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Federal Royalties on Flared Gas: The Waste Prevention Rule and the Continuing Significance of NTL-4A in North Dakota

Tony Ford
Crowley Fleck PLLP
Bismarck, North Dakota
www.crowleyfleck.com

North Dakota Law Review Symposium

April 11, 2019

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TOPICS COVERED

I. Past: how has the Dept. of the Interior assessed royalties historically, and how has that changed?
II. Present: which rules are relevant to operators currently producing federal minerals in the Bakken?
III. Future: what rule will Interior/BLM be applying five or ten years from now?

I. Past
   A. Interior's pre-1974 practice
   B. NTL-4
   C. NTL-4A
   D. 2016 Waste Prevention Rule (the "Obama Rule")
   E. 2018 Waste Prevention Rule (the "Trump Rule")
II. Present
III. Future

Introductory Note

- What is the Bureau of Land Management's current authority for regulating onshore Federal and Indian oil and gas resources?
  - Mineral Leasing Act of 1920 (30 U.S.C. 188–287)
  - Mineral Leasing Act for Acquired Lands (30 U.S.C. 351–360)
  - Federal Oil and Gas Royalty Management Act (30 U.S.C. 1701–1758)
  - Federal Land Policy and Management Act of 1976 (43 U.S.C. 1701–1785)
  - Indian Mineral Leasing Act of 1938 (25 U.S.C. 396a–g)
  - Indian Mineral Development Act of 1982 (25 U.S.C. 2101–2108)
  - Act of March 3, 1909 (25 U.S.C. 396)
  - Other authorities listed in 43 CFR 3160.0–3

Pre-1974 Royalty Assessments

- "For more than half a century, both the government, as lessor, and all of its lessees have understood . . . that all oil and gas *used on the lease* for ordinary production purposes *or unavoidably lost* were not subject to royalty payments to the government. Nor has the Department attempted to collect royalties on the aforesaid oil and gas unavoidably lost or used in venting and flaring. . ."
  - *Marathon Oil Co. v. Andrus*, 452 F. Supp. 548, 551 (D. Wyo. 1978) (emphasis added).

NTL-4 (1974)

- Notice to Lessees issued by the Secretary of the Interior
- Effective December 1, 1974
- Imposes royalty assessment on all oil and gas production, regardless of whether the production is sold, used on the lease, or lost for any reason (i.e., flaring)

NTL-4 (1974)

- Oil production subject to royalty:
  - Oil produced and sold
  - Oil used on lease for production purposes
  - Oil lost in well tests or spills and other accidents
  - Oil otherwise unavoidably lost
- Gas production subject to royalty:
  - Gas produced or sold
  - Gas vented or flared as part of well tests
  - Gas vented or flared for any other reason

NTL-4 (1974)

- Two federal district courts held that NTL-4 was an arbitrary and capricious action by Interior:
  - *Gulf Oil Co. v. Andrus*, 460 F. Supp. 15 (C.D. Cal. 1978)
  - *Marathon Oil Co. v. Andrus*, 452 F. Supp. 548 (D. Wyo. 1978)
- A third federal district court makes a similar ruling for offshore wells:
  - *Amoco Production Co. v. Andrus*, 527 F. Supp. 790 (E.D. La. 1981)
- None of the cases are appealed.

NTL-4 (1974)

- *Gulf Oil Co. v. Andrus*
  - At issue: oil used on the lease for production purposes (fuel for on-lease generator).
  - 1946 amendments to the Mineral Leasing Act of 1920 required royalty payments on "production removed or sold from said lease."
  - Court: oil and gas used on the leasehold has not been "removed or sold", therefore unlawful for Interior to assess a royalty.
    - Court also gave weight to Interior's consistent practice and interpretation of the Mineral Leasing Act prior to NTL-4.

NTL-4 (1974)

- *Marathon Oil Co. v. Andrus*
  - At issue: oil and gas used on the lease for production purposes, unavoidably lost oil and gas
  - Same statutory language at issue: "production removed or sold from said lease."
  - Court: NTL-4 is "is manifestly contrary to the Mineral Leasing Act," "plainly erroneous under the standard of review in the Administrative Procedures Act," and "arbitrary, capricious and an abuse of discretion."
    - Court again gave weight to Interior's consistent practice on royalties from 1920 to 1974.

NTL-4A

- Dated January 1, 1980
- Replaced NTL-4
- Three basic categories for unsold production:
  - Avoidably lost
    - Generally, negligent loss of oil or gas
    - Royalties owed
  - Used for “Beneficial Purposes”
    - No royalties assessed
  - Unavoidably lost
    - No royalties assessed

NTL-4A

- Rules specific to flared gas:
  - Authorized flaring categories (all wells)
    - Emergencies
    - Well purging and evaluation tests
    - Initial production tests (30 days or 50 MMcf)
    - Routine or special well tests
  - Gas wells
    - Flaring prohibited, except for the authorized categories
  - Oil wells
    - Flaring ok if gas capture not economically justified
    - Test is very strict

2016 Waste Prevention Rule

- Basic rationale for rule:

"NTL-4A neither reflects today's best practices and advanced technologies, nor is particularly effective in minimizing waste of public minerals."

81 Fed. Reg. 83008, 83017 (Nov. 18, 2016)

2016 Waste Prevention Rule

- Rule challenged in court: *Wyoming v. United States Dep't of the Interior*, No. 2:16-CV-0280-SWS (D. Wyo.)
  - Note: State of North Dakota is a party to this case.
- So-called "phase in" provisions of 2016 Rule are stayed.

2016 Waste Prevention Rule

- Provisions subject to Wyoming court's stay:
  - 3179.7 (Gas capture requirement)
  - 3179.9 (Measuring and reporting volumes of gas vented or flared)
  - 3179.201 (Equipment requirements for pneumatic controllers)
  - 3179.202 (Requirements for pneumatic diaphragm pumps)
  - 3179.203 (Storage vessels)
  - 3179.301 - 3179.305 (Leak detection and repair – LDAR)

2016 Waste Prevention Rule

- Provisions not subject to stay:
  - Permissible use
    - 3178.4 (2017) lists ten permissible uses that do not require prior BLM approval
    - 3178.5 (2017) lists uses that are only royalty free if the operator obtains prior approval from the agency
  - Unavoidable loss – limited compared to NTL-4A
    - Non-negligent flaring from oil wells unconnected to a gas gathering system - 3179.4(2) (2017)
    - Gas stripped of least 50% of liquids prior to flaring - 3179.4(1)(xii) (2017)
    - Various well test procedures

2016 Waste Prevention Rule

- Provisions not subject to stay (cont.):
  - Emergency flaring
    - Flaring resulting from capacity issues in the gas gathering system is explicitly excluded from the "emergency" category
    - 3179.105(b)(3) (2017)

2016 Waste Prevention Rule

- Local BLM officials have indicated that they intend to enforce the provisions of the 2016 Rule not subject to the Wyoming court's stay.
  - Applies to production from January 17, 2017 to November 26, 2018
  - Both Federal and Indian minerals

2018 Waste Prevention Rule

- Congressional Review Act
  - Resolution to repeal 2016 Rule passes House
  - Fails in Senate, 49-51
- Trump Administration
  - Promugates so-called “Suspension Rule” delaying implementation of 2016 Rule
  - Issues final “Replacement Rule” in September 2018
    - 83 FR 49184

2018 Waste Prevention Rule

- Legal Challenges to the Replacement Rule
  - *California v. Zinke*, No. 3:18-cv-05712 (N.D. Cal.)
  - *Sierra Club v. Zinke*, No. 3:18-cv-5984 (N.D. Cal.)
- In spite of the pending legal challenges, local BLM officials have indicated that they intend to apply the 2018 Rule to oil and gas produced after November 27, 2018.

2018 Waste Prevention Rule

- Local Deference
  - 3179.201 (2019): "…flared oil-well gas is royalty-free if it is vented or flared pursuant to applicable rules, regulations, or orders of the appropriate State regulatory agency or tribe"
- Federal minerals – BLM defers to state regulations
- Tribal/allottee minerals – BLM defers to tribal regulations

2018 Waste Prevention Rule

- State Deference applied to North Dakota
  - Does operator compliance with NDIC gas capture targets satisfy the state deference regulation?
  - Or are specific, well by well exemptions necessary?
    - N.D.C.C. § 38-08-06.4(6): "A producer may obtain an exemption from this section from the industrial commission upon application that shows…that connection of the well to a natural gas gathering line is economically infeasible at the time of the application or in the foreseeable future"

2018 Waste Prevention Rule

- Tribal Deference applied to North Dakota
  - Per BLM, the Three Affiliated Tribes are in the process of revising the tribal flaring ordinance for Fort Berthold
  - BLM will still be the enforcement agency

- Emergencies
  - No change from 2016 Rule – flaring due to capacity issues is not an emergency

I. Past

II. Present

   A. Why do we still need to care about NTL-4A and the 2016 Rule?

   B. Does the Trump Rule conform with *Gulf Oil Co. v. Andrus*? If no, does it matter?

III. Future

Reminder: Why the Older Rules Still Matter

- NTL-4A applies to oil and gas produced before January 17, 2017
  - Note: BLM North Dakota Field Office still has thousands of unprocessed sundry notices regarding NTL-4A flaring
- The 2016 Rule applies to production from January 17, 2017 to November 26, 2018
- The 2018 Rule applies to oil and gas produced after November 26, 2018

Agency Deference Standards

- Mineral Leasing Act of 1920 required royalty payments on "production removed or sold from said lease."
- *Gulf Oil Co./Marathon Oil Co.* – flared gas is not "removed or sold" within meaning of the statutory term.
- But: these cases were decided prior to *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).
  - Interior is arguably entitled to greater deference when it interprets its governing statute.

I. Past

II. Present

III. Future

   A. Which version of the Rule will ultimately apply to post-2018 production?

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