BLM Rules, Policies and Practices Affecting Royalty on Federal and Indian Oil and Gas Leases

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I. Introduction

The Office of Natural Resources Revenue (ONRR) is the agency within the Department of the Interior (DOI) responsible for determining the proper valuation of production for payment of royalty and for collecting the royalty. However, other agencies in the Department have a role in determining the amount of royalty to be paid to ONRR. The Bureau of Land Management (BLM) issues the oil and gas leases on federal lands; the Bureau of Indian Affairs (BIA) issues or approves the oil and gas leases on Tribal and Indian allotted lands. The leases issued by BLM and BIA set the royalty rate to be paid (in accordance with the leasing statutes). BLM also determines the volume of production on which royalty is owed, i.e., the volume to which ONRR's valuation regulations will apply.

In this paper, we discuss rules, policies and practices of BLM and BIA that affect payment of royalty on federal and Indian leases. We primarily focus on BLM's determination of the volume of production that is royalty-free, a determination that applies both to federal and Indian lands. We also address royalty issues that arise where communitization agreements are proposed for the drilling of horizontal wells that traverse through lands with different leases—

but BLM or BIA approval of the agreement is not timely. Finally, we summarize royalty changes included in the Inflation Reduction Act of 2022.

II. ROYALTY-FREE FLARING AND VENTING OF GAS

A. Section 17 of Mineral Leasing Act

Except for a brief period in the 1970s, since enactment of the Mineral Leasing Act (MLA), the DOI has recognized that royalty should not be due on gas lost or used in lease operations. Enacted in 1920, Section 17 of the MLA required royalty on oil and gas leases to "not be less than 12 1/2 per centum in amount or value of the production . . . ."[1] This provision "was uniformly interpreted by the [DOI] as excluding Lost and Used Hydrocarbons from royalty obligations."[2]

In 1946, the MLA was amended to require royalty on the "value of the production *removed or sold* from the lease."[3] "The legislative history of the [MLA] specifically shows that the language 'removed or sold' was added to the Act to clarify that royalty could not be collected on Lost and Used Hydrocarbons."[4] Consistent with this Congressional intent, the DOI has historically interpreted the MLA to "require unavoidable oil or gas losses to be royalty-free, but deemed the statute to authorize compensation for avoidable losses given the lessee's statutory duty to 'use all reasonable precautions to prevent waste of oil or gas.'"[5]

B. NTL-4

Despite many decades of exempting gas lost or used in lease operations from royalty, in 1974, the U.S. Geological Survey's (USGS) Conservation Division issued a Notice to Lessees and Operators No. 4 or "NTL-4." NTL-4 required lessees to pay royalty on all oil and gas produced from a lease or unit, including gas flared or otherwise unavoidably lost in lease operations.[6] Lessees challenged NTL-4 in the courts.[7] The courts found that NTL-4 improperly reversed a longstanding interpretation of the MLA—one extending over 50 years—of not requiring royalty on gas unavoidably lost or necessarily flared in lease operations.[8] The courts viewed this longstanding interpretation as deserving great weight and akin to a "rule of property."[9] As one court explained:

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[1] 30 U.S.C. § 226.

[2] Amoco Prod. Co. v. Andrus, 527 F. Supp. 790, 792 (E.D. La. 1981).

[3] *Id.* (emphasis added).

[4] *Id.*

[5] Hess Corp., 197 IBLA 299, 303–04, GFS(O&G) 5(2021) (quoting 30 U.S.C. § 225).

[6] *See* Marathon Oil Co. v. Andrus, 452 F. Supp. 548, 549–50 (D. Wyo. 1978) (quoting provisions of NTL-4).

[7] *See Marathon Oil Co.*, 452 F. Supp. 548; Gulf Oil Corp. v. Andrus, 460 F. Supp. 15 (C.D. Cal. 1978).

[8] *See Marathon Oil Co.*, 452 F. Supp. at 550–53.

[9] *See id.* at 552.

> Prior to the issuance of the NTL-4 Notice, the practice of the [DOI] had been that, in determining the amount of production to which royalty rates will be applied, no royalty is payable on oil or gas unavoidably lost, used in lease or producing operations on the leasehold premises, or beneficially used for purposes of production on the leasehold.
>
> For more than half a century, both the government, as lessor, and all of its lessees have understood and have been governed by the pertinent statutes to the end 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 or flaring in the processing facilities until the issuance of the NTL-4 Notices.[10]

The court held that "NTL-4 Notice of the Secretary, expanding and enlarging upon the legislative enactment, is manifestly contrary to the Mineral Leasing Act . . . ."[11] In reaching that holding, the court reasoned:

> A review of the legislative history of the Mineral Leasing Act, together with its many enactments and re-enactments, each leaving intact the wording that a royalty is to be paid on "value of the production removed or sold from the lease", plus the interpretation placed thereon by the Secretary of the Interior for a long period of time holding that royalties are not to be collected on oil and gas that was unavoidably lost or used in lease operations, are entitled to great weight.[12]

Another U.S. District Court reached a similar conclusion about NTL-4 after examining the legislative history of Section 17 of the MLA. It found that the Act meant to impose royalty as a specified percentage in amount or value of the production "removed or sold from the lease"—not on gas unavoidably lost or used in lease operations.[13]

C. NTL-4A

Effective January 1, 1980, in response to the court decisions reversing NTL-4, the USGS revoked NTL-4 and issued NTL-4A.[14] NTL-4A applies to both Federal and Indian leases.

Section I of NTL-4A allows royalty-free flaring of gas produced from oil wells which is (1) "used on the same lease, same communitized tract, or same unitized participating area for beneficial purposes"; (2) vented or flared with the "prior authorization, approval, ratification, or acceptance of the Supervisor";[15] (3) vented or flared "pursuant to the rules, regulations, or orders of the appropriate State regulatory agency" that have been accepted or ratified by the Secretary; or (4) not "avoidably lost," as determined by the Supervisor.[16]

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[10] *Id.* at 551.

[11] *Id.* at 553.

[12] *Id.* at 552–53.

[13] *Gulf Oil Corp.*, 460 F. Supp. at 17–18. Subsequently, two cases involving offshore leases also rejected notices issued to offshore Federal oil and gas lessees that asserted the same position taken in NTL-4. *See* Placid Oil Co. v. DOI, 491 F. Supp. 895 (N.D. Tex. 1980); Amoco Prod. Co. v. Andrus, 527 F. Supp. 790 (E.D. La. 1981).

[14] 44 Fed. Reg. 76,600 (Dec. 27, 1979).

[15] BLM later removed the requirement for "prior" authorization. *See* Ladd Petroleum Corp., 107 IBLA 5, 7–8, GFS(O&G) 29(1989).

[16] NTL-4A at 1, available at https://www.blm.gov/sites/blm.gov/files/energy_noticetolessee4a.pdf.

Section II of NTL-4A defines the terms "avoidably lost," "beneficial purposes" and "unavoidably lost." Avoidably lost gas (for which royalty is due) includes gas flared without the prior authorization, approval, ratification, or acceptance of the Supervisor when the Supervisor determines that the gas was lost because of (1) the "negligence" of the lessee or operator, (2) the failure of the lessee or operator to take all "reasonable measures" to prevent and/or control the loss, (3) the failure of the lessee or operator to comply with the lease terms and regulations, provisions of the approved operating plan, or the prior written orders of the Supervisor, or (4) any combination of the foregoing conditions.[17]

"Unavoidably lost" gas, for which royalty is not due, includes "gas vapors which are released from storage tanks or other low-pressure production vessels" (unless the Supervisor determines that the recovery of such vapors would be warranted) or gas flared "because of line failures, equipment malfunctions . . . or otherwise except where the Supervisor determines that [the] loss resulted from the negligence or failure of the lessee or operator to take all reasonable measures to prevent and/or control the loss."[18] This definition of unavoidably lost gas also includes the flaring of gas "in accordance with Section III hereof."[19]

In Section III, the DOI "hereby authorized" royalty-free venting and flaring of gas in certain circumstances, including a category called "emergencies."[20] NTL-4A gives the following examples of royalty-free flaring allowed under the "emergencies" category: "compressor or other equipment failures, relief of abnormal system pressures, or other conditions [that] result in the unavoidable short-term venting or flaring of gas."[21] This authorization for royalty-free flaring of gas is limited to 24 hours per incident and up to 144 hours per month without further authorization, approval, ratification or acceptance of the Supervisor.[22] Other scenarios conditionally authorizing royalty-free venting and flaring of gas under Section III include well purging and evaluation tests, initial production tests, and routine or special well tests.[23]

Section IV of NTL-4A addresses "other venting or flaring."[24] Under this section, "except as provided in Section II.C and III above," flaring of gas from oil wells is not allowed "unless approved in writing by the Supervisor."[25] To obtain the Supervisor's approval, NTL-4A calls for the submission of either: (1) an evaluation report, "supported by engineering, geologic, and economic data," demonstrating to the satisfaction of the Supervisor that the expenditures necessary to market or beneficially use such gas are not economically justified

[17] *Id.* at 2.
[18] *Id.* at 3.
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] *Id.*

and that conservation of the gas, if required, would ultimately lead to a greater loss of equivalent energy than would be recovered if the venting or flaring were permitted to continue, or (2) an action plan that would eliminate the flaring within one year.[26] The exception in Section II.C is for gas "unavoidably lost."[27] The exception in Section III is for gas flared during "emergencies" as well as during well purging and evaluation tests, initial production tests, and routine or special well tests.[28]

To sum up, royalty-free flaring of gas under Section IV of NTL-4A calls for Supervisor approval after submission of an economic evaluation or an action plan to eliminate flaring.[29] There is no limit to the period allowed for such Supervisor-approved royalty-free flaring. Section III of NTL-4A itself grants pre-approval for limited royalty-free flaring of gas—up to 144 hours per month per lease—for flaring within the circumstances described under that section: equipment failures, relief of abnormal system pressures, or other conditions that result in unavoidable short-term flaring. No economic evaluation is required for such "emergency" flaring, nor is further agency approval necessary.[30]

The provisions in Section III of NTL-4A allowing temporary royalty-free flaring of gas, including the "emergencies" provision, appear to follow longstanding interpretation of the MLA. One of the purposes of the MLA "was to encourage and stimulate the discovery of new petroleum reserves and the development of known petroleum reserves."[31] To further this purpose by fully realizing production from oil wells, flaring is sometimes necessary. When equipment failures or abnormal system pressures prevent gas from entering a pipeline, an operator must either flare the gas or shut in the well.[32] Shutting in the well, however, is "generally harmful" and "[s]hut-in related damage continues to accrue during subsequent shut-in events."[33] Shutting in a well can damage the reservoir, causing irreparable injury to operators and, ultimately, royalty owners.[34]

The provisions in Section III also follow and implement BLM's regulations. Those regulations provide that royalty is due on gas lost or wasted from a lease site "when such loss or waste is due to *negligence* on the part of the operator of such lease, or due to *failure of the operator to comply* with any regulation, order or citation issued pursuant to this part."[35] Temporary flaring for equipment failures, abnormal system pressures, or similar conditions is rarely due to an operator's negligence or failure to comply with any regulation or or-

[26] *Id.* at 3–4.

[27] *Id.* at 3.

[28] *Id.*

[29] *Id.* at 3–4.

[30] *Id.* at 3.

[31] Marathon Oil Co. v. Andrus, 452 F. Supp. 548, 551 (D. Wyo. 1978).

[32] *See* James W. Crafton & Sandra L. Noe, *Impact of Delays and Shut-Ins on Well Productivity*, SPE 165705 (Aug. 20, 2013).

[33] *Id.* at 4.

[34] *See id.*

[35] 43 C.F.R. § 3162.7-1(d) (emphasis added).

der issued by BLM. Thus, it makes sense that Section III of NTL-4A grants exception for such circumstances.

In 1983, soon after NTL-4A was issued, the functions of the USGS Conservation Division concerning management of onshore oil and gas operations were transferred to BLM.[36] BLM has administered NTL-4A ever since.

D. BLM's 2016 Rule to Replace NTL-4A

Near the end of President Obama's administration, in November 2016, BLM issued a rule to replace NTL-4A effective January 17, 2017. According to BLM, that rule meant to "reduce waste of natural gas from venting, flaring, and leaks during oil and natural gas production activities" and to "clarify when produced gas lost through venting, flaring, or leaks is subject to royalties, and when oil and gas production may be used royalty-free on-site."[37]

The rule took a more limited approach to royalty-free venting and flaring of gas. It prohibited venting, except in certain limited situations such as emergencies or when flaring the gas was technically infeasible.[38] It also adopted a capture-percentage approach, requiring operators to capture a certain percentage of the gas they produced each month, excluding specified volumes of allowable flared gas.[39] Operators could choose whether to comply with the capture targets on a lease-by-lease, county-wide, or state-wide basis.[40] Both the capture percentage and the flaring allowance were designed to phase in over time.[41]

The rule retained NTL-4A's distinction between avoidably and unavoidably lost gas—with royalties owed on the former but not the latter.[42] However, it eliminated BLM's discretion to make unavoidable loss determinations on a case-by-case basis and instead listed twelve categories in which a loss was always considered unavoidable.[43] Any gas flared in excess of the capture requirements was deemed an avoidable loss.[44] The rule also required operators to measure and report the amount of gas vented or flared above 50 million cubic feet per day.[45] To address gas leaks, the rule required all operators to inspect equipment twice a year and timely repair any leaks found.[46] It also required operators to minimize gas lost from storage vessels and during well maintenance, drilling, and completion.[47]

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[36] Rio De Viento, Inc., 153 IBLA 32, 41 n.8, GFS(O&G) 18(2000).

[37] Waste Prevention, Production Subject to Royalties, and Resource Conservation, 81 Fed. Reg. 83,008 (Nov. 18, 2016).

[38] *Id.* at 83,082.

[39] *Id.* at 83,023–24, 83,082.

[40] *Id.* at 83,083.

[41] *Id.* at 83,082.

[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] *Id.* at 83,083.

[46] *Id.* at 83,087–88.

[47] *Id.* at 83,085–87.

The rule did not last long. Industry groups and some states challenged the rule in federal court, and BLM never fully implemented it due to that litigation.[48] In September 2018, during President Trump's administration, BLM issued a new rule effectively rescinding the 2016 rule.[49] Environmental groups and a different group of states then challenged BLM's action rescinding the 2016 rule. Eventually, the U.S. District Court for the Northern District of California vacated the 2018 rescission on various grounds, including that the resulting regulatory regime would fail to meet BLM's statutory mandate to prevent waste.[50]

But the reinstated 2016 rule continued to face challenges from energy-producing states and industry groups. In a suit before the U.S. District Court for the District of Wyoming, the challengers argued that the rule was an attempt by BLM, under the pretense of regulating waste from oil and gas operations, to regulate air pollution associated with oil and gas production—an issue within the authority and expertise of a different agency, the Environmental Protection Agency (EPA).[51] They contended that the rule represented an unlawful agency action because it exceeded BLM's statutory authority and was otherwise arbitrary and capricious.[52]

The Wyoming federal district court agreed with the challengers. The court found that certain provisions of the rule were promulgated for the protection of air quality instead of waste prevention.[53] Further, protecting air quality fell within the jurisdiction of EPA and the states pursuant to the Clean Air Act (CAA)—not BLM.[54] As the court put it: "BLM used its waste prevention authority as a more expedient means to accomplish the primary end goal of regulating methane emissions from existing oil and gas sources – outside of, and inconsistent with, the comprehensive scheme established by Congress under the CAA."[55] The court therefore held that the rule was invalid both because BLM exceeded its statutory authority and because "BLM acted arbitrarily and capriciously in failing to fully assess the impacts of the [r]ule on marginal wells, failing to adequately explain and support the [r]ule's capture requirements, and failing to separately consider the domestic costs and benefits of the Rule."[56] The court vacated the 2016 rule.[57]

Consequently, as of early 2024, NTL–4A continues to govern venting and flaring from federal and Indian oil and gas leases. It has been the governing rule since its adoption in 1980.

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[48] *See* Wyoming v. DOI, 493 F. Supp. 3d 1046, 1052–57 (D. Wyo. 2020).

[49] 83 Fed. Reg. 49,184 (Sept. 28, 2018).

[50] *See* California v. Bernhardt, 472 F. Supp. 3d 573 (N.D. Cal. 2020).

[51] *See* Wyoming v. DOI, 493 F. Supp. 3d 1046 (D. Wyo. 2020).

[52] *See id.*

[53] *Id.* at 1070–71.

[54] *Id.*

[55] *Id.* at 1070.

[56] *Id.* at 1086.

[57] *Id.* at 1087.

E. BLM's Pending Rule Change

In November 2022, BLM proposed another "waste prevention" rule aimed at replacing NTL-4A and curtailing "the waste of natural gas from venting, flaring, and leaks during oil and gas production activities on Federal and Indian leases."[58] The proposed rule is currently being reviewed by the Office of Management and Budget (OMB) for finalization.[59] Like its predecessor, the proposed rule may face legal challenges. But unlike its predecessor, at least for new leases, the proposed rule now has the additional statutory support of the 2022 Inflation Reduction Act (IRA), which includes a provision governing new leases entitled "Royalties on All Extracted Methane."[60]

For leases issued after enactment of the IRA (August 16, 2022), that provision requires royalties on all gas produced from federal land and the Outer Continental Shelf, including "gas that is consumed or lost by venting, flaring, or negligent releases through any equipment during upstream operations."[61] The statute nonetheless provides three exceptions to the general obligation to pay royalties on produced gas:

> (1) gas that is vented or flared for not longer than 48 hours in an emergency situation that poses a danger to human health, safety, or the environment;
>
> (2) gas used or consumed within a lease, unit, or communitized area for the benefit of the lease, unit, or communitized area; and
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> (3) gas that is "unavoidably lost."[62]

BLM's proposed rule requires "operators [to] use all reasonable precautions to prevent the waste of oil or gas developed from the lease."[63] This requirement has always been part of the MLA, but the new rule changes the ways in which lessees must show they are taking reasonable measures to prevent waste. Reasonable measures required to prevent waste may include relevant advances in technology and changes in industry practice.[64]

The proposed rule mandates operators to submit a waste minimization plan with all applications for permits to drill (APD) an oil well. This plan is meant to inform BLM on anticipated associated gas production, the capacity to capture that gas for sale or use, and other steps to reduce or eliminate gas losses.[65] If an operator's plan does not demonstrate reasonable steps to avoid wasting gas, then BLM may delay action on the APD until the operator ade-

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[58] 87 Fed. Reg. at 73,588 (Nov. 30, 2022).

[59] After this paper was written, on April 10, 2024, BLM published a final version of this rule, with an effective date of June 10, 2024. *See* 89 Fed. Reg. 25,378 (Apr. 10, 2024). The new rule has been challenged in a case pending before the U.S. District Court for the District of North Dakota (No. 1:24-cv-00066).

[60] *See* 30 U.S.C. § 1727.

[61] *Id.* § 1727(a). The application of this statute appears limited to onshore and offshore oil and gas development under federal leases.

[62] *Id.* § 1727(b).

[63] 87 Fed. Reg. at 73,589.

[64] *Id.*

[65] *Id.*

quately addresses the plan's deficiencies to BLM's satisfaction.[66] BLM can also specify reasonable measures to prevent waste as conditions for approving an APD.[67]

The proposed rule recognizes that oil or gas can be "unavoidably lost"—and thus not subject to royalties—in certain situations. Oil or gas would be considered unavoidably lost if the operator has not been negligent; has taken ''prudent and reasonable steps to avoid waste"; has complied fully with applicable laws, lease terms, regulations, provisions of a previously approved operating plan, and other written orders of the BLM; and the loss is within the time or volume limits applicable to the particular situation.[68] The rule lays out a number of specific circumstances in which lost oil or gas would be considered "unavoidably lost," including during well completions, production testing, and emergencies.[69]

Similar to NTL-4A, under the proposed rule, gas lost during an "emergency situation" would be royalty-free.[70] The rule defines an "emergency situation'' as "a temporary, infrequent, and unavoidable situation in which the loss of gas is necessary to avoid a danger to human health, safety, or the environment."[71] Unlike NTL-4A, which limits royalty-free losses to a period of 24-hours per "emergency" incident, the proposed rule implements a 48-hour limit that is not subject to discretionary extensions.[72] This limit follows Section 1727(b)(1) of the IRA.[73] An operator would be required to "file a report to the BLM for any emergency situation that requires the operator to vent or flare beyond" the 48-hour period.[74]

The proposed rule also specifies conditions that do not constitute emergencies for the purposes of royalty assessment. These include: (1) recurring equipment failures; (2) failure to install appropriate equipment of a sufficient capacity to accommodate production conditions; (3) failure to limit production when the production rate exceeds the capacity of the related equipment, pipeline, or gas plant, or exceeds sales contract volumes of oil or gas; (4) scheduled maintenance; and (5) operator negligence.[75] These conditions, if ultimately adopted, would narrow the historic scope of Section III of NTL-4A for royalty-free flaring and venting of gas.

BLM clarifies that the proposed rule "would not prohibit an operator from engaging in venting or flaring when the operator deems it operationally necessary to do so" and that BLM is "not attempting to substitute its judgment for that of the operator with respect to the management of emergencies."[76] Ra-

[66] *Id.*
[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] *Id.* at 73,606.
[71] *Id.*
[72] *Id.*
[73] *See* 30 U.S.C. § 1727(b)(1).
[74] 87 Fed. Reg. at 73,606.
[75] *Id.*
[76] *Id.*

ther, BLM states that the purpose of the emergency provisions is to "safeguard the public interest in royalty revenues by ensuring that a royalty-free flaring exception for 'emergencies' is limited to events that are truly out of the operator's control and could not have been avoided through more careful management."[77]

The proposed rule also establishes a monthly volume limit on royalty-free flaring resulting from pipeline capacity constraints, midstream processing failures, or other similar events that may prevent produced gas from being transported to market. "[W]hen oil-well gas must be flared due to pipeline capacity constraints, midstream processing failures, or other similar events that prevent produced gas from being transported through the connected pipeline," the rule limits an operator to a maximum of "1,050 Mcf per month (per lease, unit, or [communitization agreement])" as royalty-free, "unavoidably lost" gas.[78]

F. Pending Disputes Under NTL-4A

In recent years, while BLM's 2016 Rule was set aside and NTL-4A was restored, BLM has attempted to restrict royalty-free flaring through interpretation of NTL-4A. Those actions include denying royalty-free flaring allowed under Section III of NTL-4A (the pre-approval for "emergency" venting and flaring of gas).[79] Historically, BLM approved and accepted royalty-free flaring of gas for up to 144 hours per month per lease resulting from high gathering line pressures, equipment problems, or similar issues beyond the control of the operators. BLM has also denied approval of royalty-free flaring under Section IV of NTL-4A.

1. The IBLA's 2021 Decision in *Petro-Hunt*

BLM's reversal from decades of past practice under Section III of NTL-4A—of exempting from royalty up to 144 hours per month per lease of flaring resulting from gathering line pressures, equipment problems, or similar issues—stems from the Interior Board of Land Appeals' (IBLA) 2021 decision in *Petro-Hunt, L.L.C.*[80] In that case, the lessee submitted 24 sundry notices to BLM's North Dakota Field Office, which were labeled as "notice[s] of intent" to engage in "venting and/or flaring."[81] The notices stated only that "Petro Hunt requests royalty-free flaring under NTL4A."[82] They did not specify which provision of NTL-4A the lessee intended to invoke.

Between November 2019 and March 2020, the North Dakota Field Office issued 24 decisions, granting in part and denying in part the requests for royal-

[77] *Id.*

[78] *Id.* at 73,603.

[79] NTL-4A at 3 ("Lessees or operators are hereby authorized to vent or flare gas on a short-term basis without incurring a royalty obligation in the following circumstances.").

[80] 197 IBLA 100, GFS(O&G) 2(2021).

[81] *Id.* at 104.

[82] *Id.*

ty-free flaring.[83] The Field Office found that because "[n]o economic justification was provided . . . to address the relevant economic criteria," "an avoidable/unavoidable loss determination [could not] be made based on economic considerations."[84] Each decision also stated that the "intermittent, short-term oil-well gas flaring reported by Petro-Hunt d[id] not meet the definition of an unavoidable loss under Section II of NTL-4A."[85] Nor did the flaring "meet the . . . threshold of an avoidable loss as a result of negligence, failure to take reasonable measures to prevent the loss, or failure to fully comply with lease terms and regulations."[86]

However, highlighting BLM's historic practice in applying NTL-4A, the Field Office allowed up to 144 hours per month per lease of royalty-free flaring of gas under the "emergency" provisions of Section III of NTL-4A.[87] The Field Office "concluded that 'the flaring is in accordance with' Section III's Emergency Provision, and therefore granted each request for royalty-free flaring subject to that provision's time limits: up to 24 hours for each incident, and 144 hours for each calendar month."[88] In other words, the BLM Field Office denied the application only for unlimited royalty-free flaring, i.e., flaring beyond the allowed 144 hours in Section III.

Petro-Hunt appealed the Field Office's denial of unlimited royalty-free flaring to the BLM State Director. It argued that the Field Office's application of the emergency provision and the 144-hour limit was erroneous because the "majority of the flaring at issue simply d[id] not conform to the plain language of [the Emergency Provision]: it [was] not 'short term,' 'temporary,' or 'abnormal' given the prevailing conditions in the Williston Basin at the time the flaring occurred."[89] Instead, Petro-Hunt argued the Field Office should have "determine[d] whether reasonable measures were taken to prevent or control the loss of gas."[90] It stated that "[t]he flaring at issue was primarily the result of, among other things, force majeure events, maintenance, and/or capacity issues in the third-party gas gathering and processing system, a common cause of flaring in the Williston Basin."[91]

The State Director affirmed the Field Office's decisions. First, the State Director found that Petro-Hunt's failure to provide an economic justification for its flaring supported the Field Office's decision not to conduct an avoidable/unavoidable loss determination based on economic considerations.[92] Instead of a comprehensive economic report, Petro-Hunt had submitted a "two-page affidavit from the company's Regulatory, Environmental, and Safety Di-

[83] *Id.*
[84] *Id.*
[85] *Id.*
[86] *Id.*
[87] *Id.* at 104–05.
[88] *Id.* at 104.
[89] *Id.* at 105.
[90] *Id.*
[91] *Id.*
[92] *Id.* at 107.

rector" who stated that "efforts to capture the flared gas would not be economic" because it would require installation of new pipeline at a cost of $1.1 million and because "Oil Revenue from the Wells significantly outweigh[ed] any potential revenue from the flared gas."[93] Second, the State Director found that one of reasons for flaring—insufficient pipeline capacity—is "viewed as a 'relief of abnormal system pressures'" and therefore supported the Field Office's decision to allow royalty-free flaring of gas for up to 144 hours per month pursuant to the emergency provisions of NTL-4A (which lists "relief of abnormal system pressures" among examples of royalty-free flaring allowed under that category).[94]

Petro-Hunt appealed the State Director's decision to the IBLA, reiterating its argument that the flaring did not fall within the emergency provisions of Section III. Petro-Hunt argued that its flaring should be considered as unavoidable loss under other provisions of NTL-4A, which are not limited to a particular number of hours.[95] It asked the Board to "hold that its flaring was fully exempt under Section II."[96]

In response, BLM largely focused on the argument seeking unlimited royalty-free flaring. It did not brief or inform the Board of its longstanding application of the emergency provisions in Section III of NTL-4A.[97] Nor did "[t]he agency . . . defend its choice to treat these incidents as 'emergency' flaring . . . ."[98] Thus, without the benefit of any briefing on the history of BLM's practices in applying the emergency provisions under Section III of NTL-4A, the Board agreed with Petro-Hunt that its flaring did not fall within the emergency provisions of Section III.[99] The Board also held that the flared gas could not be considered unavoidably lost under Section II either because "Petro-Hunt failed to provide adequate information and analysis to support its claims that the flared gas was unavoidably lost."[100]

2. BLM's Denial of Royalty-Free Flaring Under Section III

Pointing to the *Petro-Hunt* decision, in 2021, BLM began departing from its prior application of the emergency provisions under Section III of NTL-4A. BLM has since been denying the royalty-free flaring of gas for up to 144 hours per month per lease even if the flaring resulted from the same underlying causes that it had always approved as royalty-free in the past. At least one operator has challenged BLM's change in practice in an appeal to the IBLA.[101] BLM has recently obtained a remand of the appeal to reconsider its position.

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[93] *Id.* at 106.

[94] *Id.* at 108.

[95] *Id.* at 110–11.

[96] *Id.* at 110.

[97] *See id.* (explaining that BLM "focuse[d] its arguments on defending its denial of unlimited royalty-free flaring under Section II").

[98] *Id.* at 111.

[99] *Id.*

[100] *Id.* at 116.

[101] **Editor's Note:** The authors represent the operator in this appeal.

The operator has raised several grounds to challenge BLM's change in long-standing practice. First, as noted above, the Board in *Petro-Hunt* did not have the benefit of any briefing on the proper scope and historical application of the emergency provisions in Section III of NTL-4A. Thus, the Board was not made aware of BLM's past application of NTL-4A in holding that Petro-Hunt's flaring did not fall within the emergency provisions of Section III.[102]

Second, the Board's finding that Petro-Hunt's flaring did not fall within the emergency provisions of Section III was based on Petro-Hunt's description of its own situation. In other words, both parties in *Petro-Hunt* "appear[ed] to agree" that the circumstances that led to Petro-Hunt's flaring did not amount to an emergency.[103] That agreement led the Board to hold "that the circumstances that led to Petro-Hunt's flaring were chronic and recurring rather than sudden and unforeseen."[104] Other operators, however, seek approval of royalty-free flaring under the emergency provision of NTL-4A when their flaring falls within the circumstances described in Section III.

Third, the Board's decision in *Petro-Hunt* relies in a footnote on a portion of the definition of "emergency" from Ballentine's Law Dictionary: "[c]onfrontation by *sudden* peril" or "[a]n *unforeseen* occurrence or condition calling for immediate action."[105] But the Board left out the middle sentence of Ballentine's definition: "A pressing necessity; an exigency; *an event or occasional combination of circumstances calling for immediate action or remedy*." This portion of the definition is inconsistent with the notion that an emergency must always be "sudden and unforeseen," and that a "recurring" problem does not qualify.

Fourth, NTL-4A itself employed a broader view of emergency than the definition relied on by the Board in *Petro-Hunt*. This is shown by the examples of authorized royalty-free flaring of gas specifically given in Section III: "such as compressor or other equipment failures, relief of abnormal system pressures, or other conditions which result in the unavoidable short-term venting or flaring of gas."[106] The examples given are things that sometimes happen in the operation of oil and gas production and gathering. They may or may not be "sudden"; to some extent they are foreseen; and they do occur periodically. In other words, the context of the emergency provisions in Section III does not limit royalty-free flaring only to sudden and unforeseen events that rarely recur. Such a view could render superfluous all of the "temporary emergency" examples included in the provision where royalty-free flaring up to 144 hours per month per lease is allowed.

Finally, BLM's long-standing practice of recognizing royalty-free flaring up to 144 hours per month, until the *Petro-Hunt* decision in 2021, confirms that

[102] 197 IBLA at 110–11.

[103] *Id.* at 111.

[104] *See id.* ("Because the parties appear to agree that the circumstances that led to Petro-Hunt's flaring were chronic and recurring rather than sudden and unforeseen, we agree with Petro-Hunt that BLM lacked a rational basis for finding that the flaring at issue constituted 'short-term' flaring arising from 'temporary emergency situations.'").

[105] *Id.* at 111 & n.51 (emphasis added).

[106] NTL-4A at 3, available at https://www.blm.gov/sites/blm.gov/files/energy_noticetolessee4a.pdf.

NTL-4A envisages a different and broader definition of emergency than the one noted in *Petro-Hunt*.

3. BLM's Denial of Royalty-Free Flaring Under Section IV

In addition to denying royalty-free flaring under Section III of NTL-4A, BLM has also been denying royalty-free flaring under Section IV. Section IV addresses the royalty-free flaring of gas when "approved in writing by the Supervisor."[107] To obtain this approval, NTL-4A requires submission of either: (1) a report, "supported by engineering, geologic, and economic data," demonstrating to the satisfaction of the Supervisor that the expenditures necessary to market or beneficially use such gas are not economically justified and that conservation of the gas, if required, would ultimately lead to a greater loss of equivalent energy than would be recovered if the venting or flaring were permitted to continue or (2) an action plan that would eliminate the flaring within one year.[108]

Several operators have challenged BLM's denial of royalty-free flaring under Section IV of NTL-4A. These challenges are pending before the IBLA and a federal district court. The operators argue that BLM denied royalty-free flaring without considering all the information that the operators had provided to support an unavoidable loss determination. They claim that the reports they submitted demonstrated that any effort to capture gas would have been uneconomic and therefore the flaring should have qualified as an unavoidable loss not subject to royalty under NTL-4A.

These operators also maintain that undertaking the expenses to avoid flaring would have required curtailing production or shutting in the wells, hence causing monetary losses to both the operators and the royalty owners. They argue that the considerable capital required to acquire the necessary gathering, compression, and processing capacity to avoid flaring from each well would have resulted in a negative cash flow. In other words, the expenditure of millions of dollars to build redundant systems to capture gas with relatively little value was not a reasonable option. The flaring of limited volumes of gas during facility downtimes was therefore the more economically prudent choice.

The operators also maintain that, in the last decade, operators in the Williston Basin of North Dakota had to flare gas due to inadequate pipeline infrastructure and insufficient capacity at regional processing plants to accommodate the natural gas produced from newly drilled oil wells. Yet, BLM took no action to restrict the flaring through orders to shut-in or curtail production, thereby tacitly approving the operators' conduct. Furthermore, the operators contend they exercised all reasonably possible measures to avoid flaring and had no other realistic option but to flare gas.

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[107] NTL-4A at 3.

[108] *Id.* at 3–4.

III. ROYALTY-FREE BENEFICIAL USE

NTL-4A also addresses royalty-free use of oil and gas used for the benefit of operations on a lease or unit. It defines “beneficial purposes” that are excused from royalty obligations as including gas “which is produced from a lease, communitized tract, or unitized participating area and which is used on or for the benefit of that same lease, same communitized tract, or same unitized participating area for operating or producing purposes” such as fuel, as source for actuating devices at production facilities, as circulating medium, and so on.[109]

The IBLA has held that gas used as fuel to operate compressors and a processing plant may qualify as gas used for “beneficial purposes,” even if the use occurs beyond a BLM-approved wellhead point of measurement, as long as such use is within the unit area.[110] In other words, a wellhead point of measurement does not delineate the outer boundaries for what qualifies as “beneficial use.”[111] Gas used within a lease, communitized tract, or unit participating area is royalty-free regardless of the point of measurement.

In late 2016, BLM adopted regulations to supersede the provisions of NTL-4A on royalty-free beneficial use of oil and gas on federal and Indian leases.[112] These regulations were part of the rulemaking described above in which the federal district court struck down BLM’s attempt to regulate “waste,” but were not part of the litigation challenge and were deemed severable from the invalidated regulations.[113]

These regulations continue the principle that no royalty is owed on oil or gas used within a lease or communitized area for operations and production purposes—including placing oil or gas into marketable condition—so long as the oil or gas has not been removed from the lease or communitized area.[114] Similarly, royalty is not due on oil and gas produced from a unit participating area (PA) and used for operations and production purposes on the same unit PA, without being removed from the unit.[115]

The regulations go on to identify circumstances where no prior written approval from BLM is required for royalty-free beneficial use, and where prior written approval is required. Prior written approval is not required for ten specified circumstances, including use of fuel to generate power or to operate equipment, heat, separate, and dehydrate production, and to treat or compress production to put it into marketable condition.[116]

Prior written approval is required where (i) the operator removes oil or gas from a pipeline at a location downstream of the facility measurement point; (ii) the operator needs to remove gas from a lease, unit PA, or communitized

[109] NTL-4A at 2.

[110] Wexpro Co., 174 IBLA 57, 68, GFS(O&G) 7(2008).

[111] *See id.*

[112] 81 Fed. Reg. 83,078 (Nov. 18, 2016), 43 C.F.R. subpt. 3178.

[113] Wyoming v. DOI, 493 F. Supp. 3d 1046, 1086–87 (D. Wyo. 2020).

[114] 43 C.F.R. § 3178.3(a)(1).

[115] *Id.* § 3178.3(a)(2).

[116] *Id.* § 3178.4(a).

area for treatment or processing, and the gas will then be returned for use on the lease, unit PA, or communitized area from which it was produced; and (iii) any use not identified in § 3178.4.[117] If BLM denies a request for royalty-free beneficial use, the operator must pay royalty on the volumes consumed. If BLM approves the request, such approval will be deemed effective on the date the request was filed.[118]

Generally speaking, NTL-4A did not require prior BLM approval for the royalty-free beneficial use of oil or gas. For example, the beneficial use of gas within a unit, but downstream of the measurement point, did not require prior BLM approval in the IBLA's 2008 decision in *Wexpro*. By requiring prior written approval for royalty-free beneficial use of gas in certain circumstances, the 2016 regulations are somewhat more stringent than NTL-4A. However, the circumstances justifying royalty-free beneficial use of gas do not seem materially different than NTL-4A, which would explain why no challenge was filed on the portion of the 2016 regulations addressing beneficial use.

As under NTL-4A, with some exceptions, royalty is owed on oil or gas used in operations *off* the lease, unit, or communitized area.[119] One exception is where BLM grants prior written approval for off-lease treatment, the operation is being conducted off-lease (or off the unit or communitized area) for engineering, economic, resource protection, or physical accessibility reasons, and the operations are upstream of the facility measurement point.[120]

The regulations describe the information that must be included on a sundry notice requesting approval of royalty-free beneficial use.[121] The operator need not own or lease the equipment or facility that uses oil or gas royalty-free.[122]

IV. ROYALTY ON PENDING COMMUNITIZATION AGREEMENTS

Federal and/or Indian leases must often be combined with fee or state leases to drill wells in conformity with a state drilling and spacing unit. In this situation, a communitization agreement or "CA" is required under which operations or production anywhere within the unit area will be deemed operations or production as to each of the leases committed.[123] Production from wells within the CA is allocated to each lease in accordance with the agreement. BLM approval of a CA is required for federal leases to be committed.[124] BIA approval is required to commit Indian leases.[125] Where both federal and Indian leases are included within a proposed CA, both BLM and BIA approval is necessary.[126]

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[117] *Id.* § 3178.5(a).
[118] *Id.* § 3178.5(b).
[119] *Id.* § 3178.7(a).
[120] *Id.* § 3178.7(b).
[121] *Id.* §§ 3178.5(b), 3178.9.
[122] *Id.* § 3178.10.
[123] *Id.* § 3105.2-2; *see also* BLM Manual 3160-9 – Communitization.
[124] 43 C.F.R. § 3105.2-3(b).
[125] 25 C.F.R. §§ 211.28 (tribal lands), 212.28 (allotted lands).
[126] BLM Manual 3160-9, .04.A.4.

Under the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996, the Secretary of the Interior is required to issue determinations allocating production for CAs within 120 days of a request.[127] However, this Act applies only to CAs with federal leases; it does not apply to CAs with Indian leases.[128]

Despite the statutory time period for approval of a CA with federal leases, BLM does not always approve a CA within 120 days. If BLM fails to act timely, the statute waives interest that could be assessed until the end of the month after BLM approves the CA,[129] but there is no other consequence.

Until 2022, there was no time limit on BIA's approval of a CA with Indian leases. In 2016, the Government Accounting Office (GAO) identified long delays in BIA action on proposed CAs in North Dakota as a significant problem and recommended that the Secretary of the Interior instruct BIA to "establish required time frames for the review and approval of Indian CAs to ensure a more timely CA process."[130] Although the Secretary agreed to implement the GAO's recommendation, that did not happen until 2022, when the DOI finally updated its Onshore Interagency Standard Operating Procedures for Indian Fluid Minerals to state that "[CA] approval process should not exceed a total of 120 days."[131]

With no time frame on BIA approval of a CA until 2022, and even after the 120-day period was established, BIA has in some cases taken several years after wells were drilled to act on a proposed CA. These delays have left operators in a quandary on how to allocate production among the leases and how to pay royalty to the various interest owners in a well, pending CA approval.

In 2015, BLM issued an Instruction Memorandum entitled "Re-Engineered Communitization Approval Process"[132] intended to help speed up approval of CAs on both federal and Indian lands. BLM said its goal was to have a CA approved before a well begins production. However, nine years later, there are still long delays in approving CAs. In the Instruction Memo, BLM acknowledged the need to modernize its Automated Fluid Minerals Support System ("AFMSS") database for tracking horizontal wells, so all leases penetrated by a horizontal well can be included in the database.[133] Until then, BLM stated that Field Offices "must enter each horizontal well in AFMSS using the first Federal/Indian lease penetrated within the producing zone."

Because BLM has not yet modified AFMSS to link more than one lease for a well, ONRR has instructed operators that they must allocate all production from a horizontal well in a pending CA to the first federal or Indian lease pene-

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[127] Pub. L. No. 104-185, § 6(e), 110 Stat. 1714 (1996); 30 U.S.C. § 1721(j).

[128] Pub. L. No. 104-185, § 9, 110 Stat. 1717 (1996); 30 U.S.C. § 1701 note.

[129] 30 U.S.C. § 1721(j).

[130] GAO-16-553, "Indian Energy Development, Interior Could Do More to Improve Its Process for Approving Revenue-Sharing Agreements," at 17 (June 2016).

[131] BIA, "Onshore Energy and Mineral Lease Management Interagency Standard Operating Procedures (SOP)," Att. A at A-11 (Feb. 10, 2022).

[132] BLM IM 2015-124.

[133] *Id.* ("The BLM did not design the current version of AFMSS to manage horizontal wells that are often completed and producing from multiple leases.").

trated by the well. That way, royalty can be tied to the one lease identified in BLM's AFMSS database. But there is no regulation or other binding directive from ONRR conveying this instruction; nor is there any informal, nonbinding guidance such as a Dear Payor letter telling operators to pay royalty in this manner.

Some operators try to accommodate ONRR's position and pay royalty on 100% of the production from a well in a proposed CA to the first penetrated federal or Indian lease pending approval of the CA. Where there are non-federal leases penetrated by the well, and the operator also pays royalty to those interest owners, this forces the operator to pay more than the total royalty that will be owed once the CA is approved. When the CA is approved, the operators recoup the overpayment from ONRR. Where the first lease penetrated is a federal lease, and all royalty is paid to that lease, the operators are able to recoup the overpayment—albeit without recovery of any interest.

From the standpoint of the operator, however, this approach does not work where an Indian lease is the first lease penetrated. ONRR's regulations limit recoupment of overpayments on tribal leases to the current month's royalty on the overpaid lease, unless the tribe gives written permission otherwise.[134] In the case of Indian allottee leases, the regulations are even more restrictive: ONRR limits recoupment to 50% of the current month's royalty, and there is no ability to recoup from other allottee leases.[135] Consequently, if an operator must pay royalty on 100% of the well's production to a relatively small Indian allottee lease tract pending CA approval—potentially for several years and when a well's production is at its highest—the operator will almost certainly never be able to recoup the overpayment. For the operator, this presents an untenable situation, one that could force it to bear a multi-million-dollar loss on a single CA because timely approval of the CA is not given.

ONRR's approach (based on the antiquated state of BLM's AFMSS) also limits payment of royalty to the first federal or Indian lease penetrated by the well. If other Indian leases are penetrated by the well, they will not share in the royalty payments until the CA is approved, which could be many years after production from the well began.

In recent years, ONRR has advised operators they are subject to penalties if they do not pay royalty on 100% of the well's production to the first federal or Indian lease penetrated. Yet there is no statute, regulation, lease term or order that requires operators to allocate all of a horizontal well's production, and pay royalty accordingly, to the first federal or Indian lease penetrated.

Before the Instruction Memorandum in 2015, BLM and ONRR allowed operators to pay royalty based on the proposed CA allocations, using what they called a "pre-CA" process. This offered a practical solution to the dilemma posed by long delays in CA approval. But the Solicitor of the Interior's office determined that this process presented legal issues and instructed BLM and BIA to stop using it.[136] Because many years later the situation appears not to

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[134] 30 C.F.R. § 1218.53(a), (b).

[135] *Id.*

[136] *See* IM 2015-124; *see also* GAO 19-553 at 8 ("However, in early 2015 Interior's Office of the Solicitor instructed BIA and BLM to cease using this process. The Office of the Solicitor deter-

have improved significantly, the agencies may need to revisit use of the pre-CA process or devise another solution that (i) avoids placing the operator at risk of not recouping large royalty overpayments, and (ii) provides for payment to all Indian leases being produced by the wellbore, not just the first lease penetrated.

V. ROYALTY CHANGES UNDER THE INFLATION REDUCTION ACT

In the IRA, Congress included several provisions that affect royalty payments on federal and Indian leases issued after the date of the Act (August 16, 2022) or leases reinstated after that date. First, Congress adopted the provisions discussed above related to gas used or lost in operations.[137] Second, Congress increased the royalty rate for new leases—it is now 16.67%.[138] Third, for Class II Reinstatements of leases, Congress increased the royalty rate to 4% higher than the rate in the lease and not less than 20%.[139] BLM has implemented these provisions in Instruction Memorandum 2023-008.

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mined that preliminary CAs were not legally binding because documents used in the process were not formally reviewed, approved, and signed by the Secretary of the Interior or the Secretary's designee.").

[137] *See* 30 U.S.C. § 1727.

[138] *Id.* § 226(b)(1)(A).

[139] *Id.* § 188(e)(3). Class II Reinstatements apply when a lessee did not pay rental within 20 days of the lease termination date and "such failure was justified or not due to a lack of reasonable diligence, or no matter when the rental was paid, it is shown to the satisfaction of the authorized officer that such failure was inadvertent." 43 C.F.R. § 3108.2-3(a).