

INTERIOR BOARD OF LAND APPEALS

Petrocorp. and William H. Davis

152 IBLA 77 (March 24, 2000)

Title page added by:
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PETROCORP.
WILLIAM H. DAVIS

IBLA 97-543, 97-548

Decided March 24, 2000

Appeals from a decision of the New Mexico State Office, Bureau of Land Management, establishing oil and gas production reporting requirements. (NM) SDR 07-19.

Reversed.

1. Oil and Gas Leases: Generally--Oil and Gas Leases: Unit and Cooperative Agreements

For onshore operations, the Congressional grant of authority, found at 30 U.S.C. § 226(m) (1994), authorizes the Secretary to approve the combining of units and participating areas for conservation reasons.

2. Oil and Gas Leases: Unit and Cooperative Agreements

A unit agreement may not be unilaterally reformed by BLM to include land which has not been committed to the unit agreement.

3. Oil and Gas Leases: Unit and Cooperative Agreements

Once a unit operating agreement has become effective BLM lacks authority to amend the agreement without the parties' consent.

APPEARANCES: Von A. Martin, Esq., Oklahoma City, Oklahoma, for PetroCorp; William H. Huffman, Esq., Tulsa, Oklahoma, for William H. Davis; Grant L. Vaughn, Esq., Office of the Regional Solicitor, Southwest Region, Santa Fe, New Mexico, U.S. Department of the Interior, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE TERRY

On March 21, 1997, the Associate District Manager, Tulsa District Office (TDO), Bureau of Land Management (BLM), issued an order to William H. Davis (Davis), operator of communitization agreement (CA) OKNM 75348, giving specific instructions on how to report oil and gas

production from the communitization area subject to agreement OKNM 75348. By letters dated March 19, 1997, and March 24, 1997, the TDO issued a similar order to PetroCorp, operator of the Hunter Misener Sand Unit Agreement (Unit Agreement) OKNM 75408X, again providing instructions on how to report oil and gas production under its unit agreement. The Hunter Misener Unit is part of the original land area within the CA approved by BLM effective August 26, 1991, for the purpose of primary production from several formations. The result of the reporting instructions provided to Davis and PetroCorp, according to these appellants, is that Federal mineral rights have been commingled with production from Davis' Burl #1 well, notwithstanding that the Burl #1 well lies outside the Federal unit. Applying this argument to its situation, PetroCorp concludes that, if BLM's reporting instructions are valid, PetroCorp has already overpaid more than \$36,000 in royalties on production from the Hunter Misener Unit.

As brief background, the record reflects that the CA, operated by Davis and PetroCorp, includes all of sec. 7 of T. 27 N., R. 10 W., Indian Meridian, Alfalfa County, Oklahoma. The CA communitized eight formations, including the Tonkawa, Cottage Grove, Mississippi Chat, Mississippi Lime, Misener, Viola and Wilcox. The Hunter Misener Unit, was approved by TDO effective July 15, 1994, and includes lands in the E $\frac{1}{2}$, NW $\frac{1}{4}$, and N $\frac{1}{2}$ of the SW $\frac{1}{4}$ of sec. 7, T. 27 N., R. 10 W., Indian Meridian. The Hunter Misener Unit is a secondary recovery unit, limited to production from the Misener Sands Formation. On July 20, 1994, the Oklahoma Corporation Commission approved the Hunter Misener Unit West. This unit is also limited to production from secondary recovery within the Misener Sands Formation and it includes the lands in sec. 7 not made a part of the Hunter Misener Unit.

In his April 8, 1997, letter requesting administrative review (Davis RAR) of the March 21 order, Davis states that there are no Federal lands in the Hunter Misener West Unit, as the Federal lands in sec. 7 are in the Hunter Misener Unit, managed by PetroCorp. (Davis RAR at 1.) Davis argues that if BLM maintains that the CA applies to the production from the Hunter Misener West Unit and his Burl #1-7 well, the Hunter Misener West Unit owners should share in the production from any other well in sec. 7. Id. at 2. As a result, Davis claims, BLM must share ratably all revenues it receives from the Hunter Misener Unit with the other owners in sec. 7 on a 640-acre basis. Id. In effect, Davis claims, the BLM position

ignores the fact it is receiving its proportionate share of revenues attributable to its interest. In order to comply with the decision, owners in the Hunter West Unit will have to dilute their interest to pay the BLM and in return the BLM will not share its revenues from the Hunter Unit with those owners. This position is patently unfair in light of the fact the BLM is receiving its fair share of revenues attributable to its interest and in my opinion amounts to highway robbery.

Id. In its April 9, 1997, letter (Letter) to the New Mexico State Director, PetroCorp stated:

If the Decision letter of March 24, 1997 requires PetroCorp to do anything other than report production and pay royalties from the Hunter Misener Unit (OKNM75408X), then please register this letter as our request for an administrative review.

We trust that you can understand our confusion in this matter as PetroCorp already reports production and pays royalties to the MMS on the Hunter Misener Unit in accordance with OKNM7508X.

(Letter at 1.)

The New Mexico Deputy State Director's July 16, 1997, decision (Decision), here under appeal, which upheld the TDO orders, stated, in pertinent part:

PetroCorp is properly reporting production to the CA from the Hunter Misener Unit and they are in compliance with the TDO's order. It must be noted that MMS is the sole agency within the Department of Interior responsible for the collection of royalties. TDO's authority is limited to production accountability. TDO's order to PetroCorp must therefore be modified to eliminate the reference to "* * * payment of royalties * * *."

Orders of the Oklahoma Corporation Commission cannot supersede prior existing agreements, unless the parties to those authorize the change. The case file contains no evidence that the BLM and the operator mutually consented to termination or modification of the CA. The continued existence of the CA is also supported by production reporting from the Grunewald 1-7 well and allocation of Misener Formation production from the Hunter Misener Unit. Based on these facts, it is our decision that the CA remains in effect and production of communitized substances must be allocated according [to] the CA's allocation schedule.

The issues remaining are what constitutes communitized substances and if they should be allocated to the CA. We agree that production from wells producing from communitized formations other than the Misener Formation, such as from the Mississippian Lime in the Grunewald 1-7, should be allocated to the CA. Since the CA and the unit contracts are still in effect in their original form, we also determine that there is a Federal interest in both the Hunter Misener Unit and the

Hunter Misener West Unit. All production from the Misener Formation from the Hunter Misener Unit and Hunter Misener West Unit must be allocated to tracts in common with the CA. The CA allocation schedule would then allocate the unit production to each tract in the CA.

(Decision at 2.)

In its Notice of Appeal (NOA) filed August 20, 1997, and dated August 14, 1997, PetroCorp stated that its understanding of the BLM Decision is that

it is the BLM's position that by virtue of the CA its mineral rights have been "commingled" with all other mineral owners under Section 7-27N-10W. As such, and even though your rights do not lie within the outline of the Hunter Misener West Unit, this commingling has entitled you to share proportionately with all owners in Section 7 insofar as the tracts are weighted within the individual secondary recovery units. If this is not a correct reading of the Decision, we would appreciate further clarification. If this is correct, we assume this also means that the BLM only owns a commingled interest in the Hunter Misener Unit. If this were the case, the MMS has been improperly paid revenues from PetroCorp's Hunter Misener Unit. Instead of the MMS being paid for its interest within the Hunter Misener Unit outline, the interest should have been substantially diluted to account for the commingling with all owners within Section 7. Under your scenario, the MMS has been grossly overpaid because revenues from the Hunter Misener Unit are materially more significant than those generated from the Hunter Misener West Unit. The MMS has been overpaid \$37,000 since the inception of the Hunter Misener Unit, and under your formula, as we understand it, they would have been due less than \$600.

(NOA at 1.) PetroCorp states that the Unit Agreement was approved by BLM by letter dated October 19, 1994, and the unit was designated OKNM 75408X. Id. at 2. In the BLM "Approval-Certification-Determination" accompanying this letter, PetroCorp points out that paragraph C therein states: "Certify and determine that the drilling, producing, rental, minimum royalty and royalty requirements of the Federal lease or leases committed to said agreement are hereby established, altered, changed, or revoked to conform with the terms and conditions of the agreement." (NOA at 2, quoting BLM Certification.) PetroCorp notes that the Unit Agreement defines a Royalty Owner in sec. 1.7 as: "Royalty Owner means an owner of an interest in any portion of the Unitized Substances or proceeds thereof other than that of a Working Interest Owner." Id. Additionally, PetroCorp states that under the Unit Agreement, Article III, Creation and Effect of Unit, states:

Subject to the provisions of this Plan of Unitization, all Oil and Gas Rights of Royalty Owners in and to the lands

described in Exhibit "B", and all Oil and Gas Rights of Working Interest Owners in said lands, are hereby unitized insofar as the respective Oil and Gas Rights pertain to the Unitized Formation, so that Unit Operations may be conducted as if the Unitized Formation had been included in a single lease executed by all Royalty Owners, as Lessors, in favor of all Working Interest Owners, and as if the lease had been subject to all of the provisions of this Plan of Unitization.

Id., quoting Article III, 3.1, Oil and Gas Rights Unitized, at p. 3 of Unit Agreement.

PetroCorp argues that by accepting the Unit Agreement with the Approval-Certification-Determination quoted above, BLM has unconditionally accepted and adopted the Unit Agreement. In that regard, PetroCorp urges, neither Oklahoma Corporation Commission Order No. 384429 that established the Hunter Misener Unit, nor the Unit Agreement acknowledges a beneficial royalty interest in any royalty interest or working interest owner of the Hunter Misener West Unit. Id. In sum, PetroCorp asserts: "Royalty owners must own an interest within the respective tracts located within the unit outlines, and in adopting the Unit Agreement, the BLM has agreed with same." Id.

In his brief (Brief) dated September 3, 1997, Davis states that while he has been ordered by BLM to report Misener Formation production from the Burl #1-7 well, which is a well within the privately owned Hunter Misener West Unit, BLM owns no interest in that unit and can only make this claim as a result of the original CA which covers all of sec. 7. (Brief at 1.) Moreover, Davis urges: "The BLM takes the position that royalty payments are due as a result of the CA, yet the BLM takes the position they have no obligation to share royalties received from the Hunter Misener Unit with the other owners in section 7, outside that unit." Id.

Davis argues that the Unit Agreement supersedes prior voluntary and involuntary communitization agreements and creates a new formula for payment of royalties. In effect, Davis claims:

The approval of the Plan of Unitization effectively rendered OKNM75348 (CA) ineffective as to the Misener formation. It is impossible for the BLM to conclude they are entitled to the royalty from the Hunter Misener Unit free from the claims of the other royalty owners in Section 7 and outside the Hunter Misener Unit, while attempting to enforce a claim on royalties from those same persons.

Id. at 2.

In its Response, BLM states, in pertinent part:

In all cases in which a secondary recovery unit is approved for a zone or formation involving jurisdictional lands

managed by the TFO [Tulsa Field Office] already in a CA covering the same zone or formation, it is policy to keep the CA intact. This protects the correlative rights of all parties to the CA.

Each approved secondary unit delineates how the total production from the unit will be allocated or distributed. The equity formula in the unit agreement determines this participation factor for each unit tract. This participation factor determines the fraction of the total unit production each tract receives, regardless of where in the unit it is actually produced.

Under this policy, a secondary recovery unit agreement allocates the appropriate fraction of total production, regardless of where produced within the unit, to each unit tract according to the unit allocation formula and participation factor. The total of all production, whether produced from a CA or allocated to any tract covered by a CA from ANY source whatsoever is considered communitized production, and is further distributed according to the CA involved.

* * * * *

It is immaterial which wells within the two units or the CA actually produce from the Misener Formation. The total production from each unit is distributed to unit tracts according to the individual unit agreement. The unit agreements are "blind" as to origin of production, and wells lose their ability to be distinguished individually. Any Misener production allocated to sec. 7 from any source whatsoever is production covered by CA OKNM75348. It is necessary that production for a CA be reported under a well or wells. The selection of the Burl No. 1 Well is for production reporting purposes only. * * * To reiterate, the instant case neither establishes new policy nor alters existing TFO policy.

(Response at 3-4.)

The bedrock issue underlying the position advanced by each of the parties is whether and to what extent BLM has discretionary authority to disregard the specific reporting provisions of a BLM-approved unit agreement for secondary recovery within one geologic formation, and demand that the parties follow the reporting requirements found in a superseded CA negotiated for primary recovery from eight separate formations including the formation from which the secondary recovery is being realized. In its March 19 and 21, 1997, orders, BLM required that PetroCorp and Davis, the unit operators within sec. 7, report secondary recovery production from the Hunter Misener Formation as if the two units were one unit (i.e., part of the same CA, as during primary recovery), notwithstanding the facts that the lands and the substances each unit yields are not committed to the other unit, and that the Unit Agreement for the Federal lands was approved

and ratified by BLM. The October 19, 1994, BLM letter accepting the Unit Agreement (Oct. 19, 1994, Letter) states: "The Federal lease or leases committed to said agreement are hereby established, altered, changed, or revoked to conform with the terms and conditions of the agreement." (Oct. 19, 1994, Letter at 2, para C.)

The only BLM explanation for this repudiation (i.e., that the Unit Agreement reporting requirements be ignored) in the Orders to Report was the statement that

it is the position of the BLM that, notwithstanding this term, in order to protect the correlative rights of all parties signatory to a preexisting agreement now covered by another agreement, that the preexisting agreement (OKNM75348) continues in full force and effect, as though the units did not exist.

(March 19, 1997, Order to Report at 1.) There was no explanation in the March 19 or March 21, 1997, orders, or in the BLM Response to appellants' pleading, of how correlative rights of any of the parties to the CA were threatened by the Unit Agreement, or any explanation of what, if any, conditions had changed between 1994 and 1997 which might justify repudiation of a reporting provision of an agreement specifically approved by BLM. Moreover, there has been no assertion by any other lessee, and no showing by BLM, that drainage on other leases represented in the original CA is threatened by PetroCorp's secondary recovery effort. In fact, the collateral rights that could most reasonably be threatened are those represented by William H. Davis, and Davis has challenged BLM in its repudiation of the reporting provisions in the 1994 unitization agreement.

[1] The Secretary's authority to permit agreements for the purpose of conserving natural resources and collectively engendering production from a prospectively productive oil and gas field located on public lands is found in the Mineral Leasing Act, at 30 U.S.C. § 226(m) (1994). ^{1/} The

^{1/} Section 226(m) (formerly 226(j)) provides, in pertinent part:

"For the purpose of more properly conserving the natural resources of any oil or gas pool, field, or like area, or any part thereof * * *, lessees thereof and their representatives may unite with each other, or jointly or separately with others, in collectively adopting and operating under a cooperative or unit plan of development or operation of such pool, field, or like area, or any part thereof, whenever determined and certified by the Secretary of the Interior to be necessary or advisable in the public interest. The Secretary is thereunto authorized, in his discretion, with the consent of the holders of leases involved, to establish, alter, change, or revoke drilling, producing, rental, minimum royalty, and royalty requirements of such leases and to make such regulations with reference to such leases, with like consent on the part of the lessees, in connection with the institution and operation of any such cooperative or unit plan as he may deem necessary or proper to secure the proper protection of the public interest."

Unit Agreement draws significantly from the model unit agreement, which is set out at 43 C.F.R. § 3186.1.

In our review of the effect of BLM's repudiation of the previously approved reporting requirements within the 1994 Unit Agreement, we look to Federal contract law. Contracts approved by the Secretary are subject to the same rules of interpretation as are contracts between private parties. Asarco Inc., 116 IBLA 120, 126 (1990), and cases there cited. Federal law, which controls the construction of Federal contracts, follows principles of general contract law. Id. A primary task of contract interpretation is to ascertain the intent of the parties from the language of the contract and the circumstances under which it was made by giving contract provisions their natural and most commonly understood meaning. Gibbs v. Air Canada, 810 F.2d 1529, 1533 (11th Cir. 1987). The plain and unambiguous meaning of a written agreement controls unless there is clear evidence of contrary intent. Pennsylvania Ave. Development Corp. v. One Parcel of Land in D.C., 670 F.2d 289, 292 (D.C. Cir. 1981).

The Unit Agreement at issue here unambiguously states at Article III, Creation and Effect of Unit, sec. 3.1, Oil and Gas Rights Unitized:

Subject to the provisions of the Plan of Unitization, all Oil and Gas Rights of Royalty Owners in and to the lands described in Exhibit "B", and all Oil and Gas Rights of Working Interest Owners in and to said lands, are hereby unitized insofar as the respective Oil and Gas Rights pertain to the Unitized Formation, so that Unit Operations may be conducted as if the Unitized Formation has been included in a single lease executed by all Royalty Owners, as Lessors, in favor of all Working Interest Owners, and as if the lease had been subject to all of the provisions of this Plan of Unitization.

(Unit Agreement at 3.) Moreover, BLM's unconditional acceptance of the Unit Agreement is evidenced by its Approval-Certification-Determination document signed on October 19, 1994.

[2, 3] Therefore, we must examine BLM's authority to unilaterally reform the Unit Agreement to include reporting requirements not present therein, and, in effect, direct the operator to pay benefits from the Hunter Misener West Unit, by forcing a commingling of production reporting as existed under the CA. In Shannon Oil Co., 62 I.D. 252, 255 (1955), it was held that the Secretary of the Interior has no authority to reform a unit agreement, previously approved by him pursuant to the provisions of the Mineral Leasing Act, to include land not committed to the unit agreement. In that case, unlike the circumstances here, land was omitted from the Unit Agreement through error. The Shannon opinion held that only the parties could reform the agreement to state their true intentions in the matter if, in fact, it was their understanding that the tract in question should have been committed to the agreement. Id.

The 1994 Unit Agreement provides that unit production may not be allocated to land not committed to the unit. The opposite is also true. Article 1 of the Unit Agreement defines "unitized formation" as land "underlying the unit area." Article 5 of the Unit Agreement limits tract participation in allocation of all unitized substances to owners of tracts of land within the Unit. (Secs. 5.1; 5.2.) Lands not committed to the Unit have, by the terms of the Unit Agreement, no relationship to production from the unitized lands. Since the private Hunter Misener West tract in sec. 7 is not committed to the Unit Agreement, the Hunter Misener Unit Operator is not required to allocate production under the agreement, unless it is improperly draining Federal leaseholds, as addressed below.

BLM is apparently arguing, although without specificity, that it may pursue a remedy to prevent drainage from other formations in the original CA, without providing any evidence whatsoever that any well within the private Hunter Misener West Unit is draining a Federal lease. Federal regulations pertaining to drainage set forth the requirements outlined in Nola Grace Ptasynski, 63 IBLA 240, 252-253, 89 I.D. 208, 215-216 (1982), in which a lessee will be required to protect Federal lands from drainage to the extent that a reasonably prudent operator would do so, after notice to the lessee that BLM has determined the lands are being drained, and that offset drilling or compensatory royalties are required. See Bruce Anderson, 80 IBLA 286, 299, 91 I.D. 203, 211 (1986); Gulf Oil Exploration & Production Co., 94 IBLA 364, 372 (1986). The record contains no evidence that BLM has determined that any Federal lease within the original CA is being drained by the secondary recovery effort in the private Hunter Misener West Unit, or that BLM has provided any notice to PetroCorp to protect against drainage within its portion of the Hunter Misener Sand Formation represented by the Unit Agreement.

Because BLM has made no determination that drainage is actually occurring, as required by Nola Grace Ptasynski, supra, the Department is entitled to no revenue from an uncommitted private tract located adjacent to a unit area. See Bruce Anderson, supra. In Anderson, we held that unless there were an approved communitization agreement covering the land at issue, the United States could make no claim upon production within the drilling unit where the well was not located on Federal land, because

[i]n the absence of an approved communitization agreement, the Federal Government has no claim to its pro rata royalty from production of the Dishen #1-17 well, since the State's pooling order is ineffective as to the Federal royalty interest absent the expressed consent of the United States. Nor could the United States sustain a claim for compensatory royalty for the royalties earned prior to lease expiration since * * * the lessee would not be liable for any such royalties at the time the lease expired, absent his expressed commitment to tender the same. Thus, it would seem that the United States has lost any claim to royalties earned by production from the Dishen #1-17 well.

80 IBLA 301-02, 91 I.D. 211-12. That reasoning applies to this case. The original 1991 CA was superseded by the 1994 Unit Agreement which specifically states that its terms apply. It is now too late for BLM to alter the unit operating agreement by inserting a new provision into the agreement after it has become effective, absent some showing that its requirement to preserve the Federal land within the Hunter Misener Unit from drainage is implicated. At this point, BLM lacks authority to attempt to modify the agreement so as to condition terms upon which the reporting requirements are established. Consequently, BLM's attempt to condition the terms which establish the production reporting requirements must be reversed. See, e.g., Coors Energy Co., 110 IBLA 250, 259 (1989).

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the decision appealed from is reversed.

James P. Terry
Administrative Judge

I concur:

R. W. Mullen
Administrative Judge