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GAO

Report to the Chairman, Subcommittee on Mineral Resources Development and Production, Committee on Energy and Natural Resources, U.S. Senate

September 1991

# MINERAL RESOURCES

# Interior's Use of Oil and Gas Development Contracts



GAO/RCED-91-1

GAO

**United States**
**General Accounting Office**
**Washington, D.C. 20548**

**Resources, Community, and**
**Economic Development Division**

B-232829

September 17, 1991

The Honorable Jeff Bingaman
Chairman, Subcommittee on Mineral Resources
Development and Production
Committee on Energy and Natural Resources
United States Senate

Dear Mr. Chairman:

This report responds to your request that we evaluate the use of development contracts by the Bureau of Land Management, acting on behalf of the Secretary of the Interior, in its onshore federal oil and gas leasing program. Specifically, you asked whether the contracts entered into and/or approved since 1986 satisfy the legal requirements for development contracts and if the contracts have had an adverse effect on small oil and gas producers.[1]

To prevent the concentration of control over federal oil and gas resources in a few companies or individuals, the Congress enacted a statutory limitation on the number of acres of oil and gas leases that one party may control in any one state. One exception to this limitation is for lease acreage within the boundaries of development contracts. Development contracts are intended to permit oil and gas lease operators and pipeline companies to contract with a sufficient number of lessees to economically justify large-scale drilling operations for the production and transportation of oil and gas, subject to approval by the Secretary of the Interior, who must find that such contracts are in the public interest.

Interior first approved six development contracts in New Mexico during the 1950s. These contracts were between lessees and operators for the development of known gas resources on leased lands. From 1953 through 1968, Interior approved several contracts to foster exploration for oil and gas on remote, mostly unleased federal lands in Alaska. Interior called these contracts development contracts. Since 1986, after a lapse of about 18 years, Interior has entered into and/or approved 10 contracts with 12 lease operators for exploration of largely unleased

[1] Appendix I discusses our objectives, scope, and methodology.

Once a party reaches the statutory limitation, it is prohibited from controlling additional acreage in that state. Both the acts and Interior's regulations provide for the cancellation and forfeiture of leases when a party controls acreage in excess of the statutory limitation within a state. The Secretary has the authority to compel a party whose acreage is in excess of the statutory limitation to divest excess acreage.

The Mineral Leasing Act of 1920 was amended in 1931 to provide an exception to the acreage limitation for lease acreage within the boundaries of development contracts approved by the Secretary of the Interior.[4] The act's legislative history and Interior's regulations make clear that such contracts are to facilitate developing existing leases. Furthermore, the statutes provide that the Secretary may approve such contracts between lessees and other parties if they are in the public interest, but the statutes do not authorize the Secretary to be a party to the contracts.

Interior is responsible for administering the leasing and development of onshore federal oil and gas resources. Onshore federal lands are made available for oil and gas leasing through competitive bidding at public auction, followed by first-come, first-served applications for lands not leased at auction. Oil and gas lessees do not always develop their own leases and, therefore, routinely contract with lease operators and pipeline companies for necessary services.

Parties to the 10 contracts entered into and/or approved by Interior since 1986 do not receive preferential privileges to lease lands within the contract boundaries. That is, they must compete for leases on the same basis as others. Moreover, others are not precluded from exploring unleased lands within the contract boundaries.

## Contracts Since 1986 Do Not Satisfy Legal Requirements for Development Contracts

The mineral leasing acts and Interior's regulations specify certain requirements for development contracts. The contracts must be (1) for the development of existing oil and gas leases and (2) between one or more lessees and one or more other parties, then be approved by the Secretary of the Interior. None of the 10 contracts designated as development contracts by Interior since 1986 satisfy these requirements. As a result, we believe that leases within the boundaries of these contracts do not qualify for exception from the statutory acreage limitation.

[4]The Mineral Leasing Act for Acquired Lands adopted this provision of the Mineral Leasing Act of 1920.

We carefully analyzed their comments, but they did not persuade us that the Secretary has the discretion under the mineral leasing acts to use development contracts for oil and gas exploration on largely unleased federal lands. While the acts and Interior's regulations afford the Secretary a certain amount of discretion in approving development contracts, they do not place sole reliance on this discretion and the Secretary cannot substitute discretion for the acts' statutory acreage limitation. Therefore, we continue to believe that leases covered by the 10 contracts do not qualify for exception from the acreage limitation. Furthermore, our review of the legislative history, including hearings and committee reports, did not provide evidence that the Congress has ratified Interior's use of development contracts for exploration. Likewise, congressional inaction concerning Interior's prior sporadic use of similar contracts cannot be considered as legislative ratification.

## Contracts Since 1986 May Adversely Affect Others

By designating the 10 contracts entered into and/or approved since 1986 as development contracts, Interior has enabled operators to lease acreage in excess of the statutory limitation, resulting in increased concentration of control over federal oil and gas resources. One potential result of this concentration is that other parties wishing to obtain federal oil and gas leases and participate in developing these resources may be precluded from doing so.

As of about August 1989, 9 of the 12 lease operators who were party to the 10 contracts had exceeded the statutory acreage limitation in the states where they had contracts. All nine of the lease operators were major or large independent oil companies, and the amounts of leased acreage they controlled in excess of the statutory acreage limitation ranged from about 9,000 to about 878,000 acres. Five of the nine lease operators exceeded the 246,080-acre limitation within their respective contract boundaries alone. (App. III provides the acreage leased by the 12 operators in the states where they had contracts.)

In a 1988 report, a Bureau of Land Management task force on development contracts stated that the only benefit to a party to a development contract "is lease acreage excepted from the statewide limit." By being party to the 10 contracts, the nine major and large independent oil companies can compete for and control virtually unlimited amounts of federal oil and gas lease acreage, without regard for the statutory acreage limitation. Had it not been for the acreage exception provided by the contracts, that acreage would continue to be available for competitive leasing by others.

acreage limitation and not in competitive bidding among unequal competitors at public-lease auctions.

We also do not believe that concentration of control can be equated to knowledge of the oil and gas potential of the lands within the contracts' boundaries. Under the mineral leasing acts, as amended, concentration of control over federal oil and gas resources is measured by the number of acres of oil and gas leases that one party controls in any one state and not by one's knowledge of the lands' oil and gas potential.

## Interior Believes That the Contracts Are in the Public Interest

Interior believes that the 10 contracts are in the public interest. Specifically, Interior points out that parties to the contracts committed to a specific amount of exploration within their respective contract boundaries in return for exceptions from the statutory acreage limitation.

According to Interior officials, the 10 contracts further administration policy, established in 1986, that encourages exploration for and development of federal oil and gas resources. Interior believes that because the contracts have been for largely unleased, remote areas that otherwise might not have been explored, and thereby developed, the contracts are furthering this policy. Similarly, Interior and several of the parties to the contracts commented that the ability to lease land in excess of the statutory acreage limitation helps mitigate the risk of investing in exploration activities. According to them, Interior's contracts, by virtue of their exception to the acreage limitation, have their greatest utility in providing incentives for industry to undertake highly risky exploration programs that sometimes could not otherwise be efficiently and effectively conducted in states with predominantly federal acreage.

Interior also states that the information provided to the government as a result of the exploration conducted under the contracts helps foster oil and gas exploration and development. Under the contracts, the operators are required to make exploration information available for inspection by Interior, upon request. Interior says that this information is potentially useful for land use planning and to others who may be interested in leasing in the contracts' boundaries. However, Interior officials told us that Interior has requested little information from the operators of the 10 contracts.

We are sensitive to the fact that since 1985 domestic crude oil production has decreased and that this trend is expected to continue. We are also aware that lower world oil prices have discouraged investment in

Given the sharp difference of opinion between us and Interior regarding Interior's authority to be a party to and to approve development contracts for exploration for oil and gas on largely unleased federal lands, we believe that the Congress needs to resolve this matter. We recognize that in doing so the Congress must weigh the resulting increased concentration of control over federal oil and gas resources and its potential adverse effect on others against the potential benefits of using development contracts for exploration and the legal and other implications associated with terminating existing contracts.

## Recommendation to the Congress

We believe that the Congress should decide whether it wishes Interior to continue to be a party to and/or approve development contracts for exploration for oil and gas on largely unleased federal lands. Therefore, we recommend that the Congress amend the mineral leasing acts to expressly permit or prohibit Interior to enter into and/or approve development contracts for exploration for oil and gas on largely unleased federal lands and/or to increase or remove the acreage limitation.

## Agency Comments and Our Evaluation

The Department of the Interior, four oil and gas companies that are party to Interior's contracts since 1986, and two law firms representing three oil and gas companies that are party to Interior's contracts since 1986, provided written comments on a draft of this report. Interior's comments are in appendix IV, and our evaluation of them can be found in the body of this letter and in appendix V. Because Interior's comments generally reflect the essence of the comments from the contract parties, and because the parties' comments were voluminous, we did not include them in this report. However, they are available upon request.

Our draft proposed that the Secretary stop issuing development contracts for oil and gas exploration and take other appropriate actions to comply with existing legal requirements for development contracts. As an alternative, we proposed that the Secretary provide the Congress with information that supports its belief that using development contracts for exploration and/or increasing or removing the acreage limitation (1) promotes greater exploration activity than would otherwise occur, thereby leading to increased oil and gas development and production, and (2) does not adversely affect others who may wish to participate in developing federal oil and gas resources. On the basis of Interior's comments, we deleted these recommendations when it became clear that Interior did not intend to act on them, and we elevated our recommendation to the Congress.

## Abbreviations

| | |
|---|---|
| BLM | Bureau of Land Management |
| GAO | General Accounting Office |

# Contracts Designated as Development Contracts Entered Into And/Or Approved by Interior Since 1986

| Contract name | State | Parties | No. of acres | Approval date |
|---|---|---|---|---|
| South Fork | Colo. | Amoco<br>Union Pacific Resources[a] | 771,092 | 3/4/86 |
| Magic | N. Mex. | Elf-Aquitaine<br>Shell-Western E & P | 3,500,000 | 3/28/86 |
| Tres Ritos[b] | N. Mex. | Conoco<br>Leonard Minerals[c] | 182,443 | 10/9/86 |
| Pinon | Nev. | Exxon | 638,880 | 12/9/86[d] |
| Fremont Prospect | Wyo. | Exxon | 411,606 | 12/15/87 |
| Bristlecone | Nev. | Anschutz | 2,469,147 | 12/22/87 |
| Black Point | Nev. | Chevron U.S.A.<br>Mobil | 2,465,000 | 1/11/88 |
| Pancake Range[b] | Nev. | Exxon | 663,450 | 2/23/88 |
| Butte Valley | Nev. | Anadarko Petroleum<br>Basin & Range Exploration | 309,000[e] | 7/1/88 |
| Huntington Valley | Nev. | Anadarko Petroleum | 312,000 | 7/8/88 |
| **Total** | | | **11,722,618** | |

[a]This operator was formerly known as Champlin.

[b]These contracts were terminated in September 1989.

[c]Leonard Minerals subsequently withdrew as a party to this contract.

[d]This contract was signed by BLM as a party to the contract; however, there was no specific mention of approval.

[e]According to comments received from Anadarko, the size of this contract has been reduced to 210,000 acres.

# Comments From the Department of the Interior

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

MAR 1 1 1991

Mr. James Duffus, III
Director, Natural Resources
Management Issues
General Accounting Office
Washington, D.C. 20548

Dear Mr. Duffus:

We appreciate the opportunity to review General Accounting Office (GAO) draft report, Mineral Resources - Interior is Not Complying with Law on Oil and Gas Development Contracts (GAO/RCED-91-1).

Senator Jeff Bingaman requested that your office determine whether oil and gas development contracts administered by the Secretary of the Interior through the Director, Bureau of Land Management (BLM), have had an adverse effect on small and independent oil and gas operators. While unable to present a convincing case in that regard, GAO attempted to demonstrate that the Secretary had exceeded his statutory authority in the manner in which he was implementing the development contract provision of the Mineral Leasing Law.

We strongly disagree with the principal legal and policy findings in GAO's draft report and have presented our objections in Enclosure 1. Since legal opinion was central to GAO's principal findings in the draft report, we asked our Solicitor's Office to also review the report. Its discussion and analysis of the legal aspects are included as Enclosure 2 and are an integral part of the Department of the Interior's (DOI) formal comments on the draft report.

Our comments on specific allegations in the draft report, summarized below, are explained in detail in the enclosures.

GAO: Interior contracts since 1986 do not satisfy legal requirements.

We believe the Act of March 4, 1931, provides the Secretary ample discretionary authority to use development contracts to foster oil and gas exploration in frontier areas. With reference to GAO's finding that a development contract needs to involve more than one party, we note that what appear to be single party contracts usually involve both lessees and operators who share contract obligations in the form of split lease or operating interests, or other secondary agreements.

The agency contact for this response is Sie Ling Chiang, Chief, Division of Fluid Mineral Lease and Reservoir Management, BLM. Mr. Chiang may be reached at FTS 653-2133 or commercial (202) 653-2133.

Sincerely,

for David C. O'Neal
Assistant Secretary, Land and
Minerals Management

Enclosures

p. 21. Many Parties to Interior's Contracts Exceed the Statutory Acreage Limitation. This has resulted in the concentration of control over Federal oil and gas resources.

Development contracts are fixed in duration and thus convey only temporary benefit to participants. These agreements carry well-defined timeframes for the phased and orderly exploration of an area. Failure to adhere to these timeframes and to the performance standards specified in the contract results in the imposition of severe penalties, which may include termination of the contract and loss of the company's acreage exemption.

Since lands within a contract area are largely unexplored and have little or no known oil and gas potential, the acreage held by contract lessees in excess of their statutory limit (i.e., their exempt lease holdings within the contract area) can hardly be considered a "concentration of control over Federal oil and gas resources." At most, it might represent a concentration of non-exclusive exploration rights to a poorly known and highly speculative area.

p. 23. Potential Adverse Effect of Interior's Contracts.

In this section of the draft report, GAO attempts to develop a case that development contracts, as administered by BLM, have been detrimental to small independent companies. To support this view, GAO indicates on page 16 of the report that it interviewed and/or gathered information from oil and gas trade organizations. However, GAO fails to acknowledge or discuss the responses it received from these organizations.

Of particular interest in this regard are the views of the Rocky Mountain Oil and Gas Association (RMOGA) and the Independent Petroleum Association of Mountain States. These two organizations count as members and serve as spokesmen for numerous companies, both large and small, that make up a substantial part of the oil and gas industry in the Rocky Mountain region. In a response dated July 25, 1989, to a GAO inquiry regarding possible negative effects of development contracts on small producers, RMOGA stated its membership believed such contracts benefitted both large and small operators alike and were "overwhelmingly in favor of development contracts as an exploration tool." The RMOGA further stated it "does not believe there has been any negative impact on small independent operators from a development contract."

Wildcat acreage within contract areas usually drew little previous exploration interest and would likely experience little present attention if it were not for speculative interest generated by the existence of the development contract.

p. 23. **Major companies with substantial economic resources are able to acquire and retain large quantities of acreage through their ability to make larger bids at auction and to more easily absorb annual lease rental payments.**

A large company enjoys obvious advantages over its smaller competitors in acquiring competitive oil and gas leases in untested areas due to its information and financial resources. These advantages are not unique to situations involving development contracts and allow the larger company to assume greater risks in its exploration planning. The risk associated with conducting a comprehensive exploration program in a large, untested area is a risk smaller companies are usually unwilling and unable to accept.

The fact that companies involved in development contracts hold lease acreage in excess of state limitations should not be surprising, since this allowance was provided for in the law as an incentive to promote the use of such agreements.

p. 25. **Interior Believes That the Contracts Benefit the Federal Government. It has not been demonstrated that lands covered by the 10 post-1986 development contracts would not have otherwise been explored and developed.**

This "what if" conjecture can be neither verified nor refuted.

The GAO notes the area in Nevada where several development contracts overlap lies between two producing areas. However, GAO fails to acknowledge that the area under these contracts lies within an entirely different and more complex geologic setting where the existence of oil and gas is highly speculative. Areas of such complexity are subject to diverse geologic interpretation, which frequently leads different companies to target quite different oil and gas prospects for exploration. Because of the great expense of conducting a comprehensive exploration program in such a high-risk area, companies were unwilling to proceed without the chargeability waiver.

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We maintain GAO has failed to support, with factual data, its allegations that these development contracts have either harmed small independents or have resulted in any concentration of control over Federal oil and gas resources. Finally, we believe exempting lease acreage within the contract area from the statewide limitation, as provided by the 1931 Act, is a valuable and necessary incentive that encourages the industry to commit to expensive and risky programs of exploration in areas that might otherwise remain unexamined and undeveloped.

Based on our belief that GAO has failed to provide substantive and convincing evidence to support the allegations made in the draft report, the DOI sees insufficient justification to implement the punitive measures recommended by GAO against current parties to BLM development contracts.

that Congress was aware that only operators were parties to the contracts. Instead of directing inclusion of lessees in the contracts, Congress merely gave them acreage relief. And, finally, the Department has implemented the law in a manner that comports with the provisions of the Mineral Leasing Act.

Background

We first begin with an examination of the statutory background of development contracts and of the regulations implementing those provisions. The Mineral Leasing Act of 1920, 30 U.S.C. 181 et. seq., provides the basic authority for the Secretary of the Interior to issue leases for oil, gas, coal, phosphate and sodium on the pubic lands. In 1931, section 27 of the Mineral Leasing Act was amended to provide, among other things, the following:

> ... That the Secretary of the Interior is hereby authorized, on such conditions as he may prescribe, to approve operating, drilling or development contracts made by one or more permittees or lessees in oil and gas leases or permits, with one or more persons, associations, or corporations, whenever in his discretion and regardless of acreage limitations, provided for in this Act, the conservation of natural products or the public convenience or necessity may require it or the interests of the United States may be best subserved thereby ....[1]

Act of March 4, 1931, ch. 506, 46 Stat. 1523, 1525 (codified as amended at 30 U.S.C. 226(m)).

The legislative history of this provision is rather sparse, providing simply that:

> It further authorizes the approval by the Secretary of the Interior of operating, drilling, or development contracts by permittees or lessees, regardless of acreage limitations, whenever the

[1] Congress moved this provision to section 17(b) in the Act of August 8, 1946, 60 Stat. 950. No specific restrictions or criteria were included other than "conservation of natural products" or "public convenience" or "interests of the United States." Although the legislative history describes the provision as an incentive for pipeline companies, only the second criterion uses terminology related to pipelines. In light of the broad statutory language, the reference in the legislative history is clearly an example.

development contract in Alaska was approved in 1953. There were 27 other Alaska development contracts approved from 1953 to 1968.

In the Act of July 29, 1954, Congress amended section 17(b) by extending the acreage exemption to any lessee whose lease was operated under a development contract.[2] Congress struck the words "and regardless of acreage limitations provided for in this act" that were inserted by the amendment to section 27 in 1931 and instead placed at the end of the provision the following language:

> All leases operated under such approved operating, drilling, or development contracts, and interests thereunder, shall be excepted in determining holdings or control under the provisions of any section of this Act.

Act of July 29, 1954, ch. 644, 68 Stat. 583, 585 (codified as amended at 30 U.S.C. 226(m)).

The Committee reports indicate that this was needed for lessees who were not parties to a development contract, indicating that Congress was aware that only operators were parties to the contracts. Instead of directing inclusion of the lessees in the contracts, Congress merely gave the lessees acreage relief.

> (5) **Section 17(b), paragraph 5.** -- The present law provides that the Secretary may approve special operating, drilling or development contract, [sic] without regard to acreage limitations in this act. It is not clear from the present language whether the benefit accrues to the operator and the lessee or lessees affected, or just to the operator. By departmental decision, the language of the present law would limit the benefit to the operator only. The proposed amendment would extend the lessees who may not be parties to the special contract the same rights as it now extends to an operator. In other words, the acreage held by lessees subject to such special contract would not [be] charged in the limitation set by section 27 of the act.

H. Rpt. No. 2238, 83d Cong., 2nd Sess. 4, reprinted in 1954 U.S. Code Cong. and Adm. News, 2695 at 2698.

During 1959 and 1960, Solicitor Abbott and other Department officials gave speeches and testified before Congress that

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[2] This provision is now located in section 17(m) of the Mineral Leasing Act, 30 U.S.C. section 226(m) (1988).

would entertain requests for approval of operating, drilling or development contracts covering oil and gas leases on public lands within the 48 contiguous states, 33 Fed. Reg. 15,674 (October 23, 1968). The Federal Register notice stated that approval of contracts would be "contingent upon" a finding that certain conditions existed to demonstrate that approval "is prudent and in the public interest." Those conditions were:

1. Lands embraced in the contract area are in a geologic province or area which is relatively unexplored for oil and gas.

2. The terms and conditions cited in the contract are designed to insure that approval will be beneficial to the public interest.

3. The contract provides for definite exploratory objectives, a timetable for meeting those objectives, a significant expenditure during the life of the contract, and definite drilling obligations.

Id.

The notice also stated that information obtained or developed in conjunction with operating, drilling or development contracts should be furnished to the U.S. Geological Survey.

Current Departmental regulations, codified at 43 C.F.R. Subpart 3105 (1989), provide the following with respect to operating, drilling and development contracts:

**3105.3-1 Where filed.**

A contract submitted for approval under this section shall be filed with the proper BLM office, together with enough copies to permit retention of 5 copies by the Department after approval.

**3105.3-2 Purpose**

Approval of operating, drilling or development contracts ordinarily shall be granted only to permit operators or pipeline companies to enter into contracts with a number of lessees sufficient to justify operations on a scale large enough to justify the discovery, development, production or transportation of oil or gas and to finance the same.

**3105.3-3 Requirements**

The contract shall be accompanied by a statement

> private individuals. The remaining parcels [31 percent] went to mid-sized companies.

Letter from J. Steven Griles, Assistant Secretary of the Interior for Land and Minerals Management, to Senator Jeff Bingaman (Sept. 29, 1988).

On January 19, 1989, the then-Associate Solicitor for Energy and Resources responded on behalf of the Solicitor to a letter from the Assistant General Counsel for GAO. The Associate Solicitor stated that, based on the language of the Mineral Leasing Act of 1920 that authorizes the Secretary to approve oil and gas development contracts, "we must agree with your conclusion that BLM should not be a party to these contracts, but should only approve them if approval satisfies one of the statutory criteria." Letter from Thomas L. Sansonetti, Associate Solicitor for Energy and Resources, to R.A. Kasdan, Assistant General Counsel, General Accounting Office (Jan. 19, 1989). The letter went on to state, however, "... our review indicates that, for the most part, BLM is carrying out the Secretary's statutory responsibility of contract approval." Id.

Senator Bingaman wrote to Secretary Manuel Lujan, Jr. in February 1989 to advise the Secretary that he had requested GAO to examine the impacts of the development contract provision. The Senator requested that the Department "refrain from approving any further contracts until GAO has completed their study." Letter from Senator Jeff Bingaman to Secretary Manuel Lujan, Jr. (Feb. 21, 1989).

**Analysis**

**A. GAO Offers No Support For Its Allegations That Oil and Gas Development Contracts Were Intended to be for Development of Leased Lands and Not for Exploration of Unleased Lands.**

1. The Mineral Leasing Act of 1920

Leased Lands v. Unleased Lands

The Mineral Leasing Act of 1920, as amended, does not restrict operating, drilling or development contract activities to those undertaken on leased lands. The 1931 amendment to the Act states that:

> The Secretary of the Interior is hereby authorized, on such conditions as he may prescribe, to approve operating, drilling or development contracts made by one or more permittees or lessees in oil and gas leases or permits, with one or more persons, associations, or corporations, whenever in his

federal lands, ranging from about 180,000 to 3.5 million acres in Colorado, Nevada, New Mexico, and Wyoming, and has designated them as development contracts.[2] (See app. II.)

## Results in Brief

We believe that the 10 contracts entered into and/or approved by Interior since 1986 do not satisfy the legal requirements for development contracts because these contracts are for oil and gas exploration on largely unleased federal lands, rather than for developing existing leases. Furthermore, rather than being between lessees and lease operators, 9 of the 10 contracts are between Interior and lease operators, and in all 10 contracts the sole parties, other than Interior, are the operators.

By designating the 10 contracts as development contracts, Interior has enabled the contract parties to accumulate lease acreage that exceeds the statutory acreage limitation. At the time of our review, 9 of the 12 contract parties had exceeded the statutory acreage limitation in the states where they had contracts, controlling from 9,000 to 878,000 excess acres. All nine of the contract parties were major or large independent oil companies. As a result, other parties who wish to participate in developing federal oil and gas resources within those states may be adversely affected because the parties to Interior's contracts have been able to compete for and obtain lease acreage beyond the statutory acreage limitation.

Interior told us that it believes the Secretary has the discretion under law to use development contracts in the current manner. Nevertheless, on April 20, 1989, Interior ceased issuing these contracts pending the completion of our review.

## Background

The Mineral Leasing Act of 1920, as amended, and the Mineral Leasing Act for Acquired Lands, as amended, provide for developing oil and gas resources on federal lands. Each act places a limitation of 246,080 acres of oil and gas leases that one party may control in any one state,[3] reflecting congressional concern about potential monopoly control of federal oil and gas resources.

[2]Lands within the six contracts in New Mexico approved from 1952 through 1959 have generally been fully developed, and all of the Alaska contracts have expired. Of the 10 contracts since 1986, 2 were terminated in September 1989—one in Nevada and one in New Mexico. Because these contracts were in effect at the time of our review, we included them in our evaluation.

[3]In Alaska the aggregate limit is 600,000 acres.

Although designated as development contracts by Interior, the 10 contracts provide for exploration of largely unleased lands rather than for development of existing leases and do not require that leases within the boundaries of the contracts be developed. Interior's regulations recognize that oil and gas development and exploration activities are different. Under Interior's regulations, development contracts commit operators to discovery, development, production, or transport of oil and gas.[5] On the other hand, the regulations define exploration as the search for evidence of oil and gas. The 10 contracts entered into and/or approved since 1986 explicitly state that they are for exploration, and the activities described therein are aimed at obtaining evidence of oil and gas, not at developing known resources. Moreover, while the mineral leasing acts provide that leases within the boundaries of development contracts must be developed, the 10 contracts do not require a commitment to develop the leases.

The mineral leasing acts also specify that development contracts must be between lessees and others, for example, oil and gas operators. Under the acts, the Secretary of the Interior is not authorized to be a party to the contracts and the Secretary has no interest or capacity as a lessee or operator, as the statutes require of a contracting party. Rather, the Secretary's role under the acts is to approve the contracts if they are in the public interest. However, 9 of the 10 contracts are between Interior and lease operators, and in the tenth contract the parties are all operators. As a result, the sole parties in all 10 contracts, other than Interior, are the operators. Interior's Office of the Solicitor agreed with our conclusion that Interior should not be a party to development contracts.[6]

## Interior Believes That the Secretary Has Broad Discretion to Use Development Contracts

Interior believes, however, that the Secretary has the discretion under the mineral leasing acts to use development contracts in the manner in which they have been used and that the Congress has ratified this use. Interior and 7 of the 12 parties to the 10 contracts provided extensive comments on a draft of this report to support this position. Interior's comments are included as appendix IV of this report, and our evaluation of comments concerning whether the 10 contracts satisfy the legal requirements for development contracts can be found in appendix V.

[5]Discovery refers to the drilling of a well to a geologic formation capable of oil and gas production, according to H. Williams & C. Meyers, Manual of Oil and Gas Terms (7th ed. 1987).

[6]In a January 19, 1989, letter to GAO, Interior's Associate Solicitor for Energy and Resources stated "We must agree with your conclusion that [Interior] should not be a party to these contracts, but should only approve them if approval satisfies one of the statutory criteria."

## Interior Believes That Other Parties Have Not Been Adversely Affected

In commenting on a draft of this report, Interior and 7 of the 12 parties to Interior's 10 contracts generally disagreed that other parties who may wish to participate in developing federal oil and gas resources may be adversely affected because contract parties have been allowed to obtain lease acreage in excess of the statutory limitation. Specifically, they noted that (1) we offered no factual data to support this allegation, (2) Interior's competitive bid, public-lease auctions safeguard against undue concentration of control over federal oil and gas resources as evidenced by small companies holding leases within the boundaries of the 10 contracts, and (3) the oil and gas potential of the lands within the contracts' boundaries is largely unknown and can hardly be considered a concentration of control over federal oil and gas resources.

We agree that there are no factual data to prove conclusively that using development contracts for exploration has had an adverse effect on others. Rather, we show that using development contracts for exploration has resulted in increased concentration of control over federal oil and gas resources by major and large independent oil companies contrary to the concern of the Congress in placing an acreage limitation on oil and gas leases that one party may control in any one state. With the amounts of leased acreage controlled by the nine major and large independent oil companies exceeding the statutory limitation by as much as 878,000 acres, it would be difficult for Interior to prove that using development contracts in this manner has not adversely affected others who may wish to participate in developing federal oil and gas resources.

We do not believe that Interior's oil and gas lease auctions safeguard against undue concentration of control over federal oil and gas resources. As Interior pointed out in its comments: "A large company enjoys obvious advantages over its smaller competitors in acquiring competitive oil and gas leases in untested areas due to its information and financial resources. These advantages . . . allow the larger company to assume greater risks." Moreover, the fact that acreage within the contracts' boundaries is leased to other companies does not necessarily mean that these companies are able to compete for and obtain leases. The contracts' boundaries encompass over 11.7 million acres with varying degrees of oil and gas potential. Without analyzing the relative oil and gas potential of the leases, there can be no certainty whether other parties have obtained leases within the contract boundaries because they are able to economically compete with the contract parties or because the contract parties had little interest in competing for those particular leases. We believe that the safeguard lies in the statutory

U.S. oil exploration and development and that the cost to find and produce oil in the United States is higher than in any other major oil-producing country. This is due, in part, to most of the nation's oil fields having already been explored and drilled extensively and to remaining fields being expensive and hard to find and drill.[7] However, historically, exploration for oil and gas resources has occurred on both leased and unleased federal lands without the use of Interior's contracts. Moreover, the boundaries of the six contracts in Nevada overlap and are located between the two principal oil-producing areas in the state, and other companies have leased lands within the boundaries of the 10 contracts, indicating to us that these lands have exploration potential.

## Conclusions

We believe that the 10 contracts entered into and/or approved by Interior since 1986 do not satisfy the legal requirements for development contracts established by the mineral leasing acts, the legislative history, and Interior's regulations and that leases within the boundaries of these contracts do not qualify for exception from the statutory acreage limitation. Interior has taken a contrary view, asserting that the Secretary has the discretion under the mineral leasing acts to use development contracts in the manner in which they have been used and that the Congress has ratified their use for exploration.

We also believe that the increased concentration of control over federal oil and gas resources within the boundaries of the 10 contracts may have precluded other parties wishing to participate in leasing and developing these resources from doing so. Interior, on the other hand, believes that those not party to the contracts have not been adversely affected.

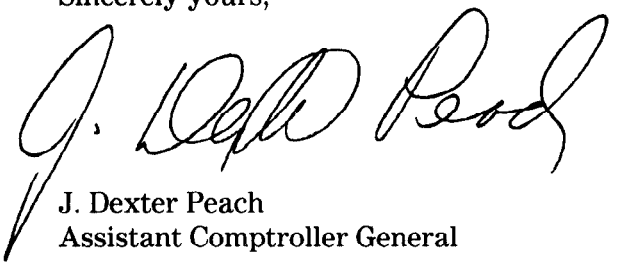
In addition, Interior believes that the 10 contracts are in the public interest in that they promote exploration for and development of federal oil and gas resources that otherwise might not have been accomplished. Although this can neither be adequately verified nor refuted, using development contracts in this manner equates to rescinding the statutory acreage limitation for the nine major and large independent oil companies that have exceeded the acreage limitation in the states where they have contracts.

[7]See Energy Policy: Developing Strategies for Energy Policies in the 1990s (GAO/RCED-90-85, June 19, 1990).

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Secretary of the Interior and other interested parties and make copies available to others upon request.

This report was prepared under the direction of James Duffus III, Director, Natural Resources Management Issues, who may be reached at (202) 275-7756 if you or your staff have any further questions. Other major contributors are listed in appendix VI.

Sincerely yours,



J. Dexter Peach
Assistant Comptroller General

# Contents

# Objectives, Scope, and Methodology

Our objectives in this review were to respond to a request from the Chairman, Subcommittee on Mineral Resources Development and Production, Senate Committee on Energy and Natural Resources, to determine whether the contracts the Department of the Interior entered into and/or approved since 1986 satisfy the legal requirements for development contracts and whether these contracts have had an adverse effect on small oil and gas producers.

To meet our objectives, we examined relevant laws and legislative histories; legal documents, including a legal opinion submitted on behalf of two companies that are parties to Interior's contracts; Interior's regulations; the contracts; and other program documents. Because the areas covered by the early New Mexico contracts have been developed and all of the Alaska contracts have expired, we evaluated the 10 contracts that Interior entered into and/or approved since 1986. We interviewed Interior headquarters officials in Washington, D.C., including attorneys in the Office of the Solicitor, and consulted with private attorneys in Washington, D.C., experienced in oil and gas matters. We also interviewed Bureau of Land Management (BLM) officials responsible for onshore oil and gas leasing, including officials at BLM's four state offices responsible for administering the contracts. In addition, we interviewed and/or gathered information from oil and gas industry officials from companies with and without development contracts and from oil and gas trade associations. To determine the amount of acreage controlled by companies with contracts, officials of BLM's Wyoming State Office, responsible for auditing controlled acreage for all Bureau offices, provided us assistance.

We conducted our review from March 1989 to July 1991 in accordance with generally accepted government auditing standards.

# Number of Acres Leased by Parties to the 10 Contracts

| Category[a]/ Operator | State | Acreage leased in contract areas | Other chargeable acreage[b] | Total |
|---|---|---|---|---|
| **Major** | | | | |
| Amoco | Colo. | 234,223 | 283,465[c] | **517,688** |
| Chevron | Nev. | 213,726 | 233,930 | **447,656** |
| Conoco | N. Mex. | 145,698 | 99,066 | **244,764** |
| Exxon[d] | Nev. | 391,145 | 215,730 | **606,875** |
| Exxon | Wyo. | 20,964 | 234,162 | **255,126** |
| Mobil | Nev. | 248,708 | 207,481 | **456,189** |
| Shell-Western E & P | N. Mex. | 644,275 | 961 | **645,236** |
| **Large Independent** | | | | |
| Anadarko Petroleum | Nev. | 159,773 | 194,018 | **353,791** |
| Anschutz | Nev. | 934,014 | 190,495 | **1,124,509** |
| Elf-Aquitaine | N. Mex. | 440,506 | 0 | **440,506** |
| Union Pacific Resources[e] | Colo. | 113,305 | 160,882 | **274,187** |
| **Small Independent** | | | | |
| Basin & Range Exploration | Nev. | 31,704 | 9,079 | **40,783** |
| Leonard Minerals | N. Mex. | 182,443 | 6,723 | **189,166** |

Note: Data were compiled during the period March-August 1989.

[a]Designations were done with the assistance of the Independent Petroleum Association of America and BLM officials.

[b]Charageable acreage is acreage that is subject to the statutory limitation. Nonchargeable acreage is not shown in this table.

[c]Amoco temporarily exceeded the acreage limitation due to a purchase of leases from Tenneco Company. Amoco was divesting excess acreage at the time of our review.

[d]Exxon was a party to two development contracts in Nevada—the Pancake Range and the Pinon. (See app. II.)

[e]This operator was formerly known as Champlin.

We agree the statute provides BLM authority to approve development contracts but not to execute them as a party to the agreement. However, for all but one of the post-1986 contracts in which the Government is identified as a "party," the BLM has also executed an approval document. We believe the agreements to which the Government is a party remain valid legal instruments, and we will make the necessary contract modifications to clarify the BLM's role in administering these agreements.

It is important to note the DOI has been issuing and administering oil and gas development contracts in much the same manner since 1953. Throughout that time, the Congress was well aware of DOI's policy and practice in making these agreements. While enacting several important revisions to the Mineral Leasing Law during this period, Congress chose to neither amend nor clarify the development contract provision of the Law. It seems likely that if Congress felt this provision was being improperly administered by the Secretary, it would have taken corrective action.

GAO: Interior contracts since 1986 may adversely affect others.

The GAO contends the post-1986 development contracts circumvent the statutory acreage limitation on lease holdings, resulting in the concentration of control over Federal resources to the detriment of others. We found nothing in the draft report to support these allegations. Rather, correspondence sent to GAO from industry trade organizations who had polled member companies revealed no evidence of any adverse effects of development contracts on its membership, which included many small and independent operators. The GAO failed to mention these results in its report.

In summary, we believe the Secretary, through the Director, BLM is, in all important aspects, acting within his legal authority in administering the development contract provision of the Mineral Leasing Law. For these reasons, we believe there is insufficient support, either legal or factual, to justify implementation of the measures called for in GAO's recommendations.

Response to GAO's Draft Report GAO/RCED-91-1,
Interior is Not Complying With Law on
Oil and Gas Development Contracts

General Comments

Many of the allegations presented in the draft report draw on GAO's narrow interpretation of the development contract provision of the Act of March 4, 1931. We believe their analysis is shortsighted. It fails to see this provision of the Act in the context of the broader statutory mandates for resource conservation and development that were the focus of energy legislation at that time. The Congress has been well aware of the Department of the Interior's (DOI) policy and practice in the use of development contracts and, by failing to clarify its intent through legislative change, has given tacit approval to the way the Bureau of Land Management (BLM) has implemented this part of the Act.

Specific Comments

Following are our comments on specific parts of the report. Where the issue addressed is primarily legal, we refer the reader to Enclosure 2, Comments on Draft GAO Report, prepared by DOI's Associate Solicitor for Energy and Resources. That enclosure also provides a comprehensive background discussion on both the legislative aspects and administrative use of development contracts.

p. 17. Contracts Are For Exploration Not Development. These contracts were intended solely for developing existing leases. They were not intended for the exploration of unleased lands.

(See Enclosure 2, pp. 8-12, for response.)

p. 18. Contracts Are Not Between Lessees and Operators. Most post-1986 contracts include BLM as a party, making them in effect single-party, operator contracts.

(See Enclosure 2, pp. 12-15, for response.)

p. 19. Leases Within the Contracts' Boundaries Do Not Qualify For Exception From the Acreage Limitation.

(See Enclosure 2, pp. 15-16, for response.)

p. 20. Prior Use and Possible Congressional Awareness Do Not Remedy Legal Deficiencies.

(See Enclosure 2, p. 15, for response.)

Enclosure 1

The Independent Petroleum Association of Mountain States (IPAMS), in a letter to GAO dated July 11, 1989, detected apprehension on the part of some of its members over development contracts but attributed this to a lack of understanding or misconception regarding such contracts. The IPAMS also pointed to the perception held by some independents that "if a situation creates an advantage for the majors, then inherently it will create a disadvantage for the independent." However, the Association concluded that development contracts, as currently awarded, do not appear to pose any problem for the independents.

The contrast is striking between these documented sentiments of the independents, as reported by their trade organizations, and the undocumented, conjectural statements of GAO regarding the effects of development contracts on that segment of the industry. Although directed by Senator Bingaman to determine if small oil and gas producers have been adversely affected by these contracts, GAO has clearly made no such determination.

p. 23. Other parties wishing to obtain Federal oil and gas leases and participate in developing resources within the contract boundaries may be precluded from doing so, since excess controlled acreage has been removed from competition and is unavailable to parties who have not reached the acreage limitation.

An area targeted for oil and gas exploration under a development contract typically represents a unique and unconventional geologic setting (e.g., the volcanic sills being studied under the South Fork contract). The geophysical work and/or drilling commitments required to explore such an area under terms of a development contract are substantial and translate into large monetary expenditures. A company would be unwilling to make such a financial commitment unless it could count on receiving some benefit from its efforts. This benefit is best assured by acquiring lease interests within the area of study.

Initially, an untested area may contain a high proportion of unleased lands which, when offered, can be leased, explored and developed by anyone with the resources to do so. However, without some indication an area has oil and gas potential, there is little serious competitive interest and, thus, little opportunity for unfair competitive advantage in acquiring lease rights.

Much of the Nevada contract area was unleased, and had never been leased, when the initial development contracts were approved. The pattern of leasing activity prior to and after issuance of these contracts suggests that speculative interest evolved as a direct consequence of the contracts and that competitive interest in the area had not been present before. It should be noted that the late 1980's were not a period of high exploration interest for the oil and gas industry, particularly in remote, highly speculative lands such as those within contract areas.

p. 25. Interior has requested little information from contract operators (suggesting that Interior's claim that this information is useful is suspect).

Development contracts require periodic reporting of contract activities, the presentation of raw and interpreted seismic data and the submission of well data, to the BLM. Although much of this information is confidential, it reveals useful information about oil and gas potential that would otherwise be unavailable for developing land use projections in BLM's resource management planning, and has been used for this purpose.

Data gathered under BLM's development contracts tells us much of what we know about the resource potential of these frontier areas. The United States Geological Survey (USGS) relies on such data in developing regional assessments of the Nation's oil and gas resources. These resource estimates are revised periodically and are widely referenced both within and outside Government. The USGS believes the exploration data obtained by contract operators will be useful in its next update of the Nation's oil and gas resource base.

p. 26. Recommendations to the Secretary of the Interior. In view of purported deficiencies identified in their report, GAO recommends the Secretary:

- terminate all post-1986 contracts;
- issue no new leases to contract parties in excess of state limits; and
- require contract parties to relinquish lease acreage in excess of state limits.

We believe the Secretary of the Interior acted well within his discretionary authority under the mineral leasing statutes in approving the post-1986 development contracts. While we agree BLM had not, in all cases, limited its role to contract approval, we do not view this as requiring termination of the affected contracts.

United States Department of the Interior

OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20240

FEB 27 1991

MEMORANDUM

TO: Assistant Director, Energy & Mineral Resources
Bureau of Land Management

FROM: Associate Solicitor, Energy and Resources

SUBJECT: Comments on Draft GAO Report

This responds to your request for review of and comments on a draft report of the General Accounting Office (GAO) entitled, "Mineral Resources - Interior Is Not Complying with Law on Oil and Gas Development Contracts" (GAO/RCED-91-1) (hereinafter "Draft Report").

The Draft Report contends that, because development contracts are for exploration for oil and gas on unleased lands, rather than for development of existing leases, the contracts do not satisfy legal requirements. Further, GAO contends that, because the contracts are between lessees and the Department of the Interior ("Department"), instead of between lessees or operators and other parties, the contracts do not comply with the law. Because of these legal deficiencies, GAO contends, the Department has "undermined" the integrity of the acreage limitation provided in the Mineral Leasing Act of 1920, which excepts from statewide acreage limitations the amount of lease acreage committed to operation, drilling or development contracts.

**Findings**

There is no basis in law or regulation for concluding that development contracts cannot be used for exploration. The Bureau of Land Management is carrying out the Secretary's authority to approve development contracts in the manner prescribed by Congress in the Mineral Leasing Act. Notwithstanding the fact that the Department may have been "a party" to one contract in which there was no other party but the lessee/operator, single-party contracts have been approved since 1953. Congress was aware of single-party contracts and did nothing to disapprove them, despite amendments to the Mineral Leasing Act in 1954, 1959, 1960 and 1987.

Further, there is nothing in law or regulation to suggest that operators of development contracts had to be lessees. To the contrary, the 1954 amendments to the Mineral Leasing Act indicate

Enclosure 2

> policy of conservation or the public necessity or convenience will be promoted. This departure is intended to permit pipe-line companies to enter into contracts with permittees or lessees in number sufficient to justify the construction of such pipe-lines and to finance the same.

S. Rpt. No. 1798, 71st Cong., 3d Sess. 3 (1931).

On June 4, 1931, Secretary Ray Lyman Wilbur published regulations to implement the amendment dealing with oil and gas development contracts, "Unit Operation of Oil and Gas Permits and Leases Under Act of March 4, 1931," 53 I.D. 386 (1932), also referred to as Circular No. 1252. The regulations state that:

> (4) The provision of section 27, authorizing the Secretary of the Interior to approve operating, drilling, or development contracts without regard to acreage limitations is primarily intended to permit pipe-line companies or other operators to enter into contracts with permittees and lessees in numbers sufficient to justify operations on a large scale for the discovery, development, production or transportation of oil or gas and to finance the same.

Id. at 390.

The regulations require that a contract submitted for approval be accompanied by a statement showing the interests held by the contractor and a proposed plan of operation or development of the field. They further require that all contracts held by the same contractor in the field be submitted for approval at the same time and that full disclosure of the project be made. And, finally, in order for the Secretary to make a determination in accordance with the Act, and to prescribe the conditions upon which approval will be made, there is a requirement that complete details be furnished to the Department.

With the statutory grant of authority to approve oil and gas operating, drilling and development contracts, and the implementation of that authority in the Department's regulations, the Department was thus prepared to proceed with approval of oil and gas development contracts. This authority, however, was not utilized until 1952, when the Department approved the first development contracts in New Mexico to facilitate gas production.

Also in 1952, the Department considered using development contracts as a means of achieving exploration in the Katalla-Yakataga area in Alaska. At that time, there were 400 lease applicants for 1,000,000 acres. The lease applicants were represented by a partnership that would share in the sale of operating rights and in royalty. The Katalla-Yakataga

development contracts are with an operator but do not mention either operating agreements or lessees.[1] Congress amended the Mineral Leasing Act again in 1959 and 1960 but did nothing to alter the substantive provisions relating to operating, drilling or development contracts. In the Mineral Leasing Act Revision of 1960, 74 Stat. 781, Congress moved the development contract provision to section 17(j), but did not amend the provision.

On October 23, 1968, Secretary Stewart L. Udall announced that the Department would entertain requests for oil and gas development contracts in the Western states "which are relatively unexplored for these mineral values." U.S. Department of the Interior, Office of the Secretary News Release, "Development Contracts In Western States To Be Considered," (October 23, 1968). The Department news release elaborated quite extensively on the purpose and value of development contracts:

> 'Quite obviously, not all public land areas can qualify for this special treatment,' Secretary Udall said. 'We regard it primarily as an incentive for exploration and development in areas of high risk where relatively little is known about the oil and gas potential.'
>
> Development contracts, authorized by the Mineral Leasing Act of 1920, envision systematic exploration of lands in the contract area. Their principal advantage to the operator is the temporary exemption of a large block of Federal leases from the acreage limitation on holdings and control. In return for this temporary exemption, the operator commits himself to a definite program of exploration, a timetable for performance, and a substantial expenditure of capital over the life of the contract.

Id.

Secretary Udall noted that in Nevada in 1967 only 10 exploratory wells were drilled and only 1.5 million acres of the 61 million acres of public lands in Nevada were under lease. "There is active interest in the oil and gas potential of this geologic province, but to have any value that interest must be translated into actual exploration and production." Id. at 2.

In conjunction with this announcement, the Department published a notice in the Federal Register that stated that the Department

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[1] See Abbott, "Federal Oil and Gas Leasing Law: Full Symphony or Overture?", Southwestern Legal Foundation, 1959 National Institute for Petroleum Landmen, 81 at 105 (1960).

> showing all the interests held by the contractor in the area or field and the proposed or agreed plan for development and operation of the field. All the contracts held by the same contractor in the area or field shall be submitted for approval at the same time and full disclosure of the projects made.

43 C.F.R. 3105.3 (1989).

In 1985, the Colorado office of the Bureau of Land Management ("BLM") began negotiations on a proposed development contract in that state. Soon thereafter, requests for approval of development contracts were filed in New Mexico, Wyoming and Nevada. In 1988, Senator Jeff Bingaman (NM) wrote to Secretary Donald Paul Hodel to express his concern that the current regulations of the BLM might work "to the disadvantage of the smaller, independent oil and gas producers, particularly in view of the greater degree of competition introduced into the onshore oil and gas leasing program by virtue of the Onshore Oil and Gas Leasing Reform Act of 1987. Letter from Senator Jeff Bingaman to Secretary Donald Paul Hodel (Aug. 10, 1988). Senator Bingaman requested that the Secretary "give immediate attention to the effect that the planned Nevada auction may have on the competitive ability of small independent operators." Id.

Senator Bingaman also wrote the Comptroller General of the General Accounting Office that same day to request that GAO undertake a study of the impacts that the development contract regulations would have on small, independent oil and gas producers. Finally, the Senator requested an analysis of "the extent to which acreage in excess of the acreage limitation is held as a result of this exception, as well as a description of the type of producers taking advantage of this exception." Letter of Senator Jeff Bingaman to Charles A. Bowsher, Comptroller General, General Accounting Office (Aug. 10, 1988).

The Assistant Secretary for Land and Minerals Management wrote back to Senator Bingaman on September 29, 1988, in response to the letter to Secretary Hodel. That letter stated, in part:

> The results of the first six sales [under the new onshore leasing reform act] show that of the total 907 parcels that were sold, only 18 percent were won by major oil companies. The successful bidders in the recent Nevada lease sale, conducted August 11, 1988, show a similar pattern of distribution. Of 156 parcels sold, which represents 25 percent of the parcels offered, 25 percent went to companies listed by the Oil and Gas Journal as among top 20 public companies (majors). Another 34 percent went to 12 different small bidders, and 10 percent went to

> discretion and regardless of acreage limitations, provided for in this Act, the conservation of natural products or the public convenience or necessity may require it or the interests of the United States may be best subserved thereby.

Act of March 4, 1931, ch. 506, 46 Stat. 1523, 1525 (emphasis added) (codified as amended at 30 U.S.C. 226(m)).

Nowhere in this broad grant of authority is there a restriction against conducting activities on unleased lands. The statute does not state that the Secretary is authorized to approve development contracts on leased lands only.[4] Nor does the statute state that the Secretary is authorized to approve development contracts on unleased lands only. The statute simply states that the Secretary is authorized to approve such contracts "whenever in his discretion ... the conservation of natural products (i.e., natural resources) or the public convenience or necessity may require it or the interests of the United States" would be served thereby.

The Draft Report concludes that, "The acts' legislative history and Interior's regulations make clear that such contracts are to facilitate developing leases." Draft Report at 3 (emphasis added). Curiously, the Draft Report later states that the legislative history "is ambiguous at best and subject to various interpretations." Draft Report at 20 (emphasis added).

In addition, GAO states that, "The Mineral Leasing Act and Interior's regulations specify certain requirements for development contracts," as if there were precisely enunciated legal provisions applicable to development contracts other than the ones cited herein. Draft Report at 17 (emphasis added). "The contracts must be (1) for the development of existing oil and gas leases ...". Id. Yet, GAO does not cite any "specific" legal requirements. The full text of the Mineral Leasing Act's provisions and the Department's regulations concerning development contracts are reprinted above, and, as stated previously, neither "specify" any such legal requirements. Nor do either state that development contracts are for "development of existing oil and gas leases."

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[4] We believe the Mineral Leasing Act contemplates leased lands within an operating, drilling or development contract area, but we do not find any indication that the contract area must solely consist of leased lands. As a practical matter, a development contract proponent will start with some lease acreage within the contract area, but may not hold all lease acreage within that area. Further, we believe the statute contemplates that the contract area may also consist of unleased acreage. We find no evidence to conclude otherwise.

Earlier in the Draft Report GAO states that, "Interior did not seek or obtain legislative authorization to use development contracts for exploration on unleased lands." Draft Report at 13. We find this statement to be offensive because it conveys an unsupported legal conclusion and declares that the Department has operated outside the provisions of the Mineral Leasing Act.

The regulations promulgated by the Department in 1931 do not restrict development contracts to development activities on leased lands either. The regulations simply refer to "operations ... for the discovery, development, production or transportation of oil or gas...". 53 I.D. 386, 390 (1932). It is an established principle of law that regulations promulgated contemporaneously with the enactment of a statute are to be given deference unless they do not comport with the law. Ripley v. Sutherland, 40 F.2d 785 (D.C. Cir.), cert. denied, 282 U.S. 865 (1930) (the Department's contemporaneous construction of the Mineral Leasing Act is valid where it is not shown to be clearly erroneous).

In our view, GAO has failed to establish that the Department has misconstrued and erroneously implemented the Mineral Leasing Act. The U.S. Supreme Court has established the principle that "the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong." Red Lion Broadcasting Co. v. Federal Communication Commission, 395 U.S. 367, 381 (1969). GAO has not offered any "compelling" evidence that the Department's construction of the statute is wrong, other than its opinion that it is wrong. What GAO may be attempting to establish, however, is that the Department has not implemented the law in a manner consistent with the way GAO believes the law should be implemented.

By engaging in a game of semantics, GAO attempts to cast a pall over the BLM's implementation of the development contracts provision. For example, in no less than 10 instances[5] in the Draft Report does GAO state that the Department has "designated" the contracts "development contracts," attempting to leave the impression that by "designating" the contracts thusly, the Department has contravened the law and excepted the lease acreage committed to the development contracts "for mere convenience."[6]

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[5] See pages 4, 5, 13, 17, 19, 21 and 26 of the Draft Report.

[6] Another example of GAO's game of semantics is in evidence on pages 17 and 18 of the Draft Report, wherein GAO distinguishes the terms "exploration" and "discovery" in an attempt to discredit BLM because, in GAO's view, development contracts are for "discovery" and not

This type of advocacy by innuendo is reprehensibly self-serving and petty.

Exploration v. Development

The Mineral Leasing Act does not preclude exploration on lands subject to development contracts either. The Department's regulations clearly contemplated "operations for the discovery, development, production or transportation of oil or gas." 53 I.D. 386, 390 (1932) (emphasis added).

The broad grant of authority can be read as a grant to the Secretary to approve development contracts on unleased lands for the purposes of exploration, because the terms "operating, drilling or development" are broad enough to subsume exploration, GAO's narrow interpretation notwithstanding. GAO has cited no authority to the contrary, nor does it introduce any evidence that Congress intended to restrict development contract activities to development of existing leases only.

2. Departmental Regulations and Practice

There is no doubt about the fact that the Department intended that development contracts be authorized for exploration on unleased lands as a means of stimulating exploration in high risk frontier areas where little was known about oil and gas potential. The practice initiated by Secretary Udall in 1968 makes this abundantly clear. The Department's continuation of this practice, based on its interpretation of the law, was in further evidence in 1974, when the Director of the U.S. Geological Survey advised:

> In view of the present domestic energy situation [presumably referring to the Arab oil embargo], and to

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"exploration." Both terms contemplate the drilling of a well. In order to have a well capable of producing, there has to be exploration and a discovery. What is disappointing about this discussion is GAO's statement that the Department's regulations "commit operators to discovery," which cannot possibly occur without exploration. Surely GAO does not intend to be so rigid in its "legal analysis" as to suggest that the Mineral Leasing Act cannot be construed to mean that development contracts were intended only for the development of proven resources, because to do so would mean that the party making the "discovery" would then have to abandon the project and let someone else produce what he had found.

> further Project Independence 1980, it is recommended that the Department of the Interior encourage exploration in those onshore sedimentary basins in the public lands States where the Geological Survey believes that the potential for further discoveries significantly exceeds the discoveries made to date, by increasing the availability of oil and gas development contracts.

Memorandum from V.E. McKelvey, Director, U.S. Geological Survey, to the Under Secretary of the Interior (June 26, 1974).

**B. GAO Mischaracterizes the Department's Role in Development Contracts, There Was More Than One Party to the Contracts, and Congress Knew That There Were Single Party Development Contracts Yet Did Nothing to Alter or Prohibit This Practice.**

1. The Department's "Role"

GAO correctly interprets the Mineral Leasing Act to conclude that the Secretary's role in development contracts, as it has been delegated to the Director of BLM, is limited to approval of such contracts. The 1931 amendments provided that:

> The Secretary of the Interior is hereby authorized, on such conditions as he may prescribe, to approve operating, drilling or development contracts ...

Act of March 4, 1931, ch. 506, 46 Stat. 1523, 1533 (codified as amended at 30 U.S.C. 226(m)).

This limitation on the Secretary's authority was acknowledged by the Department in a response to GAO in 1989, in which the then-Associate Solicitor for Energy and Resources stated, "we must agree with your conclusion that BLM should not be a party to these contracts, but should only approve them if approval satisfies one of the statutory criteria." Letter from Thomas L. Sansonetti, Associate Solicitor for Energy and Resources, to R.A. Kasdan, Associate General Counsel, General Accounting Office (Jan. 19, 1989). What is troubling about the Draft Report is GAO's failure to acknowledge the remainder of the response, because the Associate Solicitor went on to state the following:

> The form language in most of the 13 contracts that we reviewed does identify BLM as a party to the contract. In only one instance did BLM merely sign as a party to the contract. Eleven of the contracts have attached a separate document to indicate approval of the contract by BLM. On seven of these, BLM signed both the approval sheet and the contract. On the eleventh BLM only signed the contract. (Our copy of the thirteenth

> contract does not show whether BLM signed or approved it.) Thus, while we appreciate your concern over the propriety of BLM being a party to these contracts rather than merely approving them, our review indicates that, for the most part, BLM is carrying out the Secretary's statutory responsibility of contract approval. (emphasis added)

Id.

We can only conclude from the Draft Report that GAO does not intend to recognize the facts surrounding BLM's role in the development contracts, although we do appreciate GAO's statement that "the Solicitor agrees that Interior should not be a party to development contracts." Id.

GAO also gratuitously allows that, despite our belief that the Secretary has the discretion to use development contracts in the current manner, ... "[n]evertheless, Interior temporarily ceased issuing the contracts in 1989 pending the results of GAO's review." Draft Report at 4. What GAO also fails to acknowledge with respect to the response of the Associate Solicitor is the statement that:

> By copy of this letter, we are advising BLM to no longer execute these contracts but only to approve them. We also recommend that BLM modify the contract form to clarify that they are not a party.

Letter from Thomas L. Sansonetti, Associate Solicitor for Energy and Resources, to R.A. Kasdan, Assistant General Counsel, General Accounting Office (Jan. 19, 1989).

The negative implication of GAO's statement above is obvious. The Associate Solicitor's notice to BLM, when coupled with Senator Bingaman's request of Secretary Lujan, offers a more suitable explanation of the hiatus in development contract approval activity than GAO will allow.

2. The Mineral Leasing Act

As we have already discussed above, the Mineral Leasing Act authorizes the Secretary to "approve" operating, drilling or development contracts. And, as also discussed above, there was only one instance where BLM signed as a "party" to the contract. In the 13 contracts examined by the Associate Solicitor, eleven of the contracts had a separate document attached to indicate approval by BLM. In seven instances, BLM only signed the approval statement. On three contracts, BLM signed both the approval sheet and the contract. On the eleventh BLM only signed the contract.

We believe it is entirely feasible that BLM inadvertently signed the three contracts in addition to signing the approval sheet. We believe that the intention in these instances was merely to approve the contracts.

In only one instance, however, did BLM sign as a "party" to the contract. The Pinon Area Development Contract in Nevada that GAO states "was signed by BLM as a party to the contract" was executed during the tenure of the State BLM Director in office in 1986. Draft Report at 15. The next five development contracts executed in the same state in 1987 and 1988 (Bristlecone, Black Point, Pancake Range, Butte Valley and Huntington Valley) each contained a separate sheet indicating approval of the development contract, but by a different State Director. Thus, it is entirely possible that the 1986 development contract "signed" by the then-State BLM Director was an aberration, because all the others subsequently entered were only approved by a different BLM State Director. And for this, BLM is being chastised as "undermining the integrity" of the Mineral Leasing Act.

3. There Was More Than One Party to the Contracts

Whether the Department was properly a "party" to development contracts becomes less of an issue when the contracts are examined to determine the actual number of parties. If BLM was mistakenly a party to only one of the 10 development contracts examined by GAO, we must look to the contracts to determine whether there were other parties.

In the five development contracts listed in Table 1.1 of the Draft Report as single-party contracts,[7] there are other parties involved. Draft Report at 15. For example, in the Pinon contract, Pennzoil owned a 50-percent working interest and was listed as a 50 percent lessee of record on three leases within the development contract. See Exhibit "B" to the Pinon Area Developmental Contract, Eureka, White Pine and Elko Counties, Nevada, Exxon Corporation, Operator, Dated July 1, 1986.

At the time the Bristlecone contract was approved, Supron Energy was listed as a lessee of lease number N-16878, in which Union Texas Exploration Corporation and Anschutz Corporation shared an 87.222 percent and 12.778 working interest ownership, respectively. Anschutz Corporation and Texaco, Inc. shared working interest ownership in two other leases within the contract area on a 50-50 basis. See Exhibit "B" to the Bristlecone Development Area Contract, Eureka, Nye and White Pine Counties, Nevada, The Anschutz Corporation, Lessee, Dated August 1, 1987.

[7] (Pinon, Freemont Prospect, Bristlecone, Pancake Range and Huntington Valley).

Thus, a closer examination of the contracts reveals more than is disclosed by GAO. In our view, it is inappropriate to categorically condemn each of the contracts without a careful review of each to determine the participation by others.

4. Congress Knew About and Approved of Single Party Contracts

In the preceding discussion, we examined the Department's "role" in the development contracts, the Mineral Leasing Act and the number of other parties to the contracts. Even if our examination discloses that BLM was a "party" to the contracts, as we concluded in only one instance, Congress has been aware of the fact that the Department approved single-party development contracts since 1953 and has done nothing to disapprove of this practice. The case law cited above, which GAO is loathe to accept as having any bearing on this discussion at all, establishes that the BLM "practice" of approving single-party contracts, based on its interpretation of the law, is to be afforded deference, unless it is clearly wrong. And, "Congress' failure to alter this interpretation while amending the statute in other respects indicates that legislative intent has been correctly discerned." FMC Wyoming Corp. v. Hodel, 816 F.2d 496, 501 n. 11 (10th Cir. 1987), cert. denied, 108 S. Ct. 772 (1988).

The Supreme Court stated in Udall v. Tallman, 380 U.S. 1 (1964), "When faced with a problem of statutory construction, this Court shows great deference to the interpretation given the statute by the officers or agency charged with its administration." Id. at 16. GAO has not established that this practice, which has been in effect since 1953, is clearly wrong and has cited no evidence in an attempt to do so. We believe BLM's implementation of the development contract provision is consistent with law and regulation.

**C. Congress Provided An Exception to the Statewide Acreage Limitation for Acreage Contained in Operating, Drilling and Development Contracts and the Department Has Not Misapplied This Provision.**

When Congress amended the Mineral Leasing Act in 1931 to authorize the Secretary to approve operating, drilling or development contracts, it provided an exception to the statewide acreage limitation for acreage contained in the contract area. 46 Stat. 1523, 1525. GAO states that, "had it not been for the acreage exception provided by Interior's contracts, contract parties would not have been able to lease acreage in excess of the statutory limitation, and that excess acreage would instead be available for competitive leasing by others." Draft Report at 24.

There are two negative implications in this statement that require a response. First, Congress provided the acreage exception, not the contracts. The Secretary was granted the authority to approve operating, drilling or development contracts "regardless of acreage limitations." 46 Stat. 1523, 1525.

Second, GAO again attempts to impute an intent on the part of the Department to circumvent the Mineral Leasing Act. The same attempt is made when GAO states:

> Since 1986, Interior's 10 development contracts have been an exercise of Secretarial discretion that has exceeded the requirements clearly stated by the Mineral Leasing Act, its legislative history, and Interior's regulations. Accordingly, leases within the boundaries of the 10 contracts cannot be excepted from the acreage limitation.

Draft Report at 19.

Quite clearly, what GAO intends by such statements is to characterize the development contracts as an abuse of the Secretary's discretion and an attempt to contravene the Mineral Leasing Act. We do not agree. Nor do we find any substance to such inferences.

**D. GAO's Allegations Regarding the Potentially Adverse Impacts of Development Contracts on Small, Independent Oil and Gas Producers are Unsubstantiated.**

As discussed above in Assistant Secretary Griles' letter to Senator Bingaman, the experience in Nevada did not bear out any adverse consequences on small, independent oil and gas producers. See Letter from J. Steven Griles, Assistant Secretary of the Interior for Land and Minerals Management, to Senator Jeff Bingaman (Sept. 29, 1988). Forty-four percent of the leases sold went to individuals and small producers. Another 31 percent went to mid-sized companies. Id.

GAO concludes that parties other than those participating in development contracts "may be adversely affected because the parties to Interior's contracts have been able to compete for and obtain lease acreage beyond the statutory acreage limitation." Draft Report at 4 (emphasis added). Yet, again, GAO offers no support for this allegation besides a thin "may." Further evidence of the weakness of GAO's reed can be found in the statement that "Interior has not demonstrated that lands covered by the 10 contracts entered into and/or approved since 1986 would not have otherwise been explored and developed." Draft Report at 25. Being taken to task for not proving a negative is another exasperating example of GAO's attempts to put BLM's role in development contracts in the worst possible light.

**E. GAO Propounds A Self-Styled "Legal Analysis" as Determinative of BLM's Alleged Improper Implementation of the Law, When No Legal Analysis Was Requested by Senator Bingaman.**

What is perhaps most incredible of all about the Draft Report is that it is predicated upon a self-styled "legal analysis" when none was requested by Senator Bingaman. At page 2 of the Draft Report, GAO states that "Senator Jeff Bingaman asked GAO to determine whether these contracts (1) satisfy legal requirements for development contracts ...". Our review of Senator Bingaman's letter to the Comptroller General of GAO reveals that the Senator made no such request.

Senator Bingaman's letter to Mr. Bowsher consisted of eight simple sentences, the fifth and sixth of which articulated the Senator's request:

> ... I am requesting that the GAO undertake a study of whether this [development contract] rule does in fact have an adverse impact on small, independent oil and gas producers. Please include an analysis of the extent to which acreage in excess of the acreage limitation is held as a result of this exception, as well as a description of the types of producers taking advantage of this exception.

Letter from Senator Jeff Bingaman to Charles A. Bowsher, Comptroller General, General Accounting Office (Aug. 10, 1988).

Nowhere in the Senator's letter does he request that GAO determine whether the Department is properly implementing the Mineral Leasing Act or its regulations with respect to oil and gas development contracts. Yet, the Draft Report concludes that the development contracts "do not satisfy the legal requirements" under the law and the Department's regulations. Draft Report at 3. Further, claims GAO, "by designating the 10 contracts as development contracts, Interior has undermined the integrity of the statutory acreage limitations." Draft Report at 5. We must conclude that this is a contrived attempt by GAO to discredit BLM.

**Conclusion**

Our analysis of the various statutory authorities, their legislative histories, the Department's regulations and other documents, as well as the development contracts themselves, lead us to conclude that the Department has implemented the development contract provision in a manner consistent with law and regulation. The broad grant of authority provided in the Mineral Leasing Act gave the Secretary discretion to approve

operating, drilling and development contracts if the public interest would be served thereby. We believe the history of the Department's use of development contracts amply demonstrates their utility in facilitating oil and gas activities in remote, hostile, frontier areas that might otherwise not have been exposed to such activities. We believe BLM is carrying out the Secretary's authority to approve development contracts in the manner prescribed by Congress in the Mineral Leasing Act. Further, Congress has been aware of the Department's practices with respect to development contracts, based on the Department's interpretation of the law, and that interpretation should be afforded deference. Finally, we disagree with the substance of GAO's allegations, and find that they are not supported by fact or law.

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# GAO's Evaluation of Comments Concerning the Legality of the 10 Contracts

The Department of the Interior and 7 of the 12 parties to Interior's 10 contracts designated as development contracts since 1986 provided us written comments on a draft of this report.[1] Generally, they disagreed with our conclusion that the contracts do not satisfy the legal requirements for development contracts. After evaluating their comments, we continue to believe that the 10 contracts do not satisfy the legal requirements and that leases covered by those contracts do not qualify for exception from the acreage limitation. This appendix evaluates comments concerning the legality of the 10 contracts and provides additional support for our conclusions.

## Overview

Interior, as well as a number of the operating companies that have entered into the so-called development contracts, have expressed disagreement with our legal conclusion that those contracts do not qualify as development contracts under 30 U.S.C. § 226(m) and therefore, that leases acquired pursuant to such contracts do not qualify for exclusion from state acreage ceilings established under 30 U.S.C. § 184(d). The principal arguments in support of their position that these contracts are authorized under the provisions of section 226(m) are as follows:

First, even though the contracts are not between lessees and operators, but rather involve Interior and an operating company as the contracting parties, or even one so-called contracting party, an operating company, the contracts nonetheless involve proper parties under the statute.

Second, although the contracts involve activities largely on unleased federal land, neither the statute (section 226(m)) nor Interior regulations restrict development contracts to development activities on lands already under lease.

Third, the statute can be read to authorize the Secretary to approve development contracts for the sole purpose of exploration.

Fourth, the statute gives the Secretary of the Interior broad authority to exercise his discretion in approving the contracts.

[1]The 7 parties were Amoco Production Company; Anadarko Petroleum Corporation; Anschutz Corporation; Chevron U.S.A. Inc.; Conoco Inc.; Exxon Company, U.S.A.; and Mobil Oil Corporation. Interior's comments are included as appendix IV. Because Interior's comments generally reflect the essence of the comments from the contract parties, and because the parties' comments were voluminous, we did not include the parties' comments in this report; however, they are available upon request.

As discussed in detail below, we do not find these arguments persuasive. We remain of the opinion that, under the language of section 226(m) and its legislative history, as well as Interior's own regulations, the contracts we have considered do not qualify as development contracts and leases acquired pursuant to these contracts do not qualify for exclusion from applicable acreage limitations.

In treating the issues raised by Interior and the operating companies, we will first examine the purpose and requirements of section 226(m), as shown by the language of the statute, its legislative history, and Interior's regulations. Then, we will analyze one of the so-called development contracts, typical of the 10 we have considered, in relation to the purpose and requirements of the statute. Finally, we will discuss in detail the arguments presented by Interior and the operating companies.

## Statutes, Legislative History, and Interior Regulations

We begin with the language of the relevant statutes.

Section 27(d) of the Mineral Leasing Act, 30 U.S.C. § 184(d) was enacted in 1920. It provides the following restriction on the amount of oil or gas lease acreage any entity may hold or control in any one state:

"(1) No person, association, or corporation, except as otherwise provided in this chapter, shall take, hold, own or control at one time, whether acquired directly from the Secretary under this chapter, or otherwise, oil or gas leases (including options for such leases or interests therein) on land held under the provisions of this chapter exceeding in the aggregate two hundred forty-six thousand and eighty acres in any one state . . . ."[2]

Section 17(m) of the Mineral Leasing Act, 30 U.S.C. § 226(m), was enacted in 1931. It provides an exception to the state acreage limitations imposed by § 27(d), as follows:

"The Secretary of the Interior is hereby authorized, on such conditions as he may prescribe, to approve operating, drilling, or development contracts made by one or more lessees of oil or gas leases, with one or more persons, associations, or corporations whenever, in his discretion, the conservation of natural products or the public convenience or necessity may require it or the interests of the United States may be best subserved thereby. All leases operated under such approved operating, drilling,

[2]For Alaska, the limit is 300,000 acres each, for the northern and southern leasing districts.

or development contracts, and interests thereunder, shall be excepted in determining holdings under the provisions of this chapter."[3] (Emphasis added.)

The legislative history of section 226(m), the exception to the acreage limitation, is reflected in the report of the Senate Committee on Public Lands and Surveys. The Report states:

"This departure [from the acreage limitation] is intended to permit pipe-line companies to enter into contracts with . . . lessees in numbers sufficient to justify construction of such pipe-lines and to finance the same."

S. Rep. No. 1798, 71st Cong., 3d Sess. 3 (1931).

On the floor of the Senate, the manager of the bill, Senator Walsh, explained:

"This bill will permit a larger number of people to enter into drilling contracts with organizations willing to put down pipe lines, and the extent to which they may take drilling contracts, which would give them all of the gas taken out less a royalty, is likewise to be regulated by the Secretary of the Interior."

74 Cong. Rec. 6125 (1931). See also remarks of Congressman Colton, 74 Cong. Rec. 7203 (1931) (quoting statement from Senate committee report set forth above).

Department of the Interior regulations to implement the changes made by the 1931 Act provided as follows:

"(4) The provision . . . authorizing the Secretary of the Interior to approve operating, drilling, or development contracts without regard to acreage limitations is primarily intended to permit pipe-line companies or other operators to enter into contracts with . . . lessees in numbers sufficient to justify operations on a large scale for the discovery, development, production or transportation of oil or gas and to finance the same."

[3]As originally enacted in 1931, this provision read as follows:

"That the Secretary of the Interior is hereby authorized, on such conditions as he may prescribe, to approve operating, drilling or development contracts made by one or more permittees or lessees in oil or gas leases or permits, with one or more persons, associations, or corporations, whenever in his discretion and regardless of acreage limitations, provided for in this Act, the conservation of natural products or the public convenience or necessity may require it or the interests of the United States may be best subserved thereby." (Emphasis added.)

The permit system was abolished by the Act of August 21, 1935, 49 Stat. 676. The references to permits and permittees were dropped by the Act of August 8, 1946, § 6, 60 Stat. 954.

Circular No. 1262, 53 I.D. 386,390 (1931). These regulations have remained in effect to this day, essentially without change. 43 C.F.R. § 3105.3-2 (1990).

## Purpose and Statutory Requirements of Development Contracts

The purpose of section 226(m) is clear from the language of the statute, read in conjunction with the legislative history and Interior's regulations. It is to permit operators or pipe-line companies to enter into operating, drilling, or development contracts with lessees in sufficient numbers to justify large-scale drilling operations of the leases for the production of oil or gas and to finance those operations. See statement of Senator Walsh, supra. See also, S. Rep. No. 1798, supra. As Interior regulations put it, the purpose is "to permit operators or pipeline companies to enter into contracts with a number of lessees sufficient to justify operations on a scale large enough to justify the discovery, development, production or transportation of oil and gas and to finance the same." 43 C.F.R. § 3105.3-2 (1990).

Certain specific requirements are apparent on the face of section 226(m) and are plainly inferred from the language of the statute, its legislative history, and Interior regulations.

1. The Secretary of the Interior is not authorized to be a party to any contract. The Secretary's role is limited to one of approval of contracts between other parties which satisfy the requirements of the statute.

2. The contracts must be between two different sets of parties.

a. The party or parties on one side must be one or more lessees of oil or gas leases.

b. The party or parties on the other side must be one or more persons, associations, or corporations, specifically, operators or pipeline companies, that undertake to operate, drill, or develop the leases of the party or parties on the lessees' side.

3. The contract must provide for the operation, drilling, or development of the leases of the party or parties on the lessees' side by the party or parties on the operators' side.

4. The lands covered by the contract must be within existing leases held by the party or parties on the lessees' side.

The Secretary is authorized, in his discretion and on such conditions as he may prescribe, to approve contracts that conform to these specifications, when the conservation of natural products or the public convenience or necessity may require it or the interests of the United States may be best subserved thereby. Leases operated under such approved operating, drilling, or development contracts, and interests thereunder, are excepted from the statutory acreage ceilings.

## Contracts in Question Do Not Qualify as Development Contracts

In preparing this report, we examined 10 contracts to which the Secretary of the Interior, through BLM variously assented, between March 1986 and July 1988, as qualifying for treatment as development contracts under section 226(m). All of these contracts are denominated "development contracts." However, we remain persuaded that none qualifies as a development contract within the meaning of section 226(m). Accordingly, none of the leases acquired within the boundaries of the contract area qualify for exception from the statutory acreage ceiling.

Typical of the contracts we examined is that of the Anschutz Corporation, pertaining to what is styled the "Bristlecone Development Area." The contract contains a number of features and provisions which differ significantly from those required by section 226(m). These differences are of such magnitude that the contract cannot be deemed to qualify as a development contract within the meaning of section 226(m).

### Parties to the Contract

First, the contract begins by purporting to be "between the ANSCHUTZ CORPORATION . . . and THE UNITED STATES OF AMERICA, acting through the Secretary of the Interior, and his authorized officer, the State Director of the Nevada State Office of the Bureau of Land Management. . . ." However, the document is executed only by Anschutz. Attached to it is a form entitled: "Certification - Determination," executed by the Nevada director of the BLM, whereby, as the Secretary's delegate, he purports to approve the contract and to certify and determine that the interests of the United States are served by such approval.

The statute plainly does not authorize the United States or the Secretary of the Interior to be a party to a development contract. It provides only for contracts between federal oil and gas lessees on one side and operators on the other.

If, as the contract states, the United States, through the Secretary of the Interior, is one of the two parties to the contract, the contract plainly is

not a development contract within the meaning of section 226(m). But unless the United States is counted as a party, the Anschutz contract becomes a unilateral document and is not a contract at all. In either case, it is not a contract within the intendment of the statute, which requires a contract between one or more lessees of federal oil and gas leases and one or more operators.[4]

## Leases Excepted From the Acreage Limitation

Second, the Anschutz document provides that all Anschutz leases in the Bristlecone Area will be exempted from the statutory acreage limitation. Under this Anschutz agreement, the exception applies not only to the leases already held by Anschutz, but to all leases the company may subsequently hold or control in the vast Bristlecone Area.

The contract recites Anschutz's present lease interests in the Bristlecone Area and describes the size of that area:

"A. Anschutz is the owner of record title to, or has applied for, federal oil and gas leases covering certain lands located in Eureka, Nye and White Pine Counties, Nevada. These leases are located within a larger exploration area comprising approximately 2,469,147.57 acres, which is hereafter referred to as 'the Bristlecone Area', or 'the Exploration Area.'"

It then states that the contract covers all lands in the entire Bristlecone Area in which Anschutz, now or "hereafter," may acquire lease interests.

"1.1 The lands committed hereto shall be all of the federal lands within the boundary of the Bristlecone Area . . . which are now or may hereafter be subject to oil and gas leases issued to Anschutz and leases issued to others in which Anschutz may acquire an interest by option or assignment."

The document then expressly excludes all such leases—those now held by Anschutz and those the company may subsequently hold or control—in determining the company's holdings under the statutory acreage limitation.

[4]In his memorandum commenting on the report, Interior's Associate Solicitor states, under a heading entitled "There Was More Than One Party to the Contracts," that in five contracts we listed as single-party contracts, there are other parties "involved." Interior Associate Solicitor memorandum at 14. Among these contracts is the Anschutz contract pertaining to the Bristlecone Area. However, the companies the Associate Solicitor names as either a lessee or holding a working interest in leases in the Bristlecone Area are not parties to the "Bristlecone Development Area Contract." Nor does the Associate Solicitor claim that they are. Their "involvement" appears to be that they hold leases or working interests in leases in the Bristlecone Area. But the only company that is a party to the "Bristlecone Development Area Contract" is Anschutz. Thus, the statement of the Associate Solicitor does not support the point of the heading.

"2.1 All federal leases which are subject to this Development Contract, and all interests therein, shall be excluded in determining Anschutz' holdings or control of federal acreage under the acreage limitation provisions [section 184(d)] of the Mineral Leasing Act."

We remain persuaded that none of these leases qualify under section 226(m) for exemption from the acreage limitation.

The only leases committed to the contract at its inception appear to be leases already held or controlled by Anschutz in the Bristlecone Area. But under the statute, Anschutz may not contract with itself to operate or develop its own leases. Section 226(m) applies only to contracts made by one or more lessees of oil and gas leases with one or more other persons as operators. Accordingly, these leases do not qualify for an exemption from the acreage ceiling.

There are obvious reasons for this statutory restriction. If a single entity holding federal oil and gas leases could enter into a development contract with itself and thereby except the leases from counting against the acreage limitations prescribed by section 184(d), such limitations would be virtually a dead letter. By the simple expedient of entering into what amounts to a legally fictional contract with itself covering whatever federal lands it had under lease, a company could proceed to control an unlimited amount of such lands.

Beyond this, the Anschutz document would except far more than the limited amount of land in the Bristlecone Area already under lease to Anschutz. The document defines the geographical area it covers as comprising nearly 2.5 million acres, some 10 times the maximum amount of 246,080 acres that any entity is permitted under section 184(d) to hold or control in any one state except Alaska. Only a small part of this vast acreage is currently under lease to Anschutz or anyone else. It consists almost entirely of unleased federal lands. Nonetheless, under paragraph 2.1 of the document, all leases Anschutz may subsequently hold or control in this vast area, would be excepted from the state acreage limitations.

The development contract provision authorizes approval only of contracts between a lessee or lessees and another party or parties that agree to operate the leases held by the lessee or lessees. In short, the leases to be operated under the contract—and excepted from the acreage limitations—are necessarily existing leases already held by the lessee or lessees who are parties to the contract. The lessees are without

power to enter into "operating, drilling, or development" contracts involving other federal lands.[5]

Here, however, the Anschutz document purports to exempt from the acreage limitation, not only the limited amount of land already under lease to Anschutz, but also all leases Anschutz may subsequently hold or control in the vast, unleased exploration area subject to the contract. This is plainly beyond the contemplation of section 226(m).

## Contract for Exploration, Not Development

Third, the Anschutz document provides only for exploration, not development. It states that "[t]he objective of Anschutz is to explore the Exploration Area in search of oil and gas accumulations for which the drilling of oil and gas production wells can be economically justified." (Para. 4.1) It permits, but does not require, Anschutz to drill exploratory wells.[6] (Para. 7.1)

The statute authorizes the approval only of "operating, drilling, or development contracts," and refers to "leases operated under such approved operating, drilling, or development contracts." The Anschutz document commits the company to conduct nothing other than geophysical exploration.[7] It includes no obligation to "operate, drill, or develop."

Although development may include a component of exploration, Gorenflo v. Texaco, Inc., 566 F. Supp. 722,727 (M.D. La. 1983), aff'd, 735 F. 2d 835 (5th Cir. 1984), exploration and development are considered and

[5]While the Secretary may prescribe conditions incident to approving development contracts, the rights and obligations under the contracts run between the lessees on the one side and the operators on the other. The Secretary is not authorized to be a party, nor is he authorized by this statute to commit unleased federal lands to such contracts.

[6]The terms "exploratory well" and "development well" are distinguished on grounds that the former refers to "[a] well drilled . . . for the purpose of ascertaining the presence underground of a commercial petroleum deposit," while the latter refers to "a well drilled with the expectation of producing from a known productive formation. . . ." H. Williams & C. Meyers, Manual of Oil and Gas Terms 334 (7th ed. 1987).

[7]Interior's regulations define "geophysical exploration" as "activity relating to the search for evidence for oil and gas." 43 C.F.R. § 3050.0-5(a). The regulations expressly exclude "drilling for oil and gas" from the definition. Id.

defined to comprise separate and distinct sets of activities.[8] Accordingly, for this reason as well, the Anschutz document does not qualify as a development contract within the intendment of section 226(m).

## Arguments of Interior Associate Solicitor and Operating Companies

We will now discuss the specific arguments put forward by Interior's Associate Solicitor and the operating companies to support their position that these contracts conform to the requirements of section 226(m).

### Contract Parties

The first argument is that neither the statute nor Interior regulations require that a development contract be between a lessee and an operator. Further, there is ample authority for single-party contracts in which the operator is the only party and Congress has acquiesced in this practice for many years. As Interior's Associate Solicitor put it:

"[T]here is nothing in law or regulation to suggest that operators of development contracts had to be lessees. To the contrary, the 1954 amendments to the Mineral Leasing Act indicate that Congress was aware that only operators were parties to the contracts."

Interior Associate Solicitor memorandum at 1-2.

One of the operating companies, Anadarko Petroleum Corporation, states:

[8]Several federal statutes refer to exploration and development as distinct activities. For example, the National Forest Organic Act of 1891, as amended, provides:

"Nor shall anything in [this Act] prohibit any person from entering upon such national forests for all proper and lawful purposes, including that of prospecting [i.e., exploring], locating, and developing the mineral resources thereof." (Emphasis added.)

16 U.S.C. § 478

A 1991 bill proposed by the Administration to implement its National Energy Strategy, in making provision for oil and gas leasing in the coastal plain of the Arctic National Wildlife Refuge, distinguishes between exploration and development activities and requires separate plans for each. H.R. 1301, 102d Cong. 1st Sess., § 310.

Interior regulations concerning onshore oil and gas operations provide further evidence of the Department's recognition that exploration and development are separate and distinct activities, even on leased lands.

"The regulations in this part govern operations associated with the exploration, development, and production of oil and gas deposits from leases issued or approved by the United States. . . . The objective of these regulations is to promote the orderly and efficient exploration, development, and production of oil and gas." (Emphasis added.)

43 C.F.R. § 3160.0-1,4 (1990).

"Nothing in the statute or regulations requires that a . . . [development] contract be between a 'lessee' and an 'operator,' and there is ample authority in the regulations and legislative history for single-party contracts, as well as abundant evidence of Congressional acquiescence in this practice for more than three decades." Anadarko letter at 3.

We find no support for these contentions either in the language of the statute, its legislative history, Interior regulations, or the 1954 amendments to the Mineral Leasing Act.

The statute, itself, plainly provides that the Secretary may approve "operating, drilling, or development" contracts between two sets of parties—one or more lessees of oil or gas leases and one or more other "persons, associations, or corporations." As the legislative history and Interior regulations make clear, these other "persons, associations, or corporations" are "operators or pipe-line companies." In short, development contracts must be agreements between two sets of parties—lessees of oil and gas leases and operating companies.[9]

There is nothing to support the contention that contracts in which the operator is the only party—"single-party" contracts—qualify as development contracts under section 226(m). The plain language of the statute and Interior regulations refute this contention. Moreover, "single-party" contracts are incompatible with the essential purpose of development contracts, as made clear by the legislative history of the statute and Interior regulations. That essential purpose is to encourage operators with the financial means to contract with lessees who lack such financial means to develop their leases.[10]

In addition, we do not agree that the 1954 amendment to the Mineral Leasing Act indicates that the Congress was aware that only operators were parties to the contracts or that it evidenced congressional acquiescence in the practice of single-party contracts. The 1954 amendment made a simple legislative change. It eliminated the language, "and

[9]The statement by Interior's Associate Solicitor that, "there is nothing in law or regulation to suggest that operators of development contracts had to be lessees," while indisputably true, is irrelevant to the issue whether an operator may be the sole party to a development contract. Indeed, the statement appears to support our reading of section 226(m), rather than the Department's. That is, as we have previously pointed out, under the statute, lessee parties to development contracts must be persons different from the operator parties.

[10]Further, a contract is, by definition, a promissory agreement between or among two or more parties. Black's Law Dictionary, 394 (Deluxe ed. 1957). The very term "single-party contract" appears to be an oxymoron.

regardless of acreage limitations provided for in this act" and substituted in its place the language that now is the last sentence of section 226(m).

"All leases operated under such approved operating, drilling, or development contracts, and interests thereunder, shall be excepted in determining holdings or control under the provisions of this chapter."

The purpose of this amendment was to ensure that the exception from the acreage limitation extended not only to operators, but also to parties on the lessees' side of development contracts and to persons having interests on the lessees' side, whether or not they are parties to the contracts. The legislative history of the amendment states:

"It is not clear from the present language whether the [acreage exemption] benefit accrues to the operator and the lessee or lessees affected, or just to the operator. By departmental decision, the language of the present law would limit the benefit to the operator only."

H.R. Rep. No. 2238, 83d Cong. 2d Sess. 4; reprinted in 1954 U.S. Code Cong. and Ad. News at 2698.

The "departmental decision" referred to consisted of a January 1953 memorandum from Interior's then Solicitor to the Secretary, in connection with a development contract relating to the Katalla-Yakataga area in Alaska involving the Phillips Petroleum Company. The Solicitor had said:

"It should be noted that your approval of the development contract and operating agreements would also relieve Phillips Petroleum Company, the operator, of acreage charges for its operating rights in approximately 1,000,000 acres of land. The lessees and holders of overriding royalties would not, however, be relieved of acreage charges for their individual interest in the leases."[11] (Emphasis added.)

Memorandum of January 16, 1953, from the Solicitor to the Secretary.

Thus, the 1954 amendment cannot reasonably be interpreted as "indicating that the Congress was aware that only operators were parties to the contracts." Interior's Associate Solicitor memorandum at 4. It had the more modest purpose of ensuring that the benefits of the exemption

[11]Lessees who dispose of the working interests in their leases typically retain overriding royalty interests. The principal parties on the lessees' side of a development contract, in relation to leases where the lessees had previously disposed of the working interests, would be the holders of the working interests, rather than the lessees themselves, who might not appear as parties.

from acreage limitations extend to parties on the lessees' side of development contracts, as well as to the operators. There is no suggestion that Congress conceived of development contracts as anything other than agreements involving two sets of parties.[12]

Further, even if the Congress was aware of "single-party" contracts, as the Interior Associate Solicitor contends, the Congress' failure to act cannot be viewed as legislative acquiescence or ratification which, as here, would effectively have changed the law. As the Supreme Court of the United States has pointedly observed:

"This Court has many times reconsidered statutory constructions that have been passively abided by Congress. Congressional inaction frequently betokens unawareness, preoccupation, or paralysis. 'It is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law.'"

Zuber v. Allen, 396 U.S. 168,185-186, n. 21 (1969), quoting Girouard v. United States, 328 U.S. 61,69 (1946).

## Contracts Involving Unleased Federal Lands

The second argument is that neither the statute nor Interior regulations restrict development contracts to development activities on lands already under lease. Accordingly, as under the 10 contracts in question, development contracts may involve unleased federal lands which, if subsequently leased to one of the operating companies, is entitled to exemption from acreage limitations.

We disagree. In our view, the language of the statute and Interior's own regulations lead to the inescapable conclusion that development contracts must involve activities on lands within existing leases held by the party or parties on the lessees' side of the contract.

As discussed above, the statute requires that one of the two sets of parties to a development contract must be "one or more lessees of oil or gas leases." Interior regulations provide that approval of development contracts "shall be granted only to permit operators or pipeline companies to enter into contracts with a number of lessees sufficient to justify the

[12]We find even less persuasive the Associate Solicitor's contention that, because the Congress, in enacting minor amendments to the Mineral Leasing Act in 1959 and 1960, did not amend section 226(m), the Congress may be deemed to have acquiesced in the practice of "single-party contracts." There is nothing in the testimony cited by the Associate Solicitor nor in the reports of the congressional committees at the time suggesting that such contracts qualified as development contracts under section 226(m). See H.R. Rep. No. 1401; S. Rep. No. 1549; H.R. Conf. Rep. No. 2135, 86th Cong., 2d Sess. (1960).

discovery, development, production or transportation of oil or gas and to finance the same." 43 C.F.R. § 3105.3-2 (1990).

"Lessees of oil and gas leases," required under the statute and Interior regulations to be parties to the development contracts, can contract only with respect to lands on which they have existing leases. They are plainly without capacity to contract with respect to any other federal lands. Accordingly, we remain persuaded that development contracts may cover only lands within existing leases held by contracting lessees and that the exemption from the acreage limitations applies only to those existing leases.[13]

## Contracts for Exploration

The third argument is that the statute authorizes the Secretary to approve development contracts solely for the purpose of exploration. The statutory terms "operating, drilling, or development" are broad enough to subsume exploration. As Interior's Associate Solicitor put it: "The Mineral Leasing Act does not preclude exploration on lands subject to development contracts . . . ." Interior Associate Solicitor memorandum at 11. (Emphasis in original.)

We agree that "exploration" is not precluded as a component of "development" for which a development contract is properly approvable. That is, we do not believe that a contract otherwise satisfying the requirements of the statute would be disqualified as a development contract simply because it provided for exploration prior to committing the operator to undertake development activities. Thus, a contract that committed the operator to conduct an exploration program and, if the objectively evaluated results so warranted, to undertake to secure the production of oil or gas in paying quantities, could qualify as a development contract within the intendment of section 226(m).

However, here, the contracts in question are concerned only with "exploration," and not at all with "development." As discussed above,[14] "exploration" and "development" are by no means synonymous. Indeed,

[13]The Associate Solicitor mistakenly contends that "the Draft Report . . . states that the legislative history [on the development contract provision] 'is ambiguous at best and subject to various interpretations.'" (Emphasis in Associate Solicitor's memorandum.) Associate Solicitor memorandum at 9. The allusion to ambiguity in the draft report was not in reference to the legislative history of the development contract provision. Rather, it refers to the evidence Interior offers in support of the contention that the Congress was informed about Interior's view of the kinds of contracts that qualify under that statutory provision. To avoid possible misinterpretation, we have removed this statement from the final report.

[14]See n, 8 and accompanying text.

Interior has frequently pointed out the distinction between "exploration" and "development" and ruled that "exploration" without something more constitutes neither "discovery" nor "development." See, e.g., United States v. White, 118 IBLA 266,319-21 (1991); Yankee Gulch Venture v. BLM, 113 IBLA 106,130-32 (1990).[15] In our view, there can be no question that, in enacting section 226(m), the Congress' objective was to secure "development," i.e., drilling operations for the production of oil or gas in paying quantities, not merely "exploration." See, e.g., statement of Senator Walsh, supra.

## Discretionary Authority of Interior

The fourth argument is that the requirements of the statute are not as specific as GAO believes. Rather, the statute gives the Secretary of the Interior broad discretionary authority to approve contracts. Mobil Oil Corporation, one of the operating companies, states:

"In enacting the statutory provision [section 226(m)] Congress neither defined 'development contract' nor prescribed those activities such contracts may encompass. Instead Congress left it to the Secretary's 'discretion' to determine what activities may be pursued under development contracts and what form they may take."

Mobil memorandum at 7.

Similarly, Interior's Associate Solicitor expresses disagreement with our view that section 226(m) and Interior's regulations specify certain requirements for development contracts, among them, that the contracts must be for development of existing oil or gas leases. Rather, the Associate Solicitor contends:

"The statute simply states that the Secretary is authorized to approve such contracts 'whenever in his discretion . . . the conservation of such natural products (i.e., natural resources) or the public convenience or necessity may require it or the interests of the United States' would be served thereby."

[15]In Yankee Gulch, supra, Interior quoted approvingly from an earlier ruling on the difference between "exploration" and "development."

"There is a clear distinction between 'exploration' and 'development' as they relate to discovery under the mining laws. The separate stages of mining activity serve as a basis for determining what further mining activity a prudent man would be justified in undertaking. Exploration work includes such activities as geophysical prospecting, diamond drilling, sinking an exploratory shaft or driving an exploratory adit. It is that work which is done prior to a discovery in an effort to determine whether the land is valuable for minerals. When inherently valuable minerals are found, it is often necessary to do further exploratory work to determine whether a valuable mineral deposit exists, i.e. whether the minerals exist in such quality and quantity that there is a reasonable prospect of success in developing a paying mine."

Yankee Gulch, supra at 132, (quoting United States v. Lundy, A-30724 at 5 (June 30, 1937)).

Interior Associate Solicitor memorandum at 9.

In the view of Mobil and the Interior Associate Solicitor, the Congress, in enacting section 226(m), placed responsibility in the Secretary of the Interior to exercise his discretion to determine the kinds of activities that may be pursued under development contracts and the form these contracts should take. Under this interpretation, the Secretary, through the exercise of his discretion, is the sole safeguard to ensure against abuse of the development contract exception to the acreage limitation.

We strongly disagree. The Congress, by imposing the statutory acreage ceilings in section 184(d) and by specifying, in section 226(m), the circumstances under which limited exceptions would be provided to those ceilings, plainly did not place sole reliance on the Secretary's exercise of discretion. That exercise of discretion, as the statute makes clear, is a safeguard in addition to the substantive requirements of section 226(m), not a substitute for those requirements.

To read the statute in a way that omits the provisions that define the contracts which the statute authorizes, as do Interior's Associate Solicitor and the operating companies, is to read it as though Congress had, in effect, authorized the Secretary to waive the statutory acreage limitation "whenever in his discretion . . . the conservation of natural products (i.e., natural resources) or the public convenience or necessity may require it or the interests of the United States would be served thereby." Indeed, an earlier version of the 1931 legislation provided for just such waiver authority in the Secretary. As introduced, the bill provided:

"That the Secretary of the Interior is hereby authorized, on such conditions as he may prescribe, to waive, modify, or suspend acreage limits fixed by this Act with respect to any permits or leases heretofore or hereafter issued whenever in his discretion conservation of natural products or the public convenience or necessity may require it or the interests of the United States may be best subserved thereby." (Emphasis added.)

S. 6128, 71st Cong., 3d Sess., 8-9, as introduced January 26 (calendar day, February 11), 1931, and referred to the Senate Comm. on Public Lands and Surveys.

This provision, which would have provided the Secretary of the Interior the kind of full discretionary authority claimed by Interior's Associate Solicitor and the operating companies, was stricken in committee and in its place the development contract provisions were substituted.

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