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INTRODUCTION

This article aims to facilitate a comparison of the United States offshore leasing system with the systems of the United Kingdom and Norway through the exploration of certain offshore oil and gas lease terms. The following discussion does not cover all of the current Outer Continental Shelf (OCS) lease terms, but instead focuses on issues selected for their particularized comparative value. Part I provides a background on the Outer Continental Shelf Lands Act (OCSLA)[1] and discusses related law, with a particular focus on the recent decision in *Century Exploration New Orleans, LLC v. United States*. Part II identifies certain OCS lease terms and attempts to examine those provisions in the context of their statutory and regulatory structures. This article establishes a basis for comparative study with the systems of the United Kingdom and Norway, and serves as an OCS leasing primer for those companies doing business offshore.

I. BACKGROUND

Under OCSLA, the United States exercises jurisdiction and control over the submerged lands of the OCS. As defined, the OCS encompasses all submerged lands beyond the outer limits of state jurisdiction but within the limits of national jurisdiction.[2] OCSLA extends the legal jurisdiction of the United States to:

> the subsoil and seabed of the [OCS] and to all artificial islands, and all installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exploring

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1. Outer Continental Shelf Lands Act 43 U.S.C. §§ 1331–1356 (2012).
2. State jurisdiction extends three miles from shore and national jurisdiction ceases two hundred miles from shore. *See* Submerged Lands Act 43 U.S.C. §§ 1301, 1331(a), 1332 (2012); Amber Res. Co. v. United States, 538 F.3d 1358, 1362 (Fed. Cir. 2008).

> for, developing, or producing resources therefrom, or any such installation or other device (other than a ship or vessel) for the purpose of transporting such resources, to the same extent as if the [OCS] were an area of exclusive Federal jurisdiction within a State.[3]

OCSLA charges the Secretary of the Interior (Secretary) with the issuance and administration of leases authorizing private parties to explore the OCS for oil and natural gas and with the regulation of such leasing activities.[4] The Act sets out a comprehensive offshore leasing scheme and grants the Secretary authority to prescribe such rules and regulations as may be necessary to carry out lease-related activities.[5] Since OCSLA's inception, the Secretary, acting on behalf of the Department of the Interior (DOI), has promulgated myriad regulations now codified in Title 30 of the Code of Federal Regulations.

Until June 2010, a DOI bureau called the Minerals Managements Service (MMS) assumed responsibility for offshore resource management. However, following the *Deepwater Horizon* incident,[6] DOI reorganized the MMS into three new sub-agencies: (1) the Bureau of Ocean Energy Management (BOEM), (2) the Bureau of Safety and Environmental Enforcement (BSEE),[7] and (3) the Office of Natural Resources Revenue (ONRR).[8] Of the three sub-agencies, BOEM now manages all leasing activities and establishes the lease provisions for each lease sale.

A. Applicable Law

The federal offshore lease is the primary contract between the federal government and a lessee.[9] Like most oil and gas leases, leases issued on

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3. 43 U.S.C. § 1333(a)(1).
4. *See* 43 U.S.C. §§ 1331(b), 1334(a).
5. 43 U.S.C. § 1334(a).
6. On April 20, 2010, an explosion on the Deepwater Horizon drilling platform started the largest marine oil spill in U.S. history, releasing millions of barrels of oil into the Gulf of Mexico.
7. BSEE handles all field operations including permitting and research, inspections, oil spill response, training and environmental compliance functions, and pipeline right-of-way activities. BSEE's key functions include developing standards and regulations for offshore operators' Oil Spill Response Plans (OSRPs) and for the Offshore Regulatory Program to enhance operational safety and environmental protection on the OCS and ensure operators' compliance with all applicable environmental regulations. *See* 30 C.F.R. § 250.101 (2015).
8. The ONRR handles all revenue collection functions including asset management, auditing and compliance, and investigation and enforcement. *See* 30 C.F.R. § 1201.100.
9. *See* Mobil Oil Exploration & Producing S.E., Inc. v. United States, 530 U.S. 604, 608–10 (2000) (holding that offshore leases issued pursuant to OCSLA are contracts); Amber Res. Co. v. United States, 538 F.3d 1358, 1367 (Fed. Cir. 2008).

the OCS "grant and lease to the [l]essee the exclusive right and privilege to drill for, develop, and produce oil and gas resources, except helium gas, in the submerged lands of the [leased area]."[10] However, unlike typical private leases where lessors and lessees negotiate terms, Section 1337 of OCSLA sets out certain mandatory terms and conditions for "Section 8" OCS leases.[11] For example, a leased tract may not exceed 5,760 acres and certain royalties must be paid. Additionally, the lease must have an initial term of five to ten years, must provide for lease suspension and cancellation, and must entitle a lessee to explore, develop and produce oil and gas within the lease area, conditioned upon due diligence requirements and the approval of development and production plans.[12]

Offshore leases are issued on forms approved by BOEM.[13] Currently, BOEM uses Form BOEM-2005 (Lease Form) to convey mineral rights on the OCS.[14] Although the Lease Form governs the relationship between lessor and lessee for some of the most complicated and expensive drilling in the world, it is only four pages long and contains only twenty-four lease provisions.

However, the implication that the limited provisions of the Lease Form constitute the entirety of OCS lease governance is misleading; OCS leases incorporate by reference thousands of applicable statutes and regulations governing the drilling, developing and operating of OCS leases. Section 1 of the Lease Form provides that it is "issued pursuant to the Outer Continental Shelf Lands Act" and

> subject to all of the provisions of the Act, regulations promulgated pursuant thereto, and other statutes and regulations in existence upon the Effective Date of the lease, and those statutes enacted (including amendments to the Act or other statutes) and regulations promulgated thereafter, except to the extent they explicitly conflict with an express provision of this lease. It being expressly understood that amendments to existing statutes and regulations, including but not limited to the Act, as well as

10. *See* 43 U.S.C. § 1337(b)(4) (Providing that leases issued under OCSLA "entitle the lessee to explore, develop, and produce the oil and gas contained within the lease area, conditioned upon due diligence requirements and the approval of the development and production plan required by this sub-chapter.").

11. "Section 8" leases refer to leases issued according to bidding procedures pursuant to Section 8 of OCSLA. 43 U.SC. § 1337. OCS leases issued by the States are referred to as Section 6 leases. 43 U.S.C. § 1335; *see also* 30 C.F.R. § 556.79 (effect of regulations on Section 6 leases).

12. *See* 43 U.S.C. § 1337(b).

13. *See* 30 C.F.R. §§ 556.49, 556.50.

14. Form BOEM-2005 (October 2011).

> enactment of new statutes and promulgation of new regulations, which do not explicitly conflict with an express provision of this lease may be made and that the Lessee bears the risk that such may increase or decrease the Lessee's obligations under the Lease.[15]

Thus, the current version of the OCS Lease Form incorporates by reference all statutes and regulations that were in effect at the time of lease execution *and* all future statutes and regulations, provided they do not explicitly conflict with an express provision of the lease.[16]

1. Century Exploration New Orleans, LLC v. United States

Recently, *Century Exploration New Orleans, LLC v. United States* raised questions about the prospective and retroactive application of new regulations.[17] In that case, an OCS operator challenged whether new regulations may alter an OCS lease. The case arose after the DOI, in response to the 2010 *Deepwater Horizon* incident, issued new guidance increasing the required bond amounts that offshore lessees must post for oil spill financial responsibility (OSFR).

Century Exploration New Orleans, LLC's (Century) OSFR bond requirements skyrocketed from $35 million to $150 million as a result of the new regulations. In response, Century filed suit against the federal government, arguing that the United States breached the lease by amending the OSFR requirements after the effective date of their lease and that the amendments were made pursuant to the Oil Pollution Act (OPA), not OCSLA.[18] Section 1 of Century's lease provided that it was

> issued pursuant to the Outer Continental Shelf Lands Act of August 7, 1953, 67 Stat, 462[,] 43 U.S.C. §1331 et seq., as amended (92 Stat. 629), (hereinafter called the 'Act'). The lease [was] issued subject to the Act; all regulations issued pursuant to the Act and in existence upon the Effective Date of [Century's] lease; all regulations issued pursuant to the statute in the future which provide[d] for the prevention of waste and conservation of the natural resources of the

15. Lease Form at § 1.
16. *See also* 30 C.F.R. § 556.79. The regulations also authorize the BOEM to issue Notices to Lessees and Operators (NTL"s), which "clarify, supplement, or provide more detail about certain requirements." 30 C.F.R. § 550.103. Further, "NTLs may also outline what [lessees] must provide as required information in [their] various submissions to BOEM." *Id*.
17. *See* Century Exploration New Orleans, LLC v. United States, 110 Fed. Cl. 148, 182 (2013), *aff'd*, 745 F.3d 1168 (Fed Cir. 2014), *cert. denied,* 135 S. Ct. 1175 (2015).
18. *Id.*

> Outer Continental Shelf and the protection of correlative rights therein; and all other applicable statutes and regulations.[19]

Century contended that the lease was subject to all applicable statutes and regulations in effect on the execution date and subject to certain future OCSLA regulations. However, Century maintained that the lease did not incorporate amendments to existing non-OCSLA statutes—like those made to the OPA. Following a thorough analysis of OCSLA's legal framework and the construction of Section 1,[20] the court held that the OSFR revisions amended OCSLA, and not the OPA. The court specifically noted that, while the new regulation concerned blowout protection—an issue clearly within the ambit of OPA—OCSLA also authorized the government to take the same actions. Thus, the lease was subject to the OSFR regulatory changes. The court recognized that "when they executed their lease, the parties shared a mutual understanding that the law governing exploration and development under a lease might change in the future, and the terms of the lease expressly provided for such change in section 1."[21]

It is noteworthy that the broad language in Section 1 of the current Lease Form is even more expansive in scope than the language in the Century lease. Specifically, the new lease form incorporates *all* future statutes and regulations, not just those issued under OCSLA.

2. Role of State Law

Federal law governs the OCS because OCSLA extends federal and legislative jurisdiction beyond the shores of the United States and out into its surrounding waters. However, the drafters of OCSLA were concerned that federal law, due to its limited function in a federal system, might be inadequate to cope with the full range of potential legal problems presented by offshore oil and gas activities. For this reason, OCSLA supplements gaps in federal law with state law through the adoption of state law as surrogate federal law when there is no federal law on point.[22]

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19. *Id*. at 164.

20. *See id*. at 164. ("Thus, section 1 allocates the risk of certain legal changes—future regulations issued pursuant to OCSLA—to plaintiffs, and it allocates the risk of other legal changes—future statutes, amendments of existing statutes, and future regulations issued pursuant to statutes other than OCSLA—to the government.").

21. *Id*.

22. *See* 43 U.S.C. § 1333(a)(2)(A) ("To the extent that they are applicable and not inconsistent with this subchapter or with other federal laws and regulations of the secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State . . . are declared to be the law of the United

As a result, lessees must also be aware that adjacent state law may be applicable, under certain circumstances, for issues arising under OCS leases, whether such issues arise between a lessor and lessee or between the lessee and a third party.[23]

II. CURRENT OCS LEASE TERMS

A. Initial Period

OCS leases are typically issued for a primary term, or initial period, between five to ten years depending on water depth.[24] Before 2010, leases lasted for a term of five years in water depths less than 400 meters, eight years in depths from 400 meters to 800 meters, and ten years for water depths deeper than 800 meters. The most recent lease terms applicable for OCS lease sales are:

> (1) For leases in water depths of 400 meters and less, the standard initial period is five years; a lessee may earn an additional three years if a well is spudded targeting hydrocarbons below 25,000 feet True Vertical Depth during the first five years.
>
> (2) For leases in water depths of 400–800 meters, the standard initial period is five years; the lessee will earn an additional three years if a well is spudded during the first five years.
>
> (3) For leases in water depths of 800–1,600 meters, the standard initial period is seven years; the lessee will earn an additional three years if a well is spudded during the first seven years.
>
> (4) For leases in water depths of more than 1,600 meters, the period is ten years.[25]

States for [the OCS]. . . ."); *See* Rodrigue v. Aetna Cas. & Sur. Co., 395 U.S. 352, 357 (1969); *In re* Deepwater Horizon, 745 F.3d 157, 163 (5th Cir. 2014); *See also* Union Texas Petroleum Corp. v. PLT Eng'g, Inc., 895 F.2d 1043, 1050 (5th Cir. 1990) ("We find it beyond any doubt that OCSLA is itself a Congressionally mandated choice of law provision requiring that the substantive law of the adjacent state is to apply even in the presence of a choice of law provision in the contract to the contrary.").

23. While a number of circumstances bring state law into question in disputes between lessees and third parties, this article focuses on the relationship between lessees and lessors.

24. *See* 30 C.F.R. § 556.37 (2015).

25. *See* Final Notice of Sale, Central Gulf of Mexico Planning Area (CPA) Outer Continental Shelf (OCS) Oil and Gas Lease Sale 235 (CPA Sale 235), 80 Fed. Reg. 6758.01 (Feb. 6, 2015).

Annual rentals are due each year before the discovery of oil or gas on the lease. Once a lease begins production, rental payments are no longer applicable. Instead, the lease provides for payment of an annual minimum royalty, which is due at the end of the year and is prorated for actual royalties paid during the lease year.[26]

B. Extension of Lease Term by Lease Activities

Offshore leases are subject to traditional oil and gas lease maintenance concepts. Section 3 of the Lease Form provides:

> This lease shall continue from the Effective Date of the lease for the Initial Period and so long thereafter as oil or gas is produced from the leased area in paying quantities, or drilling or well reworking operations, as approved by the Lessor, are conducted thereon, or as otherwise provided by regulation.[27]

The objective of drilling or well-reworking operations under Section 3 must be to establish production in paying quantities on the lease.[28] Production in paying quantities for the purpose of continuing the lease beyond its primary term "means the production of enough oil and gas to yield a positive stream of income after subtracting normal expenses (i.e. operating costs), which include the sum of: (1) minimum royalty or actual royalty payments, and (2) the direct lease operating costs."[29]

When production in paying quantities ceases on a lease continued beyond its primary term, the lease expires unless the lessee resumes operations[30] or obtains approval for a suspension of operations or production within 180 days.[31] Yet, BOEM may exercise discretion in

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26. *See* 43 C.F.R. § 3103.3–2.

27. U.S. DEP'T INTERIOR, BUREAU OCEAN ENERGY MGMT., OIL AND GAS LEASE OF SUBMERGED LANDS UNDER THE OUTER CONTINENTAL SHELF LANDS ACT, www.boem.gov/BOEM-2005/ [http://perma.cc/A3QH-JT93] (last updated Oct. 2011); *See also* 30 C.F.R. § 556.37 ("An oil and gas lease shall continue after such initial period for as long as oil or gas is produced from the lease in paying quantities, or drilling or well reworking operations as approved by the Secretary are conducted.").

28. 30 C.F.R. § 250.180. *See also* 30 C.F.R. § 556.70.

29. U.S. DEP'T. INTERIOR, MINERALS MGMT. SERV., EXTENSION OF LEASE AND UNIT TERMS BY PRODUCTION IN PAYING QUANTITIES, NTL NO. 2008-N09 (2008).

30. For purposes of this section, the term operations means, drilling, well-reworking, or production in paying quantities. The objective of the drilling or well-reworking must be to establish production in paying quantities on the lease. *See* 30 C.F.R.§ 250.180(a)(2).

31. *See* 30 C.F.R. § 250.180(d); *See also* Kerr-McGee Oil & Gas Corp., 172 Interior Dec. 195 (IBLA 2007) (When operations cease and extraordinary events occur which adversely affect a lessee's ability to resume operations within 180

allowing a lessee more than 180 days to resume operations if operating conditions warrant extension.[32] If the lessee stops conducting operations during the last 180 days of the primary term, the lease will expire unless operations are resumed within 180 days following the cessation of operations or a suspension is granted before the end of the 180th day after operations cease.[33] If a lease term is extended following cessation for less than 180 days, rental or minimum royalty is due, as appropriate, for each year or part of the year during which the lease continues in force beyond the end of the primary term.[34]

C. Suspension of Lease Term

Because offshore operations (especially deepwater and ultra-deepwater activities) present complex issues for exploration, development, production and transportation, a lessee may seek to extend the initial term of a lease by suspension—either by a suspension of operations (SOO) or by a suspension of production (SOP).

Regulations authorize BSEE to issue "requested" or "directed" suspensions.[35] Pursuant to 30 C.F.R. § 250.172, BSEE may grant or direct a suspension of operations or suspension of production:

> (1) When necessary to comply with judicial decrees prohibiting any activities or the permitting of those activities. The effective date of the suspension will be the effective date required by the action of the court;
>
> (2) When activities pose a threat of serious, irreparable, or immediate harm or damage. This would include a threat to life (including fish and other aquatic life), property, any mineral deposit, or the marine, coastal, or human environment BSEE may require you to do a site-specific study (see §250.177(a))
>
> (3) When necessary for the installation of safety or environmental protection equipment;

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days, the lessee or operator must apply for and secure a suspension of operations or production within that 180 day period.).

32. *See* 30 C.F.R. § 250.180 (e).
33. *See* 30 C.F.R. § 250.180(b).
34. *See* 30 C.F.R. § 250.180 (c).
35. *See* 30 C.F.R. § 250.168–77; *See also* 43 U.S.C. § 1334(a)(1) (OSCLA explicitly authorizes that the regulations to be prescribed by the Secretary provide for the "suspension or temporary prohibition of any activity, including production . . . .").

> (4) When necessary to carry out the requirements of NEPA or to conduct an environmental analysis; or
>
> (5) When necessary to allow for inordinate delays encountered in obtaining required permits or consents, including administrative or judicial challenges or appeals.[36]

These criteria apply to all or any part of a lease or unit.[37] The authority of BSEE to grant a suspension at a lessee's request is discretionary;[38] BSEE issues suspensions "in the exercise of its discretion and not as a matter of right."[39]

When seeking an SOO or SOP, a lessee must submit its request for suspension prior to the termination of the lease term, either before the end of the initial period, the end of the 180 day period, or the termination of an existing SOO or SOP.[40] When suspension request filing is timely, the request tolls the expiration of the lease until BSEE responds.[41] All requests require payment of a fee and must include the reason for the suspension, the length of time requested, and a reasonable activity schedule of work to initiate or restore production.[42]

BSEE may issue suspensions for periods of up to five years[43] and may also grant subsequent consecutive periods.[44] A suspension can extend the term of the lease by indicating the length of time the suspension is in effect, except in the case of directed suspensions due to gross negligence or willful violations of the lease, barring extension.[45] A lessee must pay the annual rental or minimum royalty during the suspension period, unless BSEE directs the SOP or SOO and the lessee has complied with all applicable laws, regulations, orders, or provisions of the lease or permit.[46]

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36. U.S. DEP'T. INTERIOR, MINERALS MGMT. SERV.,NTL NO. 2000-G17, SUSPENSION OF PRODUCTION/OPERATIONS OVERVIEW (2000) [hereinafter NTL NO. 2000-G17].
37. A unit is the total area incorporated in a unitization agreement. Unitization is a combination of two or more separately owned leases for joint exploration or development of a common hydrocarbon accumulation.
38. *See* California v. Norton, 311 F.3d 1162, 1173 n.6 (9th Cir. 2003).
39. Hoyl v. Babbitt, 129 F.3d 1377, 1384 (10th Cir. 1997).
40. *See* U.S. DEP'T. INTERIOR, MINERALS MGMT. SERV.,NTL NO. 2009-N02, TIMELY SUBMISSION OF SUSPENSION REQUESTS (2009).
41. *See id*.
42. *See* NTL NO. 2000-G17, *supra* note 36.
43. *See* 30 C.F.R. §§ 250.170, 256.73(c) (2015).
44. *Id*.
45. *See* 30 C.F.R. § 250.169.
46. *See* 30 C.F.R. §§ 1218.154, 250.173.

1. Suspension of Operations

No *force majeure* provision in the Form Lease exists, under either OCSLA or the regulations. However, an SOO acts much like a *force majeure* clause, as BSEE may grant an SOO to allow reasonable time to commence drilling operations when reasons beyond the lessee's control, "such as unexpected bad weather, rough seas, unavoidable accidents or drilling rig delays," prevent work in spite of lessee's good faith and diligent efforts.[47] SOOs are also appropriate when additional time is necessary for conducting geological analysis and for certain subsalt and ultra-deep drilling operations.[48]

Lessees typically submit an SOO near the end of the lease term and they last a short duration. A well capable of producing hydrocarbons in paying quantities need not be present on the lease for BSEE to grant an SOO. However, a lessee must be able to show, where appropriate, that a "particular drilling rig was scheduled to conduct operations at [the] location before the lease expiration date."[49]

BSEE may issue a directed SOO and prohibit a lessee from drilling or performing lease activities when a lease is shut-in for violations of an applicable law or regulation; order or provision of a lease or permit; or in the interest of national security or defense.[50] BSEE sets the duration of a directed suspension, which extends the lease accordingly. A directed SOO will not extend the lease term of a lease when issued as a result of gross negligence or due to a willful violation of a provision of the lease or governing statutes and regulations.[51]

2. Suspension of Production

SOPs are typically granted to facilitate lease production and not solely for the purpose of exploration. The Regional Supervisor may grant or direct an SOP when suspension is in the national interest and meets one of the following criteria:

> (1) It will allow you to properly develop a lease, including time to construct and install production facilities;

47. 30 C.F.R. § 250.175(a).
48. *See* 30 C.F.R. §§ 250.175(b), 250.175(c).
49. ATP Oil & Gas Corp. v. DOI, No. 08-1514, 2009 U.S. Dist. LEXIS 75836, at *2 n.3 (E.D. Aug. 26, 2009), *aff'd,* 396 F. App'x 93 (5th Cir. 2010).
50. *See* 30 C.F.R. § 250.173.
51. *See* 30 C.F.R. § 250.169(b).

> (2) It will allow you time to obtain adequate transportation facilities;
>
> (3) It will allow you time to enter a sales contract for oil, gas, or sulphur. You must show that you are making an effort to enter into the contract(s); or
>
> (4) It will avoid continued operations that would result in premature abandonment of a producing well(s).[52]

A lessee must also demonstrate a "firm commitment" to develop and produce proven reserves.[53] For BSEE to grant an SOP, there should be a well capable of producing hydrocarbons in paying quantities on the lease.[54] However, BSEE may consider an SOP when a lease is nearing the end of its primary term but is not yet producing in paying quantities, insofar as there is a clear and firm commitment to production.[55] An SOP may be granted for co-development, phased development, geophysical acquisition, and analysis.[56] BSEE may also extend a lease if a Development & Production Plan (DPP) is rejected.[57] An SOP may be directed when a lease is shut-in for violations of an applicable law, regulation, order or provision of a lease or permit, or in the interest of national security or national defense.[58]

A request for an SOP must include a brief lease history demonstrating diligence and a firm commitment to produce; a description of the proposed course of action to initiate or restore production; a reasonable activity schedule with measurable milestones that ultimately lead to production; reservoir structure and isopach maps; and a reserve estimate, including the anticipated reservoir life.[59]

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52. 30 C.F.R. § 250.174.
53. *See* 30 C.F.R. § 250.171(d).
54. *See* U.S. DEP'T INTERIOR, MINERALS MGMT. SERV. GULF OF MEXICO REGION, OIL AND GAS LEASING PROCEDURES GUIDELINES, 52 (2001), http://www.boem.gov/uploadedFiles/BOEM/Oil_and_Gas_Energy_Program/Leasing/Regional_Leasing/Gulf_of_Mexico_Region/2001-076.pdf [http://perma.cc/27EM-F8QV].
55. *See id*. at 53.
56. *See id.* at 54–55.
57. *See* 30 C.F.R. § 550.183.
58. *See* 30 C.F.R. § 250.173.
59. *See* NTL No. 2000-G17, *supra* note 36.

3. Deepwater SOP Denied

DOI recently issued a denial of an SOP application that changed the standards to which all future applicants will be held.[60] In 2008, ExxonMobil, acting as the operator of a five block deepwater unit, requested an SOP to allow time to tie-back production to an adjacent host facility that had not yet been constructed. MMS denied the request, concluding ExxonMobil had not shown a commitment to production because development was based on activities outside its control.[61] MMS explained:

> This asserted commitment is contingent upon 1) the potential fabrication and installation of a facility by another operator for another field, 2) a proposed facility of which you are not a party and have no control, 3) the future success of obtaining a contract with the operator of the proposed facility in order to tie-back WR 627 Unit wells, and 4) a proposed facility that would not likely be designed to handle WR 627 Unit production upon startup.[62]

ExxonMobil and its co-lessee Statoil appealed the MMS denial, and the IBLA reversed, finding that an SOP applicant need not own, control or operate the host production facility and may plan to use transportation facilities owned by third parties that have yet to be constructed.[63] Further, the IBLA court rejected MMS' assertion that it enjoyed unfettered discretion to determine "commitment to production."[64]

The MMS sought review of the IBLA decision, and the Director of the DOI Office of Hearings and Appeals (OHA) reversed and reinstated the SOP denial.[65] ExxonMobil and Statoil filed suit against the DOI for judicial review, alleging that the SOP denial violated the Administrative Practices Act, OCSLA, and the due process and equal protection clauses of the Fifth Amendment.[66] After agreeing to a temporary stay of the lease, the parties ultimately entered into an undisclosed settlement agreement. According to BOEM leasing files, the Julia unit is currently held by unit operations preceded by a directed unit SOP stretching from December

60. Statoil Gulf of Mexico L.L.C. ExxonMobil Corp., DIR 2010-0027, 2009 WL 2946711 (May 31, 2011).
61. Statoil Gulf of Mexico L.L.C., 178 Interior Dec. 244, 253 (IBLA 2009).
62. *Id*.
63. *See id*. at 259–61.
64. *See id*. at 263–65.
65. *See* Statoil Gulf of Mexico L.L.C. ExxonMobil Corp., DIR 2010-0027, 2009 WL 2946711 (May 31, 2011).
66. *See* ExxonMobil v. DOI, 2:11-cv-01474 (W.D. La.).

2008 through October 2013, as well as a subsequent unit SOP extending from November 2013 to August 2014.

Importantly, DOI has adopted OHA's denial of ExxonMobil's SOP as "binding agency interpretation" applicable to SOP requests submitted after May 31, 2011.[67] OHA's decision underlines the following significant policy implications: (1) A deepwater host facility will be considered a production facility, not a transportation facility; (2) The SOP regulations are not interpreted to authorize SOPs to provide excess time to build or negotiate use of a production facility; and (3) Lessees should not expect the BSEE to grant an SOP on the grounds that more time is needed to tie-back a host facility, unless the lessee owns the facility or has signed a contract with the host facility owner before the lease expires. *Statoil* also bears significant weight as the first instance in which the DOI denied a deepwater unit SOP.

D. Unitization Authority

OCSLA expressly provides for "unitization, pooling and drilling agreements."[68] Section 16 also authorizes unitization, providing with specificity:

> Within such time as the Lessor may prescribe, the Lessee shall subscribe to and operate under a unit, pooling, or drilling agreement embracing all or part of the lands subject to this lease as the Lessor may determine to be appropriate or necessary. Where any provision of a unit, pooling, or drilling agreement, approved by the Lessor, is inconsistent with a provision of this lease, the provision of the agreement shall govern.[69]

Moreover, OCSLA tasks the Secretary with the duties of preventing waste, conserving natural resources, and protecting correlative rights on the OCS. As such, the Secretary has promulgated applicable regulations authorizing BSEE to approve or require unitization to fulfill those duties and to promote exploration and development.[70] The regulations provide for two types of unitization. One occurs voluntarily when a lessee asks the Regional Supervisor to approve unitization of a lease, or portions thereof, under the terms of a unit agreement. Alternatively, unitization may be

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67. *See* U.S. DEP'T. INTERIOR, MINERALS MGMT. SERV. NTL NO. 2011-N10, SUSPENSIONS OF PRODUCTION (2011) [hereinafter NTL No. 2011-N10].

68. 43 U.S.C. § 1334(a)(4).

69. U.S. DEP'T INTERIOR, BUREAU OF OCEAN ENERGY MGMT., OIL AND GAS LEASE OF SUBMERGED LANDS UNDER THE OUTER CONTINENTAL SHELF LANDS ACT § 16 (2011), http://www.boem.gov/BOEM-2005/ [http://perma.cc/A3QH-JT93].

70. *See* 30 C.F.R. §§ 250:1300(a)–(c).

compulsory, as when the Regional Supervisor requires a lessee to unitize operations after notice and hearing of all parties.[71] Compulsory units are generally reservoir units comprising competitive reservoirs and are rare.[72] More commonly, lessees approach BSEE with pre-drill unitization plans. Significantly, DOI has the authority—but not the obligation—to approve voluntary unitization requests.

To obtain unit approval, lessees must submit a detailed unit proposal and enter into a unit agreement and unit operating agreement.[73] BSEE additionally requires the parties to execute a DOI model unit agreement. The model unit agreement is a contract that modifies the existing lease agreement and enumerates the unitization terms. For example, the model agreement identifies the unit area, provides benefits to unitized leases, designates a unit operator and specifies the effective time period for the agreement.

If any lease, or any part of a lease, is subject to a unit agreement, the entire lease remains in effect as long as lease-holding operations extend the unit or a unit suspension is in effect. The model unit agreement expressly provides for this manner of extension of the primary lease term:

> Drilling and/or producing operations performed hereunder upon any unitized lease will be accepted and deemed to be performed upon and for the benefit of each and every unitized lease, and no lease committed to this agreement shall be deemed to expire by reason of failure to drill or produce a well thereon.[74]

E. Transfer of Leasehold Interest

Two types of leasehold ownership interests exist on the OCS. The first is a "record title" interest, meaning that a lessee's interest in a lease includes the obligation to pay rent and the rights to assign and relinquish the lease. The second and more limited type, referred to as an "operating right interest," is severed from a record title interest. An operating right,

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71. *See* 30 C.F.R. § 250.1301.

72. The basis for compulsory unitization is generally either the prevention of unnecessary wells and infrastructure or to prevent loss of reserves in rate sensitive reservoirs. *See*.MARK HANAN, FEDERAL OFFSHORE UNITIZATION: AN OVERVIEW, BUREAU OF SAFETY AND ENVTL. ENFORCEMENT, 24 http://www.bsee.gov/uploadedFiles/BSEE/BSEE_Newsroom/Speeches/2013/OCSAB_2013_Federal%20Offshore%20Unitization-An%20Overview.pdf [http://perma.cc/356C-WXHG].

73. *See* 30 C.F.R. §§ 250.1301(d), (e); U.S. DEP'T INTERIOR, *supra* note 69 at § 16.

74. *Model Unit Agreement for Exploration, Development, and Production Units*, BUREAU OF SAFETY AND ENVTL., ENFORCEMENT, art. 17.2(a) http://www.bsee.gov/uploadedFiles/BSEE/Exploration_and_Production/Unitization/Model%20Unit%20Agreement%20for%20Exploration.pdf [http://perma.cc/2UAP-MKKU].

or what is often referred to as a working interest, authorizes the holder of that right to enter upon the leased lands for the purpose of drilling and conducting related operations in accordance with the terms of the lease. Typically, operating rights are limited to certain aliquots,[75] depth restrictions, or some combination thereof.[76]

All assignments of OCS leasehold interests—both of record title and operating rights—must be approved by BOEM.[77] To obtain approval, an assignee must qualify to hold a lease with BOEM and provide requisite bond coverage.[78] BOEM will refuse any assignment sought by or for an unqualified company.[79]

Owners of leasehold interests must also meet general, supplemental, and right of way (ROW) bonding requirements. BOEM requires record title owners to obtain bonding or another security for leasehold rights.[80] Thus—prior to the issuance of a new lease or the approval of an assignment of an existing lease—the assignee, another record title owner, or the designated operator for the lease must have in place either a lease-specific bond lease or an area-wide bond to secure all obligations under the lease.[81] Dependent on potential decommissioning liability and a lessee's ability to carry out present and future obligations, BOEM's Regional Director also has authority to require additional security in the form of a supplemental bond or alternative security device.[82] Each lease, right-of-use and easement (RUE), and ROW evaluated as imposing heightened liability must obtain additional coverage. Currently, exception may be made to the supplement security requirement where at least one owner or right-holder can demonstrate sufficient financial ability. To prove requisite financial capacity, an owner must demonstrate sufficient solvency to ensure that wells can be plugged and abandoned, platforms can be removed, and drilling and platform sites—including pipeline corridors—can be cleared of all obstructions. While certain companies are exempt from supplemental bonding requirements, no exemption or waiver exists for the obligation to provide operator or ROW bonds.

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75. Aliquots are square subdivisions limiting the area subject to certain rights within a lease.

76. *See* MINERAL MANAGEMENT SERVICE GULF OF MEXICO OCS REGION, OCS REPORT MMS 2001-076, OUTER CONTINENTAL SHELF: OIL AND GAS LEASING PROCEDURES GUIDELINES 57–60 (2001).

77. *See* 30 C.F.R. § 556.62.

78. *See* 30 C.F.R. §§ 556.62(a), 556.35.

79. *See id.*

80. *See* 30 C.F.R. § 556.52; 43 U.S.C. § 1337(p)(6).

81. *See* 30 C.F.R. §§ 556.52, 556.53 (a), (b).

82. *See* 30 C.F.R. §§ 556.53(d) & (e). "Additional security" as used here denotes security above the operator amounts.

Aging offshore infrastructure, increased decommissioning costs, hazard risks like hurricanes, and high-profile bankruptcies led BOEM to prioritize modernization of the bonding program. Recently BOEM released general information outlining a proposal to update its financial security program, soliciting over 40 comments.[83] Industry insiders expect issuance of a draft financial security rule by December 2015. In the meantime, BOEM will likely release more near-term revisions to supplemental bonding procedures, including the adoption of a credit-based model for self-insurance.

F. Designation of Operator

Co-lessees must designate a single operator to act on behalf of all lessees. An operator must be qualified to do business on the OCS and must post security sufficient to prove an ability to serve as operator. Once selected, a co-lessee must execute a Designation of Operator form (DOO) to memorialize the appointment.[84] With authority granted through a DOO, the designated operator acts as the lessees' agent. As a matter of policy, DOI works directly with the designated operator on all matters affecting the lease, and will look first to the operator for compliance with the lease terms. Lessees and operating rights owners, however, remain jointly and severally responsible for performing lease obligations, and the operator's failure to perform may necessitate performance on the part of individual interest holders.[85] In the case of subpar operating performance, DOI retains the right to disqualify an operator on a single facility or on multiple facilities, or to remove the operator entirely.[86]

G. Duties of a Prudent Operator, Including Decommissioning Obligations

OCSLA contains several provisions related to operator performance, including Section 1334(g), controlling rates of production; Section 1347, regulating safety and health; and Section 1348, governing environmental safety. Applicable regulations supplement the prudent operator standard set forth in OCSLA and impose mandatory obligations on the lessee/operator, such as duties to:

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83. Advanced Notice of Proposed Rulemaking on Risk Management, Financial Assurance, and Loss Prevention, 79 Fed. Reg. 49027 (Aug. 19, 2014).
84. *See* 30 C.F.R. § 550.143.
85. *See* 30 C.F.R. § 550.146.
86. *See* 30 C.F.R. § 550.135.

1. perform all operations in a safe and workmanlike manner;
2. maintain all equipment and work areas in a safe condition;
3. immediately control, remove, or otherwise correct any hazardous oil and gas accumulation or other health, safety, or fire hazard; and
4. use the best available and safest technology (BAST) whenever practical on all exploration, development, and production operations.[87]

Several lease provisions also obligate a lessee to perform operations in a safe and workmanlike manner, particularly in relation to performance of significant post-termination obligations. For example, Section 9 provides that the lessee shall conduct all operations in accordance with the approved initial Exploration Plan (EP), initial Development and Production Plan (DPP) and the initial Development Operations Coordination Document (DOCD).[88] BOEM must approve all EPs, DPPs, and DOCDs and review all plans for compliance with regulations before any drilling can commence.[89] The review determines if proposed activities will cause serious or undue harm or damage to life, property, or other area mineral deposits, national security and defense, or marine coastal and human environments.[90] To deviate from an approved plan, a lessee must seek DOI approval.[91]

Similarly, Section 22 requires lessees to decommission all wells and facilities safely in a manner that does not cause undue harm or damage to human, marine, or coastal environments. That Section specifically provides that within one year after termination, the lessee is responsible for plugging all wells, abandoning and removing all platforms and facilities, and clearing the seafloor.

In light of aging infrastructure and the changing profile of certain lessees on the OCS, enforcement of post-termination decommissioning liabilities ranks among DOI's top priorities. Regulatory language emphasizes, "Lessees and owners of operating rights are jointly and severally responsible for meeting decommissioning obligations . . . *as the obligations accrue and until each obligation is met*."[92] Crucially,

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87. *See* 30 C.F.R. § 250.107. *See also* 30 C.F.R. § 250 (outlining specific BSEE performance standards). *See also* 30 C.F.R. § 550 (outlining specific BOEM standards).
88. *See* U.S. DEP'T INTERIOR, *supra* note 69 at § 9. *See generally* 30 C.F.R. § 550.20.
89. *See* 30 C.F.R. § 550.201.
90. *See* 30 C.F.R. § 550.202.
91. *See, e.g.*, 30 C.F.R. § 550.283.
92. 30 C.F.R. § 250.1701(a) (emphasis added).

decommissioning obligations accrue from a regulatory perspective, when a well is drilled, when a platform, pipeline or other facility is installed, or when an entity "becomes a lessee or owner of operating rights of a lease on which there is a well that has not been permanently plugged according to this subpart, a platform, a lease term pipeline, or other facility."[93] Applicable regulations concerning surety bonds and designation of operators also include provisions regarding joint and several liability for performance of non-monetary obligations imposed by the lease and applicable laws and regulations.[94]

Once an owner accrues decommissioning obligations, it retains those obligations notwithstanding transfer, assignment, or relinquishment of the lease.[95] For example, when an owner acquires an interest in a pre-existing lease, it accrues liability for decommissioning all pre-existing wells that were not previously permanently plugged and abandoned. That liability extends to platforms, lease term pipelines, facilities and other structures pre-existing on the lease, as well as previously plugged wells re-entered during its ownership. Furthermore, a lessee will remain liable for all accrued decommissioning obligations even after BOEM approves assignment of its interest in favor of a third party. However, the assignor will not be responsible for any new leasehold obligations accruing after approval, such as the decommissioning of a well drilled thereafter. If the designated operator or current lessees are unwilling or unable to perform accrued leasehold obligations, BOEM has the regulatory authority to

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93. 30 C.F.R. § 250.1702(d).
94. *See* 30 C.F.R. §§ 550.143, 556.52.
95. *See* 30 C.F.R. § 556.62(d) ("You, as assignor, are liable for all obligations that accrue under your lease before the date that the Regional Director approves your request for assignment . . . . The Regional Director's approval of the assignment does not relieve you of accrued lease obligations that your assignee, or a subsequent assignee, fails to perform."); *id*. § 556.64(a) (5) ("You do not gain a release of any nonmonetary obligation under your lease or the regulations in this chapter by . . . transferring operating rights."); *id*. § 556.64(h)(1) ("You are jointly and severally liable for the performance of each nonmonetary obligation under the lease and under the regulations in this chapter with each prior lessee and with each operating rights owner holding an interest at the time the obligation accrued."); *id*. § 556.76 ("A relinquishment shall take effect on the date it is filed subject to the continued obligation of the lessee and the surety to . . . abandon all wells and condition or remove all platforms and other facilities on the land to be relinquished to the satisfaction of the Director."). *See also* 30 C.F.R. § 556.62(f) (providing that "[i]f your assignee, or a subsequent assignee, fails to perform any obligation under the lease or the regulations in this chapter, the Regional Director may require you to bring the lease into compliance to the extent that the obligation accrued before the Regional Director approved the assignment of your interest in the lease.").

require predecessors in interest to absorb accrued obligations, notwithstanding the parties' contractual allocation of residual liabilities.[96]

For example, ATP Oil & Gas Corporation (ATP) recently stuck its assignor with over $100 million in decommissioning liabilities when it abandoned OCS properties as part of a bankruptcy proceeding.[97]

After filing for Chapter 11 bankruptcy protection and following a series of failed negotiations to continue offshore operations, ATP shut-in certain OCS properties (the Gomez Properties). The Gomez Properties consisted of several OCS leases including OCS-G14016, Mississippi Canyon Block 711 (the MC 711 Lease), a floating offshore platform, along with a network of pipelines and wells. As operator, ATP was responsible for decommissioning all of the wells and facilities located on the MC 711 Lease. The cost was estimated to exceed $100 million. Faced with an inability to meet these decommissioning obligations, ATP moved to concurrently reject any unexpired leases related to the Gomez Properties and abandon any property, right, or interest in the Gomez Properties.[98]

As the only predecessor in interest for the MC 711 Lease, Anadarko E&P Onshore and some of its affiliates (Anadarko) objected to the motion on a variety of grounds. These objections included arguments such as abandonment would pose an immediate threat to the environment and public safety. But the court approved abandonment and/or rejection of the Gomez Properties, allowing DOI to take possession of the property and seek reimbursement or performance from other responsible parties, including Anadarko. DOI later concluded that Anadarko, as the only predecessor in title of the MC 711 Lease, was responsible for all decommissioning obligations that accrued while it held record title to the lease and ordered Anadarko to decommission all wells, pipelines, platforms, and other facilities on the MC 711 Lease.

While the result may seem unfair,[99] the applicable decommissioning regulations discussed herein support DOI's order that Anadarko satisfy the

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96. *See* 30 C.F.R. § 556.62.

97. In re ATP Oil & Gas Corp., 2013 WL 3157567, (Bankr. S.D. Tex. June 19, 2013).

98. *Id*.

99. Judge Izgur recognized the inequities in this result:

> The Court is not unsympathetic to Anadarko. It may be forced to bear a substantial cost as a result of ATP's financial woes. Nevertheless, like many things in a bankruptcy case, the cost that Anadarko may bear is a reflection of the credit risk it took. Anadarko sold a portion of the Gomez Properties to ATP, and required ATP to bear the financial burden of plugging and abandonment in accordance with applicable federal law. This unfortunate position is no different from that of any other creditor that relies on the promise of performance from an eventually failed entity.

MC 711 leasehold obligations (at least for wells and facilities in place when Anadarko transferred its interest to ATP and for which ATP had no security posted).

H. Penalties and Sanctions

Under OCSLA, DOI retains the right to assess penalties against any party who fails to comply with the provisions of that Act, with other regulations and applicable laws, or with the terms of the lease or ROW.[100] All such failures are considered "Violations," for which administrative regulations provide a regime of civil and criminal penalties levied.[101]

Regulations assess civil penalties for: (1) Violations that are not corrected within the period the DOI grants; (2) Violations that DOI determines may constitute—or at some time constitute—a threat of serious, irreparable, or immediate harm or damage to life, property, any mineral deposit, or the marine, coastal, or human environment; (3) Violations that cause serious, irreparable, or immediate harm or damage to life (including fish and other aquatic life), property, any mineral deposit, or the marine, coastal, or human environment; or (4) Violations of the OSFR requirements at 30 CFR part 553.[102] The penalty calculation depends on the severity and duration of the offense, and fines range from $5,000 to $40,000 per day.[103] Lessees may also be subject to civil penalties—without regard to prior notice or opportunity to correct—for Violations of the Federal Oil and Gas Royalty Management Act (FOGRMA) and certain threats of serious irreparable or immediate harm.[104] The penalty calculation for FOGRMA Violations turns on severity and duration; fees range anywhere from $10,000 to $25,000 per day.[105]

In severe situations, criminal penalties may be assessed. OCSLA authorizes criminal sanctions for (1) knowing and willful Violations; (2) false statements, representations, or certifications in any application, record, report or other document required under OCSLA; (3) falsifying or tampering with devices required by OCSLA; or (4) revealing any data required to be kept

100. *See* 30 C.F.R. §§ 250.1402, 550.1402 ("Violation means failure to comply with the Outer Continental Shelf Lands Act (OCSLA) or any other applicable laws, with any regulations issued under the OCSLA, or with the terms or provisions of leases, licenses, permits, rights-of-way, or other approvals issued under the OCSLA.").

101. *See id.*

102. *See* 30 C.F.R. §§ 250.1404, 550.1404. The definition of life under these Violation classes includes fish and other aquatic life.

103. *See* U.S. DEP'T INTERIOR, BUREAU OF OCEAN ENERGY MGMT., NTL NO. 2011-N06, REVISED ASSESSMENT MATRIX (2011); 30 C.F.R. §§ 250.1404, 550.1403.

104. *See* 30 C.F.R. §§ 250.1460, 550.1460; 43 U.S.C. § 1350(b).

105. *See id*.

confidential under OCSLA.[106] For such Violations, lessees are fined up to $100,000 or imprisoned up to ten years, or both.[107] Additionally, when a corporation or other entity becomes subject to criminal prosecution, any officer or agent of that entity who knowingly or willfully organized or carried out the illicit activity is subject to the same criminal penalties.[108] Finally, lessees may also be subject to criminal penalties for violations of FOGRMA.[109]

A lease may be cancelled and forfeited for failure to comply with OCSLA, any regulation issued thereunder, or any provision of the lease.[110] Additionally, a lease may be cancelled, subject to just compensation, where the Secretary determines, after a hearing that (1) continued activity will likely cause serious harm or damage to life, property, or any mineral, to national security or defense, or to the marine, coastal, or human environment; (2) the threat of harm or damage will not disappear or decrease to an acceptable extent within a reasonable period of time; (3) the advantages to cancellation outweigh the advantages of continuing; and (4) a suspension has been in effect for at least five years.[111] A lease is also subject to cancellation when DOI has failed to approve a DPP within five years following rejection of the original plan.[112]

Finally, suspension and debarment serve as powerful tools to deter poor performance, fraud, waste, and abuse on the OCS.[113] For example, due to the criminal convictions rendered after the *Deepwater Horizon* incident, the Environmental Protection Agency (EPA) suspended twenty-five BP entities in 2012. The agency further disqualified BP Exploration and Production, Inc. from performing federal contract work, a penalty extending to the execution of new OCS leases. The EPA lifted BP's suspension and debarment in 2014 after reaching an agreement requiring BP to maintain independent audit and compliance controls and uphold certain ethics, corporate governance, and safety processes.

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106. *See* 43 U.S.C. § 1350(c) (2015).
107. *See id*.
108. *See* 43 U.S.C. § 1350(d).
109. *See* 30 C.F.R. §§ 250.1480, 550.1480.
110. *See* 43 U.S.C. § 1334(d); U.S. DEP'T INTERIOR, *supra* note 69, at § 13.
111. 43 U.S.C. § 1334(a)(2)(A)(1), (C); 30 C.F.R. § 550.181.
112. *See* 30 C.F.R. § 250.1480.
113. 2 C.F.R §§ 180.5–180.45, 1400.10–1400.30 (2015).

CONCLUSION

As discussed herein, an OCS lease is a complex contract between the United States government, as lessor, and a private lessee. While the OCS lease grants lessees the right to explore for, develop, and produce offshore mineral resources, those rights are subject to many conditions, only some of which are discussed in this article. Although relatively concise, the OCS Lease Form incorporates by reference thousands of terms found in OCSLA, formal DOI guidance, and other federal and state laws and regulations. Moreover, because the OCS leasing scheme is subject to continual amendment, lessees assuming obligations under an OCS lease must be careful to understand the regulatory scheme and to keep abreast of changes that may affect their leasehold rights.