

CHUSKA ENERGY CO.

IBLA 91-426

Decided July 9, 1992

Appeal from a decision by the New Mexico Deputy State Director, Bureau of Land Management, affirming a decision by the Farmington Resource Area Manager that assessed royalty for avoidably lost gas. SDR-91-15.

Affirmed as modified.

1. Oil and Gas Leases: Generally--Oil and Gas Leases: Incidents of Noncompliance

Before an assessment for noncompliance with a permit can be made under provision of 43 CFR 3163.1 (1988), BLM must give the affected oil and gas operator written notice of the violation and provide an opportunity to abate the violation. When, after a blowout was controlled, the operator was not notified that continued flaring of gas would not be allowed, a subsequent assessment for avoidably lost gas could not properly be assessed under Departmental regulation 43 CFR 3163.1 (1988).

2. Oil and Gas Leases: Generally--Oil and Gas Leases: Royalties: Payments--Words and Phrases

"Unavoidably lost." Notice to Lessees and Operators 4A, Part II.C.(2), provides that gas escaping in blowouts must be considered "unavoidably lost," subject to specified exceptions, among which is the failure of the operator to take all reasonable measures to prevent or control the loss. When, before a blowout occurred, the operator failed to pressure-test well casing contrary to a provision of the Federal permit under which the well was entered, an assessment for avoidably lost gas under provision of NTL-4A was proper because the operator had not taken all reasonable measures to prevent gas loss that occurred after the blowout was controlled.

APPEARANCES: Thomas A. Countryman, Esq., San Antonio, Texas, for appellant; Gilbert O. Lockwood, Deputy State Director, Mineral Resources, Santa Fe, New Mexico, for the Bureau of Land Management; Amy L. Alderman, Esq., Window Rock, Arizona, for amicus Navajo Nation. 1/

1/ The Navajo Nation, the owner of the resource at issue in this appeal, has moved to be allowed to participate as an amicus to the Board and to file

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Chuska Energy Company (Chuska) has appealed from a July 3, 1991, decision of the New Mexico Deputy State Director for Mineral Resources, Bureau of Land Management (BLM), affirming a decision of the Farmington Resource Area Manager that assessed royalty for 297,494 MCF of avoidably lost gas that escaped from well No. 2 Blackrock 1-17 (Blackrock) between May 4 and June 27, 1989. The parties agree that there was a "blowout" at the well on April 24, 1989, and that gas was thereafter vented to the atmosphere as a result, although there was a blowout preventer in place on the well at the time the gas erupted. Nonetheless, BLM determined that Chuska should be assessed royalty on the gas that was lost by flaring after the blowout had been brought under effective control, reasoning as follows:

Part II.C.(2) of [Notice to Lessees and Operators] NTL-4A [44 FR 76600, -01 (Dec. 27, 1979)] defines gas lost as a result of blowouts as unavoidably lost. This would exempt such gas from royalty assessment. The definition in this Part II further describes an exception to this exemption. The exception in the definition is where the loss of gas (underscore added) resulted from a failure on the part of the operator. The definition of avoidably lost gas, elsewhere in Part II, expands on the explanation of these failures. Chuska could have checked the flow of gas the day after the blowout occurred. They did not. Chuska's reason for not checking the flow stems from an earlier failure to pressure test the casing as explained above. * *

*. The open perforations were at depth, adjacent to potential resource formations. Diverting the flow to other potential reservoirs would have been a desirable circumstance. Had this happened, the well could have been reasonably controlled, the flow harmlessly diverted, and any lost production potentially regained from the reservoir formations into which it was diverted. Chuska's failure to comply with the casing test provision in their approved permit prevented them from taking available measures to control the loss of gas to the atmosphere. Both failures are expressly contained in the definition of avoidably lost gas. The Farmington Resource Area Manager correctly determined that the gas was avoidably lost.

As stated above, we agree with Chuska that their failure to pressure test the casing was not causal to the blowout itself. As explained above, the lack of a pressure test was causal to the loss of gas. [Emphasis in original.]

(Decision at 4).

The Blackrock well was not a new well, but had been drilled in 1973 by American Fuels Corporation, who shut-in the well in 1983 and left it

fn. 1 (continued)

a brief in support of the decision under review. The motion is granted and the brief is filed.

unplugged and abandoned (Statement of Reasons (SOR) at 5). On August 9, 1988, Chuska filed a Sundry Notice with BLM, proposing a "workover procedure" for the well. *Id.* The proposal was approved by BLM on August 15, 1988. The proposal by Chuska included, as item eight, an intention to "[p]ressure test 5-1/2" 14# & 17# casing to 500 psi" (Attachment to Sundry Notice dated August 9, 1988). This step of the proposal was reportedly omitted during actual operations. Finding the workover procedure was not followed in this regard, BLM determined that there had been a failure to take all reasonable measures to prevent loss within the meaning of NTL-4A sec. II.C.(2). The determination that Chuska should be charged royalty on the gas vented after April 24 rests on this finding. The BLM decision explains that

the operator failed to control the well when physically able to do so. This failure to control the well was due to concern caused by the failure of the operator to comply with the approved operating plan. By failing to pressure test the casing in the well prior to commencing operations, as required by the approved plan, the operator was uncertain as to the capability of the well casing to hold against the pressurization that would have occurred had the flow been checked at the surface by the second BOP [blowout preventer]. Had the pressure test been performed as required, proper casing would have been assured by (1) positive verification of the existing casing's capability; (2) negative verification, requiring installation of stronger casing or casing liner; or (3) cancellation of the workover procedure.

(Decision at 2).

Chuska defends the decision not to pressure test casing, an omission it does not admit, by arguing that no causal connection has been shown between the decision to vent gas made after the blowout was contained and any lack of testing early during the workover. Further, Chuska argues, "any alleged noncompliance with Chuska's workover proposals, if any, did not violate any regulation or have anything to do with the blowout which caused the loss of gas" (SOR at 20). Arguing by analogy to tort theory, Chuska asserts that the blowout became a supervening cause of the gas loss, which, independent of any failure to test well casing, caused the subsequent gas loss.

[1] "Blowout" is a term that is not without ambiguity. While the event that is described by the term is unexpected, it may involve gas, oil, water, or a combination of materials erupting at different places on an oil or gas well in different ways. The term is defined by A Dictionary of Mining, Mineral and Related Terms (DOI 1968), as a "sudden or violent uncontrolled escape of gas, oil, or water from the well due to (1) the formation pressure being greater than the hydrostatic head of the fluid in the hole, and (2) the failure or lack of mechanical means, such as blowout preventers, to control such an occurrence." Numerous cases interpreting insurance provisions governing such accidents have defined "blowout" for insurance purposes in terms of control of the resource. *See, e.g., Equity Oil Co. v. National Fire Insurance Company of Hartford*, 247 F.2d 303 (10th Cir. 1957), where the court more generally defined the term "as

a condition in which a well builds up sufficient gas pressure at the bottom of the hole to overcome the hydrostatic weight in the well, and forces its way to ground surface." *Id.* at 394, citing Anderson-Pritchard Oil Corp. v. Parker, 245 F.2d 831, 836 (10th Cir. 1957). Since the parties are agreed that, factually, the events described in this appeal were a "blowout," and that conclusion seems warranted on the record, we find that, for purposes of this decision, there was a blowout at the Blackrock well on April 24, 1989.

On June 29, 1989, Chuska was assessed \$5,000 pursuant to 43 CFR 3163.1(b) (1988) for failure to install a blowout preventer. This assessment was modified on July 19, 1989, to allege instead that the reason for assessment was failure to verify casing integrity and/or mitigate casing deficiencies at the Blackrock well. See decision by the New Mexico Deputy State Director for Mineral Resources dated September 28, 1989. The September 28, 1989, decision, rescinded the earlier assessment made pursuant to 43 CFR 3163.1, and found that failure to inspect the casing was not related to the blowout that occurred on April 24, while observing that "[b]y failing to pressure test the casing as stipulated, Chuska did not comply with the terms permitted in the approved plan." *Id.* at 2.

A material departure by Chuska from the workover permit requirement that there be pressure testing may have been, as BLM had first found, a nonconformity cognizable under provision of 43 CFR Subpart 3163 (1988). That regulation contains a proviso, however, that: "Whenever an operating rights * * * operator fails or refuses to comply with * * * the terms of any * * * permit, * * * [BLM] shall notify the * * * operator * * * in writing of the violation or default. Such notice shall also set forth a reasonable abatement period." 43 CFR 3163.1(a) (1988). No such abatement notice was given in this case, although a BLM employee went to the Blackrock well within a short time after the blowout on April 24 and thereafter made repeated inspections of the site until June 28 when the well was reported to be connected to the pipeline without any prior objection by BLM. See Decision at 4; BLM "Chronology of Blowout."

Chuska contends that BLM has confused the regulatory foundation for the assessment made against Chuska, and that neither NTL-4A nor the regulations at 43 CFR Subpart 3163 can be applied to the facts of this case. Concerning this contention, Chuska argues that "there is no proof in the record that the prerequisite abatement period under 43 CFR 3163.1(a) was ever afforded Chuska," and concludes that "43 CFR 3163.1(a) * * * is applicable only to situations * * * in which * * * the authorized officer has found a violation that is continuing and is still subject to being cured" (SOR at 11, 12 (emphasis in original)). This argument is clearly correct. The cited regulation provides that there must be written notice of a violation of a regulation, lease, or permit, and an opportunity to cure the offending conduct before an assessment can be made. To the extent, therefore, that the decision here under review relied on this regulation for the assessment made against Chuska, the July 3, 1991, decision is modified to eliminate any reliance on 43 CFR 3163.1, because neither written notice of violation nor an opportunity to cure were provided to Chuska by BLM before the Blackrock well was connected to the pipeline and venting of gas to the atmosphere stopped.

[2] Chuska also argues, correctly, that as a general rule, gas lost from a blowout is unavoidably lost. NTL-4A, sec. II.C.(2), 44 FR 76601 (Dec. 27, 1979). The cited notice provides that: "'Unavoidably lost' production shall mean * * * oil or gas which is lost because of * * * blowouts * * * except where [BLM] determines that said loss resulted from the negligence or the failure of the lessee or operator to take all reasonable measures to prevent and/or control the loss."

BLM does not contend that negligence was a factor in this case. 2/ Insofar as concerns gas lost after the blowout was controlled, the question therefore is whether the loss should reasonably have been prevented or differently controlled than by flaring.

BLM contends that Chuska failed to pressure test the casing on the Blackrock well in the manner required by the workover permit and that this failure was the actual cause of loss. According to BLM, there is a direct connection between omission of pressure testing and the subsequent election by Chuska to vent gas to the atmosphere following control of the blowout rather than by completely arresting any further escape of gas by closing the blowout preventers that were in place at the well. Chuska does not admit that it omitted the pressure testing step from the well workover procedure that was proposed for the Blackrock well. Nonetheless, the well data available to BLM indicates that the required pressure testing was not done as proposed, and the Deputy State Director found as a fact that it had not been accomplished. We affirm this finding. In the "Chronology of Blowout" compiled by BLM from well data for the Blackrock well, this analysis of the accident is presented:

Control of the well was lost while removing a test assembly from the well after straddle testing several recently opened zones (as listed on Chuska's Sundry Notice of July 3, 1989).

During the testing operations the primary well control system consisted of a column of water in the well bore which was maintained at a height sufficient to exert the hydrostatic pressure required to prevent a flow of fluid into the well bore from the open perforations. The secondary well control system consisted of a double ram blowout preventer (tubing rams and blind rams) with a stripper head above and a relief line below. The relief line was attached to a choke manifold with discharge lines

2/ The Navajo Nation argues that negligence is a factor that should be considered relevant to this appeal, but does not offer evidence or point to any facts that establish conduct by Chuska that could be characterized as negligent. It seems clear, as both BLM and Chuska conclude, that the blowout was not caused by failure to pressure test the well casing. Chuska points out that it is "a contractual agent exploring for, developing and marketing hydrocarbons on behalf of the Navajo Nation" (SOR at 1). Accepting this statement as fact, our review is limited to the conduct of Chuska as an operator on the public lands, subject to the permit conditions, regulations, and notices discussed in this opinion.

into a pit. The test assembly consisted of a retrievable packer made up on a work string of 2 7/8" tubing with a retrieving head and retrievable bridge plug attached below the packer.

Flow testing of the prospective producing zones had been completed and a kick occurred while the rig crew was in the process of removing the test assembly from the hole. By all appearances the initial kick was due to gas bubbles floating upward through the water column, in the well, and expanding to the extent that the well began to unload. Due to the known danger of a discharge of sour gas the rig crew closed the tubing rams and retreated from the rig when the kick surfaced. The rig crew put on breathing apparatus in order to work in the toxic gas environment prior to returning to the rig. Upon their return the well had unloaded to a degree that allowed a flow rate sufficient to push the test assembly up hole until a tool joint in the tubing was forced against the bottom of the tubing rams and gas and water was flowing from the relief line and tubing. By that time the flow rate was unmanageable, the flow channel through the tubing could not be readily closed and it was very doubtful that the well would withstand the backpressure from restricted flow or a hard shut-in due to the corroded casing between 519' and 3100.' The test assembly was left in the hole with the packer and bridge plug at about 300' below the surface and the tubing protruding above the blowout preventer.

It was determined that well control could not be quickly regained and the contingency plan to evacuate local residents was activated. Attempts to control the well proceeded from the 24th of April until May 4th.

The "Chronology of Blowout" also notes, in a section entitled "well description" that "5 1/2 casing is badly corroded from 3100' to 519'." This information was apparently obtained from "Sundry Information" provided by Chuska for operations on "Day 7" when Chuska reported "[r]an pipe analysis log from 6164' to surface. Log indicated corrosion from 517' to --3270'."

Chuska responds to this analysis that, whether or not there was a failure to pressure test the casing is irrelevant to this appeal, because the condition of the casing has not been shown to have contributed to the blowout. Chuska offers the affidavit of the president of the company that handled the blowout to establish that the blowout was properly controlled, and an affidavit from Chuska's operations manager for the proposition that well casing is not part of a blowout preventer, arguing that "the actual occurrence of the blowout is to be regarded as a supervening and, in fact, a superseding cause of any lost gas resulting therefrom" (SOR at 9 (emphasis in original)). Arguing to support this conclusion, Chuska reasons that "NTL-4A does not even concern itself with circumstances, acts or omissions which took place prior to a blowout." *Id.* To support this narrow view of the notice, Chuska contends that:

If blowouts were not regarded as superseding causes under NTL-4A, and if the Subject Exception (or, for that matter the negligence exception to NTL-4A Part II.C.(2)) were thus not intended to apply to only post-blowout acts or omissions, there would be no reason to restate them in NTL-4A Part II.C.(2). Operator failures and negligence not followed by blowouts are clearly dealt with in NTL-4A Part II.A. Thus, as a matter of regulatory construction, only failures and/or negligence resulting in lost gas after a blowout are dealt with in Part II.C.(2). [Emphasis in original.]

Id. at n.5.

Prior decisions of this Board have found that NTL-4A is a "proper exercise of the Department's authority pursuant to the regulations at 43 CFR 3162.7-1 * * * to prevent avoidable loss of * * * gas." Ladd Petroleum Corp., 107 IBLA 5, 7 (1989); see Lomax Exploration Co., 105 IBLA 1 (1988). Currently, 43 CFR 3162.7-1(d) provides the applicable rule that an "operator shall be liable for royalty payments on * * * gas lost or wasted." See Mobil Exploration & Producing U.S. Inc., 119 IBLA 76, 78, 98 I.D. 207, 208 (1991).

As the Lomax decision pointed out, the purpose of NTL-4A was to establish that "[v]enting or flaring of produced gas without prior authorization, approval, ratification, or acceptance is deemed to be avoidably lost." Id. at 7. Under the terms of the notice, gas production is subject to payment of royalty if it is "vented or flared during * * * producing operations without * * * prior authorization." NTL-4A, Part I, 44 FR 76600 (Dec. 27, 1979). An exception to the general rule that previously unauthorized flaring must be compensated appears in the "definitions" section of the notice, where it is provided that an operator seeking to establish that a blowout entitles him to an exception from the obligation to pay royalty for unauthorized gas loss must show that he has taken "all reasonable measures to prevent and/or control the loss." Id., Part II.C.(2), 44 FR 76601 (Dec. 27, 1979).

The narrow reading of the notice urged by Chuska ignores its declared purpose, which is to give definition to situations where gas may be determined to be "lost or wasted" and so subject to payment of royalty, subject only to certain exceptions. While blowouts are recognized to be an exception to the general requirement that there be royalty payment for gas vented without prior authorization, it must also appear that before any such accident the operator took "all reasonable measures to prevent" any loss. The effect of the reading Chuska would give to the notice would be to require only that it take "all reasonable measures to * * * control the loss." This approach, however, impermissibly limits the scope of the notice by omitting the language which requires an operator to "take all reasonable measures to prevent and/or control the loss."

While Chuska assumes that occurrence of the accident is a supervening cause, it does not explain how this could be true, especially in view of the fact that such accidents were anticipated and required to be guarded against at the Blackrock well, as evidenced by the fact that a blowout preventer

was required to be installed at the well during workover operations. Having required Chuska to install the blowout preventer, it was reasonable for BLM to require other measures to insure that the device would be effective should an accident take place. Chuska has not shown that the failure to pressure test casing as required by the workover procedure was a minor or inconsequential omission. The question is not whether, given the conditions at the Blackrock well on April 24, 1989, Chuska did the best that it could to control the accident. It is whether the company also took all reasonable measures required in order to "prevent" the loss of gas within the meaning of the language of NTL-4A.

Chuska argues that the workover procedure was not a "permit, notice or order" under 43 CFR 3161.1(a)," and that the approved workover procedure filed with BLM did not absolutely bind the operator to follow "every last detail of its procedures." No authority is cited for this proposition, and we can find none. We find that the "workover procedure" was an approved Federal permit. Chuska also argues, concerning the permit, that an operator "must be free to utilize its best professional judgment at the time" (SOR at 15). While this latter statement may be true enough in the abstract, it does not explain why there was a deviation from the approved procedure after Chuska had learned on the seventh day of operations that the casing which it had proposed to pressure test was corroded. The conclusion by the Deputy State Director that the operator should have tested the casing in order to understand the risks involved in further development of the well is not shown to be in error by Chuska's speculation that there might well have been other engineering considerations that justified their failure to test. Nor does Chuska explain the nature of the "professional judgment" that dictated the deviation from the approved workover procedure.

The record before us supports the finding by BLM that deviation from the testing requirement of the approved permit contributed to the subsequent loss of gas in the manner described by BLM. The affidavits of Chuska's manager and contractor do not speak to this issue, their opinions being limited to assertions concerning the correctness of their actions taken to control the blowout under conditions existing at the time of the accident on April 24. The BLM decision, however, recognizes that some gas was lost as a direct result of the blowout, before it was brought under effective control on May 4 after several days of uncontrolled flow. The controlled flow that continued thereafter, while the well was flared awaiting connection to the pipeline cannot be explained by reference to the blowout alone, because to do so leaves unexplained the need to continue to vent gas to the atmosphere while Chuska was able to stop it entirely. The decision by the Deputy State Director finding that Chuska failed to take all reasonable measures to prevent the loss when it chose to deviate from the testing proposed by the Sundry Notice filed August 11, 1988, an omission that led to gas loss after the blowout was controlled, is therefore affirmed.

Chuska suggests that even if the decision under review is affirmed, that the first 30 days of production or the first 50 million cubic feet of gas lost is exempt from royalty payment requirements under NTL-4A. BLM rejected this argument, finding that the gas lost from the Blackrock well

was lost during uncontrolled well flow and not during "well tests" conducted during "initial production tests" as allowed by NTL-4A, Part III.C. This finding is supported on the record before us, and is affirmed.

Chuska also argues that the assessment is barred by laches, because Chuska was not notified of the BLM position concerning the omitted pressure testing until January 25, 1991, after a key employee present at the Blackrock well blowout had left the country. The record does not support this contention, inasmuch as Chuska was first given notice on July 18, 1989, that failure to verify the integrity of the well casing was considered to provide the foundation for an assessment, albeit not under provision of NTL-4A. Although this decision was later modified, written notice was then given to Chuska that BLM considered the omission to be a permit violation and cause for further action. See decision dated Sept. 28, 1989. This matter has been pursued continuously, therefore, since July 1989, the month following the loss of gas from the Blackrock well, and Chuska has been on notice since then that an assessment was contemplated for the omission to test casing. The argument that laches is an issue is therefore rejected as without foundation in fact. Even if the continuing review proceedings involving BLM and Chuska could be considered to be a delay by BLM, a claim of laches is not supported by the record before us. See Kerr-McGee Corp., 118 IBLA 119, 127 (1991), aff'd, Kerr-McGee Corp. v. Lujan, No 91-CV.0114-B (D. Wyo. Dec. 19, 1991), where a 3-year delay in issuance of a production order by BLM was found not to support a claim of laches or estoppel. And See 43 CFR 1810.3(a).

Finally, Chuska contends that the blowout at the Blackrock well produced a windfall for the Navajo Nation by facilitating extension of a pipeline to serve a well which might otherwise never have been so served. This argument, characterized as an appeal on equitable grounds, overlooks the departure by Chuska from the approved workover plan, a circumstance shown by BLM to have direct relevance to the gas loss occurring after the blowout was controlled. Whether or not the accident may have produced a favorable result for the owner of the resource that otherwise might not have been obtained cannot excuse the fact that gas was avoidably lost from the Blackrock well under circumstances that included the failure by Chuska to take all reasonable measures to prevent such loss. Chuska has therefore not shown that there is a foundation for equitable relief from the assessment made by the decision here under review.

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 as modified.

Franklin D. Arness
Administrative Judge

I concur:

Gail M. Frazier
Administrative Judge

