**<u>Editor's note</u>: Reconsideration denied by Order dated April 6, 1990**

CHEVRON U.S.A. INC. <u>ET</u> <u>AL.</u>

IBLA 87-721 Decided August 23, 1989

Appeal from a decision of the Director, Minerals Management Service, denying an appeal from a determination of the Regional Director, Gulf of Mexico, that royalty is due on gas avoidably lost from OCS-G 5062, Mobile Block 861.

Affirmed in part; set aside in part; request for hearing granted; case referred to Hearings Division.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Generally--Outer Continental Shelf Lands Act: Oil and Gas Leases

   Sec. 308 of FOGRMA, 30 U.S.C. § 1756 (1982), requiring payment of royalties on oil or gas lost or wasted from a lease site, is applicable to gas vented and flared as a result of a 1985 well blowout on a lease issued prior to enactment of FOGRMA on the Outer Continental Shelf.

2. Administrative Procedure: Hearings--Hearings--Oil and Gas: Generally--Rules of Practice: Appeals: Hearings

   The Director, MMS, held that the lessee violated 30 CFR 250.41(a)(2) because it knew or should have known that its actions could result in a blowout leading to the loss of gas. The lessee has responded claiming that, based upon information available to it during drilling, its actions were reasonable and prudent, and that the sole cause of the well loss was unforeseeable. The record presents unresolved factual issues, and a hear-ing before an Administrative Law Judge is ordered.

APPEARANCES: M. Hampton Carver, Esq., M. Taylor Darden, Esq., J. Clifford Rogillio, Esq., Arthur P. Mitchell, Esq., New Orleans, Louisiana, for appellants; Lawrence R. Hoese, Esq., Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE MULLEN

Chevron U.S.A. Inc., Pennzoil Producing Company, and Union Exploration Partners (collectively Chevron) have appealed from a decision of the Director, Minerals Management Service (MMS), dated May 22, 1987, denying Chevron's appeal from a determination of the Regional Director, Gulf of Mexico, MMS, finding that gas was avoidably lost from Well No. 1, OCS-G 5062, Mobile Block 861, and that royalty is due on the lost gas. Lease OCS-G 5062 was issued effective April 1, 1982, pursuant to the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1331 (1982).

There is no dispute that Well No. 1 suffered a downhole blowout on or about March 23, 1985. A quantity of gas estimated at 3,811 million cubic feet was vented and flared as a result of this blowout. 1/ The dispute focuses on whether Chevron must pay royalty on this lost gas. Two facets of the dispute are present - the first is legal and the second is essentially factual.

The legal question posed by Chevron is whether, at the time Chevron executed OCS-G 5062, royalty accrued on gas which was lost prior to suc-cessful completion of a well if the loss was due to the operator's failure to comply with a rule or regulation. Chevron's position that gas lost prior to well completion is not subject to a royalty stems from section 6 of its lease. This section provides in part: "Royalty on Production. (a) The Lessee shall pay a fixed royalty of 16-2/3 percent in amount or value of production saved, removed, or sold from the leased area" (emphasis added). Similar language appears at 43 U.S.C. § 1337(a)(1) (1982). 2/

Chevron contends that royalty is only due on production "saved, removed, or sold" from the lease, and lost gas is not saved, removed, or sold within the meaning of either OCSLA or the lease. In support of its position, appellant cites Amoco Production Co. v. Andrus, 527 F. Supp. 790 (E.D. La. 1981), which held certain 1974 Geological Survey notices invalid. 3/ These notices required "federal oil and gas lessees to pay a royalty on oil and gas which are vented or flared, used in leasehold operations, or unavoidably lost." Id. at 791. Appellant states that prior to Survey's 1974 notices, the Department had long interpreted the phrase "removed or sold" to exclude such oil and gas from royalty obligations, and that in 1953, when it enacted OCSLA, Congress was aware of this inter-pretation and is presumed to have intended that the phrase "saved, removed, or sold" be consistently defined (Statement of Reasons, Aug. 31, 1987, at 8).

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1/ Chevron has never disputed this estimate and we accept it as accurate.

2/ Appellant also points to 30 CFR 250.66 (1982), later designated as 30 CFR 206.151, which states, "Royalty is due on all gas which is * * * produced from a reservoir but lost (vented or flared) * * *." (Emphasis added.)

3/ See Notices to Lessees (NTL) 74-14, June 28, 1974, and 74-20, Nov. 1, 1974, attached as Exhibits D and E to Chevron's Statement of Reasons to the Director, MMS, July 10, 1986; NTL 74-20 is also found at 30 FR 38684 (Nov. 1, 1974).

Chevron points out that "production" is defined at 43 U.S.C. § 1331(m) (1982) as "those activities which take place after the successful comple-tion of any means for the removal of minerals, including such removal, field operations, transfer of minerals to shore, operation monitoring, maintenance, and work-over drilling" (emphasis added). 4/ It argues that Congress intended that royalty would accrue 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 or development, regardless of the reason for its loss. The fact that Well No. 1 had not been successfully completed at the time of the blowout is not in dispute.

Chevron also argues that the Director's decision ignores a Notice to Lessees and Operators (NTL) on the Outer Continental Shelf (OCS) issued by the Department in 1982 to reflect the Amoco decision. 47 FR 20672 (May 13, 1982). This NTL acknowledges that Amoco invalidated MMS' author-ity to collect royalty payments on avoidably lost gas, i.e., gas that is leaked, spilled, vented, flared, or otherwise lost, inter alia. Chevron contends that the 1982 NTL is the latest authoritative expression of a lessee's royalty obligation, and that the Department is bound by it. 5/

The Director's May 22, 1987, decision briefly addressed the Amoco decision, noted that it involved unavoidably lost gas, and concluded that its applicability was questionable. Even if Chevron's analysis were right, the Director stated, "it is clear that Congress reimposed a requirement that royalties be paid on lost or wasted gas with the enactment of [the Federal Oil and Gas Royalty Management Act (FOGRMA), 30 U.S.C. § 1701 (1982)]" (Decision at 4; emphasis supplied). In support of this position, the Director cited section 308 of FOGRMA, which states:

> Any 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 (1982).

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4/ Regulation 30 CFR 250.2 (1982) repeats this definition and adds that the precise meaning of this term depends upon the context in which it is used. This additional language was deleted in 1988 at 53 FR 10690 (Apr. 1, 1988).

5/ This NTL superseded an unnumbered NTL dated Nov. 19, 1980, 45 FR 81669, (Dec. 11, 1980). The 1980 NTL called for payment of royalties on avoidably lost gas production. "Avoidably lost" production was therein defined to mean, inter alia, the venting or flaring of produced gas without the autho-rization, approval, ratification or acceptance of Geological Survey and the loss of produced oil or gas as a result of lessee negligence, failure to take all reasonable measures to prevent and/or control the loss, or failure to comply fully with applicable lease terms, regulations and orders."

The Director made no determination that the blowout suffered at Well No. 1 was the result of negligence on the part of the operator. He did find, however, that Chevron had violated 30 CFR 250.41 (1985) 6/ and that the loss of gas was avoidable. Regulation 30 CFR 250.41(a)(2) (1985) states:

> (2) The lessee shall case and cement all wells with a sufficient number of strings of casing in a manner necessary to: prevent release of fluids from any stratum through the well bore (directly or indirectly) into the sea; prevent communication between separate hydrocarbon-bearing strata (except strata approved for commingling) and between hydrocarbon- and water-bearing strata; protect freshwater strata from contamination; support unconsolidated sediments; and otherwise provide a means of control of the formation pressures and fluids. The lessee shall install casing strong enough to withstand collapse, burst-ing, tensile and other stresses. The casing shall be cemented in a manner which will anchor and support the casing. Safety factors in the casing program design shall be of sufficient mag-nitude to provide optimum well control during drilling and to assure safe operations for the life of the well. The lessee shall install structural or drive casing to provide hole stability for the initial drilling operation. A conductor string of casing (the first string run other than any structural or drive casing) must be cemented with a volume of cement sufficient to circulate back to the seafloor; however, if authorized by the Director, cement may be washed out or displaced to a specified depth below the seafloor to facilitate casing removal upon well abandonment. All subsequent strings must be securely cemented.

The Director found a violation of 30 CFR 250.41(a)(2) had occurred because Chevron knew, or should have known, 30 days prior to blowout that: (1) drilling was progressing into formations with pressures in excess of that which Chevron's 9-5/8-inch casing was designed to contain if the mud column was entirely replaced with gas; (2) gas had been encountered in these formations; and (3) open-hole conditions below the 9-5/8-inch casing were such that a small pressure increase could cause loss of the mud column (Decision at 7).

The Director further found FOGRMA applicable to lease OCS-G 5062, even though it had been enacted several months after lease issuance. In support of this finding, the Director quoted section 305 of FOGRMA, which provides:

> The provisions of this Act shall apply to oil and gas leases issued before, on, or after the date of the enactment of this Act [January 12, 1983], except that in the case of a lease issued

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6/ This regulation was in effect until 1988. See 30 CFR 250.50 (1988).

> before such date, no provision of this Act or any rule or regula-tion prescribed under this Act shall alter the express and spe-cific provisions of such a lease.

30 U.S.C. § 1701 note (1982).

[1] We begin our analysis with section 305, because the applica-bility of FOGRMA to lease OCS-G 5062 appears to be key to the Director's decision. In determining whether FOGRMA alters the express and specific royalty provisions of this lease, it is important to identify the applica-ble lease provisions.

As noted above, section 6 of lease OCS-G 5062 specifies that the lessee shall pay a royalty equal to 16-2/3 percent of the amount or value of pro-duction saved, removed, or sold from the leased area. Section 5 of the lease provides for a minimum royalty of $3 per acre following discovery of oil or gas in paying quantities. Section 1 of the lease clearly provides that the lessee is bound by all statutes and regulations in effect at the time of lease issuance:

> This lease is issued pursuant to the Outer Continental Shelf Lands Act of August 7, 1953 * * * (hereinafter called the "Act"). The lease is issued subject to the Act; Sections 302 and 303 of the Department of Energy Organization Act * * *; <u>all regulations issued pursuant to such statutes and in existence upon the effec-tive date of this lease</u> [April 1, 1982]; all regulations issued pursuant to such statutes in the future which provide for the pre-vention of waste and the conservation of the natural resources of the Outer Continental Shelf, and the protection of correla-tive rights therein; [7/] and all other applicable statutes and regulations. [Emphasis added.]

The Director's decision notes that, when the lease was issued in April 1982, there was a regulatory requirement to pay royalties on avoid-ably lost gas. 30 CFR 250.66 (1982). 8/ At the time of lease issuance, this regulation read in part: "Royalty is due on all gas which is * * * produced from a reservoir but lost (vented or flared), when such loss either was not specifically authorized or was <u>avoidable</u>" (emphasis added).

The Secretary's authority to issue 30 CFR 250.66 (1982) is set forth at 43 U.S.C. § 1334(a) (1982), providing: "The Secretary may at any time prescribe and amend such rules and regulations as he determines to be necessary and proper <u>in order to provide for the prevention of waste and conservation of the natural resources of the outer Continental Shelf</u> * * *"

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7/ The Secretary's authority to apply new regulations of this character to a previously issued lease is expressly granted at 43 U.S.C. § 1334(a) (1982).

8/ This requirement is currently set out at 30 CFR 202.150(c).

(emphasis added). 9/ It is thus plain that, when lease OCS-G 5062 was issued, Chevron could expect that royalties would accrue on production saved, removed, or sold and on gas produced from a reservoir but avoid-
ably lost. Equally evident is the fact that 43 U.S.C. § 1334(a) (1982) did not limit the Secretary's authority to issue 30 CFR 250.66 to events occurring after well completion. To interpret 30 CFR 250.66 (1982) so narrowly as to exclude gas avoidably lost prior to formally achieving production status would frustrate the stated Congressional policy, set forth at 43 U.S.C. § 1332(6) (1982), that operations on the OCS were to be conducted in a manner "to prevent or minimize the likelihood of blow-outs, loss of well control, fires, spillages" etc. (Emphasis added.) Accordingly, we decline to do so.

Assuming, for the moment, that the phrase "gas produced from a reservoir" in 30 CFR 250.66 can be construed to limit the collection of royalties to avoidably lost "production," as that term is defined in the regulation (i.e., to gas avoidably lost after well completion), we will address the question of whether section 308 of FOGRMA altered Chevron's lease obligations. As noted above, section 305 of FOGRMA provided that the Act would apply to leases issued before, on, or after the date of its enactment, but no provision of the Act would alter the express and specific provisions of a previously issued lease.

Section 308 of FOGRMA is captioned "Expanded Royalty Obligations." If 30 CFR 250.66 cannot be interpreted to include avoidable losses occurring prior to well completion, section 308 of FOGRMA fills this gap, i.e., it complements, without changing, Chevron's existing duty to pay royalty on avoidably lost gas. Our view of section 308 as complementing, rather than altering, Chevron's existing duties is consistent with section 304(a) of FOGRMA, which provides, "The penalties and authorities provided in this Act are supplemental to, and not in derogation of, any penalties or author-ities contained in any other provision of law" (emphasis added). 30 U.S.C. § 1753(a) (1982).

"Complementary" and "supplemental" both mean serving to fill out, to complete, mutually satisfying each other's lack, to fill deficiencies. Herman M. Brown Co. v. Johnson, 248 Iowa 1143, 82 N.W.2d 134 (1957). A

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9/ Despite considerable litigation concerning the Department's authority to issue various Notices to Lessees, see Amoco Production Co. v. Andrus, supra, the Secretary's authority to issue 30 CFR 250.66 remains unchal-lenged. Our review of Amoco, supra; Placid Oil Co. v. U.S. Department of the Interior, 491 F. Supp. 895 (N.D. Tex. 1980); Marathon Oil Co. v. Andrus, (D. Wyo. 1978); and Gulf Oil Corp. v. Andrus, 460 F. Supp. 15 (C.D. Cal. 1978), reveals no basis for MMS' conclusion that Amoco has the effect of invalidating MMS' authority to collect royalty on avoidably lost gas. Unnumbered NTL, 47 FR 20672 (May 13, 1982). A more accurate character-ization of Amoco is set forth by the Acting Assistant Secretary, Land and Minerals Management, at 52 FR 3797 (Feb. 6, 1987).

"supplemental act" is that which supplies a deficiency, adds to, completes, or extends that which is already in existence, without changing or modifying the original. State v. Healy, 95 N.E.2d (Ohio App. 1950). To "alter," on the contrary, means to make a change in, to modify, or to vary in some degree. Davis & Rankin v. Campbell, 93 Iowa 524, 61 N.W. 1053 (1895).

Having concluded that section 308 is applicable to pre-completion losses on OCS-G 5062, we turn now to the second facet of this case -- whether the loss of gas was "avoidable." MMS bases its conclusion that the loss was avoidable on its finding that Chevron had violated 30 CFR 250.41.

As noted above, the Director held that Chevron violated 30 CFR 250.41(a)(2) because Chevron knew or should have known 30 days prior to blowout that: (1) drilling was progressing into formations with pressures in excess of that which Chevron's 9-5/8-inch casing was designed to contain if the mud column was entirely replaced with gas; (2) gas had been encountered in these formations; and (3) open-hole conditions below the 9-5/8-inch casing were such that a small pressure increase could cause loss of the mud column.

Chevron disagrees with the Director's view and contends that, based upon information available to it during drilling, its actions were reason-able and prudent. Chevron's consultant, Harvey J. Fitzpatrick, states that the sole cause of the well loss was the unforeseeable failure of a drill-pipe elevator and not a lack of pressure capability of the 9-5/8-inch protective casing. As Chevron drilled below the 9-5/8-inch casing set at 19,007 feet, saltwater influxes containing relatively low units of gas were present (Statement of Reasons, Aug. 31, 1987, at Exh. D).

Having reached a depth of 21,300 feet, Chevron states, it reasonably believed that it could not have set a string of 7-inch casing above its Norphlet Sand objective and still reach that objective at 23,000 feet. Had it set such a string of pipe below the 9-5/8-inch casing and above the Norphlet Sand, its ability to continue efficient holemaking would have been severely constrained or eliminated by the reduced casing size (Statement of Reasons at 12).

In a memorandum of March 4, 1987, the Regional Director, Gulf of Mexico OCS Region, noted that Chevron had submitted data with its application for permit to drill showing two other wells were being drilled in the Norphlet formation through 7-inch casing and a third well had been completed using 5-1/2-inch production casing. The Regional Director found that, although setting a smaller diameter casing would have resulted in increased well completion cost, it would have controlled the continuing lost circulation and high pressures and reduced the risk of a downhole blowout. However, in an earlier memorandum by the Regional Director, dated September 30, 1986, he states that, had Chevron chosen to set 7-inch casing at 21,426 feet, any chance it had to make a permanent completion in the Norphlet objective or even test the well would have been eliminated.

[2] We are left with the factual issue of whether a violation of 30 CFR 250.41 has occurred. After examining the record now before us, we are unable to reach the conclusion that this issue of fact has been adequately resolved below. Factual disputes such as those discussed above suggest the need for findings by a trier of fact. The Director's finding that Chevron's actions resulted in a violation of 30 CFR 250.41 is there-fore set aside, and Chevron's request for a hearing before an Administrative Law Judge is granted. The burden of persuasion shall rest with MMS. The parties are directed to adduce evidence focusing on the cause(s) of the blowout, and in particular on the role played by elevator failure, kick, casing, mud, and the blowout preventer. The parties are particularly encouraged to have their expert witnesses carefully define the concepts and terms used when describing the events leading to the blowout, and submit illustrative evidence in order that the Administrative Law Judge, and, if necessary, this Board may gain a full understanding of the facts. The decision of the Administrative Law Judge shall be final in the absence of a further appeal to this Board.

Therefore, 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 is affirmed in part, set aside in part, and referred to the Hearings Division for action consistent herewith.

R. W. Mullen
Administrative Judge

I concur:

David L. Hughes
Administrative Judge