



ANADARKO PETROLEUM CORPORATION

181 IBLA 388

Decided January 20, 2012



United States Department of the Interior  
Office of Hearings and Appeals  
Interior Board of Land Appeals  
801 N. Quincy St., Suite 300  
Arlington, VA 22203

ANADARKO PETROLEUM CORPORATION

IBLA 2010-228

Decided January 20, 2012

Appeal from a demand letter (order to pay) of the Director, Bureau of Ocean Energy Management, Regulation, and Enforcement, directing non-operating owner to pay royalty on volumes of oil captured from the Macondo well subsequent to the BP Deepwater Horizon Oil Spill. Lease OCS-G 32306, Mississippi Canyon Block 252.

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982:  
Royalties--Outer Continental Shelf Lands Act:  
Administrative Construction--Outer Continental Shelf  
Lands Act: Oil and Gas Leases--Statutory Construction:  
Administrative Construction--Statutory Construction:  
Legislative History--Words and Phrases: "Production"

Oil discharged as the result of the BP oil spill that is subsequently captured and sold is "production" for purposes of calculating royalty to be paid to the United States pursuant to governing provisions of OCSLA, FOGRMA, and the Lease.

2. Outer Continental Shelf Lands Act: Oil and Gas Leases--Oil and Gas Leases: Royalties

Despite the fact that the oil captured and sold from an oil and gas well resulted from efforts to stymie the uncontrolled flow of oil spewing from the well as the result of a blowout that occurred during the temporary abandonment phase of development, it was nonetheless production "saved, removed, [and] sold from the leased area," and thus was a royalty-bearing resource under section 6(a) of the appellant's lease assignment.

3. Administrative Practice--Administrative Procedure:  
Decisions

It is incumbent upon BOEMRE to ensure that its decision is supported by a rational basis, which is set out in the written decision and demonstrated in the administrative record accompanying the decision. Parties affected by a BOEMRE decision deserve a reasoned and factual explanation of the rationale for the decision and must be given a basis for understanding and either accepting it or, alternatively, appealing and disputing it. However, where BOEMRE presents a factual and legal rationale sufficient to permit an appellant to present an informed and organized rebuttal, the Board will not reverse the agency's decision on the basis of an inadequate decision and record.

APPEARANCES: Peter J. Schaumberg, Esq., Washington, D.C., for Anadarko Petroleum Corporation; Lance C. Wenger, Esq., Office of the Regional Solicitor, U.S. Department of the Interior, Lakewood, Colorado, for the Bureau of Ocean Energy Management, Regulation, and Enforcement.

OPINION BY ADMINISTRATIVE JUDGE ROBERTS

Anadarko Petroleum Corporation (Anadarko) has appealed from the August 24, 2010, order to pay (demand letter) of the Director, Bureau of Ocean Energy Management, Regulation, and Enforcement (BOEMRE or BOEM),<sup>1</sup> holding that, as “owner of 25 percent of the legal record title in Lease OCS-G 32306,” Anadarko is liable for 25 percent of the royalty payments due on the Lease, and requiring Anadarko to “report and pay royalties immediately for 25 percent of all oil and gas

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<sup>1</sup> On May 19, 2010, the Secretary of the Interior separated the responsibilities previously performed by the Minerals Management Service (MMS) and reassigned those responsibilities to three separate organizations. As part of this reorganization, MMS' Minerals Revenue Management Program was renamed the Office of Natural Resources Revenue (ONRR), which was directed to transition to the Office of the Assistant Secretary–Policy, Management and Budget. On Oct. 1, 2010, the Secretary transferred the royalty and revenue functions of MMS into the ONRR, and created a separate division, BOEMRE, with specific authority to administer Federal oil and gas leasing on the Outer Continental Shelf (OCS). See 75 Fed. Reg. 61051, 61052 (Oct. 4, 2010). The Decision on appeal was issued on Aug. 24, 2010, while BOEMRE was administering all functions of OCS leasing.

captured from the Macondo well” subsequent to the BP Deepwater Horizon Oil Spill.<sup>2</sup> Decision at 1.

Anadarko raises two basic arguments on appeal. First, it claims that the captured oil is not “production” as that term is defined by section 2 of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1331(m) (2006) (hereinafter occasionally referred to as § 1331(m)), and, consequently, that no royalty is owed on spilled oil captured and sold following the catastrophe. Second, it argues that the August 24, 2010, decision should be vacated because it is “facially inadequate and unsupported by the administrative record.” Statement of Reasons (SOR) at 28. In this opinion, we reject Anadarko’s reasoning and hold that the definitions in section 2 of OCSLA and section 3 of the Federal Oil and Gas Royalty Management Act (FOGRMA), 30 U.S.C. § 1702 (2006), are inclusive of the oil captured and sold by BP Exploration Production, Inc. (BP), from the Macondo Well, and that Anadarko is obligated to pay 25 percent of royalty due on that production in accordance with the terms of Lease OCS-G 32306. Further, as explained below, we summarily reject as without merit Anadarko’s contention that the decision and record involved herein are inadequate.

### I. LEGAL AND FACTUAL BACKGROUND

An understanding of the imperatives at work in this appeal is not possible without a general understanding of the governing statutes; the Lease and assignment agreements between MMS and BP and between BP and the Anadarko companies; and relevant operational details that led to the blowout and that impact our analysis here.

#### A. The Statutes

The relevant statutory criteria governing this appeal are found in OCSLA, which governs the exploration for and development of oil and gas originating in the OCS, and FOGRMA, which governs the Federal royalty interest that attaches to oil and gas produced from all Federal lands. We begin with OCSLA.

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<sup>2</sup> This title is given to the Apr. 20, 2010, disaster by the Chief Counsel’s Report to the President, entitled *Macondo, The Gulf Oil Disaster*, released Feb. 17, 2011. For general background information pertaining to the BP oil spill, we have relied, to some extent, on both the Chief Counsel’s Report and the National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling, Report to the President, entitled *Deepwater: The Gulf Oil Disaster and the Future of Offshore Drilling*. We refer to these reports in this opinion as the Chief Counsel’s Report and the National Commission Report.

OCSLA was passed in 1953 to establish Federal ownership and control over the mineral wealth of the OCS and to provide for the development of those natural resources. *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 480 n.7 (1981). The OCSLA thus vests the Federal government with a proprietary interest in the OCS and establishes a regulatory scheme governing leasing and operations there. *EP Operating Limited Partnership v. Placid Oil Co.*, 26 F.3d 563, 566 (5th Cir. 1994); *Laredo Offshore Constructors, Inc. v. Hunt Oil Co.*, 754 F.2d 1223, 1227 (5th Cir. 1985).

Congress amended OCSLA significantly in 1978.<sup>3</sup> See Pub. L. No. 95–372, 92 Stat. 629 (Sept. 18, 1978). As amended, OCSLA establishes a national policy to make the OCS “available for expeditious and orderly development, subject to environmental safeguards, in a manner which is consistent with the maintenance of competition and other national needs.” 43 U.S.C. § 1332(3). Before 1978, OCSLA did not define the terms “exploration,” “development,” or “production.” *Secretary of the Interior v. California*, 464 U.S. 312, 336 (1984). Since 1978, “four distinct statutory stages to developing an offshore oil well” have been recognized: “(1) formulation of a five year leasing plan by the Department of the Interior; (2) lease sales; (3) exploration by the lessees; (4) development and production.” *Id.* at 337. As conceptualized by Congress, “[e]ach stage involves separate regulatory review that may, but need not, conclude in the transfer to lessees of rights to conduct additional activities on the OCS.” *Id.*

As in *Ensco v. Salazar*, 786 F. Supp. 2d at 1156-58, the third stage—exploration—and the fourth stage—development and production—are relevant to our inquiry here. Accordingly, we quote provisions of OCSLA that govern these phases. Under OCSLA, “exploration” is

the process of searching for minerals, including (1) geophysical surveys where magnetic, gravity, seismic, or other systems are used to detect or imply the presence of such minerals, and (2) any drilling, whether on or off known geological structures, including the drilling of a well in which a discovery of oil or natural gas in paying quantities is made and the drilling of any additional delineation well after such discovery which is needed to delineate any reservoir and to enable the lessee to determine whether to proceed with development and production.

43 U.S.C. § 1331(k). “Development” is defined as “those activities which take place following discovery of minerals in paying quantities, including geophysical activity, drilling, platform construction, and operation of all onshore support facilities, and

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<sup>3</sup> We are indebted here to the Court’s opinion in *Ensco Offshore Co. v. Salazar* (*Ensco v. Salazar*), 786 F. Supp. 2d 1151, 1156-58 (2011), for its synopsis of the law pertaining to the Outer Continental Shelf.

which are for the purpose of ultimately producing the minerals discovered.” *Id.* § 1331(l). “Production” comprises “those activities which take place after the successful completion of any means for the removal of minerals, including such removal, field operations, transfer of minerals to shore, operation monitoring, maintenance, and workover drilling.” *Id.* § 1331(m); *Ensco v. Salazar*, 786 F. Supp. 2d at 1156-57.

Two sections of FOGRMA are relevant to our later analysis. The first, section 102(a) of FOGRMA, was relied upon by BOEMRE in its August 24, 2010, letter to Anadarko demanding royalties. Section 102(a) addresses, among other things, who shall be liable for royalty payments:

The person owning operating rights in a lease shall be primarily liable for its pro rata share of payment obligations under the lease. If the person owning the legal record title in a lease is other than the operating rights owner, the person owning the legal record title shall be secondarily liable for its pro rata share of such payment obligations under the lease.

30 U.S.C. § 1712(a).

The second, section 308 of FOGRMA, has been either distinguished or analogized by the parties to the facts here. Section 308 provides that lessees are

liable for royalty payments on oil or gas lost or wasted from a lease site when such loss or waste is due to negligence on the part of the operator of the lease, or due to the failure to comply with any rule or regulation, order or citation issued under this chapter or any mineral leasing law.

30 U.S.C. § 1756.

#### *B. The Lease and the Assignment Agreements*

Lease OCS-G 32306, Mississippi Canyon Block 252 (MC 252), was issued to BP pursuant to section 8 of OCSLA, 43 U.S.C. § 1337, effective June 1, 2008. The offshore oil and gas parcel was offered for sale during Central Gulf of Mexico Lease Sale 206, conducted by MMS on March 19, 2008. MMS Receipt Confirmation Report List for Gulf of Mexico Sale 206. The Lease is located about 50 miles off the coast of Louisiana and about 5,000 feet below the surface of the water.

Lease OCS-G 32306 was issued with a royalty rate of 18¾ per cent. Section 6(a) of the Lease provides that “[t]he Lessee shall pay a fixed royalty as shown on the face hereof in amount or value of *production saved, removed, or*

*sold from the leased area*”; that “gas (except helium) and oil of all kinds are subject to royalty”; and that “[a]ny Lessee is liable for royalty payments on oil or gas lost or wasted from a lease site when such loss or waste is due to negligence on the part of the operator of the lease, or due to the failure to comply with any rule or regulation, order, or citation issued” under FOGRMA or OCSLA.<sup>4</sup> (Emphasis added.) Additionally, standard terms of the Lease provide that it is subject to all regulations issued pursuant to OCSLA “in the future which provide for the prevention of waste and conservation of the natural resources of the Outer Continental Shelf and the protection of correlative rights therein; and all other applicable statutes and regulations.” Lease, § 1.

Anadarko became a co-lessee on Lease OCS-G 32306 effective October 1, 2009, by acquiring a 2.5 percent share of the Lease. That same day, Anadarko’s subsidiary, Anadarko Exploration and Production Company, L.P. (Anadarko Exploration), acquired a 22.5 percent share of Lease OCS-G 32306, and BP acquired a fourth partner, MOEX Offshore 2007 LLC (MOEX), who acquired and currently holds a 10 percent share of the Lease. These assignments were executed on MMS Form MMS-150, which contains standard language making clear that by executing the contract, an assignee agrees to accept all applicable terms, conditions, stipulations, and restrictions pertaining to Lease OCS-G 32306, as well as the provisions of OCSLA and implementing regulations. By December 17, 2009, all assignees had designated BP as operator of the Lease.<sup>5</sup> Effective April 1, 2010, Anadarko acquired all of Anadarko Exploration’s interest in the Lease, thus achieving a 25 percent share of Lease OCS-G 32306.

### *C. The Macondo Well: Relevant Operational Details*

As the first well to be drilled on Lease OCS-G 32306, the Macondo well was one of two wells proposed by BP in an initial exploration plan. SOR, Exs. 3 and 4, OCS Plan for Lease OCS-G 32306, and the Application for Permit to Drill (APD) New

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<sup>4</sup> Section 6 of the attached “Sale 206 Lease Addendum” provides that, under certain conditions, the lessee may be eligible for royalty relief, including a royalty suspension of 12 million barrels of oil equivalent (royalty suspension volume (RSV)), under section 345 of the Energy Policy Act of 2005, which provides for royalty relief for production from deep water wells. Paragraph 2(f) of that section provides that “[f]ull royalties are owed on all production from a lease after the RSV is exhausted . . . .” The Aug. 24, 2010, demand letter does not address the impact, if any, of this addendum.

<sup>5</sup> Anadarko Exploration and Anadarko each executed a separate Designation of Operator form on Dec. 17, 2009, designating BP as lease operator; MOEX signed a similar document on Nov. 18, 2009.

Well on the Lease, respectively. An APD was approved by MMS on May 29, 2009. *Id.*, Ex. 4.

BP began drilling the Macondo well on MC 252 on its own behalf and on behalf of its business partners in October 2009.<sup>6</sup> SOR at 1. The Macondo well was drilled below 5,000 feet of seawater to 9,090 measured depth (md)/true vertical depth (tvd) feet with the Transocean Marianas rig, and an 18-inch liner was set at 8,983 md/tvd feet when the Marianas was removed from the well site, prior to Hurricane Ida. SOR, Ex. 5 at unpaginated (unp.) 2 (“Drilling Plan Summary,” Application for Bypass submitted by BP and approved by MMS on Mar. 15, 2010). On January 31, 2010, the Deepwater Horizon replaced the Marianas, which was damaged during Hurricane Ida. National Commission Report at 92. In March, the Deepwater Horizon drilled the well to a depth of 12,350 md/tvd feet when lost circulation began and a kick was taken at 13,305 md/tvd feet, resulting in loss of the bore hole assembly at 12,100 md/tvd feet, causing well kill operations to be commenced. SOR, Ex. 5 at unp. 2. On March 15, 2010, BP filed the Application for Bypass. *Id.* at unp. 1.

Although BP had originally planned to drill to 20,200 md/tvd feet, those plans were abandoned when a final lost circulation event<sup>7</sup> occurred due to fracturing in the pay zone.<sup>8</sup> National Commission Report at 93-94. Due to the fragility of the formation, the decision was made to initiate temporary abandonment of the well at the pay zone depth of 18,360 md/tvd feet. *Id.* at 94. At that point, “[t]he engineers concluded they had ‘run out of drilling margin.’” *Id.* “BP informed its leases partners Anadarko and MOEX that ‘well integrity and safety’ issues required the rig to stop drilling.” *Id.* Crews began preparations for temporary abandonment. The blowout occurred during the temporary abandonment phase of the work. *Id.* at 103-04.

It is customary for lease operators to “give the job of completing and producing oil” from a well capable of production to “a smaller and less costly rig,”

<sup>6</sup> According to Chapter 4 n.7 of the National Commission Report, “BP maintained regular contact with Anadarko and MOEX throughout the drilling of the well.” National Commission Report, Endnotes at 321.

<sup>7</sup> In all, there were a total of eight lost circulation events prior to the Apr. 20, 2010, blowout: one in mid-February, four in March, and three in April. National Commission Report, Lost Returns Video, [http://oilspillcommission.gov/chief-counsel/video/C21462-325\\_CCR\\_Lost\\_Returns](http://oilspillcommission.gov/chief-counsel/video/C21462-325_CCR_Lost_Returns) (last visited Jan. 20, 2012).

<sup>8</sup> National Commission Report, Macondo Well Video, [http://oilspillcommission.gov/chief-counsel/video/C21462-330\\_CCR\\_Macondo\\_Well](http://oilspillcommission.gov/chief-counsel/video/C21462-330_CCR_Macondo_Well) (last visited Jan. 17, 2012).

whose task is to install “hydrocarbon collection and production equipment.”<sup>9</sup> For BP, the goal of temporary abandonment of the Macondo was to secure the well and remove its blowout preventer and riser so the well could be brought into production when the collection and production rig arrived. National Commission Report at 103.

The procedures undertaken by BP to temporarily abandon the Macondo well are well-documented and unnecessary for us to narrate here, except for two observations. First, it is important to note that all the temporary abandonment procedures undertaken with respect to the Macondo well were performed with the foreknowledge that this well had tapped an economically viable reservoir that was in fact being prepared for subsequent production. *Id.* at 94. Second, at least one job normally reserved for the completion and production crew—setting the lockdown sleeve in place—was performed by the drilling crew. *Id.* at 104. The National Commission stated the following with respect to setting the lockdown sleeve:

Before the Macondo blowout, a lockdown sleeve was not generally considered a safety mechanism or barrier to flow prior to the production phase of the well. *Drilling rigs did not generally set lockdown sleeves. Rather, completion or production rigs did so after the drilling phase.* BP decided to have the Deepwater Horizon set the lockdown sleeve because the Horizon could do the job more quickly than the completion rig.

*Id.* (emphasis added). The Commission went on to state that the decision to set the lockdown sleeve before or during temporary abandonment is actually the better practice. *Id.*

On April 20, 2010, subsequent to attempts to cement the casing in place and plug the well, a catastrophic blowout occurred, resulting in the deaths of 11 oil rig workers, the burning and sinking of the Deepwater Horizon, and the discharge of large amounts of Federally-owned oil and gas into the atmosphere and waters of the Gulf of Mexico. National Commission Report at 87.<sup>10</sup> The discharge occurred through two leaks in the riser pipe, which was severed from the rig during the explosion, but remained connected to the well head. *Id.* at 132.

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<sup>9</sup> National Commission Report, Temporary Abandonment Video, [http://www.oilspillcommission.gov/chief-counsel/video/C21462-334\\_CCR\\_Temporary\\_Abandonment](http://www.oilspillcommission.gov/chief-counsel/video/C21462-334_CCR_Temporary_Abandonment) (last visited Jan. 20, 2012).

<sup>10</sup> The National Commission Report, at 87, estimates that nearly 5 million barrels of oil escaped from the Macondo well before it was capped on July 15, 2010.

From April 21 through September 19, 2010, BP engineers and outside experts from government, industry, and academia worked to “kill” the flow spewing from the well and, in the interim, to contain and/or capture it, and finally, to permanently seal the reservoir. See National Commission Report at 131, 145-150, 155-160, 167, 169. While early attempts failed, on June 3, 2010, a successful collection device was installed over the wellhead. *Id.* at 159. Production that BP captured and removed by this device, or “top hat,” as it was called, was conveyed by a new riser pipe extending from the device to a collection vessel, the *Discoverer Enterprise*, stationed above the Macondo well. *Id.* By June 8, the *Discoverer Enterprise* was collecting nearly 15,000 barrels of oil per day. *Id.* A second ship, the *Q4000*, became operational on June 16, amassing up to 10,000 additional barrels of oil per day.<sup>11</sup> *Id.*

The oil captured from the Macondo well by these collection vessels was conveyed to off-lease facilities, where it was metered, processed, and sold. BOEMRE Answer at 5. According to ONRR, BP reported that approximately 679,000 barrels of oil from the Macondo well were produced, removed, and sold, generating approximately \$47.3 million in proceeds for the lessees, and 35% of those proceeds, or approximately \$11.8 million, are attributable to Anadarko and MOEX. See BOEMRE Answer at 5, ¶¶ 17, 18 n.4, referring to the attached Exs. 2 and 3, Affidavits of Robert Prael, dated May 27, 2011. ONRR asserts that “[t]he \$47.3 million in total proceeds generated approximately \$8.2 million in total royalties due and owing to the United States”; and that “[t]he amount of royalty owed by Appellant to the United States from its \$11.8 million share of these proceeds is approximately \$2 million.”<sup>12</sup> Answer at 5-6, ¶¶ 19 to 22.

#### *D. The Demand Letter*

On July 15, 2010, BOEMRE issued an order requiring BP to immediately report and pay royalties on all oil captured from the Macondo well. Answer at 6,

<sup>11</sup> According to the National Oceanic and Atmospheric Administration’s (NOAA’s) Nov. 23, 2010, news release of its revised Oil Budget Calculator, about 17% of the oil spilled was directly recovered; about 3% was collected by skimming it from the water. There is no indication in that Report as to whether any of the oil collected by skimming was sold, and, if so, the amount of proceeds realized. See *NOAA News*, [http://www.noaanews.noaa.gov/stories2010/20101123\\_oilbudget.html](http://www.noaanews.noaa.gov/stories2010/20101123_oilbudget.html).

<sup>12</sup> The Board makes no findings here as to the volumes of oil BP ultimately measured, processed, or sold, or the value of those volumes. The sole question before us here is one of law: *i.e.*, whether, as assignee of 25% of the record title interest in Lease OCS-G 32306, Anadarko is legally responsible for paying royalty on the portion of proceeds from oil recovered and sold from the Macondo spill attributable to its ownership interest.

¶ 23. According to Anadarko, on or about July 30, 2010, BP sent Anadarko a letter seeking 25 percent payment by Anadarko and enclosing a check that, according to BP, reflected 25 percent of BP's realized proceeds from its measurement and sale of oil captured from the Lease during June 2010. SOR at 5. Anadarko returned BP's check, explaining that Anadarko was not entitled to any of those volumes or the proceeds from their disposition because they were not "production" from the Lease. *Id.* On August 2, Anadarko informed BP that it believed that BP was responsible for payment due, but BP did not agree; also on August 2, BP informed BOEMRE that it would pay royalties for its 65 percent share of the total proceeds. SOR at 5; Answer at 6.

After failing to receive the full amount due from BP under the July 15 order, ONRR issued Anadarko the August 24 demand letter, or order to pay, that is the subject of this appeal. ONRR also issued a nearly identical letter to MOEX the same day, corresponding to its 10 percent record title interest in the Lease. Citing section 8 of OCSLA, 43 U.S.C. § 1337 (2006), and section 102 of FOGPMA, 30 U.S.C. § 1712(a) (2006), the one-page demand letter to Anadarko states that, as a 25 percent record title owner, "Anadarko is liable for 25 percent of the royalty payments due on the Lease"; and, "[u]ntil notified otherwise, Anadarko is required to report and pay royalties immediately for 25 percent of all oil and gas captured from the Macondo well using Form MMS 2014." The demand letter warns Anadarko that failure to comply may trigger civil penalties under 30 U.S.C. § 1719 (2006). Thereafter, Anadarko and MOEX began making royalty payments under protest. Answer at 6. On August 31, 2010, Anadarko and MOEX appealed.

## II. ARGUMENTS OF THE PARTIES

Anadarko's central argument is that the discharged volumes captured and sold from the Lease do not constitute "production" as that term is defined by OCSLA, 43 U.S.C. § 1331(m), and that, therefore, they do not meet the "specific conditions under which a 'royalty' obligation is owed to the United States as lessor." SOR at 2. Anadarko maintains that "BOEM exceeded its authority by ordering Anadarko to pay a royalty where none is due." *Id.*

Anadarko challenges BOEMRE's reliance upon section 8 of OCSLA, 43 U.S.C. § 1337(a), in demanding royalty payments from Anadarko. Anadarko emphasizes that under section 8 of OCSLA, royalty is owed "at not less than 12½ per centum . . . in amount or value of the *production saved, removed, or sold.*" 43 U.S.C. § 1337(a)(1)(A) (emphasis added). Similarly, states Anadarko, OCSLA's

implementing regulations<sup>13</sup> provide that “[r]oyalties [are] due on oil *production* from leases subject to the requirements of [Part 1200]” (30 C.F.R. § 1201.100(a)); that “[a]ll oil [subject to certain exceptions] *produced* from a Federal or Indian lease to which this part applies is subject to royalty” (30 C.F.R. § 1202.100(b)); and that gas *produced* from a Federal or Indian lease is subject to royalty (30 C.F.R. § 1202.150). SOR at 9. Anadarko also refers to Section 6(a) of BP’s Lease document as requiring the payment of “a fixed royalty . . . in amount or value of *production* saved, removed, or sold from the leased area,” and to an Addendum to the Lease providing that “[f]ull royalties are owed on all *production* from a lease after the RSV [royalty suspension volume] is exhausted.” *Id.* (quoting Ex. 2 to SOR).

Anadarko posits that OCSLA, the regulations, and the Lease “set forth two principal prerequisites for the imposition of royalty on oil and gas volumes derived from the OCS.” *Id.* “First,” states Anadarko, “the oil and gas must constitute ‘production,’” and “[s]econd, that production must be ‘saved, removed, or sold’ from the Lease.” *Id.* Anadarko asserts that “[t]his appeal concerns *only* the first criterion.” *Id.* (emphasis added). In Anadarko’s view, “[b]ecause the captured volumes do not constitute ‘production’ in the first instance, the method of their disposition is irrelevant for royalty determination purposes.” *Id.* at 9-10.

Anadarko quotes the definition of “production” in OCSLA, 43 U.S.C. § 1331(m), *i.e.*, “those activities which take place *after the successful completion* of any means for the removal of minerals” (emphasis added by Anadarko), for the proposition that, “[f]or deepwater oil and gas on the OCS, production is accomplished via a successfully completed well.” SOR at 10. Anadarko states that “successful completion” is not separately defined in OCSLA, OCSLA’s legislative history, or relevant case law, but that “BOEM’s regulations supply a consistent definition of ‘completion,’ recognizing that well completion must *precede* production.” *Id.* (citing, *inter alia*, 30 C.F.R. §§ 250.105, 250.501; 75 Fed. Reg. 63376 (Oct. 14, 2010) (amending 30 C.F.R. § 250.1500 to separately define “well completion/well workover” to mean “those operations following the drilling of a well that are intended to establish or restore production”)).

Anadarko argues that “by defining ‘production,’ Congress has expressly established the prerequisite conditions under which royalty may be assessed.” SOR at 11. Anadarko states those conditions in unequivocal terms: “In short, only oil and gas volumes derived from a successfully completed well constitute production, and in

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<sup>13</sup> BOEMRE explains that the Department recently promulgated a direct final rule recodifying its royalty regulations within the newly created ONRR. *See* 75 Fed. Reg. 61051 (Oct. 4, 2010). The regulatory provisions cited by BOEMRE previously existed at 30 C.F.R. §§ 202.100 and 202.150, and were otherwise left unchanged by the 2010 final rule.

turn, are subject to a royalty. Conversely, if oil and gas volumes do not meet this legal definition of production, the statutory, regulatory, and lease royalty obligations are not triggered.” *Id.* Anadarko’s argument in this regard is set forth below:

The captured oil volumes at issue clearly do not meet the statutory definition of production. First, the discharge and capture of hydrocarbons resulting from the Deepwater Horizon incident did not follow the “completion” of a well. The well was in fact never completed. Although drilling operations were finished at the time of the incident, several remaining steps necessary to complete the well for production had not been planned or performed. Indeed, as of April 20, operations were underway to cement and temporarily abandon the well. Necessary well-completion steps to interface between the reservoir and the surface to enable production had not been taken, including but not limited to pressure-testing, installation of the “Christmas tree,” and perforation of the well. . . . Moreover, . . . the BOEM plans and approvals required to transition from exploration to development and production were neither sought nor granted.

Second, the Macondo well plainly was not “successfully” completed. As illustrated by the April 20 blowout and premature discharge of oil volumes until July, and the eventual “bottom kill,” the exploration well obviously was the essence of *unsuccessful*.

*Id.* at 12.

Anadarko reasons that “[a]t the time of the Deepwater Horizon incident, the Lease was undisputably only in its initial exploration phase,” and that “[b]ecause exploration activities had not yet concluded, and the necessary regulatory approvals to commence production had not yet been sought or granted, production could not take place at MC 252 and no royalty was due.” *Id.* at 13. According to Anadarko, OCSLA “divides OCS leases into three different sequential phases: exploration, development, and production.” *Id.* Thus, Anadarko states:

OCSLA defines “exploration” as “the process of searching for minerals,” including drilling “to enable the lessee to determine whether to proceed with development and production.” 43 U.S.C. § 1331(k). In turn, “development” consists of activities, “following discovery of minerals in paying quantities,” conducted “for the purpose of ultimately producing the minerals discovered.” *Id.* § 1331(l). Finally, as detailed above, “production” may begin “after the successful completion” of a well. *Id.* § 1331(m).

*Id.* Applying these definitions of exploration, development, and production, Anadarko claims that “[t]he activities underway at MC 252 as of April 20, 2010, only constituted exploration,” and that “[n]o development, let alone production, had begun.” *Id.* (citing Congressional Research Service, *Deepwater Horizon Oil Spill: Selected Issues for Congress*, at 32 n.164 (July 30, 2010) (“At the time of the incident, the oil and gas formation was still being explored, and was not yet in the production phase of the project. . . . [I]t would have taken some years to develop the project into a producing facility.”)).<sup>14</sup>

Anadarko states that section 11 of OCSLA and BOEMRE’s regulations require submission and approval of an Exploration Plan (EP) before exploration. *See* 43 U.S.C. § 1340(c)(1) (2006); 30 C.F.R. § 250.201. Anadarko states that at the time of the explosion and blowout, exploration of MC 252 was proceeding pursuant to BP’s Initial EP, approved by MMS early 2009, before Anadarko acquired its interest in the Lease. On the accompanying OCS Plan Information Form (Form MMS-137, Ex. 3), BP’s proposed activities included only “exploration drilling,” and later activities, including “development drilling,” “well completion,” and “commence production,” were not selected on Form MMS-137. SOR at 16. Such later “activities were not permitted, and production could not occur,” under the Initial EP. *Id.* In its Application for Permit to Drill (APD), BP designated the Macondo well as “exploration,” and BP’s drilling plan summary indicated that “[t]he well will either be P&A’ed [plugged and abandoned] or temporarily abandoned for future completion.” *Id.* (quoting Ex. 4). Anadarko states that “BP never requested approval to complete the Macondo well,” and that none of the revised and additional APDs or Applications for Permit to Modify (APMs) to adapt its activities to circumstances on MC 252, “including but not limited to the need to substitute the Transocean Deepwater Horizon rig for the Transocean Marianas rig and to conduct bypass operations[,] . . . altered the Macondo well’s status as an uncompleted exploration well.” *Id.* at 17.

“[B]efore the operator may ‘conduct any development and production activities on a lease or unit in the Western GOM [Gulf of Mexico],’ including MC 252,” Anadarko argues that BOEMRE requires submission and approval of a Development Operations Coordination Document (DOCD). *Id.* (citing 30 C.F.R. § 250.201, 250.241 to 250.273; *Mobil Oil Exploration & Producing Southeast v. United States*, 530 U.S. 604, 610 (2000) (noting that if exploration is successful, the company must prepare and obtain Interior approval for a Development and Production Plan—a Plan that describes the proposed drilling and related environmental safeguards)). Further, states Anadarko, a deepwater lease like

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<sup>14</sup> In addition, Anadarko asserts that BOEMRE’s regulatory program parallels OCSLA in defining exploration, development, and production. *See* 30 C.F.R. § 250.105.

MC 252, *i.e.*, water depths greater than 1,314 feet, requires the filing of a Conservation Information Document (CID) with the DOCD. *See* 30 C.F.R. § 250.201. “The CID must be submitted and approved before the operator may ‘commence production.’” SOR at 18 (citing 30 C.F.R. §§ 250.201, 250.299). Moreover, water depths at MC 252 necessitate submission and approval of a Deepwater Operations Plan (DWOP) in advance of production. 30 C.F.R. §§ 250.201, 250.286. The DWOP process consists of two components—a “Conceptual Plan” and the DWOP, *id.* §§ 250.296 to 250.295, both of which must be approved prior to production. *Id.* § 250.290.

Thus, Anadarko argues, based upon the OCSLA’s statutory definitions and scheme, as implemented in BOEMRE’s regulatory program, that the “several prerequisites to ‘production’ . . . were not satisfied at MC 252.” SOR at 20. Anadarko asserts that “[t]he blowout on the Lease occurred before exploration work was finished under the approved EP”; that “BOEM authorized BP to drill and temporarily abandon the exploration well, and nothing more, at MC 252”; and that “[n]one of the other prerequisite approvals for completion, development, and production was sought, let alone secured.” *Id.* Anadarko concludes, therefore, that “the uncontrolled flow of hydrocarbons from the blowout of the sole Macondo Exploration well drilled could not, and did not, constitute production, and BOEM may not assess royalty on those oil volumes if they are captured and then disposed of.” *Id.*

Anadarko further disputes BOEMRE’s reliance upon section 102 of FOGRMA, 30 U.S.C. § 1712(a), in ordering Anadarko to pay royalty on the captured oil. Section 102 of FOGRMA, as amended by the Royalty Simplification and Fairness Act of 1996 (RFSA), Pub. L. No. 104-285, requires lessees to pay royalty in proportion to their share of ownership in a lease. Anadarko argues that section 102 of FOGRMA triggers “[p]roportionate royalty payments . . . only where royalty is due in the first instance.” SOR at 21. According to Anadarko, since “[t]he volumes uncontrollably discharged from the Lease and later captured and sold by BP are not subject to ‘royalty’ under OCSLA because they do not meet the definition of ‘production.’ . . . [N]o royalty is owed, [and] Anadarko’s 25 percent ownership interest in the Lease is irrelevant for royalty purposes.” *Id.*<sup>15</sup>

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<sup>15</sup> Anadarko speculates that the Federal government might, in a subsequent action, “assert entitlement to a different form of compensation for the discharged and captured volumes from the Lease.” SOR at 21. However, unlike the requirement to pay royalty under OCSLA, “potential liability or other compensation is not statutorily proportionate among co-lessees.” *Id.* at 21-22. Anadarko would hold BP solely responsible for non-performance of Lease obligations and resulting damages. We offer no opinion on the merits of this theory.

Anadarko next argues that the only other existing legal vehicle for BOEMRE to assess the equivalent of a royalty is the “[e]xpanded royalty obligations” in section 308 of FOGRMA, 30 U.S.C. § 1756. As noted, section 308 provides that “[a]ny lessee is liable for royalty payments on oil or gas lost or wasted from a lease site when such loss or waste is due to negligence on the part of the operator of the lease, or due to the failure to comply with any rule or regulation, order or citation issued under this Act or any mineral leasing law.” 30 U.S.C. § 1756. Thus, Anadarko states, “[s]ection 308 requires payment equivalent to a royalty for oil or gas negligently (i.e., ‘avoidably’) lost or wasted, even if production has not occurred.” SOR at 23.

According to Anadarko’s reasoning, the expanded royalty obligations of section 308 do not apply since oil discharges from Lease MC 252 were not “lost or wasted.” *Id.*; see also Reply at 4. Anadarko states that the term “lost or wasted” is not defined by statute, but that “[t]he ordinary meaning of [the term] applies to volumes that are gone and cannot be recovered, i.e., the opposite of the ordinary meaning of ‘capture,’ the term employed by BOEM’s Order.” *Id.* (footnote omitted). According to Anadarko, “BOEM recognizes this difference.” *Id.* (citing 30 C.F.R. §§ 250.1160(e), 250.1162(b), under which the term “lost or wasted” includes oil that is burned or gas that is flared or vented). Anadarko argues that “while FOGRMA may expand royalty obligations to cover volumes of oil or gas that are lost or wasted, it does not impose royalty on volumes that are instead captured and sold.” *Id.* at 24.

Anadarko engages in what ONRR refers to as “an amorphous discourse about circumstances in which discharged oil may not constitute ‘production.’” *Id.* at 24-26. Anadarko reviews the regulatory history on the subject of lost or wasted volumes and states that “[t]he end result is a legal scheme that provides separately for compensation on avoidably lost or wasted volumes as opposed to royalty on production, despite both being styled as a ‘royalty.’” *Id.* at 24-25. In addition, Anadarko claims that “no case has squarely addressed the government’s remedy for uncontrollably discharged and later captured volumes from a lease during exploration activities due to operator misconduct.” SOR at 26. According to Anadarko, “the case law . . . does not support imposition of a royalty here.” *Id.* Anadarko reviews *Chevron U.S.A. Inc.*, 110 IBLA 216 (1989), and *Diamond Shamrock Exploration Co. v. Hodel (Diamond Shamrock)*, 853 F.2d 1159 (9th Cir. 1988), and argues that neither of those opinions supports BOEMRE’s attempt to assess royalty on “the uncontrollable discharge and later recovery of volumes as a result of a blowout while drilling an uncompleted exploration well.” *Id.* at 28. Anadarko concludes that “the volumes that prematurely escaped from MC 252 and were later captured by BP are not production and thus are not subject to a corresponding royalty on production.” *Id.*

ONRR answers that “[t]his case is about a company which is attempting to avoid paying royalties for oil produced, removed and sold from a federal lease . . . despite the facts that approximately 679,000 barrels of oil were produced, removed and sold from its lease, and that sale of this oil generated \$47.3 million in proceeds from the three leases.” Answer at 1. In ONRR’s view, “[t]his attempt to avoid a clear legal obligation is especially egregious in light of the circumstances.” *Id.* ONRR devotes much of its Answer to addressing Anadarko’s “core argument,” *i.e.*, that “oil captured, removed and sold from the Macondo well on Lease OCS-G 32306 does not meet the definition of ‘production’” under OCSLA, and “[t]herefore, . . . that no royalty is owed on that oil.” *Id.* at 2.

ONRR contends that the oil captured from the Macondo well was “[o]il produced, removed, and sold” from Lease OCS-32306, and in fact meets the definition of “production” in § 1331(m) of OCSLA. Answer at 9-13. Relying upon *Diamond Shamrock*, 853 F.2d at 1165-66, ONRR argues that the “plain language reading” of § 1331(m) is not intended to exclude accepted industry meanings for the term, “including the actual products of an oil and gas well.” *Id.* at 11. ONRR argues that Anadarko’s “attempts to distinguish *Diamond Shamrock*” are not supportable because “the Fifth Circuit’s interpretation of the term ‘production’ was not contingent upon or linked to the facts of that case,” and “[t]here is no indication” that the Court intended to ignore the phrase “by any means” set forth in § 1331(m). Answer at 11-13 (citing *Murphy Exploration*, 148 IBLA 266, 273 n.2 (1999)). Moreover, ONRR argues that the appellant and its partners “would realize a multi-million dollar windfall if not required to pay royalty on the oil captured and sold from the Macondo well,” and that the Board has traditionally declined to interpret the law in a manner that creates windfalls, citing *Steve Crooks*, 167 IBLA 39, 46 (2005), and *Mesa Petroleum Co.*, 111 IBLA 201, 203-04 (1989). Answer at 16.

Anadarko replies that *Diamond Shamrock* is distinguishable because it addressed the meaning of the value of production within the context “of whether contractual ‘take-or-pay’ clauses required royalty payments to be made prior to the actual severance of the minerals from the lease.” Reply at 5-6. In distinguishing *Diamond Shamrock*, Anadarko states: “In reality, *Diamond Shamrock* held only that if there was *no* severance of minerals, then there was *no* production. This holding does not mean that whenever there *is* severance of minerals, there *is* production.” *Id.* at 5. Anadarko argues that the Board’s decision in *Chevron U.S.A. Inc.*, 110 IBLA 216 (1989), also is not on point, even though it involved a blowout situation, because at issue was a large quantity of gas that was lost during drilling through “venting and flaring,” and because the Board held that the statutory basis for collecting royalty on the lost gas in that case was not 43 U.S.C. § 1331(m), but rather “the expanded royalty in FOGRMA section 308 [30 U.S.C. § 1756 (2006)].” *Id.* at 26-27. With the Deepwater Horizon disaster, Anadarko argues, the captured oil was not “lost” and therefore was not subject to section 308 of FOGRMA. *Id.*; Reply at 4.

The Government's loss is a tort issue rather than a royalty issue, Anadarko maintains (SOR at 26), as, under § 1331(m), "production" is properly limited to that product which is removed and sold from a well after the well's successful completion, and does not extend to the capture and sale of oil emanating from a blowout during exploratory drilling. SOR at 26; Reply at 8. Anadarko argues that this limited approach to defining production is consistent with Congress's recognition that not all discharged oil volumes constitute "production subject to royalty," referring to volumes (1) unavoidably lost or wasted, (2) used for the benefit of the Lease, or (3) lost due to drainage. SOR at 24-26. Anadarko asserts that ONRR is mistaken in its assertion that Anadarko will receive a windfall if royalty is not paid. In Anadarko's view, there is no windfall because no royalty inures to the lessor since there was no production. Anadarko argues that the proper remedy for the government's loss is a damages claim against BP, the operator. Reply to Answer (Reply) at 6-8.

In a Sur-Reply to Anadarko's Reply, ONRR argues that Anadarko's arguments ignore the plain language of OCSLA and its implementing regulation, 30 C.F.R. § 250.105, defining "production." Sur-Reply at 3. ONRR maintains that, "[b]y its plain language, the definition of 'production' is not limited solely to completion of a well, but rather to "the successful completion of *any means for the removal of minerals.*" *Id.* (emphasis by ONRR). ONRR argues that in its Answer it has demonstrated (1) "that there was 'successful completion' of at least one 'means for the removal of minerals'"; and (2) "that the oil removed and sold from Lease OCS-G 32306 meets multiple meanings applicable to the term 'production.'" *Id.* at 2-5. Further, ONRR asserts, its interpretation of the statutory definition of "production" "conforms to the plain language of the statute and precedent," and prevents all record title lessees from obtaining "a windfall of royalty-free oil." Sur-Reply at 5-9.

### III. ANALYSIS

[1, 2] We reject Anadarko's central premise, *i.e.*, that the oil captured, removed, and sold from the Macondo well is not "production" under OCSLA, 43 U.S.C. § 1331(m). As discussed below, we find no support for Anadarko's limited definition of "production."

We agree with ONRR that the phrase "successful completion" in § 1331(m) must be read with the phrase "of any means"; that "[l]imiting the ability to realize royalties from a lease based on the way in which those minerals were taken would not effectuate Congress's goal of reimbursing the United States for those minerals"; and that "[s]uch a limitation would particularly run afoul of Congress's goal in the present case, given that 679,000 barrels of oil were removed from the Macondo well using non-typical means, then sold on the lessees' behalf for \$47.3 million in proceeds." *Id.* To accept Anadarko's argument that the captured oil is not royalty-

bearing would undermine OCSLA's primary objective, *i.e.*, "the efficient exploitation of the minerals of the OCS, *owned exclusively by the United States.*" *Amoco Production Co. v. Sea Robin Pipeline Co.*, 844 F.2d 1202, 1210 (5th Cir. 1988) (emphasis added; quoted in *EP Operating Limited Partnership v. Placid Oil Co.*, 26 F.3d at 570 ("The government's interest in the minerals of the OCS is proprietary. . . . It leases out the minerals and receives a royalty on the amount produced. Thus, the government is concerned with the total recovery of the federally-owned minerals from the reservoirs underlying the OCS.")).

Anadarko's efforts to distinguish *Diamond Shamrock* are not persuasive. That case involved take-or-pay payments pursuant to a take-or-pay clause in a gas sales contract, and the Fifth Circuit denied the demand for royalty on the basis that the production had not yet been physically severed from the ground. The Fifth Circuit looked to the lease itself, to the contract between the producer and the pipeline-purchaser, and a common-sense definition of the term "production" to reach its conclusion "[f]or purposes of royalty calculation and payment, production does not occur until the minerals are physically severed from the earth." 853 F.2d at 1168. The Fifth Circuit stated that "[t]he word 'production' is a horse of many colors." 853 F.2d at 1165. In observing that the term "production" has a variety of meanings in the oil and gas industry, the Fifth Circuit stated:

The term "production" is used in the oil and gas industry in several different but related senses. The term can be used to refer to an abstract noun: (i) the act or process of producing. It can also refer to either of two concrete nouns: (ii) the products of an oil and gas well, or (iii) the well itself.

853 F.2d at 1166. ONRR rightly states that "the oil which emanated from the Macondo well clearly fits the second definition posited by the Fifth Circuit: this oil is obviously "the product[] of an oil and gas well." Answer at 10. ONRR also correctly observes that "[t]he first definition is also appropriate: BP engaged in 'the act or process of producing' oil by using various devices to capture it as it emanated from a well which BP had drilled (and, for some of the oil, after it had reached the surface of the water." *Id.*

The Court's explicit rejection of a limited interpretation of the term "production," as used in § 1331(m), undermines Anadarko's argument:

Even accepting the proposition that "production" in these leases is used in the abstract noun sense, as in (i) above, this court cannot accept "*the conclusion that § 1331(m) was intended to define production to exclude all other accepted meanings in the industry, including (ii) above, the actual products of an oil and gas well.*"

*Id.* at 1166 (emphasis added; footnote omitted). The Court stated that “[i]n the interests of consistency, logic and economics,” it was “adopt[ing] as the legal definition of the word ‘production,’ as used in the context of calculating royalty payments, the *actual physical severance of minerals from the formation.*” *Id.* at 1168 (emphasis added; footnote omitted) (citing, e.g., *Christian v. A.A. Oil Corp.*, 506 P.2d 1369, 1373 (Mont. 1973) (production is mineral withdrawn from land and reduced to possession). The Fifth Circuit emphatically rejected the Department’s argument that the definition of production in § 1331(m) “relates to only one possible interpretation,” and stated: “With all due deference to the Secretary, juxtaposing the definition of § 1331(m) onto these oil and gas leases makes little sense, either economically, logically or geologically.” 853 F.2d at 1166. The same can be said about Anadarko’s definition of “production” in the present case.

In *Diamond Shamrock*, as with Lease OCS-G 32306, the royalty provision provided that royalty will be paid on “the amount or value of the production *saved, removed, or sold from the leased area.*” 853 F.2d at 1166 (emphasis added). This is a very broadly phrased provision. The Fifth Circuit stated that in 30 C.F.R. § 206.150 the Department has defined “value of production” as “fair market value.” *Id.* The Fifth Circuit then stated: “At a minimum, fair market value is at least ‘the gross proceeds accruing to the lessee from the disposition of the produced substances.’” *Id.* (quoting 30 C.F.R. § 206.150). Accepting Anadarko’s argument means that the gross proceeds accruing to Anadarko and its co-lessees are not from the disposition of produced substances. According to Anadarko’s theory, the substances were not “produced.” Such a rendering is contrary to the specific holding in *Diamond Shamrock* that “[f]or purposes of royalty calculation and payment, production does not occur until the minerals are physically severed from the earth.” *Id.* at 1168. The Fifth Circuit made this point again, stating: “Royalty payments are due only on the value of minerals actually produced, i.e., physically severed from the ground.” 853 F.2d at 1168. In the face of the Fifth Circuit’s analysis in *Diamond Shamrock*, Anadarko’s protestations that the oil from the Macondo well is royalty-free because the minerals were not produced are unconvincing.

The oil emanating from the Macondo well was “physically severed,” even if the manner in which it was severed involved a series of unfortunate events that were unplanned and unpermitted. In characterizing the captured oil, Anadarko carefully avoids any wording that would suggest that the oil was “produced” or constitutes “production” within the limited meaning that Anadarko projects onto § 1331(m). Anadarko uses such terms, *inter alia*, as “uncontrollable discharge” (SOR at 1); “discharged volumes” (*id.*); “captured oil volumes” (*id.* at 12); “uncontrolled flow of hydrocarbons” (*id.* at 20); the “subject volumes” (*id.*); “volumes uncontrollably discharged” (*id.* at 21); “volumes that prematurely escaped” (*id.* at 28); “captured hydrocarbons” (*id.* at 29); “discharged and captured volumes” (*id.*); and “recovered

oil volumes” (*id.* at 30). We conclude that production by any other name is still production.

Anadarko would have us construe and apply § 1331(m) only in those circumstances when the sequence of stages and events (*i.e.*, exploration, development, and production) takes place as contemplated in OCSLA and the regulations. As ONRR states, the regulatory scheme embodied in § 1331(m) and the implementing regulations “envision[s] an orderly progression, in which a lessee obtains the necessary authorizations, drills and completes a well, then extracts oil through the well by conventional means.” Answer at 12. We are in complete agreement with the following summation, offered by ONRR:

The flaw in Appellant’s narrow reading of the term “production” is perfectly illustrated by the present case. Here, large quantities of oil were severed from the formation by the drilling of the Macondo well. This oil then emanated from the Macondo well. A significant amount of this oil, 679,000 barrels, was captured by various devices. This oil was then removed from the lease, metered, processed, and sold, just like oil produced through more conventional means. Arguing that this oil is not royalty bearing because there was not the standard orderly progression ignores reality.

*Id.* at 13. The logical end to application of Anadarko’s narrow definition of “production” would be to allow an operator to avoid paying royalty on oil severed and sold by deliberately *not* securing the permits required prior to development and completion of a well, since under Anadarko’s theory there is no production because the mineral has not been extracted as planned and in accordance with the phases Anadarko would impose onto § 1331(m). In the world imagined by Anadarko, the lessees would be entitled to keep the proceeds from the sale of the recovered oil and the Federal government’s recourse would be a tort action for damages. We find no support for such an approach. Imposing Anadarko’s “interpretation of § 1331(m) onto these oil and gas leases makes little sense, either economically, logically or geologically.” 853 F.2d at 1166.

In *Chevron U.S.A.*, which Anadarko also deems inapplicable, the Board considered the assessment of royalty in a blowout scenario in which an uncompleted OCS well suffered a blowout during drilling, resulting in a large quantity of gas being lost through venting and flaring. 110 IBLA at 217. The MMS sought to impose a royalty on the lost gas. On appeal, Chevron U.S.A. argued that by its definition of “production” in § 1331(m), “Congress intended that royalty would accrue [only] on that oil or gas severed after successful completion of a well, but no royalty would accrue on that gas which escaped into the atmosphere during exploration and development, regardless of the reason for its loss.” *Id.* at 218. The Board noted that

“[t]he fact that Well No. 1 had not been successfully completed at the time of the blowout [was] not in dispute.” *Id.* The Board did not resolve the issue as to whether § 1331(m) applied because it concluded that the expanded royalty obligation in section 308 of FOGRMA, 30 U.S.C. § 1756 (2006), “fills this gap” and requires payment of royalty on avoidably lost gas volumes. *Id.* at 221. Anadarko argues that the “recovered oil volumes” at the Macondo well “were not lost,” and so “FOGRMA does not apply or preclude a Board determination that the subject volumes are not royalty-bearing ‘production’ within the meaning of OCSLA, the regulations, and the Lease.” SOR at 27. Indeed, Anadarko argues that FOGRMA’s provisions do not include volumes discharged as a result of a blowout and subsequently captured. The end result of Anadarko’s logic is that, had BP not captured the oil it in fact captured, but that all of the oil was *lost* and none captured, royalty would be payable on *all* oil as lost under section 308 of FOGRMA. According to Anadarko, the Secretary is entitled to collect royalty on the lost oil, but not oil reduced to BP’s possession and sold on the market. *See id.* at 21. Such an argument is not sustainable.<sup>16</sup>

The very nature of the Deepwater Horizon catastrophe is inconsistent with Anadarko’s position that a successful completion for royalty purposes takes place only when a well is completed and oil and gas are extracted on schedule and in accordance with the required permits. In enacting OCSLA, Congress was aware that the phases of exploration, development, and production on the OCS are not always distinctly separated. According to the testimony of the Chairman of the Council on Environmental Quality reported in the legislative history of the 1978 amendments to OCSLA, the statute would, of course, provide “[a]uthority for a distinct pause between exploration and development to reevaluate how and whether to proceed.” H.R. 95-590, 95th Cong. (1977) *reprinted in* 1978 U.S.C.C.A.N. 1450, 1520. And the House Report stated that section 25 of the Act, “Oil and Gas Development and Production,” codified at 43 U.S.C. § 1351, “provides a means to separate the Federal decision to allow private industry to explore for oil and gas from the Federal decision to allow development and production to proceed if the lessee finds oil and gas.” *Id.* While this testimony shows an understanding that exploration, development, and production in connection with an OCS lease may take place in discrete stages, those phases are defined largely for regulatory convenience. The Committee demonstrated a sophisticated working knowledge of the realities of oil and gas development, where, as the National Commission Report on the BP spill vividly demonstrates, decisions are made under the pressure of the moment:

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<sup>16</sup> We note that by Anadarko’s own reasoning BOEMRE would be well within its authority under section 308 of FOGRMA to demand payment of royalty on the oil and gas that was in fact *lost* as a result of the Deepwater Horizon blowout. That issue is not before us, however.

*The committee recognize[s], that in many cases, there is no real separation between exploration and production. Exploration activities, including delineation drilling, can continue in a lease area even after production has commenced. However, the committee also recognize[s] that there is a point in time when the lessee has to make a decision whether or not he is going to order a platform, seek related, onshore support facilities, and commence substantial development and production in a lease area. This decision is perhaps, with the exception of the purchase of a lease, the key decision, with the most significant effects, relating to OCS activities. This section utilizes the natural pause that occurs when a lessee determines he is to commence major development as the basis to supply needed information to affected states and other interested persons, and to provide a mechanism for decisions as to continued activity on a lease.*

H.R. 95-590, 1978 U.S.C.C.A.N. at 1570-71 (emphasis added).

What the Deepwater Horizon catastrophe demonstrates in stark and tragic terms is that there was very little that was “natural” about the blowout and the series of efforts taken to stymie the uncontrolled flow of oil from the well. The Chief Counsel’s and National Commission Reports make clear that, as the disaster unfolded, there was in reality no “natural pause” between “exploration” and “production.” The plan for orderly development of MC 252 was destroyed with the blowout. The capture of the oil was prudent from the viewpoint of minimizing, to the extent possible, the environmental harm that would result if the oil were not captured. The capture was also prudent from the perspective of preventing the waste of Federally-owned minerals. However, there was no “natural pause” between development and production. Any suggestion that BP and Anadarko should be excused from paying royalty because the project failed to materialize according to plan is meaningless. The Deepwater Horizon plan, even though thwarted by the blowout, was aimed at the production of oil and gas. *See Tennessee Gas Pipeline v. Houston Casualty Ins. Co.*, 87 F.3d 150, 154 (5th Cir. 1996) (“[T]he operation involves ‘exploration, development, or *production*’ of minerals on the OCS. These terms denote respectively the processes involved in searching for minerals on the OCS; preparing to extract them by, inter alia, drilling wells and constructing platforms; and *removing the minerals and transferring them to shore.*”).

Anadarko argues that, under the terms of OCSLA, there was no “successful completion” of the well and that, therefore, there was no production upon which to base a royalty demand. ONRR argues, on the other hand, that the operative language is the phrase “*by any means,*” such that there is a successful completion *for the purpose of collecting royalty* even if the production phase contemplated by the statute was never reached, and that royalty is properly demanded under the rationale set forth in *Diamond Shamrock*. Thus, we are asked to interpret a statutory definition

containing two phrases that may be seen as inconsistent under the opposing arguments presented.

In construing the seemingly ambiguous language in dispute, we will interpret the provision “with common sense in order to accomplish a reasonable result.” 3 Singer, *Sutherland Statutory Construction* § 57:3 at 16 (6th ed. 2001) (citation omitted); *see also U.S. v. Ryan*, 284 U.S. 167, 175 (1931) (“All laws are to be given a sensible construction. A literal application of a statute which would lead to absurd consequences is to be avoided whenever a reasonable application can be given which is consistent with the legislative purpose.”) (citations omitted); *see Jerry Grover d.b.a. Kingston Rust Development (Grover III)*, 160 IBLA 234, 255 (2003).

OCSLA has very little to say regarding the effective collection of royalty for oil and gas inuring to the United States from Federal oil and gas leases. The 1978 amendments to OCSLA predated FOGRMA by over 4 years; FOGRMA became law in January 1983. Congress stated that the purpose to be accomplished by FOGRMA is “to clarify, reaffirm, expand, and define the authorities and responsibilities of the Secretary of the Interior to implement and maintain a royalty management system for oil and gas leases on Federal lands, Indian lands, and the Outer Continental Shelf.” 30 U.S.C. § 1701(b)(2) (emphasis added). Under section 3 of FOGRMA, “production” is defined as “those activities which take place for the removal of oil or gas, including such removal, field operations, transfer of oil or gas off the lease site, operation monitoring, maintenance, and workover drilling”; and “royalty” means “any payment based on the value or volume of production which is due to the United States . . . on production of oil or gas from the Outer Continental Shelf . . . under any provision of a lease.” 30 U.S.C. § 1702(13) and (14).

There can be no doubt that, for purposes of determining royalty on the value of production saved, removed, or sold from the leased area, the “successful completion” of a well under § 1331 of OCSLA is not a limiting factor, at least in the sense that Anadarko would define “successful completion.” Moreover, a reasonable construction of the definition of “production” for royalty-bearing purposes is that, to the extent the two statutory definitions may be viewed as inconsistent, the definition of production in section 3 of FOGRMA, embracing “activities which take place for the removal of oil or gas,” without regard to the sequence of those activities, amended and clarified the definition of “production” set forth in § 1331(m) of OCSLA. This reasonable construction, which is consistent with both OCSLA and FOGRMA, avoids many potential “absurd consequences” of Anadarko’s literal application of § 1331(m). *U.S. v. Ryan*, 284 U.S. at 175.

However, we do not find the two definitions inconsistent. The legislative history quoted *supra* indicates that Congress was indeed aware of the realities of

oil and gas exploration and development. Thus, a reasonable interpretation of the clause “*by any means*” in § 1331(m) is that it operates as a limitation on the phrase “successful completion,” and thereby acknowledges, and is consistent with, the comment in the House Report accompanying OCSLA that “in many cases, there is no real separation between exploration and production,” quoted *supra*. This interpretation renders the definition of “production” in § 1331(m) consistent with the definition of “production” set forth in FOGRMA. There is no question that the Macondo well was drilled, and there is no question that the subject oil emanated from the well as the result of the operator’s drilling activities. Thus, we hold that the capture and sale of oil severed from the ground as the result of the BP oil spill is properly deemed a “successful completion” for purposes of determining whether royalty must be paid to the United States, pursuant to the definitions of “production” under both OCSLA and FOGRMA.

We have no doubt that section 102(a) of FOGRMA, 30 U.S.C. § 1712(a) (2006), as well as the agreements between Anadarko and BP as assignee and assignor, respectively, and MMS’ successor, BOEMRE, as the lessor, clearly define Anadarko’s legal obligation to the United States as required by BOEMRE’s August 24, 2010, Order. Accordingly, we conclude that the oil collected from the Macondo well was production “saved, removed, [and] sold from the leased area,” and, therefore, was royalty-bearing under section 6(a) of the Lease and under section 3 of FOGRMA, 30 U.S.C. § 1702(13). Under BP’s assignments to Anadarko of 25 percent of the record title interest, a pro rata amount of the royalty to be collected was properly chargeable to Anadarko pursuant to section 102(a) of FOGRMA, 30 U.S.C. § 1712(a) (2006).

To conclude otherwise would mean that “the lessees would realize a \$47.3 million windfall in royalty-free oil.” Answer at 16. Of this \$47.3 million amount, approximately \$11.8 million is attributable and owed to Anadarko in accordance with its 25 percent interest in the Lease. The royalties due on Anadarko’s proportionate share of the proceeds amounts to \$2 million. Anadarko’s premise would have us ignore the fact that “the minerals of the OCS [are] *owned exclusively by the United States.*” *Amoco Production Co. v. Sea Robin Pipeline Co.*, 844 F.2d at 1210. The lessees severed, captured, removed, metered, processed, and sold the Government’s oil. In construing OCSLA, FOGRMA, and the Lease to mean that such oil may be sold free of royalty, Anadarko positions itself to realize a windfall of \$2 million. Anadarko’s argument that the captured and sold oil is royalty-free runs contrary to the Government’s interest in the “total recovery of the federally-owned minerals from the reservoirs underlying the OCS.” *EP Operating Limited Partnership v. Placid Oil Co.*, 26 F.3d at 570.

[3] We summarily reject Anadarko’s assertion that BOEMRE’s order to pay should be reversed because it is “facially inadequate and unsupported by the

Administrative Record.” SOR at 8, 28-30. It is incumbent upon BOEMRE to ensure that its decision is supported by a rational basis which is set out in the written decision and demonstrated in the administrative record accompanying that decision. *E.g., Nevada Division of Wildlife*, 145 IBLA 237, 247 (1998). Parties who are affected by a BOEMRE decision deserve a reasoned and factual explanation of the rationale for the decision and must be given a basis for understanding it and accepting it or, alternatively, appealing and disputing it. *Id.* BOEMRE’s order to Anadarko to pay royalty on the captured oil clearly meets this standard.

A cursory glance at the appealed order shows that BOEMRE cited OCSLA, 43 U.S.C. § 1337, as well as the terms of the Lease itself, as authority for Anadarko’s obligation to pay royalties. Those authorities require Anadarko to pay royalty on oil and gas “production saved, removed, or sold.” The order certainly set forth sufficient factual and legal bases for Anadarko to mount a sophisticated and vigorous defense against it. In *Kingston Rust Development*, 160 IBLA 234, 241 (2003), and *Nevada Division of Wildlife*, 145 IBLA at 247, the Board held that where an agency presents a factual and legal rationale sufficient to permit an appellant to present an informed and organized rebuttal, the appellant has not demonstrated a basis for a reversal. Our failure to find merit in Anadarko’s arguments is not the result of any deficiency in the record or in the order to pay issued to Anadarko.

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 affirmed.

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James F. Roberts  
Administrative Judge

I concur:

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Christina S. Kalavritinos  
Administrative Judge