DEPARTMENT OF THE INTERIOR

Bureau of Land Management

43 CFR Parts 3100, 3106, 3108, 3130, and 3160

[WO–310–1310–01–24 1A–PB]

RIN 1004–AC54

Oil and Gas Leasing: Onshore Oil and Gas Operations

AGENCY: Bureau of Land Management, Interior.

ACTION: Final Rule.

SUMMARY: The final rule will: Clarify the responsibilities of oil and gas lessees and operating rights owners for protecting Federal and Indian oil and gas resources from drainage; specify when the obligations of the lessee or operating rights owner to protect against drainage begin and end; clarify what steps to take to determine if drainage is occurring; and specify the responsibilities of assignors and assignees for reclamation and other lease obligations.

EFFECTIVE DATE: This rule is effective on February 9, 2001.

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I. Background

The existing regulations in 43 CFR part 3100 allow for agreements to compensate the Federal Government for drainage of (oil and gas) mineral resources. Those regulations and the regulations at part 3160 require the lessee or operating rights owner to drill and produce wells necessary to prevent drainage or, instead, to pay compensatory royalties. These regulations are based on BLM's authority under the Mineral Leasing Act of 1920 (MLA), as amended and supplemented, and other cited authorities to issue a rule to carry out their purposes. The existing regulations and the standard oil and gas lease terms make express covenants to protect the lessor against drainage that is implicit in the law of all oil and gas producing states. An audit by the Department's Office of the Inspector General and a BLM Internal Control Review in 1990, both recommended we revise our regulations on drainage protection to clarify:

(1) When the obligations of the lessee or operating rights owner begin and end; and

(2) What steps to take to determine if drainage is occurring.

In 1995, BLM's Director appointed the Bureau Performance Review Bonding and Unfunded Liability Team to review a broad range of liability issues. The Team recommended we revise and clarify our regulations on lessee and operating rights owner liability for drainage prevention, compensatory royalty payments, well plugging and abandonment, lease site reclamation and environmental remediation. This final rule enables BLM to fulfill its responsibility to ensure that the public and Indian lessors receive full value for their oil and gas resources.

In addition to addressing drainage issues, the final rule clarifies the current regulations concerning the responsibilities of assignors and assignees of record title or operating rights interests. The current version of 43 CFR 3106.7–2 expressly states that an assignor is fully responsible after the assignment and prior to BLM approval of the assignment, but the current rule is not clear as to the responsibility of the assignor after approval. The final rule makes clear that the assignor continues to be responsible for satisfying those obligations that accrued prior to the approval of the assignment.

The final rule clarifies that assignees have responsibilities for certain plugging and abandonment, reclamation and environmental liabilities that arose prior to their assignment and which were evident to a purchaser exercising due diligence.

The final rule implements a change in the definition of the term ''lessee'' to include the operating rights owner, consistent with the substantive provisions of the proposed rule.

II. Final Rule as Adopted

The final rule reorganizes the order of the questions and answers, renumbers subpart 3162, and locates the sections into a more logical sequence. Some commenters suggested these regulations should also apply to Indian oil and gas leases. The final rule adopts the suggestion to make these regulations apply to both Federal and Indian oil and gas leases. To accomplish this result, the final rule consolidates all drainage provisions in part 3160. The following table lists the section numbers in the proposed and final rule.

Proposed rule section	Final rule section
3100.5	3160.0–5
3100.21	3162.2–2
3100.22	3162.2–3
3100.23	3162.2–4
3100.70	3162.2–5
3100.50	3162.2–6
3100.24	3162.2–7
3100.40 and 3100.45	3162.2–8
3100.51	3162.2–9
3100.52	3162.2–10
3100.60	3162.2–11
3100.61	3162.2–12
3100.71	3162.2–13
3100.80	3162.2–14
3100.55	3162.2–15
3165.3	3165.3
3165.4	3165.4
3106.7–2	3106.7–2
3106.7–6	3106.7–6
3108.1	3108.1
3130.3	3130.3
3160	3160
3162.2	3162.2
3165.3	3165.3
3165.4	3165.4

III. Responses to Comments

On January 13, 1998, (63 FR 1936), BLM published in the **Federal Register** the proposed rule on oil and gas drainage. In a notice published on February 24, 1998, (63 FR 9171), we extended the comment period for 60 days. In response to several requests, we reopened the comment period for 60 days in a notice published on December 3, 1998, (63 FR 66776). We reopened the comment period to consult with Indian Tribes, under Executive Order 13084, on the issue of whether the proposed rule should apply to Tribal and individual Indian oil and gas leases. We extended the reopened comment period by notice published on January 13, 1999 (64 FR 2166), with the comment period ending April 5, 1999, and extended the reopened comment period again in a notice published on April 12, 1999 (64 FR 17598) with the comment period ending on June 4, 1999. Some provisions were proposed for comment in another rule (see 63 FR 66840). We received 40 written comments on the proposed rule from industry, organizations, and individuals.

Specific Comments

A commenter objected to the question and answer format and suggested these regulations were repetitive, poorly organized, and required a reader to look in multiple sections to find related information. The final rule simplifies the question and answer format and utilizes plain language in accordance with the Administration's Reinventing Government Initiative. We believe this format will help everyone find relevant topics more easily. We restructured the final rule to better group topic related sections.

A commenter suggested we should not apply this rule to reinterpret the meaning of terms in existing leases. Except where changes are expressly acknowledged in this preamble, the final rule is consistent with and interprets existing lease provisions and so may lawfully apply to existing leases. In addition, all Federal and Indian oil and gas leases are subject to future regulations except to the extent such regulations are inconsistent with express lease provisions or the rights granted in the lease.

A commenter suggested it was not worthwhile for BLM to adopt a rule that generates $250,000 in revenues while increasing Federal expenditures by $150,000 and driving industry to move to private lands or abroad. The final rule did not adopt this suggestion. Our previous estimates were based on the assumption that no revenues other than additional compensatory royalty assessments would be generated from drainage cases. In addition, the compensatory royalties estimates were understated due to insufficient data. Based on our recent survey of State offices, if the number of potential drainage cases and the success rate of case retirements remain at the 1998 level (1,665 cases and 8.82 percent respectively), we expect additional revenues around $9.2 million from the oil and gas drainage program. These revenues include royalties from protective wells, compensatory royalty assessments, unitization and communitization agreements, or bonus bid payments on previously unleased lands. Besides the additional revenues, lessees benefit from the implementation of this rule because they have a better understanding of when, why, and how to fulfill their obligations to protect Federal and Indian minerals from drainage. By adopting this final rule, the Federal Government benefits because it reduces the time needed to correspond with the lessees regarding procedural matters, and thus leads to greater efficiency in performing technical and economic analyses to determine whether prudent operators need to drill an offset well. Further, it reduces the need for reviews and appeals to the State Director. The estimate of $150,000 is equivalent to 10 percent of the annual expense for the oil and gas drainage program, and a one-time cost for implementing these regulations. These expenses may increase if we postpone the implementation of this rule.

A commenter suggested this rule violates the Administrative Procedure Act because the preamble to the proposed rule was misleading in characterizing the rule as merely a clarification of existing law. The section-by-section analysis of the proposed rule described every modification to the existing rule so that all potentially affected parties were properly advised of its provisions. While the rule does provide greater detail than existing regulations with respect to both drainage and the duties of parties holding various interests in a lease, the substantive obligations remain those established in the lease and existing regulations.

Some commenters suggested we should not cover plugging and abandonment issues in this ''drainage'' rule. The final rule retains the provision for well plugging and abandonment. Nothing precludes us from promulgating rules on several topics in a single rulemaking if we provide adequate notice to the affected public.

Several commenters suggested the rule reverses IBLA interpretations of the lease and current regulations, particularly with respect to who bears the burden of proof of drainage. The final rule preserves IBLA's precedent that BLM bears the burden of proof that drainage exists and the lessee's notice or knowledge of drainage, but the rule shifts the burden of proof after BLM has established a *prima facie* case (*i.e.,* sufficient evidence absent rebuttal by the lessee). This shift of the burden of proof to the lessee is warranted because the lessee, by undertaking the duty to protect, agreed to take the responsibility to monitor activities that could result in drainage of Federal or Indian mineral resources. Moreover, the lessee is in a better position to obtain and interpret relevant geologic and reservoir data.

Some commenters suggested it is uneconomical for lessees who hold leases for speculative purposes, with no intent to drill, to monitor activity on adjacent leases for drainage. The final rule did not adopt this suggestion. The duty to detect drainage and drill to protect the Federal or Indian lessor from drainage is not a new requirement, but is a lease obligation voluntarily entered by lessees. A lessee who cannot protect the Federal or Indian lessor from drainage should not acquire a Federal or Indian lease. To allow anyone to hold a Federal or Indian lease without requiring an agreement to prevent the uncompensated loss of valuable mineral resources is not in the interest of the public or Indian mineral owners.

A commenter suggested that if BLM directs the drilling of a protective well and the well does not return a reasonable profit to the lessee, BLM should pay the cost of drilling, completing and equipping the well. The final rule did not adopt this suggestion. However, we address the issue of uneconomic wells under § 3162.2–5.

Several commenters suggested economic self-interest leads lessees to drill protective wells when it is economic to do so. Therefore, the rule is not necessary. While we agree with the suggestion that economic self-interest motivates an operator to drill protective wells; we cannot permit a reluctant operator to allow the uncompensated loss of mineral resources that belongs to the American public or to an Indian mineral owner. We have the responsibility to issue regulations we feel in the best interest of the public and Indian mineral owners. We also have the responsibility to ensure that lessees drill all necessary wells to protect public and Indian mineral interest owners from drainage at the earliest possible time. This final rule better serves the oil and gas industry by ensuring it has a clearer understanding of obligations to protect its oil and gas leases from drainage.

Several commenters believe that inasmuch as existing regulations provide for BLM to make drainage determinations, additional responsibilities for drainage detection could not be imposed on lessees. The final rule permits us to make drainage determinations and assess compensatory royalty damages against lessees as we have done in the past. Lessees are not excused from their lease obligations to take initiatives to protect the Federal or Indian lessors. This final rule simply provides additional detail on how a lessee should fulfill existing lease obligations.

A commenter suggested we notify adjacent lessees when we approve an Application for Permit to Drill (APD). The final rule did not adopt the suggestion. However, we post APD's for 30 days in State Office public rooms before we approve them. The oil and gas data service industry publishes information on the approval status of APD's on a regular basis. It is the lessees' responsibility to monitor APD

approvals to ensure that they protect Federal and Indian lessors from drainage.

One commenter suggested the arbitrary decisions about what constitutes drainage might be avoided by standardizing drainage parameters at 330 feet from the lease line. The final rule did not adopt the suggestion. The characteristics and performance of the oil and gas reservoir are primary factors which determine the necessary actions to take to protect the lease from drainage. Since each oil and gas reservoir is unique and has different characteristics and performance capabilities, it is inappropriate to adopt a single baseline standard for drainage.

An Alaska environmental group recommended that these regulations state that BLM has the authority to address drainage by prohibiting the removal of its oil and gas. It also wanted these regulations to make clear that BLM is not obliged to lease or permit drilling. The final rule is quite clear that we have discretion when to lease and regulatory authority over drilling. We do not possess the practical ability to prohibit removing oil and gas from beneath Federal surface because fluid minerals follow no political or property boundaries. Where we cannot permit surface disturbance, lessees must pursue other means of protecting the lessor from drainage such as horizontal drilling or through communitization when feasible.

An Alaska environmental group suggested that the authority citations be broadened to include additional sections of the Federal Land Policy and Management Act of 1976 (FLPMA) and the Mineral Leasing Act of 1920 (MLA), as well as the Alaska National Interests Lands Conservation Act, the National Wildlife Refuge Administration Act, and the Naval Petroleum Reserves Production Act of 1976. The final rule uses the appropriate citations to sections that grant relevant rulemaking authority to the Secretary of the Interior. BLM does not administer the Naval Petroleum Reserves. The National Wildlife Refuge Administration Act does not grant regulatory authority with respect to mineral production.

Section-by-Section Analysis

The final rule renumbers many sections. In the following discussion, we reference the section number of the proposed rule and indicate in parentheses where the section appears in the final rule. We also describe the final rule and how, if at all, it differs from the proposed rule. Further, we respond to comments on the section.

Section 3100.5 (3160.0–5)

The final rule amends § 3160.0–5 to alphabetize and add these definitions: ''drainage,'' ''lessee,'' ''operating rights owner,'' ''protective well'' and ''record title holder.'' We modified the definitions of ''lessee'' and ''operating rights owner'' and added new definitions for ''drainage,'' ''protective well,'' and ''record title holder.''

Several commenters suggested that we modify the drainage definition to refer to ''oil or gas'' rather than hydrocarbons, inert gases or associated resources. The final rule did not adopt this suggestion because ''inert gases'' is needed to make clear that the rule applies to drainage of non-petroleum gases such as carbon dioxide.

A commenter suggested that the drainage definition does not allow for the concept of counter drainage and suggested that we include the phrase ''and not offset by counter drainage'' at the end of the definition. The final rule did not adopt this suggestion because the drainage definition already contemplates only the net loss after consideration of counter drainage.

Some commenters suggested that we modify the protective well definition to include the options of well deepening, plugging back an existing well bore, adding laterals to address drainage situations, or recompleting existing wells, and removing the language ''on nearby or adjacent lands'' from the definition. The final rule modifies the ''protective well'' definition to provide for wells drilled ''or modified'' and by dropping the reference to nearby or adjacent lands. We agree with commenters that ways exist to protect the lease from drainage other than drilling new wells.

Section 3100.21 (3162.2–2)

This section indicates the steps BLM will take to ensure the Federal Government and Indian lessors are compensated for drainage of mineral resources. The final rule differs from the proposed rule. We modified the question of this section to make clear that Indian lessees must protect the leased resources from drainage. We changed the language in this section from ''wells draining oil or gas'' to ''wells draining mineral resources'' to clarify the rule applies to other mineral resources. We deleted the phrase ''on adjacent lands'' from the rule text as unnecessary. We modified paragraph (a) to clarify we will consider applicable Federal, State, or Tribal rules, regulations, and spacing orders when determining which drainage protective action to take. We modified paragraph (b) to clarify that the Secretary may enter into agreements with owners of the draining well to compensate for drainage of leased or unleased Federal minerals or (in consultation with the Indian mineral owner and BIA) leased or unleased Indian minerals. We also deleted the reference to ''Federal lands.'' We modified paragraph (c) to clarify we may offer for lease any qualifying unleased mineral resources under part 3120 and deleted the phrase referring to ''offering unleased lands'' from the rule text. We added paragraph (d) to conform to the provisions of § 3181.5.

Some commenters suggested that we apply these regulations to ''Federal minerals'' instead of ''Federal lands.'' The final rule amends this section to clarify that these regulations apply to Federal minerals not Federal surface in a split-estate situation. The lessee of Federal minerals owes the duty of drainage protection and surface ownership is not relevant.

Some commenters questioned whether BLM found owners of an adjacent well willing to enter into a drainage compensation agreement. We have found owners in the past willing to enter into such agreements. This final rule implements the provision of Section 17 of the MLA on agreements to compensate the Federal Government for drainage.

One commenter wanted to know what we reported to Congress about drainage compensatory royalty agreements. We reported annually to Congress as required by statute until the reporting requirement was repealed in 1987.

Some commenters questioned the BLM's authority to communitize an unleased tract. The final rule clarifies if spacing precludes us from authorizing the drilling of a well on our land, as a mineral owner, we have the right to communitize an unleased tract with others in the spacing unit. We recognize that a mineral owner who does not contribute to drilling costs is subject to receiving a smaller share of production than if BLM were able to share in the costs of drilling a well.

A trade association suggested that BLM be required to notify prospective bidders that a sale tract was being drained and questioned the interest in bidding for such a tract. The final rule did not adopt this suggestion. We notify prospective bidders of drainage tracts in the oil and gas lease sale notices. In the past, there have been bidders who bid on such drainage tracts.

Some commenters expressed concern over whether BLM had authority to order operators to drill protective wells or to order the lessees to enter into communitization agreements without

considering State spacing orders. These commenters suggested to BLM to include the following language ''When determining which action to take, the BLM will give consideration to the existing State rules, regulations, and spacing orders.'' The final rule modifies the language to adopt this suggestion. However, spacing determinations for Federal minerals are made by the BLM under 43 CFR 3162.2–2(a).

Section 3100.22 (3162.2–3)

This section clarifies when lessees are responsible for protecting their leases from drainage. The final rule differs from the proposed rule. In response to comments, we modified this section to:

(a) Include Indian leases;
(b) Change lands to minerals; and
(c) Change oil and gas to mineral resources.

We also combined the provisions concerning drainage by wells in other units or communitization agreements.

Section 3100.23 (3162.2–4)

This section provides a list of actions BLM may require a lessee to take to provide drainage protection. The final rule differs from the proposed rule. We modified the question to make clearer what we may require the lessee to do to protect leases from drainage. We modified paragraph (a) to include the language ''drill or modify and produce all wells that are necessary to protect the leased mineral resources from drainage'' and deleted the language ''leased lands from drainage, subject to provisions of § 3100.70'' to clarify that we refer to leased mineral resources not leased lands. We modified paragraph (b) to delete the cross reference to subpart 3105 and part 3180.

A commenter suggested that we give lessees the option of paying compensatory royalty rather than drilling a protective well because BLM is not authorized to require either communitization or the drilling of a protective well. The final rule does not represent a change from the previous regulations that require the BLM's consent to propositions to pay compensatory royalty in lieu of drilling protective wells. We agree that a lessee may have to estimate the compensatory royalties due to compensate Federal or Indian lessors for all drainage that has occurred, is occurring, or will occur; however, there is no guarantee that such compensation is adequate. Requiring payment of royalties on production from an economic protective well is the most effective way of ensuring that the amount of compensation that is due for drainage is accurate. Additionally, certain spacing and mineral ownership scenarios dictate well drilling for correlative right protection. We did not adopt the suggestion.

Some commenters expressed concern over whether lessees are liable for compensatory royalties if drainage involves an area in which BLM will not permit drilling due to a wilderness area, environmental reasons, or a no surface occupancy stipulation. In the final rule, we state a lessee who cannot, as a practical manner, drill a protective well for reasons not specified in the lease itself will not be required to pay compensatory royalties. The lessee will have an obligation to consider the feasibility of the other means of compliance: drilling directional or horizontal wells or entering into agreements with the owner of the well causing the drainage.

Section 3100.24 (3162.2–7)

This section specifies that all record title holders are jointly and severally liable for paying compensatory royalties when more than one person owns record title interest in the same lease. Operating rights owners having an interest in the same lease are jointly and severally liable with one another and with the record title holders for the compensatory royalties attributable to drainage. The final rule is unchanged from the proposed rule.

Several commenters suggested that only operating rights owners with an interest in the mineral resources in the horizon or formation being drained are responsible for drainage protection. The final rule did not adopt the suggestion. Operating rights owners with interest only in other formations are not liable; but a sublease does not exempt any record title holder from liability. The record title holder has an interest in all horizons and formations and the sublease of operating rights does not diminish the record title holder's responsibility for compliance with all lease terms.

Several commenters suggested that the responsibility for drainage protection be imposed only on the operating rights owners and not on the record title holders. They argue that without operating rights, you have no right to drill a protective well. These commenters suggested we should not demand drainage protection from record title holders until we exhaust demands against the operating rights owners. The final rule continues the policy found at 43 CFR 3100.0–5 of the previous regulations which requires the lessee to retain the responsibility for complying with lease obligations when it subleases operating rights to another party. We do demand performance first of the designated operator who represents all parties with interest in the lease. It is the responsibility of the lessee who creates subleases of operating rights to make sure that the sublessee performs all lease obligations.

Some commenters suggested that joint and several liability for compensatory royalties is contrary to 30 U.S.C. 1712(a) as amended by the Royalty Simplification and Fairness Act. These commenters suggested that IBLA has recognized that joint and several liability for drainage protection or compensatory royalty is unfair. We do not know of any IBLA cases on this point. The provisions in 30 U.S.C. 1712(a) address lease obligations to pay money such as rentals and royalties. The duty to protect from drainage is not an obligation to pay money. Rather, it is the nonperformance of an obligation of diligent development for which we may assess compensatory royalties. Compensatory royalties are not true royalties payable on lease production. Rather, they are liquidated damages for nonperformance of the obligation. We measure damages by the royalty value of resources the lessee has allowed to be drained. Each party to a BLM or Indian lease makes the same promise as every other lessee and is responsible for full performance of those obligations, regardless of the inability of its co-lessees to share in the performance. A lessee may choose to pay compensatory royalty instead of drilling a protective well or we may assess compensatory royalties as damages if the lessee does not take direct protective action. However, this action does not make the drainage obligation a monetary one.

Sections 3100.40 and 3100.45 (3162.2–8)

This section specifies the responsibility for drainage protection and compensatory royalties after assignment or transfer of operating rights. The final rule combines two sections of the proposed rule (3100.40 and 3100.45) to form § 3162.2–8. The final rule differs from the proposed rule. We modified the question of these two sections to read ''Does my responsibility for drainage protection end when I assign or transfer my lease interest?'' to specify the responsibility for drainage protection and compensatory royalties after assignment or transfer. We modified the section to address lessee obligations for drainage protection and payment of compensatory royalties after assignment or transfer.

One commenter suggested that it was not clear whether BLM is to assess compensatory royalty against an

assignee for drainage that occurred before acquiring the interest. The final rule clarifies that as an assignee, your liability to pay compensatory royalties begins on the date you acquire the lease interest. We believe this rule makes clear that an assignee is not responsible for drainage that occurred before acquiring the lease interest.

Some commenters suggested that we include the following language in this section: ''Your liability for paying compensatory royalties will begin a reasonable period of time after notice from the BLM or after a reasonably prudent operator knew or should have known that drainage was occurring. If you acquire your lease interest after this time, your liability to pay compensatory royalties begins the date you acquire the lease interest.'' The final rule adopts the language ''If you assign your record title interest in a lease or transfer your operating rights, you are not liable for drainage that occurs after the date we approve the assignment or transfer'' in response to comments.

Some commenters suggested that BLM uses an undefined and arbitrary standard for when a prudent operator should have known when drainage began. These commenters believe that BLM sets an impossible compliance standard in drainage situations. The final rule clarifies when a prudent operator has constructive notice that drainage may be occurring under § 3162.2–6. When a lessee signs a lease, the lessee has agreed to protect the lessor (the United States or an Indian mineral owner) against drainage. Nothing in the lease terms conditions this obligation on BLM notifying lessees of drainage. We believe it is reasonable to expect that a lessee will:

(1) Evaluate the potential for drainage at the earliest time it can receive information about a well drilled on an adjacent lease; and

(2) Immediately consider the economic feasibility of taking protective action.

A commenter suggested that the responsibilities of an assignor for drainage should end the earlier of 30 days after an assignment is properly submitted to BLM or on the approval date. The final rule did not adopt this suggestion because we disagree with the commenter. In section 30a of the MLA, 30 U.S.C. 187a, it is clear that an assignor of a partial interest remains responsible for all lease obligations that accrued before BLM approved the assignment. We believe Congress intended not to release the assignor of accrued obligations upon assigning all record title interest.

Section 3100.50 (3162.2–6)

This section clarifies when we deem a party with interest in a lease to have constructive notice that drainage may be occurring. The final rule is unchanged from the proposed rule except to change the order of the clauses in paragraph (b).

Some commenters suggested that we should not utilize the information in this section as constructive notice to lessees because such information does not reflect drainage occurrence. These commenters believe that lessees need enough time to evaluate production information from the well to determine if drainage is occurring. The final rule did not adopt the suggestion because IBLA has long recognized that a lessee may be on constructive notice of drainage. This final rule clearly defines what constitutes constructive notice of potential drainage (see § 3162.2–6) and allows the lessee to rebut the occurrence of drainage (see § 3162.2–9). It also allows a lessee to state that the information then available is not adequate to make a conclusive determination of drainage; but will continue to monitor the situation and make a further report at a later date (see § 3162.2–9(c)).

Several commenters suggested that a well completion report never gives enough information to determine if a well is capable of draining the minerals covered by the adjacent Federal lease. The commenters also suggested that drainage protection should not be required until sufficient production information is available to show potential drainage, including information adequate to determine the type of reservoir, the drive mechanism, the depletion rate, the permeability and porosity of the formation, and many other factors before you can determine if drainage is occurring. A commenter suggested that impressive initial production may not be sustained and encouraging drill stem results may be disproved by later well performance. Therefore, the rule should not use these items as a basis for constructive notice. The final rule did not adopt these suggestions. Well completion reports and first production reports from a draining well provide sufficient information to alert a prudent operator or lessee that drainage may be occurring. If the lessee does not have an interest in the draining well, the lessee is not required to take action to protect the lease from drainage until information sufficient to determine whether an economic well can be drilled becomes publicly available. Drill stem tests may be one factor used to determine well performance; but the lessee must gather other information as soon as it is available to determine whether to drill an economic well.

Section 3100.51 (3162.2–9)

This section clarifies the duty of lessees and operating rights owners to monitor the drilling of wells in the same or adjacent spacing units and gather sufficient information to determine whether drainage may be occurring. The final rule differs from the proposed rule. We modified paragraph (a) to include the language ''in the same or adjacent spacing units'' and deleted the phrase ''on adjacent lands'' from the rule text to establish clear limits of responsibility on a lessee. We modified this section to change the words ''offending well'' to ''draining well'' to establish a clearer description of a well draining Federal or Indian mineral resources. Commenters suggested we modify paragraph (a)(1) to include the language ''specify the amount of drainage from production of the draining well.'' We modified paragraph (a)(3) to delete the cross reference to § 3100.50. We modified paragraph (b) to change the cross reference from ''§ 3100.50'' to ''§ 3162.2–4'' to clarify that an election of remedies is envisioned, not a detailed plan of action. We modified paragraph (c) to indicate that if you do not have sufficient information to comply, you must indicate when you will provide the information to BLM. We added paragraph (d) to clarify that you must provide BLM with the analysis within 60 days after we request it.

One commenter objected to requirements to monitor wells on adjacent lands and to gather information sufficient to determine whether drainage is occurring. The commenter suggested that such monitoring was impossible and the requirement would lead many to relinquish their Federal or Indian leases because such requirements prevent operators from having sufficient time to pursue exploration and production. As stated above, the final rule adopts a change to specify that you must monitor wells in the same or adjacent spacing units. This change better defines the area which a lessee and operating rights owner must normally protect from drainage. When a lessee undertook the duty to protect against drainage, the lessee agreed to be responsible for, and aware of, activities that might result in drainage of Federal or Indian oil and gas. In addition, the lessee is in a better position to obtain and interpret geologic and reservoir data than the BLM.

A commenter suggested that basing the prudent operator economic analysis on the facts at a time when the lease is

owned by another party is an illegal retroactive application of a new law to events of years past. It is not. The rule only applies to those who acquire an interest hereafter. It will not change the prudent operator standard for those who already hold interests.

A commenter suggested that we should not apply these regulations to prior lessees unless the lessees or operating rights owners had an interest in the draining well or BLM notified them of potential drainage before they assigned their lease interest. The final rule did not adopt this suggestion. The final rule does not change the obligations of those who disposed of their interest before these regulations take effect. Under existing law, constructive notice triggers the obligation to protect against drainage. It is not necessary for BLM to notify the lessee of such drainage.

A commenter suggested that we should not require lessees to develop plans in all instances since the duty to take protective action arises only when drilling an economic well. The commenter also suggested that BLM be more concerned with the lessee taking protective measures rather than filing ''useless'' plans. The final rule did adopt a change in response to the comment. The final rule clarifies that operators need only inform BLM of the form of drainage protection they will provide, not a detailed plan. Further, the lessee must choose a remedy only when drilling a protective well is economic.

Some commenters suggested that the 60-day time period is unrealistic to provide BLM with drainage protection plans. These commenters indicated that much of the required information may be confidential or unavailable within 60 days. The final rule did adopt a change from this suggestion. We added paragraph (c) to this section to allow you to choose an appropriate schedule.

A commenter suggested that we replace ''is'' with the word ''may be'' prior to the word ''occurring'' in the first sentence. The final rule did not adopt this suggestion because the purpose of this section is to determine if you must protect the lease from drainage.

Section 3100.52 (§ 3162.2–10)

This section clarifies when BLM will provide a demand letter to lessees on drainage protection. The final rule is substantively unchanged from the proposed rule. Ordinarily, BLM will serve record title holders, operators, and operating rights owners.

A commenter suggested that the question might mislead operators into thinking that they may wait until they received the demand letter from BLM before taking action. The final rule was not changed in response to this suggestion. We disagree with the comment, because the rule clearly states that the duty of the lessee to take protective measures is not dependent on the BLM sending a demand letter.

Some commenters suggested that we retain the current regulations, which anticipate BLM sending a drainage demand letter. The final rule did not adopt this suggestion. The lessee has the duty to monitor and take protective action. IBLA already recognizes that a lessee may have constructive notice of drainage without a BLM demand letter. Significant Federal and Indian oil and gas resources may already be drained before the lessee receives BLM's demand letter. The lessee is in a better position than BLM to know whether drainage is occurring.

Some commenters expressed concern with BLM's demand letter time frame and the assessing of compensatory royalty damages. The lessee or operating rights owner is allowed a reasonable time from when the draining well establishes production to take protective action. Since there is no average reasonable time for every drainage situation, we will determine what is a reasonable time on a case-by-case basis.

Section 3100.55 (§ 3162.2–15)

This section clarifies the burden of proof in a drainage contest. BLM has the burden in a drainage contest of establishing a *prima facie* case that drainage is occurring. The burden then shifts to the lessee and operator to refute the existence of drainage, to prove the lessee could not have known of drainage or to prove that a protective well is not economic. The final rule is substantively unchanged from the proposed rule.

Some commenters expressed concern that lessees are at a distinct disadvantage in their ability to refute BLM's *prima facie* case that drainage is occurring. These commenters oppose shifting the burden of proof for drainage to the lessees. The final rule did not adopt this comment. Once we establish the existence of drainage and constructive notice, the lessee and operating rights owner under current precedent have the burden of proving that drainage has not occurred or that they could not have known of drainage. Under current precedent, the lessee and operating rights owner have the burden of proving that a protective well would not be economic.

BLM is also confident that we and IBLA will continue to fairly consider all geological and engineering data that the operator furnishes on the existence of drainage and will not hold lessees to an impossible standard of proof.

Section 3100.60 (§ 3162.2–11)

This section clarifies what is a reasonable time to take protective action after a draining well begins to produce oil or gas resources with the actual time determined on a case-by-case basis. The final rule differs from the proposed rule. We modified this section to delete these words ''earliest,'' ''oil or gas,'' ''offending wells,'' and ''lands adjacent or nearby'' to establish a clearer understanding of this section as commenters suggested. We changed the format and the leading sentences to the answer to form paragraph (a). We added paragraph (b) to clarify some of the factors we consider when determining whether the lessee took protective action within a reasonable time. We added paragraph (c) to clarify that if you take protective action but do not do so in a timely fashion, you are responsible for compensatory royalty for the period of the delay as provided in § 3162.2–12. In response to comments, we modified paragraph (d) to change the word ''assessments'' to ''analysis,'' which is a more accurate term.

A commenter suggested that we add ''split estate'' to the list of factors we consider in determining what might be a reasonable time to take protective action. The final rule did not adopt this suggestion. It is not practical to attempt to list all of the relevant data on cost and revenue in the regulation. Depending on the circumstances of each case, it may or may not require a different amount of time to take protective action where there is separate surface estate ownership.

A commenter suggested that it is impractical to interrupt an ongoing drilling schedule to drill an offset well. The final rule did not change in response to this comment. The lessee is obligated by its lease terms to take protective action. If the lessee does not want to interrupt its drilling schedule, it can request BLM's approval to pay compensatory royalty or communitize the lease with the tract containing the draining well.

Some commenters suggested that the title question of this section should read: ''How soon must I take protective action?'' The commenters also suggested that we delete the first sentence of the section. The final rule adopted the language to change the question to read ''How soon after I know of the likelihood of drainage must I take protective action?'' We adopted the suggestion to delete the first sentence of this section. We reformatted this section

and formed new paragraphs (a) and (b). The lessee or operating rights owner is responsible for initiating action at a reasonable time after constructive notice that drainage is occurring.

Some commenters suggested that we establish a time frame for protection instead of the ''earliest reasonable time.'' These commenters also suggested that BLM provide specific guidelines or criteria for determining what is the ''earliest reasonable time.'' The final rule did not adopt the suggestion to establish a specific time frame. We deleted the word ''earliest'' because all reasonable time requirements vary greatly for each situation. We must determine the reasonable time on a case-by-case basis.

A commenter suggested that we include ''time required for acquisition and evaluation of geological and/or geophysical data'' in paragraph (b). The final rule adopted the language time required to evaluate the characteristics and performance of the draining well'' for paragraph (b)(1), but did not include the geological/geophysical data.

Section 3100.61 (3162.2–12)

This section describes the period of time for which the Department will assess compensatory royalties against a lessee or operating rights owner who does not drill and produce from a protective well or enter into a unitization or communitization agreement to protect the lease from drainage. The final rule differs from the proposed rule. We deleted the word ''earliest'' to establish a clearer time frame for which the Department will assess compensatory royalties against a lessee or operating rights owner. We deleted the cross reference to § 3100.60. In response to comments, we modified paragraph (a) to include the word ''economic.'' In response to comments, we modified paragraph (b) to change the language ''the lands being drained'' to ''the mineral resources being drained'' to clarify that we refer to mineral resources not lands. In response to comments, we modified paragraph (c) to change the phrase ''ceases production'' to ''stops producing.'' In response to comments, we modified paragraph (d) to change the language ''the oil and gas lease interests in spacing units, lots, or aliquot parts of the Federal lands being drained'' to ''your interest in the Federal or Indian lease.''

A commenter suggested that we change the language to add ''economic'' before ''protective'' in paragraph (a) and add ''until drainage ceases in the offending well'' to paragraph (c). The final rule adopted a change to paragraph (a) to add the word ''economic,'' but not to paragraph (c). We did not change paragraph (c) because the duty to pay compensatory royalty stops when the draining well stops producing. The level of compensation required is based on determining the percentage of the draining well's overall production attributed to the lease with mineral resources being drained.

A commenter suggested that the obligation to pay compensatory royalty ends when the drilling of a protective well demonstrates insufficient production to recover drilling and operating costs. The final rule did not adopt this suggestion because it was unnecessary. No compensatory royalty is to be paid because drilling a protective well satisfies the obligation to protect against drainage. In the lease, the lessee has promised to protect the Federal or Indian lessor from drainage.

A commenter suggested that we change paragraph (d) to read ''You relinquish the oil and gas lease interests in spacing units, lots, or aliquot parts in the geological horizon(s) of the Federal land being drained.'' We do not recognize the division of record title by geological horizon(s). Therefore, we did not adopt that comment.

Section 3100.70 (3162.2–5)

This section, as in the proposed rule, states that you do not have to take action under § 3162.2–4 if you can demonstrate that it is not possible to do so and get a reasonable profit above the cost of drilling, completing, and operating the protective well. The final rule differs from the proposed rule. We modified the question of this section to read ''Must I take protective action when a protective well is uneconomic?'' We modified the first sentence to change the language ''will not assess you compensatory royalty'' to ''you are not required to take any of the actions listed in § 3162.2–4'' to establish a clearer understanding of when a lessee does not take action for drainage protection.

Section 3100.71 (3162.2–13)

This section informs an assignee or transferee that if they acquire a lease being drained, they will be assessed compensatory royalty for all drainage obligations accruing on and after the approval date of the assignment of record title or transfer of operating rights. The final rule is substantively unchanged from the proposed rule with the exception of including the word ''Indian'' to clarify that this section applies to Indian assignees or transferees.

A commenter suggested that we notify an assignee or transferee of a lease interest that is subject to drainage and the obligation to pay compensatory royalty or drill a protective well. The final rule did not adopt this suggestion because a prudent purchaser of a lease interest should examine the lease file prior to purchase. After BLM approves an assignment of record title or transfer of operating rights, the assignee or transferee assumes all lease obligations including the obligation to protect the lease from drainage.

Section 3100–80 (3162.2–14)

This section indicates that a lessee or operating rights owner may request BLM State Director review as outlined in 43 CFR 3165.3, and appeal to IBLA as outlined in 43 CFR Parts 4 and 1840, a BLM decision to require drainage protective measures. The final rule includes language that a lessee or operating rights owner may request for a BLM State Director review. This language was omitted in the proposed rule in anticipation of a new appeals rule.

Section 3106.7–2

This section specifies that an assignor or transferor remains responsible for all obligations accruing prior to the approval of the assignment or transfer, including the payment of compensatory royalties for drainage and the plugging and abandonment of any unplugged wells drilled or used prior to the effective of the transfer. The final rule differs from the proposed rule. We modified this section to change the question to read ''If I transfer my lease, what is my continuing obligation?'' to better reflect that the purpose of the section is to inform the lessee of its continuing obligations. Also, we reformatted the section to make it easier to understand.

A commenter suggested that we recognize the terms of assignment agreements that specify which responsibilities are assigned or transferred. The final rule did not adopt this suggestion because we cannot be bound by agreements to which we are not a party.

A commenter suggested that we clarify that the assignee merely assumes reclamation responsibilities and not all wells must immediately be plugged when we approve the assignment. The final rule did not adopt this suggestion. We do not believe that the rule implies otherwise. If additional beneficial uses for the wells exist, you do not need to plug the wells immediately.

Some commenters suggested that the original lessee or operator should not be responsible for plugging and abandoning when control and all

obligations have been conveyed to other parties. The final rule did not adopt this suggestion. While we first look to the current lessee for lease compliance, we believe it prudent to reserve our rights against all parties who had the potential to benefit from the well's existence.

Section 3106.7–6

This section informs a transferee of its obligations to comply with the original lease terms, including plugging and abandonment of unplugged wells, reclaiming the lease site, remediating environmental problems in existence which should have been known at the time of assignment, as well as maintaining an adequate bond to ensure performance of those responsibilities. The final rule differs from the proposed rule. We modified this section to add paragraphs (a) and (b) to differentiate between record title holders and operating rights owners.

Section 3108.1

This section adds a requirement that where more than one party holds record title interest in the same lease, all such parties must sign the relinquishment form. In addition, all parties relinquishing the lease are still responsible for settling all outstanding lease obligations, including placement of all wells on the lease in proper condition for suspension or abandonment, and for reclaiming leased land in accordance with an approved plan. The final rule is substantially unchanged from the proposed rule. In response to comments, we deleted the phrase ''leased land'' in the rule text.

Section 3130.3

This section amends the cross reference of these provisions. The final rule amends the cite to read ''§ 3162.2.''

Section 3162.2

This section adds ''lessees'' to the persons who must satisfy the requirement of drilling and producing operations related to drainage. The final rule differs from the proposed rule. We modified this section to consolidate the previous drainage requirements of Part 3100 with those of Part 3160. We also modified this section to remove paragraph (a) and to redesignate current paragraphs (b) and (c) as paragraphs (a) and (b).

A commenter suggested that we should not require the lessees to have the same development responsibilities as the operating rights owners if they are not the same entity. The final rule did not adopt this suggestion because we must ensure that if either party is negligent in its responsibilities, we have a recourse by holding the other party responsible for fulfilling the lease obligations. A sublease does not relieve the lessee of the responsibility for lease performance.

Section 3165.3

This section adds ''lessee'' to the list of parties notified by BLM in the case of an alleged violation of the lease or regulations pertaining to operations on an oil and gas lease. The final rule differs from the proposed rule. We modified this section to add the phrase ''and the lessee(s)'' after ''appropriate party'' in the first sentence of paragraph (a) to clarify that we will notify lessees of alleged violations of the lease or regulations.

Section 3165.4

This section adds a provision specifying that an appeal of BLM's determination of drainage does not stay the determination and that compensatory royalties and interest will accrue during the appeal. The final rule is substantively unchanged from the proposed rule.

IV. Procedural Matters

Executive Order 12866

In accordance with the criteria in Executive Order 12866, this rule is not a significant regulatory action and is not subject to review by the Office of Management and Budget (OMB).

(a) This rule will not have an annual economic effect of $100 million or adversely affect an economic sector, productivity, jobs, the environment, or other units of government. Since fiscal year 1996, the drainage protection program has generated an average of about $16.1 million to the U.S. Treasury per year, with about 10 percent of these revenues attributed to compensatory assessments. These revenues are from payments by lessees and operating rights owners obligated to pay royalties and compensatory royalties under the drainage protection program. The adoption of this final rule could result in the generation of additional revenues from compensatory royalty assessments, royalties from the drilling of new protective wells, and royalties from entering unitization or communitization agreements totaling about $2 million. This is far below the $100 million threshold set out in the Executive Order.

(b) This rule will not create inconsistencies with other agencies' actions. This rule does not change the relationships of the drainage protection program with other agencies' actions.

(c) This rule will not materially affect entitlements, grants, user fees, loan programs, or the rights and obligations of their recipients. This final rule clarifies ambiguities in the existing regulations and does not add new requirements to protect the lessor from drainage to those in the lease itself or impose new obligations on lessees and operating rights owners. Since the final rule merely clarifies how a lessee meets the terms in the lease that created their property interest, and imposes no limits on the use of the property, there will be no rights or obligations impaired as a result.

(d) This rule will not raise novel legal or policy issues.

Regulatory Flexibility Act

Congress enacted the Regulatory Flexibility Act of 1980 (RFA), as amended (5 U.S.C. 601–612), to ensure that government regulations do not unnecessarily or disproportionately burden small entities. The RFA requires a Regulatory Flexibility Analysis if a rule has a significant economic impact, either detrimental or beneficial, on a substantial number of small entities. The Department certifies that this document will not have a significant economic effect on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). A Regulatory Flexibility Analysis and a Small Entity Compliance Guide are not required. This final rule does not produce an impact of $100 million or more on the economy. Its initial annual impact is estimated at $20.2 million or about one-third of one percent of revenues generated by oil and gas leases. Our estimate on the drainage liabilities is based on the average yearly amount of revenues recovered by BLM from successfully retired drainage cases. These revenues include royalties on protective wells, compensatory royalty assessments, royalties generated through protective agreements, or bonus bid payments on unleased lands.

Small Business Regulatory Enforcement Fairness Act

This rule is not a major rule under 5 U.S.C. 804(2), the Small Business Regulatory Enforcement Fairness Act. This rule:

a. Does not have an annual effect on the economy of $100 million or more.

b. Does not cause a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions. This final rule would not affect costs or prices for consumers that are associated with the actions of this rulemaking.

The Department has determined that this final rule is not a major rule under

5 U.S.C. 804(2), the Small Business Regulatory Enforcement Fairness Act. This final rule is not a major rule because annual total royalty revenues we anticipate receiving through drainage protections, including any increases as a result of these regulations, barely exceed $25 million.

Unfunded Mandates Reform Act

We have determined that in accordance with the Unfunded Mandates Reform Act (UMRA) (2 U.S.C. 1501, *et seq.*):

a. This rule will not ''significantly or uniquely'' affect small governments. A Small Government Agency Plan is not required. The final rule would not change the relationship between BLM and small governments.

b. This rule will not produce a Federal mandate of $100 million or greater in any year, *i.e.,* it is not a ''significant regulatory action'' under the Unfunded Mandates Reform Act. This final rule does not impose an unfunded mandate on State, local, or tribal governments, or the private sector of more than $100 million per year. The final rule does not have a significant or unique effect on State, local, or tribal governments, or the private sector. A statement containing the information required by the Unfunded Mandates Reform Act (2 U.S.C. 1531 *et seq.*) is not required.

Government-to-Government Relationship With Tribes

We have considered the impact of this rule on the interests of Tribal governments under the President's memorandum of April 29, 1994, ''Government-to-Government Relations with Native American Tribal Governments'' (59 FR 22951) and Department of the Interior Manual (512 DM 2). BLM did consult with Indian Tribes, under Executive Order 13084, on the issue of whether these regulations should apply to Tribal and individual Indian oil and gas leases. This complies with Executive Order 13175 which takes effect on January 6, 2001. However, we have determined the government-to-government relationship will not be affected as a result of the consultation on the applicability of these regulations. This rule will enhance the protection of Indian oil and gas resource owners.

Executive Order 12630

In accordance with Executive Order 12630, the final rule does not represent a government action capable of interfering with constitutionally protected property rights. A takings implication assessment is not required. The Department has determined that the final rule would not cause a taking of private property or require further discussion of takings implications under this Executive Order. Since the final rule merely clarifies how a lessee meets the terms in the lease that created their property interest, and imposes no limits on the use of the property, there will be no private property rights impaired as a result.

Executive Order 13132

We have considered the effect of the final rule in accordance with Executive Order 13132 and have determined that it does not have sufficient Federalism implications to warrant the preparation of a Federalism summary impact statement. The final rule does not have substantial direct effects on the States, on the relationship between the national government and the States or on the distribution of power and responsibilities among various levels of government.

Executive Order 12988

In accordance with Executive Order 12988, the Office of the Solicitor has determined that this final rule does not unduly burden the judicial system and meets the requirements of sections 3(a) and 3(b)(2) of the Order. This final rule clarifies the drainage obligations of lessees and operating rights owners and ambiguities in the existing regulations.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the information collection required by these regulations has been approved by the Office of Management and Budget under Approval No. 1004–0185 which expires May 31, 2002.

National Environmental Policy Act

BLM has determined that this final rule is not subject to the review process established by the National Environmental Policy Act (NEPA) of 1969, since it is categorically excluded under 516 Departmental Manual (DM), Chapter 2, Appendix 1, Item 1.10, and 516 DM, Chapter 2, Appendix 2. We also determined that the final rule does not meet any of the ten criteria for exceptions to categorical exclusion listed in 516 DM, Chapter 2, Appendix 2. Pursuant to Council on Environmental Quality regulations (40 CFR 1508.4) and the environmental policies and procedures of the Department of the Interior, the term ''categorical exclusion'' means a category of actions that have been found not individually or cumulatively to have a significant effect on the human environment and in procedures adopted by a Federal agency for which neither an environmental assessment nor an environmental impact statement is required.

The environmental effects of this rule are too speculative or conjectural to lend themselves to meaningful analysis. Although this rulemaking requires that Federal lessees and operating rights owners protect their leases from drainage of oil and gas resources by producing wells on adjacent lands, there are several steps that must be taken before it is determined that an operator will take actions subject to NEPA review. The lessee must monitor well activities on adjacent lands, and then conduct an analysis of information available to determine if the adjacent well is too far away to be capable of draining the Federal lease. Even if draining the Federal lease, the lessee might be able to exercise options such as forming a unitization or communitization agreement with the owners of the draining well or paying compensatory royalties. These two options are exercised in more than 80 percent of the cases where there is economic drainage and a NEPA analysis is not required.

In about 10 percent of all drainage cases identified, it might be determined that drilling a protective well is the only option for protecting the lease from drainage. However, the lessee might prove that even if it drilled a protective well, it might not be economic. This is perhaps true in 75 percent of the cases where drilling a protective well is considered. If the lessee determines it can drill an economic protective well, then obtaining approval to drill the well is subject to a review under procedures established by BLM to comply with NEPA.

Authors: The principal author of this rule making is Donnie Shaw, Fluid Minerals Group, assisted by Shirlean Beshir, Regulatory Affairs Group.

List of Subjects

43 CFR Part 3100

Government contracts, Land Management Bureau, Mineral royalties, Oil and gas exploration, Public lands-mineral resources, Reporting and record keeping requirements, Surety bonds.

43 CFR Part 3130

Alaska, Government contracts, Mineral royalties, Oil and gas exploration, Oil and gas reserves, Public lands-mineral resources, Reporting and record keeping requirements, Surety bonds.

43 CFR Part 3160

Government contracts, Hydrocarbons, Land Management Bureau, Mineral royalties, Oil and gas exploration, Public lands-mineral resources, Reporting and record keeping requirements.

Dated: January 2, 2001.

Sylvia V. Baca,

Assistant Secretary, Land and Minerals Management.

Accordingly, under the authorities cited below, BLM adopts as final the amendments to Parts 3100, 3106, 3108, 3130, and 3160, Group 3100, Subchapter C, Chapter II of Title 43 of the Code of Federal Regulations to read as follows:

SUBCHAPTER C—MINERALS MANAGEMENT (3000)

1. Remove the heading and the note following Group 3000—Minerals Management.

PART 3000—MINERALS MANAGEMENT: GENERAL

2. Revise the authority citation for Part 3000 to read as follows:

Authority: 30 U.S.C. 189 and 359; and 40 Opinion of the Attorney General 41.

3. Remove the heading and the note following Group 3100—Oil and Gas Leasing.

PART 3100—OIL AND GAS LEASING

4. Revise the authority citation for part 3100 to read as follows:

Authority: 30 U.S.C. 189 and 359; 43 U.S.C. 1732(b), 1733, and 1740; and 40 Opinion of the Attorney General 41.

5. Revise § 3106.7–2 to read as follows:

§ 3106.7–2 If I transfer my lease, what is my continuing obligation?

(a) You are responsible for performing all obligations under the lease until the date BLM approves an assignment of your record title interest or transfer of your operating rights.

(b) After BLM approves the assignment or transfer, you will continue to be responsible for lease obligations that accrued before the approval date, whether or not they were identified at the time of the assignment or transfer. This includes paying compensatory royalties for drainage. It also includes responsibility for plugging wells and abandoning facilities you drilled, installed, or used before the effective date of the assignment or transfer.

6. Add new § 3106.7–6 to read as follows:

§ 3106.7–6 If I acquire a lease by an assignment or transfer, what obligations do I agree to assume?

(a) If you acquire record title interest in a Federal lease, you agree to comply with the terms of the original lease during your lease tenure. You assume the responsibility to plug and abandon all wells which are no longer capable of producing, reclaim the lease site, and remedy all environmental problems in existence and that a purchaser exercising reasonable diligence should have known at the time. You must also maintain an adequate bond to ensure performance of these responsibilities.

(b) If you acquire operating rights in a Federal lease, you agree to comply with the terms of the original lease as it applies to the area or horizons in which you acquired rights. You must plug and abandon all unplugged wells, reclaim the lease site, and remedy all environmental problems in existence and that a purchaser exercising reasonable diligence should have known at the time you receive the transfer. You must also maintain an adequate bond to ensure performance of these responsibilities.

7. Revise § 3108.1 to read as follows:

§ 3108.1 As a lessee, may I relinquish my lease?

You may relinquish your lease or any legal subdivision of your lease at any time. You must file a written relinquishment with the BLM State Office with jurisdiction over your lease. All lessees holding record title interests in the lease must sign the relinquishment. A relinquishment takes effect on the date you file it with BLM. However, you and the party that issued the bond will continue to be obligated to:

(a) Make payments of all accrued rentals and royalties, including payments of compensatory royalty due for all drainage that occurred before the relinquishments;

(b) Place all wells to be relinquished in condition for suspension or abandonment as BLM requires; and

(c) Complete reclamation of the leased sites after stopping or abandoning oil and gas operations on the lease, under a plan approved by the appropriate surface management agency.

PART 3130—OIL AND GAS LEASING: NATIONAL PETROLEUM RESERVE, ALASKA

8. Revise the authority citation for part 3130 to read as follows:

Authority: 42 U.S.C. 6508; 43 U.S.C. 1732(b), 1733, and 1740; and 40 Opinion of the Attorney General 41.

§ 3130.3 [Amended]

9. Amend § 3130.3 by revising the cross reference of ''§ 3100.3'' to read ''§ 3162.2.''

PART 3160—ONSHORE OIL AND GAS OPERATIONS

10. Revise the authority citation for part 3160 to read as follows:

Authority: 25 U.S.C. 396d; 30 U.S.C. 189 and 359; 43 U.S.C. 1733 and 1740; and 40 Opinion of the Attorney General 41.

§ 3160.0–5 [Amended]

11. Amend § 3160.0–5 as follows by:

a. Removing the paragraph designations (a) through (w) and alphabetizing all definitions;

b. Adding new definitions for *Drainage, Protective well,* and *Record title holder,* and revising the definitions of *Lessee* and *Operating rights owner* to read as follows:

* * * * *

Drainage means the migration of hydrocarbons, inert gases (other than helium), or associated resources caused by production from other wells.

* * * * *

Lessee means any person holding record title or owning operating rights in a lease issued or approved by the United States.

* * * * *

Operating rights owner means a person who owns operating rights in a lease. A record title holder may also be an operating rights owner in a lease if it did not transfer all of its operating rights.

* * * * *

Protective well means a well drilled or modified to prevent or offset drainage of oil and gas resources from its Federal or Indian lease.

* * * * *

Record title holder means the person(s) to whom BLM or an Indian lessor issued a lease or approved the assignment of record title in a lease.

* * * * *

12. Amend § 3162.2 as follows by:

§ 3162.2 [Amended]

a. Revising the heading;

b. Adding ''(s)'' after ''operating rights owner'' in paragraph (b) and (c) each time it appears, and by adding the term ''a lessee(s) and'' before ''operating rights owners'' each time it appears; and

c. removing paragraph (a).

§ 3162.2 Drilling, producing, and drainage obligations.

* * * * *

13. Add a new § 3162.2–1 and redesignate paragraphs (b) and (c) of

§ 3162.2 as paragraphs (a) and (b) of this new section.

§ 3162.2–1 Drilling and producing obligations.

* * * * *

14. Add new §§ 3162.2–2 through 3162.2–15 to read as follows:

Sec.

3162.2–2 What steps may BLM take to avoid uncompensated drainage of Federal or Indian mineral resources?
3162.2–3 When am I responsible for protecting my Federal or Indian lease from drainage?
3162.2–4 What protective action may BLM require the lessee to take to protect the leases from drainage?
3162.2–5 Must I take protective action when a protective well would be uneconomic?
3162.2–6 When will I have constructive notice that drainage may be occurring?
3162.2–7 Who is liable for drainage if more than one person holds undivided interests in the record title or operating rights for the same lease?
3162.2–8 Does my responsibility for drainage protection end when I assign or transfer my lease interest?
3162.2–9 What is my duty to inquire about the potential for drainage and inform BLM of my findings?
3162.2–10 Will BLM notify me when it determines that drainage is occurring?
3162.2–11 How soon after I know of the likelihood of drainage must I take protective action?
3162.2–12 If I hold an interest in a lease, for what period will the Department assess compensatory royalty against me?
3162.2–13 If I acquire an interest in a lease that is being drained, will the Department assess me for compensatory royalty?
3162.2–14 May I appeal BLM's decision to require drainage protective measures?
3162.2–15 Who has the burden of proof if I appeal BLM's drainage determination?

§ 3162.2–2 What steps may BLM take to avoid uncompensated drainage of Federal or Indian mineral resources?

If we determine that a well is draining Federal or Indian mineral resources, we may take any of the following actions:

(a) If the mineral resources being drained are in Federal or Indian leases, we may require the lessee to drill and produce all wells that are necessary to protect the lease from drainage, unless the conditions of this part are met. BLM will consider applicable Federal, State, or Tribal rules, regulations, and spacing orders when determining which action to take. Alternatively, we may accept other equivalent protective measures;

(b) If the mineral resources being drained are either unleased (including those which may not be subject to leasing) or in Federal or Indian leases, we may execute agreements with the owners of interests in the producing well under which the United States or the Indian lessor may be compensated for the drainage (with the consent of the Federal or (in consultation with the Indian mineral owner and BIA) Indian lessees, if any);

(c) We may offer for lease any qualifying unleased mineral resources under part 3120 of this chapter or enter into a communitization agreement; or

(d) We may approve a unit or communitization agreement that provides for payment of a royalty on production attributable to unleased mineral resources as provided in § 3181.5.

§ 3162.2–3 When am I responsible for protecting my Federal or Indian lease from drainage?

You must protect your Federal or Indian lease from drainage if your lease is being drained of mineral resources by a well:

(a) Producing for the benefit of another mineral owner;

(b) Producing for the benefit of the same mineral owner but with a lower royalty rate; or

(c) Located in a unit or communitization agreement, which due to its Federal or Indian mineral owner's allocation or participation factor, generates less revenue for the United States or the Indian mineral owner for the mineral resources produced from your lease.

§ 3162.2–4 What protective action may BLM require the lessee to take to protect the leases from drainage?

We may require you to:

(a) Drill or modify and produce all wells that are necessary to protect the leased mineral resources from drainage;

(b) Enter into a unitization or communitization agreement with the lease containing the draining well; or

(c) Pay compensatory royalties for drainage that has occurred or is occurring.

§ 3162.2–5 Must I take protective action when a protective well would be uneconomic?

You are not required to take any of the actions listed in § 3162.2–4 if you can prove to BLM that when you first knew or had constructive notice of drainage you could not produce a sufficient quantity of oil or gas from a protective well on your lease for a reasonable profit above the cost of drilling, completing, and operating the protective well.

§ 3162.2–6 When will I have constructive notice that drainage may be occurring?

(a) You have constructive notice that drainage may be occurring when well completion or first production reports for the draining well are filed with either BLM, State oil and gas commissions, or regulatory agencies and are publicly available.

(b) If you operate or own any interest in the draining well or lease, you have constructive notice that drainage may be occurring when you complete drill stem, production, pressure analysis, or flow tests of the well.

§ 3162.2–7 Who is liable for drainage if more than one person holds undivided interests in the record title or operating rights for the same lease?

(a) If more than one person holds record title interests in a portion of a lease that is subject to drainage, each person is jointly and severally liable for taking any action we may require under this part to protect the lease from drainage, including paying compensatory royalty accruing during the period and for the area in which it holds its record title interest.

(b) Operating rights owners are jointly and severally liable with each other and with all record title holders for drainage affecting the area and horizons in which they hold operating rights during the period they hold operating rights.

§ 3162.2–8 Does my responsibility for drainage protection end when I assign or transfer my lease interest?

If you assign your record title interest in a lease or transfer your operating rights, you are not liable for drainage that occurs after the date we approve the assignment or transfer. However, you remain responsible for the payment of compensatory royalties for any drainage that occurred when you held the lease interest.

§ 3162.2–9 What is my duty to inquire about the potential for drainage and inform BLM of my findings?

(a) When you first acquire a lease interest, and at all times while you hold the lease interest, you must monitor the drilling of wells in the same or adjacent spacing units and gather sufficient information to determine whether drainage is occurring. This information can be in various forms, including but not limited to, well completion reports, sundry notices, or available production information. As a prudent lessee, it is your responsibility to analyze and evaluate this information and make the necessary calculations to determine:

(1) The amount of drainage from production of the draining well;

(2) The amount of mineral resources which will be drained from your Federal or Indian lease during the life of the draining well; and

(3) Whether a protective well would be economic to drill.

(b) You must notify BLM within 60 days from the date of actual or constructive notice of:

(1) Which of the actions in § 3162.2–4 you will take; or

(2) The reasons a protective well would be uneconomic.

(c) If you do not have sufficient information to comply with § 3162.2–9(b)(1), indicate when you will provide the information.

(d) You must provide BLM with the analysis under paragraph (a) of this section within 60 days after we request it.

§ 3162.2–10 Will BLM notify me when it determines that drainage is occurring?

We will send you a demand letter by certified mail, return receipt requested, or personally serve you with notice, if we believe that drainage is occurring. However, your responsibility to take protective action arises when you first knew or had constructive notice of the drainage, even when that date precedes the BLM demand letter.

§ 3162.2–11 How soon after I know of the likelihood of drainage must I take protective action?

(a) You must take protective action within a reasonable time after the earlier of:

(1) The date you knew or had constructive notice that the potentially draining well had begun to produce oil or gas; or

(2) The date we issued a demand letter for protective action.

(b) Since the time required to drill and produce a protective well varies according to the location and conditions of the oil and gas reservoir, BLM will determine this on a case-by-case basis. When we determine whether you took protective action within a reasonable time, we will consider several factors including, but not limited to:

(1) Time required to evaluate the characteristics and performance of the draining well;

(2) Rig availability;

(3) Well depth;

(4) Required environmental analysis;

(5) Special lease stipulations which provide limited time frames in which to drill; and

(6) Weather conditions.

(c) If BLM determines that you did not take protection action timely, you will owe compensatory royalty for the period of the delay under § 3162.2–12.

§ 3162.2–12 If I hold an interest in a lease, for what period will the Department assess compensatory royalty against me?

The Department will assess compensatory royalty beginning on the first day of the month following the earliest reasonable time we determine you should have taken protective action. You must continue to pay compensatory royalty until:

(a) You drill sufficient economic protective wells and remain in continuous production;

(b) We approve a unitization or communitization agreement that includes the mineral resources being drained;

(c) The draining well stops producing; or

(d) You relinquish your interest in the Federal or Indian lease.

§ 3162.2–13 If I acquire an interest in a lease that is being drained, will the Department assess me for compensatory royalty?

If you acquire an interest in a Federal or Indian lease through an assignment of record title or transfer of operating rights under this part, you are liable for all drainage obligations accruing on and after the date we approve the assignment or transfer.

§ 3162.2–14 May I appeal BLM's decision to require drainage protective measures?

You may appeal any BLM decision requiring you take drainage protective measures. You may request BLM State Director review under 43 CFR 3165.3 and/or appeal to the Interior Board of Land Appeals under 43 CFR part 4 and subpart 1840.

§ 3162.2–15 Who has the burden of proof if I appeal BLM's drainage determination?

BLM has the burden of establishing a *prima facie* case that drainage is occurring and that you knew of such drainage. Then the burden of proof shifts to you to refute the existence of drainage or to prove there was not sufficient information to put you on notice of the need for drainage protection. You also have the burden of proving that drilling and producing from a protective well would not be economically feasible.

§ 3165.3 [Amended]

13. Amend § 3165.3 by adding the phrase ''and the lessee(s),'' after ''appropriate party'' in the first sentence of paragraph (a).

14. Amend § 3165.4 by adding a new paragraph (e)(4) to read as follows:

§ 3165.4 Appeals.

* * * * *

(e) * * *

(4) When an appeal is filed under paragraph (a) of this section from a decision to require drainage protection, BLM's drainage determination will remain in effect during the appeal, notwithstanding the provisions of 43 CFR 4.21. Compensatory royalty and interest determined under 30 CFR Part 218 will continue to accrue throughout the appeal.

* * * * *

[FR Doc. 01–446 Filed 1–9–01; 8:45 am]

BILLING CODE 4310–84–P