

ALTA ENERGY CORP.

IBLA 86-280

Decided December 28, 1987

Appeal from a decision of the Utah State Office, Bureau of Land Management, denying a request for a lower royalty rate after reinstatement of oil and gas lease U-44429.

Set aside and remanded.

1. Federal Oil and Gas Royalty Management Act of 1982:
Royalties--Mineral Leasing Act: Royalties--Oil and Gas Leases:
Royalties

The Department is authorized to reduce the royalty rate on a lease reinstated pursuant to sec. 401 of the Federal Oil and Gas Royalty Management Act at a higher royalty rate where "there are uneconomic or other circumstances which could cause undue hardship." 30 U.S.C. § 188(i)(2) (1982). Where the lessee has offered evidence that a reinstated competitive lease was extended by drilling over the lease expiration date, that a producing well was subsequently completed, and that the well will never reach payout, a decision rejecting a petition without applying the statutory criteria will be set aside and remanded for further consideration.

APPEARANCES: William G. Stehlin, Esq., and John R. Kunz, Esq., Salt Lake City, Utah, for appellant.

OPINION BY ADMINISTRATIVE JUDGE GRANT

Alta Energy Corp. (Alta), appeals from a December 18, 1985, decision of the Utah State Office, Bureau of Land Management (BLM), rejecting Alta's petition for a royalty reduction on reinstated Federal oil and gas lease U-44429. Lease U-44429 embraces land situated at sec. 15, NW 1/4 NE 1/4, T. 9 S., R. 17 E., Salt Lake Meridian, Utah.

Effective March 1, 1980, pursuant to section 17 of the Mineral Leasing Act of 1920, as amended, 30 U.S.C. § 226(b) (1982), BLM issued the competitive oil and gas lease which is the subject of this appeal to a predecessor-in-interest of Alta, Jack Trigg. The lease was assigned twice, the second time to Alta, approved by BLM on May 1, 1984. The competitive lease was issued for a term of 5 years. See 30 U.S.C. § 226(e) (1982). In order to effect a 2-year extension of the lease, appellant began drilling operations prior to the expiration of the primary term, February 28, 1985. See 30 U.S.C.

§ 226(e) (1982); 43 CFR 3107.1. Alta spudded the Federal 15-1-B well on about February 4, 1985, set casing on about February 27, 1985, and began completion operations on about March 24, 1985, with first production resulting on about April 15, 1985. Although appellant submitted a sixth-year rental payment of \$80 on April 25, 1985, the payment was not timely paid by the lease anniversary date. Accordingly, the lease, which was subject to extension by reason of drilling over the lease expiration date, terminated for failure to pay the annual rental on or before the lease anniversary date. See 30 U.S.C. § 188(b) (1982); 43 CFR 3107.1 and 3108.2-1(a).

In a decision dated May 23, 1985, BLM informed Alta that the lease terminated and noted that the lease was subject to reinstatement pursuant to the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), § 401, 30 U.S.C. § 188(d) and (e) (1982). BLM informed Alta that the annual rental for this reinstated lease would be \$10 per acre or fraction thereof, and the royalty would be 4 percentage points over the competitive royalty schedule otherwise in force but not less than 16-2/3 percent. In a May 31, 1985, letter to BLM, Alta requested that BLM reinstate the lease.

Pursuant to Alta's reinstatement petition, in a September 11, 1985, decision, BLM reinstated the lease effective March 1, 1985, subject to the increased rental and royalty rates. BLM acknowledged the lease was subject to a 2-year drilling extension to and including February 28, 1987. In addition, BLM noted that the lease term was subject to further extension because of production from Federal well No. 15-1-B.

On November 22, 1985, Alta petitioned BLM for a royalty reduction on the lease, pursuant to section 401(i)(2) of FOGRMA, 30 U.S.C. § 188(i)(2) (1982), and 43 CFR 3108.2-3(f). In its petition, Alta asserted it expended \$30,200 to acquire the lease and \$526,683 to complete the producing well thereon. Petitioner claimed an independent consulting firm estimated the well "may have a nine-year expected life, which would give an approximate yield of \$1,000,000.00." Alta contended in the petition the well would never reach payout, i.e., never repay petitioner's investment in the well. Hence, Alta asserted the royalty increase will cause undue hardship. Petitioner further asserted that these same circumstances coupled with Alta's good faith effort to preserve and develop the lease established equitable grounds for royalty relief.

On December 18, 1985, BLM rejected Alta's petition for a reduction in the rental and royalty rate. In that decision BLM stated:

It is understood that 43 CFR 3108.2-3(f) authorizes reduction of royalty on a Class II reinstated lease if it is determined there are either economic or other circumstances which could cause undue economic hardship or premature termination of production; or because of any written action of the United States, its agents, or employees which preceded, and was a major consideration in, the lessee's expenditure of funds to develop lands covered by the lease after the rental had become due and had not been paid; or if the authorized officer determines it is [equitable] to do so for any other reason.

Having recognized the authority for reduction in the royalty rate in reinstated leases, BLM acknowledged the "subject of undue hardship is difficult to address." BLM noted in the decision that appellant had been producing the well for over 30 days when informed of the lease termination, but found that appellant was not forced to accept the increased royalty, being merely required to do so if it desired reinstatement. Without further elaboration, BLM concluded: "It has not been demonstrated conclusively that undue hardship has been caused by the reinstatement terms." Hence, BLM rejected Alta's petition for a reduction in the royalty.

On appeal, Alta contends that the authorized officer may reduce a royalty rate in the case of "undue economic hardship" or "if it is equitable to do so for any other reason." Alta submits that it is entitled to a royalty reduction under both tests and that the BLM decision denying its royalty reduction was arbitrary, capricious, and an abuse of discretion. Acknowledging the discretion vested in the Department by the statute and the regulation, appellant contends the exercise of that discretion must be based on a reasoned application of the statutory and regulatory criteria. Appellant reasserts that the increased royalty rate will cause an additional loss of \$40,000 on a well which will never reach payout, contending this constitutes "economic hardship."

Alta further contends BLM's findings that it "acted in good faith and attempted to do whatever necessary to preserve and protect the lease" and BLM's characterization of the situation as "unfortunate," establish that this is an appropriate case for equitable relief.

[1] Lease U-44429 was reinstated pursuant to section 401 of FOGRMA, P.L. 97-451, 96 Stat. 2447, 2462, which amended section 31 of the Mineral Leasing Act of 1920, 30 U.S.C. § 188 (1982).

Section 401(i)(2) of FOGRMA, as codified at 30 U.S.C. § 188(i)(2) (1982), provides that under certain circumstances the Secretary is authorized to reduce the royalty in reinstated leases:

In acting on a petition for reinstatement pursuant to subsection (d) of this section * * * the Secretary is authorized to reduce the royalty in that reinstated lease on the entire leasehold * * * if, in his judgment, there are uneconomic or other circumstances which could cause undue hardship or premature termination of production; * * * or if in the judgment of the Secretary it is equitable to do so for any reason.

30 U.S.C. § 188 (i)(2) (1982); see 43 CFR 3108.2-3(f).

We have previously held that under section 401 of FOGRMA the Secretary may reduce the royalty rate under certain limited circumstances. Gulf Oil Corp., 83 IBLA 289, 294 (1984). In Gulf Oil Corp., we stated: "[T]he resolution [of the House Committee on Interior and Insular Affairs], the legislative history, and the statutory provisions combine to indicate that the Congress invested the Secretary with discretionary authority to reduce the prescribed statutory royalty rate only in those extraordinary instances where that action is warranted by such circumstances as undue hardship or resource conservation." (Emphasis supplied.) Id.

In Gulf Oil Corp., *supra* at 292-293, the Board noted that the legislative history of P.L. 97-451 provides the Secretary with guidance in the exercise of his discretionary authority:

Section 401(i) provides the Secretary of the Interior with the discretionary authority to reduce the royalty rates on a reinstated lease, or an abandoned oil placer claim converted to a noncompetitive lease, if, in his opinion, such a reduction is justifiable due to hardship, premature termination of production, or uneconomic conditions surrounding a particular lease. This should not be construed as blanket authority for royalty reductions on all reinstated leases. While the Committee feels that the substantially increased royalty rates on reinstated leases are justified, it also recognizes that there may well be individual situations where a lesser royalty rate, even below the specified minimum, may be justified and necessary to keep a well on production. This is not considered by the Committee as any "windfall," and should not be used as such. It is a measure that is necessary to achieve conservation of a resource and maximum ultimate production from those leases and wells that would otherwise be shut down prematurely with a resulting loss of a badly needed resource. (Emphasis supplied.)

H.R. Rep. No. 859, 97th Cong. 2nd Sess. 41, reprinted in 1982 U.S. Code & Ad. News 4295. Against this background, the Board in Gulf Oil Corp., *supra*, affirmed a BLM decision declining to reduce the royalty of a noncompetitive, nonproducing oil and gas lease reinstated pursuant to section 401 of FOGRMA. Although the Gulf opinion contains no discussion of the nature of the evidence tendered by appellant in support of the reduction in royalty, the Board noted the lease was not producing and that "[a]ppellant failed to set forth any evidence of undue hardship which would justify reducing the royalty rate for equitable reasons." 83 IBLA at 291.

We find the case before us to be distinguishable from Gulf in certain respects. In particular, appellant spudded a well prior to the lease anniversary date and proceeded with drilling operations over the lease expiration date. This effort was found by BLM to be a diligent drilling effort justifying a 2-year extension of the lease term pursuant to statute and regulation. 30 U.S.C. § 226(e) (1982); 43 CFR 3107.1. Subsequently, after termination of the lease for failure to pay the rental by the anniversary date, a producing well was brought in and the lease is now apparently in a producing/royalty status. In addition, appellant has set forth the specific expenses entailed in development of the lease and argued forcefully, on the basis of a consultant's report, that the well will never reach payout even with the lower, former royalty rate. On the other hand, although appellant has asserted it will suffer a greater loss on the investment if the petition for royalty reduction is not granted, there is no indication the well would be prematurely abandoned.

We do not read our opinion in Gulf or the legislative history so narrowly as to limit royalty reduction relief to those situations where the economic hardship is so severe the well would be abandoned (and resources not recovered) but for royalty reduction relief. ^{1/} On the other hand, it is clear from the terms of the statute that Congress did not intend to guarantee profitability or insure against loss by lessees. ^{2/} Our difficulty with the decision under appeal stems from the conclusory holding that "[i]t has not been demonstrated conclusively that undue hardship has been caused by the reinstatement terms." Although this Board will not substitute its judgment for that of the delegated decisionmaker in decisions such as this, appellant has essentially alleged a failure to apply the statutory and regulatory standard. See Marathon Oil Co., 90 IBLA 236, 244-45, 93 I.D. 6, 11 (1986). Apart from the conclusion quoted above and BLM's acknowledgment in the decision that "[t]he subject of undue hardship is difficult to address," we find no analysis of the grounds stated in appellant's petition for reduction or of the statutory criteria except for the absence of any misrepresentation by BLM in the matter. It appears that more information may be required from appellant (e.g., a copy of the consultant's report complete with the data on which it is based) in order to allow BLM to properly adjudicate appellant's petition. Notwithstanding this fact, we believe appellant is entitled to an adjudication of the petition on the basis of the statutory and regulatory standard.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is set aside and the case is remanded for further consideration.

C. Randall Grant, Jr.
Administrative Judge

We concur:

Gail M. Frazier John H. Kelly
Administrative Judge Administrative Judge

^{1/} There is preexisting statutory authority for reduction of the royalty obligation on mineral leasing act minerals including oil and gas "in the interest of conservation of natural resources * * * whenever in [the Secretary of the Interior's] judgment it is necessary to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein." 30 U.S.C. § 209 (1982); see also Mountain States Resource Corp., 92 IBLA 184, 93 I.D. 239 (1986) (No showing by lessee of how royalty reduction would encourage recovery).

^{2/} The statutory standard of "uneconomic or other circumstances which could cause undue hardship" clearly implies that some hardship is to be expected. 30 U.S.C. § 188(i)(2) (1982) (Emphasis added).

