

SUN OIL CO. ET AL., APPELLANTS
SHELL OIL CO., APPELLEE

IBLA 81-883

Decided September 10, 1982

Appeal from decisions of the Director, Geological Survey, ordering unitization of oil and gas leases OCS-G-2087 and OCS-G-2088, and imposing a unit plan and formula for allocation of proceeds from these leases.

Affirmed in part, and referred to the Hearings Division.

1. Oil and Gas Leases: Communitization Agreements -- Oil and Gas Leases: Unit and Cooperative Agreements -- Outer Continental Shelf Lands Act: Oil and Gas Leases -- Outer Continental Shelf Lands Act: Unit Plans

Under regulations adopted pursuant to Sec. 5(a) of the Outer Continental Shelf Lands Act, both before and after its amendment in 1978, the Geological Survey can direct two lessees on a single competitive offshore gas reservoir to enter into a unit agreement if doing so is "in the interest of conservation." Survey's decision to require unitization will be affirmed where, but for unitization, one of the lessees would have been entitled to drill an additional well or wells in order to protect its correlative rights, in view of the waste of expensive, critical offshore drilling resources and the potential for adverse environmental consequences which drilling the additional well would have entailed, and in view of the fact that such additional drilling would have done nothing to increase ultimate recovery.

2. Oil and Gas Leases: Communization Agreements -- Oil and Gas Leases: Unit and Cooperative Agreements -- Outer Continental Shelf Lands Act: Oil and Gas Leases -- Outer Continental Shelf Lands Act: Unit Plans

Where actual production figures from a jointly-produced offshore gas reservoir show that one party overproduced its entitlement to gas-in-place, as determined by Geological Survey, by a factor of almost 3, and where the record contains nothing suggesting that this party engaged in drilling practices that might have unfairly increased its production, the matter will be referred for a hearing to allow that party to show that Survey's entitlement determination is incorrect.

APPEARANCES: Theodore L. Garrett, Esq., William P. Skinner, Esq., Lawrence T. MacNamara, Esq., Washington, D.C., for appellants, Sun Oil Co. et al.; Joseph C. Bell, Esq., Mary Anne Sullivan, Esq., David W. Hayes, Esq., Washington, D.C., for appellee, Shell Oil Co.; John H. Kelly, Esq., Office of the Solicitor, Department of the Interior, for the Director, Geological Survey.

OPINION BY ADMINISTRATIVE JUDGE HENRIQUES

Sun Oil Company (Sun) et al. 1/ have appealed the June 5, 1981, decision of the Director, Geological Survey (GS), 2/ affirming two orders of the Conservation Manager, Gulf of Mexico Outer Continental Shelf (OCS) Region. Shell Oil Company (Shell), which has a substantial interest in this matter, has filed an answer. A full statement of the long history of this dispute is necessary.

In February 1971, the Department awarded OCS lease OCS-G-2087, covering Block No. 320, to Sun, and OCS lease OCS-G-2088, covering adjacent Block No. 321, to Shell. Sun and Shell cooperated in drilling two exploratory wells near the common border of their respective blocks in May 1971. One

1/ Sun Oil Company has appealed on behalf of the following other coowners of lease OCS-G-2087: Anadarko Production Company, Diamond Shamrock Corporation, Northern Michigan Exploration Company, Elf Aquitaine Oil and Gas Corporation, and Petro-Lewis Corporation.

2/ We recognize that the Conservation Division, GS, was reorganized effective June 30, 1982, and is now known as the Minerals Management Service, and that its officials now bear different titles. Secretarial Order No. 3071 (Jan. 19, 1982), 47 FR 4751 (Feb. 2, 1982). However, for simplicity, we shall refer to GS and its officials as they were known at the times of their actions.

of these wells indicated an excellent potential for recovery of natural gas from the underlying sands, called the "P" sands. ^{3/}

From November 1972 to November 1973, Sun drilled 17 developmental wells from one platform, and later built a second platform from which it drilled an additional seven wells. Sun began production of gas from the "P" sands in November 1974.

Beginning in May 1973, Shell drilled 25 wells into the "P" sands from a single platform. However, Shell did not begin production until September 1975, keeping its wells shut in until this time.

On September 24, 1974, the Area Oil and Gas Supervisor (the Supervisor), GS, made a preliminary determination that there was one sand reservoir underlying Sun's and Shell's leases (the "P" sands) and that it was "competitive," as defined in OCS Order No. 11 (May 1, 1974).

When Sun subsequently began its production in November 1974, Shell, which was not yet producing, monitored a steady drop in formation pressure in its shut-in wells, corresponding to Sun's production. Based on this evidence of communication in the "P" sands, the Supervisor concluded that the reservoir was competitive and issued a final determination so stating on May 2, 1975. He also gave the parties 90 days to submit development and production plans for the "P" sands reservoir. Sun and Shell were unable to agree on a joint plan, and, on July 31, 1975, Shell requested that GS consider the appropriateness of requiring unitization instead of joint production.

At Shell's request, the Conservation Manager, Gulf of Mexico OCS Operations, GS (the Conservation Manager), convened a joint conference on September 9, 1975, at which the parties presented technical evidence supporting their different views as to the nature of the structure(s) underlying their leases, Shell arguing for and Sun arguing against unitization. On November 10, 1975, the Supervisor ordered unitization, in order to best serve the interests of conservation, to prevent drilling unnecessary wells and attendant economic waste, to increase ultimate recovery, and to protect correlative rights. Further, he indicated that unitization would avoid compelling Sun to curtail its production in order to balance production between the two leases. He directed the parties to prepare a unitization agreement providing, *inter alia*, for the allocation of proportionate shares of gas produced from the unit. The effective date of the agreement was left open to negotiation, but the parties were advised that it would be no later than the date they had received this order.

Sun and the other joint owners of lease OCS-G-2087 appealed this decision to the Director, GS. While this appeal was pending, Sun and Shell evidently continued to negotiate a unit agreement, including a term to allocate the

^{3/} Sun refers to the sands under its lease as the "P-15" sands and Shell refers to the sands under its lease as the "P" sands. For simplicity, we shall use the latter designation to refer to the common gas-bearing sands underlying these two leases.

gas produced from the "P" sands between them, but these negotiations were unsuccessful. Accordingly, on February 3, 1977, the Conservation Manager issued an order proposing a unit agreement for Sun and Shell, with terms effective retroactive to November 1, 1975. This unit agreement included an allocation formula based in part on net acre-feet of gas-in-place and in part on actual rate of production, as measured by production figures from January 1 to June 30, 1976. Following written comments by Sun and Shell, the Conservation Manager modified this proposed unit plan and, on March 23, 1977, ordered them to subscribe to it. Sun filed timely appeals of both of these orders to the Director, and they were joined with the pending appeal. ^{4/}

On February 5, 1979, the Director issued his first decision affirming the orders directing unitization and imposing the unit agreement and allocation formula. The Director concluded that compulsory unitization was authorized because it was in the interest of conservation, and that the allocation formula was reasonable. Sun appealed the Director's decision to this Board, but, before it was reached on our docket, GS requested that the case be remanded to it for further consideration by the Director. We remanded the case to him on August 23, 1979. Sun Oil Co., 42 IBLA 254 (1979).

Following another round of briefing, the Director issued his revised decision on June 5, 1981. It affirmed the Conservation Manager's orders again, holding that he did not act unreasonably in ordering unitization, since the reservoir was competitive and unitization prevented the drilling of unnecessary wells, thus furthering the interest of conservation and that the relevant rules allowed him to compel unitization in these circumstances. The Director also upheld the allocation formula, holding that it was a reasonable synthesis of two factors, the amount of gas-in-place beneath Shell's and Sun's respective portions of the tract, and the productivity of their respective wells. Finally, the Director concluded that it was reasonable to use November 14, 1975, the date the parties received the unitization order, instead of November 1, 1975, as the retroactive effective date for the unitization agreement, thus slightly modifying the Supervisor's orders. Sun's present appeal to this Board followed.

[1] In section 5(a) of the Outer Continental Shelf Lands Act (the OCS Act), as amended in 1978, 43 U.S.C. § 1334(a)(4) (Supp. II 1978), Congress expressly directed the Secretary to adopt regulatory provisions, inter alia, for unitization, pooling, and drilling agreements in order to provide for the prevention of waste and conservation of the natural resources of the Outer Continental Shelf, and in order to provide for the protection of correlative rights therein. The Department has done so in 30 CFR 250.50 and .51. The record leaves no doubt that Shell's correlative rights to the "P" sands were threatened by Sun's production. Accordingly, under the OCS Act, as amended, unitization was proper here.

However, the provisions of the OCS Act in effect prior to the 1978 amendments simply allowed the Secretary, in his discretion, to prescribe such

^{4/} Sun has succeeded in postponing the implementation of the unit agreement throughout the appeal process. The Director and this Board have issued continuous stays against its implementation, up to the present.

regulations as he determined to be necessary to provide for the prevention of waste and conservation of OCS natural resources and correlative rights therein. No regulation authorizing compulsory unitization to protect correlative rights was in place in 1975. Compulsory unitization, pooling, and drilling agreements were authorized only "in the interest of conservation." 30 CFR 250.50 (1975).

The Chief of the Conservation Division, GS, published detailed procedures governing compulsory unitization in OCS Order No. 11, effective May 1, 1974 (39 FR 15885 (May 6, 1974)). This order sets out the additional requirement that the reservoir be "competitive," that is, "reasonably delineated and determined to be productive," before compulsory unitization may be imposed. The "P" sands are a gas accumulation which is separated from and not in gas communication with any other such accumulation, and they contained one or more producible or producing well completions on each of Shell's and Sun's leases. Accordingly, they meet the definition of "competitive" set out in OCS Order No. 11. It remains to decide whether compulsory unitization was "in the interest of conservation" in 1975 as required by 30 CFR 250.50 (1975).

From the Conservation Manager's viewpoint in November 1975, unitization was properly seen to be in the interest of conservation. The wells completed at that time were, by themselves, adequate to achieve full recovery of natural gas from the reservoir. However, as many as seven additional producing wells could have been drilled into the reservoir without decreasing full recovery, due to the presence of a "slight" water drive in the reservoir, although the additional wells would not increase ultimate gas recovery. Further, in July 1975 Shell had asked the Conservation Manager to unitize or, alternatively, to grant it permission to drill a number of additional wells in order to counter Sun's alleged overproduction of gas-in-place under Shell's lease. The Conservation Manager had no basis to deny it permission to do so in light of the reservoir's tolerance to additional wells. Thus, the drilling of additional wells appeared to be a real possibility.

It reasonably appeared to the Conservation Manager in November 1975 that drilling even one additional well would be unnecessary (except to protect Shell's correlative rights), and a waste of critical, expensive offshore drilling resources; that it would present a potential for adverse environmental consequences; and that additional drilling would not increase ultimate recovery. Unitization provided Shell an alternative to drilling an additional well or wells to protect its correlative rights, by allowing the parties to negotiate an agreement fairly allocating production. Thus, even though the unitization order had the ancillary effect of protecting Shell's correlative rights, it also served the interest of conservation by removing Shell's motivation to drill an unnecessary well or wells and so avoided unnecessary expense and environmental risk. We conclude that the Conservation Manager's decision to require unitization was a proper exercise of his regulatory authority.

Sun stresses that there is no evidence that Shell would have drilled even one additional well. In July 1975, Shell requested that the Conservation Manager allow it to drill a number of wells if he decided not to compel unitization. This request was an adequate indication that Shell would have attempted to drill additional wells if he did not order unitization. Sun

makes much of the fact that it was not involved in the Conservation Manager's discussions with Shell in July 1975, charging that these were "ex parte communications." Officials of GS are entitled to deal with any lessee about matters concerning its lease and are not obliged to involve all interested parties in these dealings, which are not adversarial legal proceedings. Nor are we persuaded that Shell's July 1975 meeting with the Conservation Manager was other than as he described it in the record. The Conservation Manager's statement is amply corroborated by Shell's statements.

[2] We turn now to the question of the correctness of the unit agreement imposed on the parties by the Conservation Manager in his order of March 23, 1977. GS based all agreement terms governing the division of production from the well on its finding that, prior to production, 81.1 percent of the gas-in-place underlay Shell's lease and the remaining 18.9 percent underlay Sun's lease. Sun alleges that actual production from the reservoir from November 14, 1975, through May 1981, during which time both Sun and Shell were producing, was 70.11 percent by Sun and 29.89 percent by Shell. Even during the period from January 1 through June 30, 1976, chosen by GS as representative of the productive capacity of the "P" sands, Sun produced 54.9 percent and Shell only 45.1 percent. Thus, Sun outproduced its assigned reservoir volume by a factor of nearly 3 during this sample period and, allegedly, by a factor of nearly 4 from November 1975 through May 1981. There is no evidence that Sun engaged in drilling practices that might have greatly increased its rate of recovery, such as using oversized drilling pipe. Cf. Texaco, Inc., 51 IBLA 332, 87 I.D. 648 (1980) (where one lessee had used oversized drilling pipe). To the contrary, Shell apparently had five producing wells in the unit and Sun only three wells, thus suggesting that, if anything, Shell had the edge in production capacity. These actual production rates are so divergent from GS's determination of the division of the reservoir volume that we must allow Sun an opportunity to establish by relevant evidence that the reservoir was different.

Accordingly, as Sun requested, pursuant to 43 CFR 4.415, we refer the matter to the Hearings Division for appointment of an Administrative Law Judge, who will convene a hearing in the place most convenient for the presentation of evidence concerning the distribution of gas-in-place in the "P" sands. Sun, the party challenging the accuracy of GS's 81.1/18.9 percent division, shall have the burden of showing by persuasive evidence that it is incorrect. Of course, Shell may appear and present whatever relevant evidence it wishes. The parties may avail themselves of the subpoena power given to Administrative Law Judges in 43 CFR 4.26 in order to secure appropriate testimony from officials of the Minerals Management Service 5/ concerning the basis for its division. The Administrative Law Judge will issue a decision which, in the absence of timely appeal to this Board, will be final for the Department. The effectiveness of GS's orders will remain stayed until the matter is finally resolved within the Department.

The allocation formula imposed by GS relies in large part on the 81.1/18.9 percent division and may therefore be altered. Further, we are

5/ See note 2, supra.

unable to determine the basis for the 36 percent "weighting factor" used by GS to recognize Sun's production in allocating production. The parties may also wish to present evidence concerning whether or not this factor is arbitrary.

We recognize that our holding will further delay final Departmental action in this matter, which has already consumed a great deal of time and resources. However, we discern from the pleadings of the parties that judicial review of final Departmental action is a virtual certainty in view of the large amount in controversy here. We feel that it will serve the ultimate resolution of this matter to allow Sun the opportunity to challenge the accuracy of the factual determination on which so much rests.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed in part and referred to the Hearings Division to convene a hearing in accordance with the instructions herein.

Douglas E. Henriques
Administrative Judge

I concur:

Anne Poindexter Lewis
Administrative Judge

ADMINISTRATIVE JUDGE BURSKI CONCURRING:

I agree with the majority decision both in its finding that the "P" sands reservoir is competitive and that unitization was properly ordered. I also agree that appellant should be afforded a fact-finding hearing on the question as to the proper allocation of production. My sole difference with the majority is that I do not believe unitization is properly authorized herein "in the interest of conservation," in the limited sense that this phrase is normally used. Rather, I think it clear that if unitization is to be authorized herein it must be based on the protection of correlative rights. However, since it is my view that compulsory unitization was authorized for the protection of correlative rights even prior to the 1978 amendments to the OCS Act, I am of the opinion that this aspect of the decision below can be sustained.

My difficulty in affirming the decision of the Director on a finding that unitization is justified under the traditional meaning of the phrase "in the interest of conservation" lies in the fact, as pointed out by appellant, that this term has generally related to conservation of the mineral being produced. Thus, in the vast majority of oil or gas fields maximum recovery is dependent upon systematic production in a manner designed to maintain the natural drive of the field and, after depletion, to repressurize by secondary recovery measures. It is, therefore, often necessary for individual lessees to either limit production, or, occasionally to forego it entirely to ensure that the maximum amount of hydrocarbons is recovered from the entire field. Unitization provides the legal mechanism whereby the individual lessees can accomplish these goals without ultimate detriment to their own financial interests. What is being "conserved" by this process is the ultimate recovery of the maximum amount of oil or gas. This is not, however, the reason for ordering unitization in the instant case.

As appellant has indicated, the maximum efficient rate (MER) at which the gas from the "P" sands can be produced without loss of reservoir energy appears unlimited. Thus, while protection of its correlative rights would have required Shell to drill additional offset wells into the "P" sands, this action would not have had a detrimental effect on total ultimate recovery. Clearly, such a course of action would have proved costly to Shell, but no interest of "conservation," as it is traditionally understood, would have been sacrificed had Shell drilled those wells. ^{1/} If the traditional meaning of "conservation" were applicable to this appeal I would agree with Sun that unitization had been improperly ordered. I do not believe, however, for reasons which I shall set forth, infra, that the term "in the interest of conservation" as used in the OCS Act was used in the traditional limited sense. Rather, it is my view that it embraced all the normal justifications for imposing unitization, including the protection of correlative rights.

^{1/} In this regard, while I agree that conservation of natural resources other than oil or gas might fit under the rubric of "conservation," there was virtually no showing made, whatsoever, that unitization was necessary under "the interests of conservation" regardless of how expansive the term "natural resources" is determined to be.

The legislative history surrounding the adoption of section 5 of the OCS Act, 43 U.S.C. § 1334 (1976), was extensively set out in the 1980 Solicitor's Opinion entitled New OCS Unitization Rules--Authority of the Secretary to Segregate Partially Unitized Offshore Leases, 87 I.D. 616 (1980). Solicitor Martz noted that, as originally proposed in H.R. 5134, the 1953 Act would have made the unitization provision of the Mineral Leasing Act of 1920, as amended, 30 U.S.C. § 226(j) (1976), applicable to OCS leases. The bill introduced in the Senate, S. 1901, merely provided that "The Secretary may prescribe such rules and regulations as he determines to be necessary and proper in order to provide for the conservation of the natural resources of the Outer Continental Shelf."

On June 8, 1953, Secretary McKay wrote Senator Cordon, sponsor of S. 1901, in reference to the Senate bill. He suggested that section 5 be amended to expressly authorize the Secretary to deal with matters, such as unitization, by regulation. He noted that:

If the authority to promulgate regulations on these subjects is cast in general terms, the Department would be free to incorporate the provisions of the Mineral Leasing Act on the same subjects, but would also be free to modify them as circumstances peculiar to operations and actual experience in administering a leasing program in the submerged lands made appropriate.

S. Rep. No. 411, 83d Cong., 1st Sess. 28 (1953). With this letter, Secretary McKay also submitted proposed language. With only two amendments, not relevant here, that language was eventually adopted as section 5 of the OCS Act.

It seems reasonably clear that the phrase "in the interest of conservation" was not meant as words of limitation circumscribing the authority of the Department to require unitization, but were rather designed as a shorthand expression of the general authority of the Department as it then existed. Section 17(j) of the Mineral Leasing Act, 30 U.S.C. § 226(j) (1976), granted the Secretary extremely broad authority to mandate unitization, authorizing him to approve such unit plans "as he may deem necessary or proper to secure the proper protection of the public interest," and to prescribe plans "which shall adequately protect the rights of all parties in interest, including the United States." I think this was the scope of the Secretary's authority under section 5 of the OCS Act even prior to the 1978 amendments. Such authority clearly embraced the prescribing of unit plans to protect correlative rights and on this basis I think GS's decision herein is sustainable. Accordingly, I concur in the affirmation of the Director's decision ordering unitization of the two subject leases.

James L. Burski
Administrative Judge

