

SHELL OIL CO.

IBLA 82-445

Decided August 31, 1982

Appeal from decision of the Director of the Geological Survey denying request to participate in certain continental offshore stratigraphic test wells without penalty as an original participant.

Affirmed.

1. Outer Continental Shelf Lands Act: Geological and Geophysical Exploration: Generally

Under 30 CFR 251.6-3(d), the Director of Geological Survey will require republication of an exploratory test drilling application and a period for other persons to join in a venture as original participants without penalty where the applicant proposes changes to the original application and the Director determines that those changes are significant. Proposed changes to the Department of the Interior's announced Outer Continental Shelf leasing schedule or proposed changes to regulations governing test drilling are not significant changes within the meaning of 30 CFR 251.6-3(d).

APPEARANCES: Dan A. Bruce, Esq., Houston, Texas, for Shell Oil Company; Risher M. Thornton, Esq., Anchorage, Alaska, for ARCO Alaska, Inc.; L. Poe Leggette, Esq., Department counsel for Minerals Management Service.

## OPINION BY ADMINISTRATIVE JUDGE IRWIN

On February 9, 1981, ARCO Alaska, Inc. (ARCO), announced its proposal to drill three continental offshore stratigraphic test (C.O.S.T.) wells off the western coast of Alaska and invited interested parties to participate in one or more of the wells. The announcement required that in order to participate without paying any late penalty an interested party had to commit itself in writing to ARCO by March 15, 1981. Participating parties would bear a proportionate share of the cost risk and expense of drilling and share the data obtained from the wells. Seventeen companies joined ARCO as original parties. Shell Oil Company (Shell) did not. By letter dated October 31, 1981, Shell requested the Director of the Geological Survey (Survey) 1/ to provide an additional opportunity for interested parties to participate in all three wells as an original member without penalty. 2/ The Director declined and Shell has appealed that decision to this Board.

Section 11 of the Outer Continental Shelf Lands Act, as amended, 43 U.S.C. § 1340 (Supp. II 1978), permits the Secretary of the Interior to

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1/ By Secretarial Order No. 3071, dated Jan. 19, 1982, the Secretary of the Interior established the Minerals Management Service (MMS) and, transferred to MMS the minerals-related functions of the Conservation Division of the Geological Survey. See 47 FR 4751 (Feb. 2, 1982). References in 30 CFR Part 251 and other Departmental regulations to Survey were changed to MMS by final rule on June 30, 1982. 47 FR 28368. Since Survey existed at the time that the decision on appeal was issued, we will refer to Survey in this opinion.

2/ The initial cost estimates for the three wells were \$98 million. Thus each of the 18 original participants were obligated to contribute approximately \$5.5 million assuming each had joined in all three wells. On that basis, late participation cost nearly \$11 million, a share of the cost plus 100 percent of that share (Department counsel's brief at 2). Shell reports, however, that March 1982 cost estimates were \$218.7 million total or approximately \$12 million for each participant making the late participation cost approximately \$24 million for all three wells (Appellant's response brief at 5 n.16).

authorize geological and geophysical exploration in the Outer Continental Shelf (OCS) that does not interfere with or endanger actual operations under any OCS lease and that is not unduly harmful to aquatic life in the area. The Department permits deep stratigraphic testing on the basis of section 11. See Solicitor's Opinion, M-36922, 87 I.D. 517 (1980). Permit requirements for C.O.S.T. wells are set forth in 30 CFR Part 251, generally, and 30 CFR 251.6-2, specifically. In order to minimize duplicative exploration activities involving penetration of the seabed of the OCS, the Secretary requires that a party proposing to drill a C.O.S.T. well afford all other interested parties, in a signed agreement, an opportunity to participate in the drilling on a cost-sharing basis. 30 CFR 251.6-3(a). Departmental regulations provide that the agreement "may include a penalty for late participants of not more than 100 percent of the cost to each original participant in addition to the original share cost." Id.

The ARCO notice announced that it was proposing to drill three C.O.S.T. wells: St. George Basin C.O.S.T. No. 2, North Aleutian Shelf C.O.S.T. No. 1, and Navarin Basin C.O.S.T. No. 1. ARCO's drilling plan, dated February 23, 1981, estimated that each well would take 111 days to drill and that drilling would begin in April 1982, August 1982, and July 1983, respectively.

Under 30 CFR 251.6-5, 3/ if a C.O.S.T. well is drilled within 50 geographic miles of any OCS tract tentatively identified for a lease sale, as listed on the currently approved OCS leasing schedule, the driller must complete the well "at least 3 months prior to the first day of the

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3/ 30 CFR 251.6-5 was revised by final rule effective May 13, 1982. 47 FR 15781 (Apr. 13, 1982). References in this opinion are to the unrevised version (see 30 CFR 251.6-5 (1981)) since that provision was in effect at the time this case arose.

month in which the Proposed Notice of Sale is listed." The Survey Director may extend a permit's expiration date, however, if it is determined to be in the national interest. All three of ARCO's wells were subject to this rule when it announced its proposal to drill.

At the time ARCO filed its permit applications and published its notice to interested parties, the June 1980 5-year OCS Oil and Gas Leasing Schedule was in effect. Under this schedule, the St. George Basin was scheduled to be leased in December 1982 (sale No. 70), the North Aleutian Shelf in October 1983 (sale No. 75), and the Navarin Basin in December 1984 (sale No. 83). The proposed notice of sale for each was to be issued 5 months prior to the sale date. Therefore, under 30 CFR 251.6-5, the required completion dates for the ARCO wells were March 31, 1982, January 31, 1983, and March 31, 1984. Consequently, ARCO's announced drilling plans for the St. George Basin well would not meet the well completion requirements of 30 CFR 251.6-5 unless the Survey Director extended the permit.

In a letter to the Survey Director, dated October 31, 1981, Shell requested that the Director require republication of ARCO's well proposal allowing additional parties to join as original participants in accordance with 30 CFR 251.6-3(d) or, alternatively, extend the time for joining without penalty because of "many significant changes" affecting ARCO's plans. The changes identified by Shell were:

1. A draft proposed OCS leasing schedule issued in April 1981 that advanced the sale dates for the North Aleutian Shelf 4/ to April 1983 and

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4/ The April and July 1981 schedules referred to this sale as the North Aleutian Basin.

the Navarin Basin to December 1983 with the notice of proposed sale issued 4 months earlier so that ARCO's drilling plans in those areas could not meet the completion requirements of 30 CFR 251.6-5.

2. A proposed OCS leasing schedule issued in July 1981 which delayed the St. George Basin and Navarin Basin sales until February 1983 and March 1984 which would accommodate ARCO's plans in the St. George Basin and the Navarin Basin.

3. A proposed amendment to 30 CFR 251.6-5, published on September 9, 1981 (46 FR 44994 to 44995), which would change the required completion date to "at least 60 days prior to the first day of the month in which the lease sale is scheduled to be held."

4. Indications in the press that the St. George Basin and North Aleutian Shelf lease sales might be deferred until completion of certain onshore studies in the Bristol Bay area.

Shell argued that the ARCO proposal had been announced at a time when the Department was reviewing the June 1980 schedule with the announced aim of accelerating OCS leasing. It explained that it was not originally supportive of the ARCO wells because "we favored prompt execution of the OCS schedule, however revised, and anticipated that demands would arise, as they did, for further delays to accommodate the C.O.S.T. program [and] \* \* \* the timing was such that the St. George C.O.S.T. well would not produce significant information in view of the time limitation provisions of 251.6-5." Shell urges that changes in the lease sale schedule and regulations severely

impact the planning processes of offshore operators and therefore should be considered significant changes for the purposes of 30 CFR 251.6-3(d).

The cited regulation reads: "(d) If the applicant proposes changes to the original application and the Director determines that such changes are significant, the Director shall require a republication of the changes and an additional 30 days for other persons to join as original participants."

By letter dated November 19, 1981, the Survey Director informed Shell that he had concluded that the proposed 5-year OCS Oil and Gas Leasing Schedule and proposed revision to 30 CFR 251.6-5, both of which were beyond the control of ARCO, were not significant changes within the meaning of 30 CFR 251.6-3(d).

In its statement of reasons for appeal, Shell makes two arguments. First, Shell urges that ARCO's announcement amounted to notice of intention to perform an impossibility in that the St. George Basin well could not be timely drilled and such notice does not constitute notice at all. Second, Shell contends that the effect of the proposed regulatory change was no different than if ARCO had proposed to accelerate its drilling plans and, in that case, the Director would surely have found the acceleration a significant change and required republication. <sup>5/</sup>

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<sup>5/</sup> By letter dated June 14, 1982, Shell exercised its right to join in the St. George Basin C.O.S.T. well No. 2 as a late participant to avoid an increased penalty should drilling result in a significant hydrocarbon occurrence. See 30 CFR 251.6-3(a). Shell has also requested that if it prevails on appeal, the Board order ARCO to return the penalty payment or apply it to participation in one of the other wells.

Counsel for Survey responds first that the timely drilling of the St. George Basin well was not an impossibility because the Survey Director could approve an extension and that, at the time the ARCO plans were announced, it was simply a matter of whether the interested parties chose to take the risk that the Director would do so. Counsel suggests that if Shell were not so inclined it could have participated in the other two wells that were scheduled for timely completion. Second, counsel argues that 30 CFR 251.6-3(d) applies where significant changes are proposed by the applicant, and the proposed regulatory change was made by Survey, not ARCO. Counsel contends that originally Shell evaluated the ARCO proposals and chose not to participate but now having reevaluated the risk with the advantage of the passage of time wants to participate without having to pay the penalty. Counsel also contends that if Shell prevails, it will encourage other companies to delay in joining a test well group and hinder the Department's ability to obtain data to evaluate OCS tracts for leasing.

ARCO urges that Shell's appeal be denied because Shell's arguments on appeal are spurious. ARCO responds with arguments similar to those expressed by counsel for Survey and also suggests that if Shell is now allowed to join as an original participant, it will reap the benefits of the drilling without having assumed the risks. Future C.O.S.T. well programs will be imperiled because the incentive to join as an original participant and incur substantial risk would be reduced.

[1] The geological and geophysical exploration activities authorized by section 11 of the Outer Continental Shelf Lands Act are intended to produce information on OCS mineral resources including data directed to possible

exploration and development activity for the benefit of the participants and the Federal Government. The regulatory scheme is intended to promote maximum participation in test wells by all interested parties to avoid duplicative activities on the OCS and to ensure that the risk of a venture is equally shared since participating parties share the resulting information. The penalty provisions encourage early commitment to the drilling projects and protect those who are willing to assume the risk of the venture at the outset. <sup>6/</sup>

The regulation upon which Shell bases its argument that it be allowed to join the ARCO wells as an original participant, 30 CFR 251.6-3(d), requires republication and an additional opportunity to participate without penalty when the Director of Survey finds that the applicant proposes significant changes to its original application. It thus furthers the regulatory goal of encouraging group ventures by permitting a new opportunity

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<sup>6/</sup> In discussing comments to proposed revisions to 30 CFR 251, the Department addressed the penalty provisions as follows:

"We have decided not to change the maximum penalty (i.e., 100 percent of the cost to each original participant in addition to the original share cost) for late entry into a deep stratigraphic test. We feel that this amount is sufficient to encourage the early participation of most interested parties, but is not overly burdensome to others, such as smaller companies, which may take longer to acquire sufficient funds in order to enter the group. We have, however, raised the maximum penalty for late participants who wait until after the Director announces a hydrocarbon occurrence to enter the group to 300 percent of the cost to each original participant in addition to the original share cost. We feel that this provision will protect those involved in the initial drilling consortium from companies that want to buy into the consortium only after hydrocarbon occurrences are detected in a test and will encourage early participation in such a consortium.

"The comment was also made that the penalties should be assessed by the participants and shared by all parties who participated as of the time the hydrocarbon occurrence is announced. We believe that the amount and distribution of monetary penalties should be spelled out in the initial agreement between the participants as a further stimulus for early participation." 45 FR 6342 (Jan. 25, 1980).

for interested persons to participate when the nature of the venture is significantly changed by the applicant. The regulation does not apply in the manner suggested by Shell. It is not sufficient for Shell to identify changed circumstances which impact in a manner similar to changes that an applicant might propose, and the Survey Director might find to be significant; the changes must be made to the original application at the initiative of the applicant.

The proposed changes in the OCS leasing schedule and the proposed change to 30 CFR 251.6-5 result from the ongoing evaluation and administration of the OCS leasing program. At the time that ARCO proposed its C.O.S.T. wells, the effects of program changes, whether beneficial or adverse, were part of the risk evaluated and assumed by the parties joining the venture. Although at the time that Shell entered its request to join without penalty neither the schedule changes nor the revision of the regulation had been finalized, the enhanced potential for benefit from the drilling as a result of the proposed changes lessened the risk of joining in ARCO's wells. The penalty provisions are directed to just such a case so that the difference in risk assumed may be equalized among participating parties.

Finally, we suggest that the impact of the changes identified by Shell go to the question of permit issuance since, presumably, the Department would not issue a permit for a well which could not be drilled in a manner consistent with the regulation. In making application for a well that could not be drilled timely under existing OCS leasing scheduling, ARCO was speculating that the Federal Government would modify the schedule in its favor or

grant it an extension. <sup>7/</sup> The Government might well be motivated to do so because of the information it would receive from the drilling project. Interested parties had the option to not participate in the St. George Basin well as proposed. Shell chose not to participate in any of the wells because it did not want the lease sales to be delayed to allow for test well drilling (Appellant's response brief at 4). If Shell now wants to participate, it must pay the penalty.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the Director of the Geological Survey is affirmed.

Will A. Irwin  
Administrative Judge

We concur:

Bruce R. Harris  
Administrative Judge

Douglas E. Henriques  
Administrative Judge

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<sup>7/</sup> The permits for all three ARCO wells were issued Jan. 21, 1982, requiring completion 6 months prior to the first day of the month in which the appropriate lease sale is scheduled. At that time, the July 1981 proposed schedule was the last published schedule. Under that schedule and the permit terms, the St. George Basin and Navarin Basin wells could be timely completed under ARCO's announced plans, the North Aleutian Shelf well could not be timely completed without an extension granted by the Survey Director. However, a tentative proposed final OCS leasing schedule was announced Mar. 19, 1982, which eliminates the North Aleutian Shelf sale altogether. See 47 FR 11980 to 11983 (Mar. 19, 1982). The final schedule announced July 21, 1982, did not further change the status of these sales.

