MAXUS EXPLORATION CO.

IBLA 91-49 Decided February 10, 1993

Appeal from a decision of the Wyoming State Office, Bureau of Land Management, approving decisions issued by the Buffalo and Platte River Area Managers assessing compensation for avoidably lost gas from oil and gas leases WYW58926, WYW66397, WYW43056, WYW220504, and WYW58545.

Reversed in part, affirmed in part, and remanded.

1. Oil and Gas Leases: Generally--Oil and Gas Leases: Royalties: Generally

Proof that a Federal lease was being drained by a private lease and that complications during completion of a well on the lease required more than 30 days in order to complete initial testing justified allowance of flaring of gas from an oil well even though prior application to flare had not been sought.

2. Oil and Gas Leases: Generally--Oil and Gas Leases: Royalties: Generally

There was insufficient evidence to establish that a Federal lease was being drained by a well on a private lease where no evidence was submitted to show that the Federal well experienced any decline in reservoir pressure when tested.

3. Administrative Authority: Generally--Oil and Gas Leases: Generally--Oil and Gas Leases: Royalties: Generally

The burden to establish that there are engineering, geologic, or economic reasons to justify venting or flaring gas from an oil well rests with the lessee who appeals a decision that there has been avoidable waste as a result of such venting or flaring. Where no proof is offered by the lessee to support allega-tions that there was a danger of drainage, relief cannot be afforded. Arguments that assessment for avoidably lost gas were barred by laches or limitations of action cannot be considered favorably where the lessee was timely notified of an audit that indicated avoidable loss was occurring, even though subsequent review of the matter was protracted.

4. Administrative Authority: Generally--Oil and Gas Leases: Generally--Oil and Gas Leases: Royalties: Generally--Regulations: Force and Effect As Law

Proper application of Instruction Memorandum 87-652 required that BLM evaluate whether, if an application to flare gas had been made for oil wells produced by the lessee prior to flaring, the application would have been entitled to approval on the merits.

5. Oil and Gas Leases: Generally--Oil and Gas Leases: Royalties: Payments

Current law requires that compensation for avoidably lost gas is to be limited to payment of royalty value.

APPEARANCES: Michael J. Wozniak, Esq., Denver, Colorado, for appellant; Lyle K. Rising, Esq., Office of the Regional Solicitor, Department of the Interior, Denver, Colorado, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Maxus Exploration Company, successor to Diamond Shamrock Exploration Company (Maxus), has appealed from a September 10, 1990, decision by the Wyoming State Office, Bureau of Land Management (BLM), that affirmed decisions issued on June 12, 1990, by the Buffalo Resource Area and on June 26, 1990, by the Platte River Resource Area. Both resource area decisions assessed compensation at full value for avoidably lost gas vented from oil wells located on Federal leases.

This appeal is the culmination of a review that began in October 1983, when Minerals Management Service (MMS) initiated an audit of Federal and Indian royalty payments made by Maxus. The audit disclosed that Maxus had flared or vented natural gas from 15 Federal leases in 3 states without prior permission from an authorized officer of the United States. After making a preliminary finding that this gas had been wasted, MMS notified Maxus on November 5, 1984, of the tentative conclusions of the audit, and invited comment. Thereafter, on February 20, 1985, Maxus was billed for the gas determined by MMS to have been wasted, and an appeal was taken from that determination on March 25, 1985. On October 16, 1987, the Director, MMS, remanded the Maxus appeal for recalculation of assessments pursuant to BLM Instruction Memorandum (IM) 87-652, Policy for Avoidably Lost Gas (Aug. 17, 1987). The Director outlined development of the administrative review process to that point:

> Section 16 of the Mineral Lands Leasing Act, 30 U.S.C. 225 (1982), requires a lessee to prevent the waste of oil and gas.

Since 1931 the Oil and Gas Operating Regulations have authorized the assessment of the full value of gas that is wasted. The Oil and Gas Operating Regulations were administered by the U.S. Geological Survey (USGS) until January 19, 1982, when these

> responsibilities were transferred to the newly created MMS. On December 3, 1982, all onshore mineral functions on non-Indian lands, other than royalty and other mineral revenue management, were transferred to the Bureau of Land Management (BLM).

(Director's Decision dated Oct. 16, 1987, at 2).

After describing the development of legislative and regulatory provisions governing payment for avoidably lost gas ending with enactment of the Federal Oil and Gas Royalty Management Act of 1982 and promulgation of IM 87-652 on August 17, 1987, the Director concluded that BLM should

> determine pursuant to IM 87-652 whether [Maxus] is obliged to pay the full value of the gas flared, whether the assessment should be limited to a royalty on that value, or whether no assessment is payable. Part of that analysis is a determination as to whether or not it was economically feasible to capture the flared gas.

Id. at 3.

Subsequent decisions following remand by the Director have reduced the number of leases under review to five leases in Wyoming containing six Federal oil wells from which gas was vented or flared without prior authorization. Three leases located within the Buffalo Resource Area, WYW58926, WYW66397, and WYW43056, contain, respectively, the Marietta Federal No. 22-19, the Allspaugh Federal No. 14-11, and the Kelly Federal No. 32-14 oil wells. Within the Platte River Resource Area, Federal leases WYW58545 and WYW220504 contain the Connor Federal Nos. 21-30 and 41-31 and the Flat Top Federal No. 32-10. Maxus has argued that there should be no assessment made on account of the gas flared from any of these wells and that the decision by the Wyoming State Office affirming the two Area Managers should be reversed because it was necessary to vent gas from all six wells in order to prevent drainage of the Federal leases by other producers. Maxus also argues that regulations governing venting and flaring are in conflict, that laches and a statute limiting court actions by the United States bars the assessments made by BLM, that BLM has failed to correctly apply IM 87-652 and Notice to Lessees (NTL-4A), 44 FR 76600 (Dec. 27, 1979), in the decision under review, and that, should any assessment for avoidably lost gas be made, that no more than royalty value should be assessed.

Citing Ladd Petroleum Corp., 107 IBLA 8 (1989), for the proposition that analysis of the question whether an assessment for avoidably lost gas must follow guidance provided by IM 87-652, the decision under review first considers the three wells located in the Buffalo area, beginning with the Marietta Federal No. 22-19 located on Federal Lease WYW58926, [that] was completed (Dakota Formation) in August 1983 and by September 1983 was producing

> 1467 BO/day and 2933MCF/day. Gas sales commenced in October 1983. Maxus demonstrated that by the time the 22-19 well was completed, the reservoir pressure in the 22-19 well was down 432 psi from the initial reservoir pressure in the [draining] well. Based upon the significant production volumes from [the draining well] and the subsequent decline in reservoir pressure, Maxus made the decision to produce the 22-19 well for a short period of time (August and September 1983) in order to avoid drainage and protect correlative rights. The Area Manager assessed Maxus full value compensation for 92,300 MCF avoidably lost gas.

(Decision at 1-2). After discussion and analysis of an engineering report submitted by Maxus to support the contention that it was necessary to vent gas before a pipeline was available to capture gas produced with the oil from the well because encroachment by the nearby well was draining the Federal lease, the decision concluded that:

> [W]e concur with Maxus that drainage was occurring. Maxus had an economic decision to make and they chose to produce the oil and vent the gas. We have determined that approximately 33,900 BO and 66,800 MCF would have been permanently lost to the nonFederal well had Maxus shut their well in for two months. Assuming $35.00 BO and $3.00 MCF (average prices actually received by Maxus), the gross value of such loss is $1,390,000.00. The gross value of the vented gas determined to be avoidably lost is $276,900.00. Maxus can argue that they made the right decision. We are forced to decide which of our regulations holds more weight: 43 CFR 3100.2-1 (Compensation for Drainage), 43 CFR 3162.1(a) (Drilling and Producing Obligations), 3160.0-5(k) (Maximum Ultimate Economic Recovery), 3162.7-1(d) (Disposition of Production). On one hand, it is difficult to argue that Maxus
> did not attempt to maximize ultimate economic recovery from leased lands in a manner that a prudent operator could be expected to make given existing reservoir knowledge. On the other hand, <u>in the strictest sense</u>, the gas that was vented, was an economic waste, and an avoidable loss has occurred. We conclude that the Government correctly received royalty payments from the produced oil and that we are also entitled to compensation for the gas. Therefore, we affirm the Area Manager's decision to assess full value compensation for 92,300 MCF avoidably lost gas. [Emphasis supplied.]

(Decision at 2).

The phrase emphasized above, "in the strictest sense," is explained by reference to <u>Ladd Petroleum Corp.</u>, <u>supra</u> at 7, where the observation was made that BLM had relaxed an "absolute requirement for <u>prior</u> approval of flaring under NTL-4A" (emphasis in original) when IM 87-652 was issued, allowing lessees to justify flaring after the fact if it could be shown that it was uneconomic to capture gas at the end of the initial test period allowed by NTL-4A. In this case, since the Marietta well was completed in August 1983, the 30-day test period allowed by the notice expired in September 1983. (NTL-4A Section III.C. grants blanket permission for venting to take place for 30 days or until 50,000 cubic feet (mcf) of gas has been released.) Connection to a gas pipeline was obtained in October 1983. The question presented to BLM concerning this well was, therefore, whether Maxus correctly determined that it was uneconomic to shut in the well until the gas pipeline was ready to accept production from the well, because drainage of oil would otherwise take place from the nearby State lease at a rate approximately equivalent to 15 percent of the oil on the Federal lease.

While the Area Managers refused to consider this argument, the Acting Deputy State Director, who issued the September 10, 1990, decision, professed to do so. Nonetheless, he found there was a conflict between the drainage regulations and the oil and gas operating regulations which could only be resolved by ignoring the economic calculations and making an assessment for any gas vented over the general authorization granted by NTL-4A without prior authorization. How the perceived conflict between regulations operates is not, however, explained by him, nor is it self-evident. The drainage regulation requires a Federal lessee to "drill and produce all wells necessary to protect the leased lands from drainage" or else "pay compensatory royalty." 43 CFR 3100.2-2. The operating regulations require a lessee to comply with "the lease terms, Onshore Oil and Gas Orders, NTL's" and other orders and to operate so as to obtain "maximum ultimate economic recovery of oil and gas with minimum waste." 43 CFR 3162.1(a). The cited regulation governing disposition of production, 43 CFR 3162.7-1(d), requires the operator to "conduct operations in such a manner as to prevent avoidable loss of oil and gas." There is no actual conflict between these regulations, and the decision speaks of none, merely concluding that, "in the strictest sense" there was waste.

There was at one time, however, a conflict in the regulations govern-ing the administration of operations generating avoidably lost gas. As explained in the Supplementary Information published with rulemaking when 30 CFR 206.100 (1987) was promulgated, regulations published by BLM in 1984 were inconsistent with MMS rules on the subject, BLM requiring payment of royalty value for avoidably lost gas, while MMS required full value compensation. 52 FR 3796, 3797 (Feb. 6, 1987). The rulemaking adopted the approach taken by BLM, explaining that:

> The amended rule provides that the lessee is obligated to prevent the waste of Federal and Indian onshore oil or gas production in accordance with BLM regulations. The determination of what constitutes waste is the responsibility of BLM, under its operational regulations. * * * This final rule clarifies all existing production value directives regarding wasted or avoidably lost onshore oil or gas production contained in various Secretarial, MMS, and U.S. Geological Survey Conservation Division (Now BLM, Onshore Operations Division) directives, regulations, and NTL's (Notice to Lessees) issued prior to and after the effective date of this rulemaking. * * * BLM, not MMS, is

the agency within the Department of the Interior to which the Secretary has delegated the authority to establish substantive regulations governing lease operations and remedies for failure by lessees to comply with its regulations.

Id. It is, therefore, to those BLM regulations we must look to determine whether BLM properly evaluated the data submitted by Maxus to show that it was not economic to capture gas from the Marietta well in 1983. The pertinent BLM regulation provides in relevant part that:

> A [sic] operator shall be liable for royalty payments on * * * gas lost or wasted * * * when such loss or waste is due to negligence on the part of the operator of such lease, or due to the failure of the operator to comply with any regulation, order, or citation issued pursuant to this part.

43 CFR 3162.7(d).

As Maxus points out in a statement of reasons (SOR) filed in support of appeal, there is no suggestion by BLM that there has been negligent conduct that would support the assessment made in this case (SOR at 15). The decision by BLM that there was avoidable loss of gas rests, therefore, entirely on the second clause of the quoted regulation, which makes the provisions of NTL-4A applicable to the facts of this case. The decision under review acknowledges that Ladd Petroleum Corp. found that IM 87-652 required BLM to relax the requirement of NTL-4A that economic factors can only be considered where there has been a prior application to vent or flare gas. Nevertheless, it did not do so, but applied instead the rule that there must be a prior application to vent gas "in the strictest sense" or else any gas vented must be paid for, regardless whether the action taken would have been economic or not.

Concerning the reason why economic data is always relevant to a question whether gas was avoidably lost, IM 87-652 explains that an operator should be allowed to show that it was not economic to capture gas in defense to an assessment for avoidable loss, because to do otherwise would be to exalt a form (the application) over substance (engineering, geologic, and economic data showing the venting to be necessary). Having determined that economic considerations are always entitled to consideration on the merits, a description of a method for determining economic feasibility is offered:

> The feasibility of capturing gas at any point shall be based on the economics of the operator's total operation on the lease, unitized area, or communitized tract rather than on the total production of the well or wells from which the gas is being vented or flared or only on the gas production from such well(s), i.e., one must consider not only the value of the gas being vented or flared, but also the value of the liquefiable hydrocarbons entrained in the vented or flared wet gas stream, and the oil and other gas which is being captured and sold.

(IM 87-652 at 8). This is the method that should have been applied in this case.

After reciting that the Marietta Federal was produced to protect against drainage, as described above, the decision under review stated:

> If the operator chooses to produce the well and vent the gas, he must request and receive permission from the Government to vent the gas prior to the end of the authorized test period [30 days or 50,000,000 mcf of gas] or risk an assessment. Maxus did not have approval to vent the gas. The Area Manager maintains that if an operator were to come in and request permission to vent 2933 MCF day for two months, he would not approve it.

(Decision at 2).

[1] It is therefore clear that, as Maxus contends, there was ultimately no analysis made of the engineering, geologic, and economic data it offered to BLM for the Marietta well, although the decision acknowledged that such an analysis was owed to the lessee. Moreover, in addition to the evidence concerning drainage of the lease, Maxus submitted evidence indicating that the Marietta well presented unusual characteristics that required special development procedures during the initial production and testing of the well that prolonged the time necessary to test the well and resulted in a "70 day clean-up period" (Engineer's Report dated July 24, 1990, at 3-6). This aspect of the engineer's report is not discussed by BLM, and was apparently also not considered. On the record before us, therefore, it appears that substantial drainage of the Federal lease would have occurred had not Maxus produced the Marietta well when it did, and that complications in drilling, producing, and testing the well necessitated a 70-day testing period, taking the initial production time 40 days past the blanket 30-day period allowed all wells by NTL-4A, and into October 1983. We therefore find that Maxus has established that engineering, geologic, and economic circumstances justified venting gas from the Marietta well in August and September 1983 and that no assessment for avoidably lost gas should have been made for this well for those months.

[2] The merits of engineering and economic arguments concerning drainage of the Kelly Federal No. 32-14 well on lease WYW43056, however, were considered by BLM. After discussing evidence offered by Maxus of drainage by non-Federal wells, BLM rejected Maxus' argument that there was a drainage potential from this lease because, "[t]here is no evidence that the Kelly Federal 32-14 well experienced any decline in reservoir pressure when it was tested" (Decision at 3). Data concerning the Kelly well was offered in conjunction with a report concerning the Allspaugh Federal No. 14-11 on adjacent lease WYW66397. Maxus argued that both the Kelly and the Allspaugh wells were subject to drainage by two wells on private land, a contention ultimately rejected by BLM after analysis of the geology of the leases and the production history of the four wells concerned. Maxus has pointed to no error in the analysis provided by BLM for the Kelly and Allspaugh wells, and we find that there was none. It is required that an appellant before the Department offer proof to support an appeal. The proof offered must, to be sufficient to overcome the adverse decision, establish by a preponderance of the evidence of record that there was error. See Bender v. Clark, 744 F.2d

1424 (10th Cir. 1984). No such showing has been made here. The BLM decision finding that gas vented by Maxus in the volume of 17,512 mcf on Federal lease WYW43056 and 7,912 mcf on WYW43056 was avoidably lost is therefore affirmed.

[3] Concerning the Flat Top Federal No. 32-10 well on Federal lease WYW220504, Maxus has offered a letter dated June 29, 1981, addressed to the Geological Survey, on the stated subject: "Justification for Flaring Gas Lease W-0220504 NE1/4, Sec. 10, T35N, R69W Flattop Field Converse County, Wyoming." The entire message of the letter is as follows:

> In reply to your letter dated May 14, 1981, the referenced lease is flaring gas and at the present time is under contract with Phillips Gas Company. Phillips is trying to get a right-of-way for the proposed sales line.
>
> Please contact me if I can be of further assistance.

There is no other documentary evidence in the case file to establish the existence of engineering, geologic, or economic necessity to vent the Flat Top Federal well. BLM's decision observed that although Maxus argued that continued production accompanied by flaring of gas before the pipeline arrived at the site was necessary to protect the Federal lease from drainage, no evidence was ever presented either that drainage was occurring or that it was not economic to capture the vented gas. Maxus contends that, because of the lapse of time since the events surrounding the drilling and production of the Flat Top well, it no longer possesses records on the well needed to establish that such flaring as occurred was necessary and that BLM should be barred from assessing any amount for avoidably lost gas from this lease as a consequence.

This argument overlooks the fact that Maxus received notice in November 1984 that an audit covering the period from January 1978 through September 1983 had discovered flaring or venting that was believed to be wasteful under Departmental regulations sanctioning oil and gas operations. While it is true that subsequent review of the suspected losses indicated by the 1983 audit has been lengthy, Maxus has actively participated throughout the process, which includes this appeal, and cannot now contend that the Department's position concerning these operations comes as a surprise. In a similar case involving payment for avoidably lost gas, Mobil Exploration & Producing U.S., Inc., 119 IBLA 76, 98 I.D. 207 (1991), we rejected an argument that recovery of compensation for gas flared before 1983 was barred by a 6-year limitation against actions by the United States, stating "[w]e do not hold that there are no limits on the time that may be spent in administrative review, but only find that, in this case, there has been no showing that any limit on such review set by law has been infringed." 119 IBLA at 81, 98 I.D. at 210. Maxus has not shown that its ability to participate in the evaluation of these lease operations has been hindered or affected in any way by the time spent in reviewing the operations of the affected leases. We therefore affirm BLM's decision assessing Maxus for 29,500 mcf of avoidably lost gas from the Flat Top well.

[4] The assessment for gas vented from Connor Federal No. 21-31 and 41-31 wells on lease WYW58545 is attacked by Maxus on the grounds that it was made by BLM in mistaken reliance on NTL-4A and IM 87-652. IM is characterized as a vague and therefore invalid regulation. Further, Maxus argues, IM 87-652 was wrongly applied by BLM when evaluating whether it was economic to vent these wells. Maxus argues that BLM used IM to establish a "permanent and irrebuttable presumption" that it would always have been profitable to connect a well to a gas pipeline if the well eventually was connected to a pipeline (SOR at 33). Maxus also complains that the word "economic" is never defined, either in IM 87-652 or in NTL-4A, and that this lack of guidance has lead to arbitrary and capricious decisionmaking. 1/ Finally, Maxus contends that the initial testing of the well was prolonged by the need to hydraulically fracture the well, which delayed its connection to a gas pipeline. As in the case of the Flat Top well, Maxus argues that the lengthy review of these cases has caused records to document this circumstance to be lost.

As Maxus correctly points out, IM's are not regarded as regulations, but are internal operating brochures used by BLM to provide guidance to employees, which nonetheless "must be properly applied" (SOR at 34). Where application of IM's has led BLM employees into error, we have not hesitated to correct them. See generally Shell Offshore, Inc., 96 IBLA 149, 94 I.D. 69 (1987), aff'd sub nom. Chevron U.S.A., Inc. v. United States, No. 90-5053 (Fed. Cir. Jan. 16, 1991); United States v. Kaycee Bentonite Corp., 64 IBLA 182, 89 I.D. 262 (1982).

In Ladd Petroleum Corp., supra, we considered the use by BLM of both IM 87-652 and NTL-4A. Concluding that NTL-4A had been properly issued under authority provided by Departmental regulations, we found that IM permitted BLM to consider economic considerations when deciding whether an operator was justified in venting gas regardless whether a prior application to allow venting had been submitted, a change we considered to be beneficial to lessees. In that case, we allowed the lessee the benefit of the amended notice, even though the amendment by the 1987 IM had occurred after the events giving rise to the appeal. In this case also, we find that Maxus is entitled to be able to present evidence to establish that it was necessary, for reasons of economy, that it vent or flare gas from each of the wells here under consideration. Although the Area Managers had not allowed such review, the Acting Deputy State Director did make the review required. That review, however, could not be conducted in a vacuum. It was necessary that Maxus submit to BLM evidence to show that conditions at the time of venting required that such venting be allowed, even though no application to vent or flare had been submitted at the time venting exceeded the generally allowed

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1/ This question is, of course, the ultimate issue in this case, as it would be in any case involving the defense raised by Maxus, that engineering, geologic, or economic reasons required venting of gas beyond generally allowed limits imposed by BLM. It is a question of fact that must be answered on a case-by-case analysis of data presented by the lessee. As the word "economic" is used in NTL-4A, it relates to a lessee's argument that "conservation of the gas is not viable from an economic standpoint and, if approval is not granted to continue the venting or flaring of gas, that it will result in the premature abandonment of oil production and/or the curtailment of lease development." Id. at 44 FR 76601. The meaning of the term as it is used by the notice is certain, as Maxus has shown by the arguments which it has made on appeal.

initial maximum amounts. In the case of the Connor wells, Maxus has submitted no evidence to show that, in fact, the hydraulic fracture operations described caused a delay in connection to the gas pipeline. On the record before us, therefore, the BLM determination that the Connor Federal operation avoidably lost gas in the amount of 2,782 mcf is affirmed.

[5] Having decided that in four of the five leases here under review there was avoidably lost gas for which an assessment must be made, we are confronted with the argument by Maxus that it is improper to assess this gas at full market value. In Mobil Exploration & Producing U.S., Inc., supra, we determined that, because the law governing payment for avoidably lost gas had changed, that fact required assessment of all parties at the rate set by current law. 119 IBLA at 80, 98 I.D. at 209. The same is true here: under provision of the current regulation, 43 CFR 3162.701(d), assessment for gas avoidably lost from all the wells here under review is properly made at the royalty rate. Accordingly, the BLM decision requiring payment of full value for avoidably lost gas is reversed, and it is ordered that BLM assess compensation at the royalty rate for all wells found by this decision to have properly been assessed to pay for avoidably lost gas.

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 reversed in part, affirmed in part, and the case file is remanded to permit computation of the amount of royalty due on gas avoidably lost from Federal leases WYW66397, WYW43056, WYW220504, and WYW58545.

Franklin D. Arness
Administrative Judge

I concur:

James L. Byrnes
Administrative Judge