

MERIDIAN OIL INC.

IBLA 93-60 Decided July 31, 1997

Appeal from a decision of the Deputy State Director, New Mexico State Office, Bureau of Land Management, affirming the rejection of an application for the initial formation and first, second, and third revisions of a participating area under a unit agreement. SDR 92-25.

Reversed and remanded.

1. Oil and Gas Leases: Unit and Cooperative Agreements

When, under the terms of a unit agreement requiring the establishment of separate participating areas for each separate pool or deposit, a unit operator seeks approval of participating areas including nonadjacent areas, there is a rebuttable presumption that nonadjacent areas produce from different pools or deposits and, therefore, may not properly be joined in a single participating area. A unit operator may overcome the presumption by presenting evidence that those areas, in fact, do produce from the same pool or deposit.

APPEARANCES: Marla J. Williams, Esq., Denver, Colorado, for Appellant; Margaret Miller Brown, Esq., Office of the Field Solicitor, U.S. Department of the Interior, Santa Fe, New Mexico, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE TERRY

Meridian Oil, Inc., (Meridian) has appealed from a Decision of the Deputy State Director, New Mexico State Office, Bureau of Land Management (BLM), dated October 9, 1992, affirming a July 6, 1992, Farmington Resource Area (FRA), BLM, Decision which returned, without approving, Meridian's application for the initial formation of, and the first, second, and third revisions to, the Fruitland Coal participating area (PA) for the Huerfano Unit.

On June 2, 1952, the Department approved the unit agreement creating the Huerfano Unit which embraces approximately 10,245.36 acres of Federal, State, and Navajo allotted land described as all of secs. 1, 2, 3, 4, and 12, the N $\frac{1}{2}$ sec. 10, and the N $\frac{1}{2}$ sec. 11, T. 26 N., R. 9 W., and all of secs. 22, 23, 26, 27, 28, 33, 34, 35, and 36, the W $\frac{1}{2}$ sec. 24, and

the W $\frac{1}{2}$ sec. 25, T. 27 N., R. 9 W., New Mexico Principal Meridian (NMPM), San Juan County, New Mexico. See Attachments C and E to Meridian's Request for State Director Review (SDR Request). ^{1/} On February 11, 1992, in accordance with section 11 of the unit agreement, Meridian, the unit operator, applied for the initial, first, second, and third expansions of the Fruitland Coal PA based on its determination that the identified wells were capable of producing unitized substances in paying quantities from the Fruitland Coal Formation. The requested initial PA (based on well No. 150) included lands within the E $\frac{1}{2}$ sec. 1, T. 26 N., R. 9 W., NMPM; the first expansion (based on well No. 167) encompassed lands within the E $\frac{1}{2}$ sec. 2, T. 26 N., R. 9 W., NMPM; the second expansion (based on well No. 22) contained lands within the E $\frac{1}{2}$ sec. 4, T. 26 N., R. 9 W., NMPM; and the third expansion (based on well No. 51) delineated lands within the W $\frac{1}{2}$ sec. 36, T. 27 N., R. 9 W., NMPM. Meridian also submitted economic summary sheets documenting each well's commerciality, expansion schedules, and unitized substance allocation percentages. (Attachment I to SDR Request.)

On March 3, 1992, FRA returned Meridian's application as unapproved, stating:

You submitted your application as one PA. This is not correct for what is typically termed a geologic inference unit. Your agreement provides that a separate PA should be established for each pool or any group thereof based upon geologic and engineering data. We, in the BLM interpret this to mean that only those lands that are abutting are a common PA. Separate PA's can then be combined through revisions as necessary.

(Attachment J to SDR Request at 1.) The FRA suggested that Meridian establish an Initial Fruitland Coal "A" PA consisting of well No. 150 and the E $\frac{1}{2}$ sec. 1, T. 26 N., R. 9 W., with the first revision the Fruitland Coal "A" PA embracing well No. 167, the E $\frac{1}{2}$ sec. 2, and by geologic inference, the W $\frac{1}{2}$ sec. 1, T. 26 N., R. 9 W., and its second revision containing well No. 51 and the W $\frac{1}{2}$ sec. 36, T. 27 N., R. 9 W. An Initial Fruitland Coal "B" PA could also be established, FRA continued, encompassing well No. 22 and the E $\frac{1}{2}$ sec. 4, T. 26 N., R. 9 W., which could eventually be combined with the Fruitland Coal "A" PA by adding in the lands between the two PA's through later drilling or through geologic and engineering inference. While acknowledging that its proposal reflected a change in methodology for establishing PA's, FRA explained that the method previously used conflicted with guidance pertaining to units and radically departed from procedures utilized in other areas.

^{1/} The documents cited in our recitation of the facts of this case, although not included in BLM's official case file, were provided as attachments to Meridian's submission supporting its request for SDR, but not all of the supplemental information referenced in the documents was appended to those documents.

Meridian met with FRA officials on April 10, 1992, to discuss its interpretation of the unit agreement's provisions for PA revisions and requested that FRA further consider its decision on this issue. Subsequently, in an application dated June 23, 1992, Meridian again requested approval of the initial, first, second, and third expansions of the Fruitland Coal PA. (Attachment F to SDR Request.) This request was identical to the February 11, 1992, request, except that, as suggested by FRA's March 3, 1992, letter, Meridian added the W $\frac{1}{2}$ sec. 1, T. 26 N., R. 9 W., to the first expansion of the Fruitland Coal PA based upon geologic inference and enclosed data supporting that inference. ^{2/}

On July 6, 1992, FRA again returned Meridian's application for the formation and revision of a Fruitland Coal PA in the Huerfanito Unit. (Attachment A to SDR Request.) The FRA reiterated its interpretation of the unit agreement as requiring that a single PA be contiguous, adding that BLM's Unitization Taskforce had reviewed the matter during a meeting on June 10-12, 1992, and had unanimously agreed that a revision to a PA must be contiguous. The FRA directed that future revisions to PA's be based on that interpretation. However, based on its recognition that this method of PA revision differed from Meridian's past practice, FRA agreed, for the sake of consistency, to continue to allow noncontiguous revisions in PA's where such revisions had previously been accepted and to approve nonabutting PA revisions in numbered units due to the unique language found in those unit agreements. Therefore, since Meridian's request for a noncontiguous PA revision did not fall within one of the delineated exceptions, FRA returned the application.

Meridian sought State Director review of the FRA Decision, asserting that the rejection of the Fruitland Coal PA expansions based on a contiguity requirement was contradictory to the terms of the approved unit and operating agreements adopted for the Huerfanito Unit, conflicted with the method of operation previously applied to the unit, differed from the historical method of operation of other units in the San Juan Basin, and unnecessarily complicated and increased the expenses of operating oil and gas units. Meridian argued that, in conformity with the unit agreement, the wells it sought to be included within the common PA produced from a separate pool and were operated as a single pool or zone, citing an October 17, 1988, Order of the New Mexico Oil Conservation Division (NMOCD) creating the Basin-Fruitland Coal Gas Pool, as well as geologic and engineering data demonstrating that the wells produced from a common source of supply. Meridian noted that BLM had previously approved a noncontiguous expansion to another PA within the Huerfanito Unit and requested

^{2/} Although, as delineated in the June 23, 1992, request, the area described in the first PA expansion adjoins the land included in the initial PA and the tract defined by the third expansion abuts the first expansion's acreage, the second expansion encompasses land separated from the first expansion by the W $\frac{1}{2}$ of sec. 2 and all of sec. 3, T. 26 N., R. 9 W.

that the unit agreement, which had been in effect for over 40 years and contained no contiguity requirement for PA revisions, continue to control unit operations.

In his October 9, 1992, Decision affirming the FRA Decision, the Deputy State Director rejected Meridian's arguments that the noncontiguous second revision ^{3/} was in the same pool or deposit as the rest of the PA and that the language in section 11 of the unit agreement allowed for a single noncontiguous Fruitland Coal PA, noting that approximately 1-1/2 miles separated the second revision from the remainder of the PA. Citing the language in section 11 of the unit agreement requiring a PA to include land reasonably proved productive of unitized substances in paying quantities, he determined that Meridian had not proved the Fruitland Coal to be productive between the PA revision areas. Since the intent of the unit agreement was to require separate productive areas to be placed in separate PA's, the Deputy State Director concluded that the FRA Decision corresponded with the current BLM interpretation and affirmed that decision.

On appeal Meridian argues that the Huerfano Unit Agreement is a contract that must be construed under the same rules of construction as a contract between private parties with the intent of the parties gleaned from the language of the contract itself. Meridian insists that the clear and unambiguous language of the unit agreement does not require separate PA's for noncontiguous lands, but, to the contrary, requires separate PA's only when unitized substances are being produced from separate pools or deposits. Because the historic interpretation of the unit agreement underlying Meridian's PA revisions conforms to the plain language of the agreement, the reasonableness of that construction, Meridian maintains, precludes BLM from retroactively imposing an admittedly new interpretation of the PA revision provisions on Meridian's operations. Meridian further avers that the FRA and Deputy State Director Decisions' lack of analysis or rationale supporting the contiguity requirement renders those Decisions arbitrary and capricious. Since the requested PA revisions embrace wells producing from a common pool or deposit, Meridian requests that BLM be directed to approve Meridian's application.

In response, ^{4/} BLM challenges both the legal and factual underpinnings of Meridian's appeal. The BLM characterizes Meridian's contract interpretation arguments as seeking to estop FRA from correcting its past fallacious administration of PA revisions in unit agreements and asserts that Meridian has failed to show the reliance and resultant harm necessary to support a claim of estoppel. While BLM agrees that the unit

^{3/} Although the Deputy State Director identifies the third PA revision as not contiguous, it is the second expansion, not the third, which fails to abut the remainder of the requested PA. See n.2 *supra*.

^{4/} The BLM's response includes a submission by the Field Solicitor's Office and two memoranda, one from the BLM Deputy State Director and an accompanying memorandum from the Farmington District Office (formerly FRA).

agreement mandates different PA's for different pools or deposits, BLM disputes Meridian's apparent equation of such a pool or deposit with a pool created by the NMOCD, arguing that State-designated pools may contain multiple producing reservoirs, intervals, zones, or deposits, rather than the single zone or deposit envisioned by the unit agreement. The BLM implies that allowance of noncontiguous PA revisions permits the joinder of physically separate and unconnected formations to the formation drained by a unit well and thus violates the public trust, since unconnected formations would not be protected by the unit well and might be drained by a nonunit well. The BLM insists that the proper interpretation of the unambiguous unit agreement contradicts its prior erroneous allowance of nonadjoining PA revisions and that, therefore, its earlier construction not only cannot form the basis of an estoppel against the Government, but should not be accorded any weight at all.

The BLM also disputes Meridian's contention that all the lands included in the requested PA and revisions produce from the same pool or deposit. According to BLM, Meridian interprets section 11 of the unit agreement as directing the creation of individual formation-specific PA's, while BLM construes that section as restricting each PA to a single deposit or specific geological occurrence of the unitized substance, rather than an entire formation. The BLM explains the rationale for the contiguity requirement as follows:

Sound engineering practices and geologic data support the conclusion that if a new well is capable of producing unitized substances in paying quantities and is in the same paying deposit as the existing PA, then the paying deposit must extend between the two occurrences. Thus, any revision of the existing PA to include lands reasonably proven productive by the new well must include the lands between the two occurrences. Thus the PA and its revisions are contiguous. If it is not reasonable to include the lands in between the two occurrences of paying production, then the two occurrences must be separate and distinct deposits, thus requiring separate PA's.

(Feb. 12, 1993, Memorandum from the Assistant District Manager, Farmington District Office, at 2.) The BLM claims that the BLM Unitization Taskforce's unanimous agreement construing noncontiguous PA revisions to be in conflict with the terms of the unit agreement, as well as the addition of a sentence to section G of the BLM Unitization Handbook stating that all revisions to a PA must be contiguous to the base PA, further bolster its position.

In a brief rebuttal, Meridian emphasizes that its appeal rests on basic principles of contract interpretation, not estoppel or acquiescence as intimated by BLM. Meridian denies that the parties' historic interpretation of the unit agreement was erroneous, arguing that BLM has failed to show that the contract language or any statute or regulation compels the imposition of a contiguity requirement. Meridian further objects to BLM's interjection for the first time of the insinuation that the requested PA

revisions would join separate and unconnected formations in a PA being drained by a unit well. It avers that not only does the un rebutted evidence establish that the wells on which its requested PA revisions are premised produce from a common pool or deposit of unitized substances as required by the unit agreement, but that nothing in the record available to Meridian suggests that FRA disagrees with Meridian's data concerning the source of its wells' production. Meridian requests that this portion of BLM's response be stricken.

[1] The dispute on appeal focuses on section 11 of the Huerfanito Unit Agreement. Under that section, upon completion of a well capable of producing unitized substances in paying quantities, the unit operator must seek approval of a PA embracing all unitized land then regarded as proved to be productive of unitized substances in paying quantities. Section 11 further provides:

A separate participating area shall be established in like manner for each separate pool or deposit of unitized substances or for any group thereof produced as a single pool or zone, and any two or more participating areas so established may be combined into one * * *. The participating area or areas so established shall be revised from time to time, subject to like approval, whenever such action appears proper as a result of further drilling operations or otherwise, to include additional land then regarded as reasonably proved to be productive in paying quantities or to exclude land then regarded as reasonably proved not to be productive * * *. * * *

It is the intent of this section that a participating area shall represent the area known or reasonably estimated to be productive in paying quantities * * *.

Section 11 of the unit agreement does not expressly address the contiguity of PA revisions. That section does, however, as acknowledged by both parties, confine each PA and its revisions to either a separate pool or deposit of unitized substances or any group thereof produced as a single pool or zone. Thus, under the explicit language of the agreement, all lands producing from the same pool or deposit, whether adjoining or not, should be included within a single PA.

Although BLM's current policy of directing that a PA revision be contiguous to an existing PA appears to conflict with the unit agreement, BLM's expressed rationale for the change in policy reveals that the modification stems from BLM's opinion that, as a general rule, nonadjacent lands do not produce from a common pool or deposit. ^{5/} Additionally, the

^{5/} While we agree with Meridian that neither the FRA nor the Deputy State Director Decision adequately explained the basis for the contiguity requirement, the memoranda submitted by BLM on appeal adequately rectify those omissions.

Draft BLM Unitization Handbook section adding the contiguity requirement for PA revisions recognizes that, while separate PA's should be established for each separate productive reservoir, pool, formation, or zone covered by a unit agreement, "separate participating areas should be combined if subsequent information shows them to be producing from a common reservoir." (Draft BLM Unitization Handbook, H-3180-1.II.G.2, at 15.) ^{6/} We construe BLM's contiguity requirement consistently with section 11 of the unit agreement as simply creating a rebuttable presumption that nonadjacent areas produce from different pools or deposits and, therefore, may not properly be joined in a single PA. A unit operator may overcome this presumption by presenting evidence establishing that, in accordance with the unit agreement, the nonabutting areas do produce from a common pool or deposit or any group thereof produced as a single pool or zone.

Based on our review of the case record, we find that Meridian has provided sufficient evidence that the wells upon which it bases its requested PA revisions produce from a common pool or deposit. Thus, it has rebutted the presumption.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Decision appealed from is reversed, and the case is remanded to BLM for action not inconsistent with this Decision. ^{7/}

James P. Terry
Administrative Judge

I concur.

Bruce R. Harris
Deputy Chief Administrative Judge

^{6/} While BLM Manual provisions do not have the force and effect of law and are not binding on either this Board or the public at large, see e.g., Pamela S. Crocker-Davis, 94 IBLA 328, 332 (1986), such provisions do guide BLM actions and provide insight into BLM's interpretation of its authority.

^{7/} Our resolution of this appeal renders moot the outstanding motions filed by Meridian.

