls far short of what could be reasonably seen as indicating what revenues might be, and there is no evidence as to what operating costs might have been expected to be. Nor is there any expert testimony that this evidence, standing alone, supports a finding of commercial producibility.

To the extent that it can be considered, other contemporary evidence, in the form of an induction-electric log analysis of the area performed in 1974, was equally weak. ^{3/} It indicated that the reservoir included 12.5 feet of producible sand, rather than the 15 feet required under paragraph 2.A. of OCS Order No. 4. Although I agree that the insufficiency of the induction-electric log analysis did not preclude a finding of commercial producibility from the other tests specifically mentioned in section 3312(d)(2)(B)(iii), I cannot conclude that Mobil did reasonably

^{3/} Induction-electric log analysis would appear to be governed by 15 U.S.C. § 3312(d)(ii) (1988). As such it would have to meet the requirements of OCS Order No. 4 to support a determination that the well was discovered prior to July 26, 1976.

believe or could have reasonably believed that the 1974 sidewall core analysis indicated that, at the time of the analysis, the reservoir was commercially producible. Thus, Mobil failed to establish that it reasonably believed that the last sub-condition had been met and that the reservoir was discovered before July 26, 1976.

In summary, the evidence does not establish that Mobil could reasonably have believed that it did not qualify for the increased prices under 15 U.S.C. § 3312(d) (1988). I would accordingly affirm the Minerals Management Service's decision.

David L. Hughes
Administrative Judge

