Drilling Down On DOI's Oil And Gas Regulatory Agenda

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In March 2015, the Obama administration announced an expansive regulatory initiative to propose and finalize a number of rules impacting both onshore and offshore oil and gas operations on federally managed public lands. Secretary of the Interior Sally Jewell announced the government's regulatory agenda in a speech before the Center for Strategic and International Studies in Washington, D.C., stating that “our task by the end of this administration is to put in place common-sense reforms that promote good government and help define the rules of the road for America’s energy future on our public lands.”[1]

While the Obama administration has publicly committed to help facilitate new energy development on federally managed lands, this spate of new rule-makings tackling a wide variety of issues may have significant cost and regulatory impacts to industry.

The U.S. Department of the Interior and its subagencies, including the Bureau of Land Management, Bureau of Ocean Energy Management, Bureau of Safety and Environmental Enforcement, the National Park Service and the U.S. Fish & Wildlife Service, are leading the regulatory charge and have issued or are expected to issue more than 10 new or proposed oil and gas-related regulations by the end of the Obama administration's tenure.

Together, the DOI and its subagencies manage the vast majority of the surface rights and/or mineral rights and the corresponding energy projects on federal lands, both onshore and offshore. Many, though not all, of the regulatory initiatives are still in the early phases and have not yet been finalized, affording industry and interested parties a number of opportunities to become involved in the rule-making process. This article will provide a high-level survey of some of the key regulatory initiatives impacting energy development on onshore and offshore public lands, as well as some upcoming changes to federal oil and gas royalty rates.

Onshore Public Lands Rule-Makings

The DOI onshore energy agenda includes four key onshore public lands initiatives: (1) the BLM’s final rule regulating hydraulic fracturing on federal and tribal lands, (2) site security standards for federal and tribal oil and gas leases, (3) anticipated regulations governing drilling on National Park Service lands and
regulations setting standards for oil and gas operations in National Wildlife Refuge System lands.

Regulating Fracking on Federal and Tribal Lands

In March 2015, the BLM issued its final rule regulating fracking on federal and tribal lands.[2] Unquestionably the most high profile of DOI’s onshore oil and gas rule-makings, the regulation has elicited significant public interest since the BLM’s initial proposal in May 2012, with over 1.5 million public comments submitted during the rule-making process.[3] The rule is expected to impact 2,814 fracking operations per year on federal and tribal lands in the near term, and according to the DOI, cost industry $26 million per year.[4]

The BLM’s final fracking rule requires, among other things, public disclosure of information related to the fracking activities, including chemical compositions, and allows industry to use the FracFocus website to disclose the components of fracking fluids. The rule has a limited trade secret provision that requires owners or operators to make an affirmative claim to exempt information from public disclosure as a trade secret.[5] The rule also allows “variances” to states and tribes to regulate fracking operations as long as the state or tribal regulations meet or exceed the BLM’s minimum requirements. Finally, the rule requires that operators use above-ground tanks to store recovered flowback fluids in lieu of lined pits.[6]

Although many of the requirements in the final rule were already considered industry best practices, industry has generally opposed the rule on two grounds: (1) Fracking is already adequately regulated at the state level and (2) that the BLM regulations add an unnecessary level of redundancy with state regulations and increase costs.

Multiple suits challenging the final rule were filed in the U.S. District Court for the District of Wyoming, the same day the rule was released. The Independent Petroleum Association of America and the Western Energy Alliance filed suit requesting an injunction on the grounds of irreparable harm. Colorado, Utah and North Dakota joined Wyoming in a separate suit requesting a separate injunction.

A Wyoming federal district court judge issued a temporary stay of the rule’s effective date, originally set for June 24, 2015. The court is expected to issue a final ruling on the injunction in August. In addition to state and industry groups, the Ute Indian Tribe has joined the suit, arguing that rule infringes on tribal sovereignty. A number of environmental groups, including the Sierra Club and Earthworks, have also intervened in the litigation, arguing that BLM does not adequately represent their interests. Finally, legislation has been introduced in Congress to declare that states have an exclusive right to regulate fracking.

Site Security Standards for Federal and Tribal Leases

On the heels of finalizing its controversial fracking rule, the BLM recently issued a proposed rule that would update security requirements and production measurement standards for oil and gas leases on federal and tribal lands.[7] Unlike the fracking rule, the proposed site security rule would apply to all oil and gas leases on federal and tribal lands, not just fracking operations. The rule-making would update BLM regulations to address the dramatic changes in technology and industry practices since the current standards were issued in 1989. The proposed rule comes in the wake of recommendations made by the Government Accountability Office and DOI’s Subcommittee on Royalty Management regarding the BLM’s production verification efforts.[8]
The proposed rule would update the regulations under which it issued Onshore Oil and Gas Order No. 3, one of seven onshore oil and gas orders.[9] Order 3 governs site security standards for oil and gas leases overseen by the BLM. Of note, the proposed rule would establish uniform procedures for determining the point where oil and gas production is measured for a particular unit for the purposes of calculating the volume or quality of the production for which royalty is owed, or facility measurement points. It would also codify existing guidance related to approving commingling, update requirements safety and reporting requirements, require operators to provide new site facility diagrams to assist in the BLM’s oversight responsibilities, and require purchasers and transporters to comply with the same standards as operators with respect to records. The proposed rule would also identify certain acts of noncompliance that would result in an immediate assessment and establish a process for BLM to consider variances from the requirements of this proposed regulation.

The public comment period on the proposed site security rule is open until Sept. 11, 2015. Comments on the proposed rule can be submitted at regulations.gov (docket “BLM-2015-0003”).

Oil & Gas Drilling in National Parks

As the BLM moves forward with implementing and finalizing its rules governing fracking operations and site security on lands subject to BLM-management, two other DOI subagencies are also contemplating updates and expansions to their existing oil and gas regulations for other public lands. These efforts are largely in response to increased interest in energy development on public lands in the eastern U.S., such as the Marcellus Shale. The National Park Service is expected to soon issue a proposed rule that would update and expand existing NPS regulations to cover all activities associated with nonfederal oil and gas developments within the boundaries of units of the National Park System.[10]

The current regulations have been in effect for over 35 years and have not been substantively updated during that period. The National Park Service issued an advance notice of proposed rule-making (“ANPR”) on Nov. 25, 2009[11] and the proposed rule is currently under review by the White House Office of Management and Budget, and is expected to be issued for public comment in the coming months.

According to the ANPR, the existing regulations provide exemptions that allow more than half of the oil and gas operations within parks to operate without National Park Service approval and oversight, including exemptions for: (1) older wells that were in existence at the time of the 1978 regulations and were grandfathered in because their operations were covered by a valid state permit (roughly 37 percent of wells) and (2) operations that were exempt because access to those areas did not require crossing on or through federal lands and waters.

The proposed rule is expected to eliminate these exemptions, thereby requiring all operations on National Park Service lands to comply with park service regulations. It is also expected to update operating standards, bonding and establish fees to build new drilling roads or pipelines across park lands.

The proposed rule would directly impact active operations in a dozen national park units, primarily in the South, and 14 additional parks with pre-existing private mineral rights but no active development. All future operations would also need to comply with the new National Park Service rules. The National Park Service estimated that operators would incur annual compliance costs of approximately $1.71 million, or $3,200 per well. The National Park Service is also preparing a programmatic environmental impact statement to assess potential environmental impacts associated with the regulations. Interested
parties may submit public comments on the proposed rule and the draft EIS when released.

**Oil & Gas Development in the National Wildlife Refuge System**

The FWS is also expected to propose updates and expansions to its existing oil and gas regulations governing nonfederal oil and gas development within the National Wildlife Refuge System (“NWRS”). The NWRS is a set of protected public lands and waters managed by the FWS that are set aside for the conservation of fish, wildlife and plants. Nonfederal oil and gas wells are present on 103 refuges and four wetland management districts within the NWRS. Due to the increased use of horizontal drilling and fracking, the NWRS is experiencing an unprecedented level of interest in new operations, including those accessing formations such as the Marcellus Shale in the eastern U.S. and the Bakken Shale in North Dakota and Montana.

The FWS issued an ANPR on Feb. 24, 2014, and a proposed rule is expected later in 2015.[12] The ANPR suggests that the FWS will attempt to clarify and expand its existing regulations to establish a comprehensive system to manage energy development on national wildlife refuges, including the more than 200 refuges that currently have over 5,000 wells oil and gas operations. The ANPR sought comment on how best to manage nonfederal oil and gas operations on NWRS lands to avoid or minimize adverse effects on natural and cultural resources, wildlife-dependent recreation and refuge infrastructure and management, ensure a consistent and effective regulatory environment for oil and gas operators, and protect public health and safety. The FWS also indicated in the ANPR that it would begin the public scoping process for programmatic EIS analyzing the potential environmental effects of the proposed rule and alternatives. Interested parties may also review and submit comments on the proposed rule and the draft EIS when released for public comment.

**Offshore Rule-Makings and Programs**

In addition its role managing onshore public lands, the DOI also manages the lands comprising the U.S. outer continental shelf (“OCS”) under the authority of the Outer Continental Shelf Lands Act.[13] The OCS lands are those that are within the continental shelves adjacent to the U.S., as defined by the U.N. Convention on the Law of the Sea, but that do not fall under the jurisdiction of a state. OCS lands comprise of four regions: the Gulf of Mexico, Atlantic, Pacific and Alaska OCS regions, which cover approximately 1.76 billion acres in total.

The DOI has focused on tightening federal regulation of energy activities in offshore waters since the 2010 Deepwater Horizon incident in the Gulf of Mexico. As part of this regulatory agenda, the DOI has recently issued multiple proposed rules, ANPRs and programs focused on blowout prevention, bonding requirements, offshore oil and gas leasing programs and exploratory drilling, many of which offer industry and interested parties the opportunity to participate in the rule-making and public comment processes.

**Blowout Preventer Systems and Well Control**

In April 2015, the BSEE issued a proposed rule that would update standards for blowout prevention systems and other well controls for offshore oil and gas operations.[14] The proposed rule addresses some of the key recommendations following investigation of the Deepwater Horizon incident and formally expands offshore safety regulations. The BSEE estimates the cost of the new regulations to be as much as $883 million over 10 years.
The proposed rule would incorporate industry-developed standards for the design, manufacture, repair and maintenance of blowout preventers, which are used in the event of an emergency to cut drill pipe and block off the well hole. In particular, the rule would require that blowout preventers have so-called double shear rams which can shear drill pipes in case of an emergency and help prevent a loss of well control, as well as third-party reviews of maintenance and repair records and third-party certification of shearing capabilities. The proposed rule would also require real-time monitoring, cementing wells and criteria for safe drilling margins consistent with recommendations made by the U.S. Department of Justice and the DOI's inspector general following the Deepwater Horizon disaster. Finally, it would incorporate guidance from the BSEE notice to lessees and operators issued immediately following the Deepwater Horizon incident.

The comment period for the proposed rule ended on July 16, 2015, and BSEE received over 170 comments. A deadline for publication of the final rule has not been set.

**Offshore Financial Assurance Requirements**

The BOEM is in the process of updating its regulations and program oversight for OCS financial assurance requirements to develop a more robust set of criteria to determine the creditworthiness of companies taking over well leases. This push follows a high demand for the decommissioning of existing infrastructure, largely in the Gulf of Mexico, where it is estimated that there are approximately 27,000 abandoned oil and gas rigs. Decommissioning costs of these “idle iron” facilities are estimated to be $37 billion in total. The proposed new financial assurance regulations are intended to create comprehensive procedures to evaluate the financial ability of offshore lessees and operators, and determine when additional financial assurance may be required.

The BOEM recently announced that it would initiate a two-phase rule-making focusing first on the amounts and coverage of general bonding and best methods to decommission and, second, on a general update to the comprehensive set of financial assurance rules. These rule-makings would update and expand those requirements in the BOEM’s 2008 Notice to Lessees (“NTL”) covering supplemental financial assurance requirements.[15] The BOEM initiated this process by issuing an ANPR in August 2014.[16] The ANPR identified four major topics on which it sought comment: (1) identification of pertinent risks/liability, (2) risk monitoring and risk management, (3) demonstrating financial assurance over project lifecycle and (4) financial assurance, bonding levels and requirements.

It is expected that a proposed rule will incorporate the input received on these four topics, and some experts have speculated that the proposed rule could set upfront decommissioning costs at 100 percent of the facility per operator, even for wells with multiple operators.[17] There are no cost estimates associated with an ANPR, but an increase in bonding requirements would almost certainly increase the per-well upfront costs for offshore operations.

**2017-2022 Outer Continental Shelf Oil Gas Leasing Draft Proposed Program**

In January 2015, the BOEM issued the 2017-2022 Outer Continental Shelf Oil Gas Leasing Draft Proposed program.[18] The five-year OCS leasing programs are required by the OCS Lands Act to establish a five-year schedule for the sale of OCS leases for oil and gas exploration and development in order to develop a plan to guide offshore oil and gas leasing. Under the OCS leasing program, qualified entities can bid for leases that are reviewed and ultimately approved or rejected by the BOEM, which is charged with overseeing the leasing program. The lease grants the entity exclusive rights to explore, develop and produce oil and gas for a specified period and includes bonding requirements, environmental and social
standards and any other conditions required by the BOEM.

The current five-year OCS leasing plan from 2012-2017 blocked drilling in the vast majority of OCS lands with the exception of the western and central gulf areas and off the north coast of Alaska.[19] As proposed, the draft 2017-2022 OCS leasing plan would allow the first lease sale in the Atlantic Ocean in decades, as well as continued leasing in the Arctic Ocean, but no lease sales would occur in the Pacific Ocean. However, waters could be removed from the leasing plan as the BOEM crafts an EIS and identifies sensitive areas that it concludes should be protected, based on public comments.

The draft 2017-2022 OCS leasing plan has been the subject of considerable political controversy since its release. Public comment on the draft closed on March 30, 2015 and the BOEM received hundreds of thousands of public comments, along with political inquiries from Capitol Hill.

On April 23, 2015, a group of 150 Republican members of Congress sent a letter to Secretary Jewell expressing their concerns with the proposal. At the same time, on the other side of the aisle, 10 East Coast Democratic senators introduced a bill that would prohibit the DOI from leasing any Atlantic waters for oil and gas development. Environmental groups are also generally opposed to the lease sales. The BOEM expects to issue its second five-year OCS leasing program proposal for public comment in 2016, along with a draft programmatic EIS to analyze potential impacts of the lease sale. Interested parties will continue to have the opportunity to participate in the process.

Arctic Outer Continental Shelf Oil & Gas Exploration Standards

The DOI is also focused on tightening safety regulations for drilling in the Arctic. The BSEE and BOEM issued a proposed rule in February 2015 that would specifically enhance regulations on planning, oil spill response and safety requirements for offshore exploratory drilling operations off the northwest coast of Alaska.[20] Though the harsh operational environment has historically limited exploration and development in the Arctic OCS, recent years have witnessed increased interest in developing oil and gas reserves.

The proposed rule focuses solely on planning, oil spill response and safety requirements for offshore exploration drilling operations within the Arctic OCS, defined as the Beaufort Sea and Chukchi Sea planning areas, and includes several administrative and operational requirements that are more stringent than those required for other OCS areas. The proposed rule would only apply to exploration, and not development of oil and gas resources and the agencies indicated that it will address regulations for commercial development after it completes this rule-making process. The DOI estimated the regulations would result in economic costs ranging from $1.1 billion to $1.2 billion over a 10-year period. The comment period on the proposed rule closed on April 27, 2015, and generated nearly 1,300 comments.

Public Land Oil & Gas Royalty Rates and Valuation

Finally, the DOI is focused on raising royalty rates and changing the way resources are “valued” for oil and gas operations on public lands. This marks the first major effort in decades to update and increase public lands royalty rates.

Public Lands Royalty Rates

In April 2015, the BLM issued an ANPR seeking comment on the how the bureau might revise its rules,
which have not been materially updated since the Eisenhower administration, regarding the minimum acceptable bid paid by parties seeking a lease at auction, and the annual rental payments that are due after a lease is obtained.[21] Currently, the royalty rate for onshore competitive oil and gas leases on public lands are 12.5 percent of the value of production, while production from offshore leases is charged at 18.75 percent.

Specifically, the ANPR seeks comment on how best to adjust royalty rates, annual rental payments, minimum acceptable bids, bonding requirements and civil penalty assessments for federal onshore oil and gas leases. Revision to royalty rates would be applicable only to new leases obtained competitively. Royalty changes would not affect any leases issued under the Indian Mineral Leasing Act or the Indian Mineral Development Act. The public comment period on the ANPR closed on June 5, 2015, but interested parties will have the opportunity to comment when the proposed rule is issued.

**Federal and Tribal Oil & Gas Valuations**

On Jan. 6, 2015, the DOI’s Office of Natural Resources Revenue (“ONRR”) issued a proposed rule that would update existing valuation methodologies for all onshore and offshore oil, gas and coal operations on public lands.[22] The valuation process is used to determine the underlying value of the asset, particularly assets acquired in nonarms’ length transactions, on which the royalty rate is then based.

The ONRR proposed rule would update the valuation procedures, in place since 1988, to set the baseline valuation methodology for all onshore and offshore extracted minerals. The ONRR estimates that the proposed rule would cost industry approximately $80 million on an annual basis. The public comment period closed on March 9, 2015, and the ONRR received over 300 comments on the proposed rule.

**Conclusion**

The Obama administration’s energy regulatory agenda is vast and ambitious, and comes at a time of oil price decline that has impacted the global energy industry. Overall, these regulations and proposed regulations, if and when they are issued, will expand the regulatory reach of the DOI and, in many cases, impose more stringent rules and significant costs on oil and gas operations on U.S. public lands.

As we have seen with the BLM’s fracking rule, it is likely that many of these rules may be challenged in the courts as well. Many of the initiatives have not yet reached the “proposed rule” phase but are expected to be released for public comment in the months ahead. Interested parties should monitor and engage in the rule-making process to ensure their interests are considered by the DOI.

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[5] To be codified at 43 C.F.R. Section 3162.3-3(j).

[6] To be codified at 43 C.F.R. Section 3162.3-3(h).

[7] Onshore Oil and Gas Operations; Federal and Indian Oil and Gas Leases; Site Security, 80 Federal Regulation 40767 (July 13, 2015).


[14] Oil and Gas and Sulphur Operations in the Outer Continental Shelf — Blowout Preventer Systems and Well Control, 80 Federal Regulation 21503 (proposed April 17, 2015).


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