CONOCO, INC.

IBLA 2001-353 Decided January 6, 2005

Appeal from a decision of the State Director, New Mexico State Office, Bureau of Land Management, ordering lessee to recalculate the volume of gas production from a Federal oil and gas lease. SDR 00-14.

Reversed.

1. Administrative Procedure: Adjudication--Oil and Gas Leases: Production

An amended version of a regulation or a Notice to Lessees may be applied to a pending matter if it would benefit the affected party and there are no public interests or third party rights which would be adversely affected. When a variance is granted regarding the method of measuring gas volume, which variance is necessarily predicated on a finding that the method met the regulatory standard, approval may be made retroactive when it would not violate the public interest or third party rights.

APPEARANCES: Bruce A. Connell, Esq., Houston, Texas, for appellant.

OPINION BY ADMINISTRATIVE JUDGE GRANT

Federal oil and gas lessee Conoco, Inc. (Conoco) has brought this appeal from a decision of the New Mexico State Director, Bureau of Land Management (BLM), regarding calculation of the volume of gas production measured by certain meters. This dispute involves use of the "FW" factor setting on the gas metering equipment which adjusts the measured volume for the "free-water" vapor content of the gas.

A brief discussion of the legal requirements for gas measurement will clarify the factual issues in this appeal. The authority of BLM to regulate gas metering equipment used by Federal gas lessees is set forth in the regulations. 43 CFR 3162.7-3. This regulatory authority is implemented in part by the promulgation of Onshore Oil and Gas Orders and Notices to Lessees (NTL's). 43 CFR 3164.1, 3164.2.

As discussed below, the regulation at 43 CFR 3162.1(a) and NTL 89-2 require compliance with Onshore Oil and Gas Order No. 5, which controls the measurement of gas on Federal onshore leases under the Federal oil and gas onshore operating regulations at 43 CFR Part 3160. Onshore Oil and Gas Order No. 5, Measurement of Gas, 54 FR 8100 (Feb. 24, 1989). Section I.B. of Onshore Oil and Gas Order No. 5 describes its two main purposes. The first is to ensure accurate royalty calculations by establishing minimum standards for accurate gas measurements. 54 FR at 8106. The second is to establish abatement periods for corrective action when noncompliance with the minimum standards is identified. Id. The gas measurement standards in Onshore Oil and Gas Order No. 5 are based on the 1985 American Gas Association's Committee Report No. 3, second edition (1985 AGA Report). 54 FR at 8107.

Section IV of Onshore Oil and Gas Order No. 5 provides that a lessee desiring to use a measurement system different from that authorized in Order No. 5 may request a variance from the standard. 54 FR at 8110. A variance "shall" be approved if the alternative meets or exceeds the minimum standards or if it "does not adversely affect royalty income or production." Id.

The facts are not disputed. Conoco is a Federal gas oil and gas lessee in New Mexico's Warren Unit. Lease production was measured using the six gas meters involved in this appeal,[1/] which are independently owned and operated by Dynegy, Inc. Dynegy enabled the FW factor setting on one meter in March of 1999 and on the five remaining meters in September of 1999.

In a decision dated August 7, 2000, the Hobbs, New Mexico, Field Station, BLM, notified Conoco that gas volume calculations at the six gas meters were in violation of Oil and Gas Order No. 5 because the FW factor setting had been turned on at the meters. (Decision of Aug. 7, 2000, at 1.) Acknowledging that use of the FW factor was part of a 1992 AGA Report and standard industry practice, BLM stated that use of the FW factor was not permissible because it was not addressed in Oil and Gas Order No. 5, which requires gas measurement to be based on the 1985 AGA Report or an approved variance. Id. at 1-2. The Hobbs BLM office then ordered Conoco to disable the FW factor, provide the date when the FW factor was enabled, and correct gas volumes for the time period when the FW factor was enabled. Dynegy promptly disabled the FW factor on all six meters by August 31, 2000.

Conoco requested State Director Review of the Field Station decision. After promptly contacting Dynegy and having the FW factor turned off by the end of August 2000, Conoco asked to be excused from recalculating the royalty

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[1/] The six meters are: 118000447, 118000465, 118212582, 118000703, 118000787, and 118000967.

measurements or, alternatively, to be granted a retroactive variance allowing use of the FW factor for the time, dating back to March 1999. Conoco advanced three grounds for relief that are relevant to this appeal. First, it argued that it was being held to an unspecified minimum standard because the 1985 AGA Report was silent concerning the FW factor and did not prohibit its use. Second, Conoco argued that the measurement difference was de minimis and would actually reduce Federal royalty payments by 0.056 percent for the meter with the largest throughput. Finally, Conoco argued that since it had already disabled the FW factor after receiving the Field Station letter, recalculating the volumes would be unduly burdensome and impractical, especially considering that recalculation might reduce BLM's royalty payments.

In a February 14, 2001, decision, the New Mexico State Director denied Conoco's request to be relieved of retroactive recalculation. (Decision of Feb. 14, 2001.) As background for the decision, BLM cited New Mexico NTL 89-2, which required compliance with the gas measurement standards of Oil and Gas Order No. 5. Id. at 2. The State Director also noted that while Onshore Oil and Gas Order No. 5 was based on the "standards and specifications" in the 1985 AGA Report, BLM regulations had not approved any deviation from this standard to date. Id. The State Director then cited 43 CFR 3162.1(a), which requires all Federal gas lessees to comply with the terms of Onshore Oil and Gas Order No. 5 and NTL 89-2. Id. Acknowledging that the 1985 AGA Report did not discuss application of the FW factor when metering gas production, the State Director upheld the Hobbs Field Station decision: "Under the current minimum standards for Gas Measurement as it pertains to [the 1985 AGA Report] the "FW" Factor is not addressed. Therefore, the order is hereby upheld and the request for stay is denied." (Feb. 14, 2001, decision at 2.) Finding that use of the FW setting when metering gas production was not addressed in the 1985 AGA Report, the State Director implicitly concluded it was not authorized by Onshore Oil and Gas Order No. 5 and rejected the request for a retroactive variance.

By Sundry Notice dated January 31, 2001, prior to the State Director's decision, Conoco had applied for a variance concerning use of the 1985 AGA Report to allow use of the 1992 AGA Report standards, including use of the FW factor, in its gas meters:

> Conoco, Inc. requests a variance to Onshore Oil and Gas Order No. 5 concerning the use of AGA Committee Report No. 3, 1985 Second Edition. These standards were revised and published as AGA Committee Report No. 3, 1992 Third Edition, which has been adopted by the industry as the standard practice. We request the option to use AGA committee Report No. 3, 1992 Third Edition since publishing.

(Sundry Notice filed Feb. 1, 2001.) As noted previously, the initial BLM order recognized that use of the FW factor was addressed in the 1992 AGA Report. BLM approved Conoco's request for a variance on May 4, 2001, but did not approve Conoco's request that the variance be applied retroactively.

In its statement of reasons (SOR) for appeal, Conoco explains that the FW factor setting on the meter impacts the

> calculation of the thermal content and volume of natural gas flowing through the meter. When in the "off" position, the effect is a slightly higher volume [Mcf] reading, but a correspondingly lower thermal [Btu] reading. Conversely, when in the "on" position, the effect is a slightly lower volume [Mcf] reading, but a correspondingly higher thermal [Btu] reading. Neither setting results in an "erroneous" measurement of the gas flowing through the meter.

(SOR at 2.)[2/] Appellant contends that since the 1985 AGA Report does not address the FW factor setting, BLM must provide a reasoned basis for the exercise of its discretion to require that the FW factor be turned off. Acknowledging that it is subject to the minimum standards set forth in the 1985 AGA Report, Conoco argues that it is improper for BLM to impose additional standards without engaging in rulemaking. (SOR at 3-4.) Further, appellant asserts that requiring it to correct the data will be unduly burdensome and may reduce BLM's royalties. No answer has been filed on behalf of BLM.[3/]

The issue in this appeal is limited to that part of the BLM letter/order of August 7, 2000, requiring Conoco to recalculate production volumes for the period of time during which the FW factor was turned on. As ordered by BLM, appellant had Dynegy promptly turn off the FW factor setting on the meters involved. It further appears that by Sundry Notice approved by BLM on May 4, 2001, Conoco was subsequently granted a variance permitting calculation of gas volumes in accordance with the 1992 AGA Report.

[1] We note that by its terms, Oil and Gas Order No. 5 provides that a variance from the standards may be requested with an explanation of the

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[2/] In its supplemental SOR before BLM on SDR, Conoco noted that "[s]ince royalties are calculated on the basis of the product of both the volume and thermal content, the resulting differences are de minimus" and "can be in either direction, sometimes resulting in an overpayment of royalties due." (Supplemental SOR at 3-4.)

[3/] Under the Board's appeal regulations, failure to answer will not result in a default. 43 CFR 4.414.

circumstances warranting approval and the proposed alternative means by which the minimum standards will be satisfied. Oil and Gas Order No. 5 at IV., 54 FR at 8110. That is what happened in this case during the course of the appeal proceedings when Conoco filed a Sundry Notice requesting a variance to use the 1992 AGA Report standards. After considering all relevant factors, BLM "shall approve the requested variance(s) if it is determined that the proposed alternative(s) meets or exceeds the objectives of the applicable minimum standard(s), or does not adversely affect royalty income or production accountability." Id. This request was approved by BLM on May 4, 2001. Accordingly, it appears that BLM subsequently determined use of the FW factor met the relevant regulatory standard.

Under established precedent, the Board has upheld the application of revised versions of regulations and NTL's to pending matters when neither public interest nor the intervening rights of third parties would be prejudiced:

> In the past, this Board has applied an amended version of a regulation to a pending matter if to do so would benefit the affected party, and if there were no countervailing public policy reasons or intervening rights. James E. Strong, 45 IBLA 386 (1980). The rationale for such action is equally appropriate here where BLM has indicated a change in its policy regarding the application of NTL-4A concerning avoidably lost gas which would benefit appellants, and there are no countervailing regulations, public policy considerations, or intervening rights. See Somont Oil Co., Inc., 91 IBLA 137 (1986).

Ladd Petroleum Corp., 107 IBLA 5, 8 (1989). We find this principle applicable to this case, in which BLM subsequently found that use of the FW factor in measuring gas production was consistent with the relevant regulatory standard.

In this case, BLM provided no basis for ordering a recalculation of production volume without use of the FW factor except to state that use of this setting was not addressed in the 1985 AGA Report and a variance had not been obtained. When the relevant regulation, NTL, Oil and Gas Order, or another case specific BLM order sets an operative requirement, we will generally uphold placing the burden on the lessee or operator to comply pending justification for and approval of a variance. In this case, however, no basis has been cited by BLM in terms of either Departmental regulations, Oil and Gas Order No. 5, or the 1985 AGA Report, to rule out use of the FW factor. In Luff Exploration Co., 115 IBLA 134, 137 (1990), we recognized the authority of BLM to issue orders and notices setting forth the methods and procedures for measuring gas production and upheld the method of measurement ordered by BLM to be applied in the future pursuant to the 1985 AGA Report. We declined, however, to sustain the assertion by BLM that appellant had violated the relevant regulatory standard regarding measurement of gas production by failing to

measure gas in the manner directed by the BLM order prior to notice and an opportunity to comply with the terms of that order. 115 IBLA at 138. To the extent that BLM relies upon a previously unannounced interpretation of the terms of the 1985 AGA Report to retroactively preclude use of the FW setting, without notice, it would be generally required to provide a rational basis for its decision. See Samedan Oil Corp., 163 IBLA 63, 70 (2004); Larry Brown & Associates, 133 IBLA 202, 205 (1995); Burnett Oil Company, Inc., 122 IBLA 330, 332 (1992); Roger K. Ogden, 77 IBLA 4, 7, 90 I.D. 481, 483 (1983).[4/]

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.

C. Randall Grant, Jr.
Administrative Judge

I concur:

David L. Hughes
Administrative Judge

[4/] This is required to establish that application of the standard to the facts of the case is predicated on a rational basis so as not to be arbitrary and capricious under the Administrative Procedure Act, 5 U.S.C. § 706(2)(A) (2000). See Mobil Producing Texas & New Mexico, Inc., 115 IBLA 164, 169 (1990).