



GENE R. AND MARY J. HILTON

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Decided December 28, 2015



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Interior Board of Land Appeals
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GENE R. AND MARY J. HILTON

IBLA 2013-192

Decided December 28, 2015

Appeal from a decision of the Colorado State Director, Bureau of Land Management, affirming, on State Director Review, a decision of the Colorado River Valley Field Office approving an application for a communitization agreement. COC 75098.

Set aside and remanded.

1. Oil and Gas Leases: Generally--Oil and Gas Leases:
Communitization Agreements--Oil and Gas Leases:
Drilling--Mineral Leasing Act: Generally

Section 17(m) of the Mineral Leasing Act, 30 U.S.C. § 226(m) (2016), authorizes the Secretary to issue a communitization agreement when a two element test is met. The Secretary may communitize tracts (1) when separate tracts cannot be independently developed and operated in conformity with an established state well-spacing or development program; and (2) communitization is in the public interest. If either element is lacking, then BLM has no statutory authority under section 17 of the Mineral Leasing Act to issue a communitization agreement.

2. Oil and Gas Leases: Generally--Oil and Gas Leases:
Communitization Agreements--Oil and Gas Leases:
Drilling--Mineral Leasing Act: Generally

The Board will set aside a BLM decision approving a communitization agreement when the record includes evidence, unaddressed by BLM, showing that a Federal lease is capable of being independently developed under section 17(m) of the Mineral Leasing Act, 30 U.S.C. § 226(m) (2012).

3. Oil and Gas Leases: Generally--Oil and Gas Leases: Communitization Agreements--Oil and Gas Leases: Drilling--Mineral Leasing Act: Generally

Whether a communitization agreement is in the public interest under section 17(m) of the Mineral Leasing Act, 30 U.S.C. § 226(m) (2012), depends on whether it provides for the efficient recovery of the maximum quantity of hydrocarbons from the communitized pool, and furthers the goals of proper development and the prevention of waste. Approval of a communitization agreement will be set aside and the case remanded where there are questions in the record regarding whether the agreement will meet those objectives.

4. Oil and Gas Leases: Generally--Oil and Gas Leases: Communitization Agreements--Oil and Gas Leases: Drilling--Mineral Leasing Act: Generally

A communitization agreement must be signed by all necessary parties. BLM's Communitization Manual provides that a non-Federal royalty interest owner must either sign the agreement, be force-pooled by a State order, or be a signer of a lease that already contains a force-pooling provision. While provisions of the Communitization Manual are not binding on the Board, the Board will set aside a BLM decision when BLM provides no justification for deviating from provisions of the Manual that are reasonable and consistent with the law.

APPEARANCES: Cynthia L. Bargell, Esq., Dillon, Colorado, for appellant; Sandra A. Snodgrass, Esq., Janet N. Harris, Esq., and Ann Lane, Esq., for WPX Energy Rocky Mountain, LLC (Intervenor); Kristin C. Guerriero, Esq., Office of the Regional Solicitor, U.S. Department of the Interior, Lakewood, Colorado, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE ROBERTS

Gene R. and Mary J. Hilton (the Hiltons) have appealed from a Decision of the Deputy State Director, Colorado State Office (CSO), Bureau of Land Management (BLM), affirming, on State Director Review (SDR), the November 30, 2012, decision of the Colorado River Valley Field Office (CRVFO) to approve communitization agreement (CA) COC 75098. In its Decision dated June 14, 2013 (2013 SDR Decision), the CSO upheld the CRVFO's determination "that the Federal lease or

leases as to the lands committed to the . . . agreement cannot be independently developed and operated in conformity with the well-spacing program for the field or area in which said lands are located, and that consummation and approval of the agreement will be in the public interest.” Determination–Approval–Certification dated Nov. 30, 2012. The CSO agreed with the CRVFO that “[c]ommunitization . . . is appropriate.” 2013 SDR Decision at 9.

For the following reasons, we conclude that BLM’s approval of the CA is not supported by the record, and that significant questions remain as to whether BLM properly determined that the CA meets the standards of section 17(m) of the Mineral Leasing Act, 30 U.S.C. § 226(m) (2012), and the implementing regulation at 43 C.F.R. § 3105.2-2. There is evidence that Federal lease COC-58668 is capable of independent development and that communitization is not in the public interest. We therefore set aside the SDR Decision and remand the case for further review, in accordance with our opinion.

I. FACTUAL BACKGROUND

The Hiltons own a 50% fee interest in the minerals in the NE $\frac{1}{4}$ NW $\frac{1}{4}$, sec. 36, T. 7 S., R. 91 W., Sixth Principal Meridian, in Garfield County, Colorado (Hilton Tract). The Hiltons leased their interest to Orion Energy Partners LP (Orion), which later transferred its interest to WPX Energy Rocky Mountain, LLC (WPX), on April 1, 2009. SDR Decision at 2. The Hilton Tract, comprised of 80 acres, contains the Hilton No. 36-21D Well (Hilton Well), which was drilled from a surface location in sec. 25, approximately $\frac{1}{2}$ -mile north of section 36, and completed between July 27 and September 13, 2009. “WPX operates the Hilton well.” Notice of Appeal and Request for Stay (NOA/Stay) at 2.

The Hilton Tract borders a 1,040-acre tract of Federal mineral estate lands (Federal Tract) operated by WPX (Federal lease COC-58668) and held by production by virtue of CA COC-70802, approved in 2007 (back-dated to 2003) for the McBurney 8-12 Well located in sec. 12, T. 7 S., R. 91 W., Sixth Principal Meridian. The Federal Tract spans portions of secs. 1, 2, 35, and 36, T. 7 S. R. 91 W., Sixth Principal Meridian.

The minerals underlying sec. 36 are subject to several drilling and spacing orders issued by the Colorado Oil and Gas Conservation Commission (COGCC). Two such orders are of particular importance to the present appeal. Order No. 191-8 (Jan. 10, 2005) recognized a 640-acre drilling and spacing unit in sec. 36 for the Williams Fork Formation, and Order No. 191-10 (Apr. 25, 2005) recognized a 640-acre drilling and spacing unit in sec. 36 for the Iles Formation. Both Orders granted the request by Bill Barrett Corporation (BBC), predecessor-in-interest to WPX, for an option of drilling one well per 10 acres in sec. 36. Within the spacing unit, the Hilton Tract occupies 80 acres and the Federal Tract occupies 520 acres. CA at 7. The remaining 40 acres is occupied by a separate tract also leased to WPX.

On March 10, 2010, BBC requested COGCC to vacate the 640-acre drilling and spacing unit for the Williams Fork and Iles Formations in sec. 36 and establish two units, one comprising 80 acres under which the Hiltons own a mineral interest, and the other comprised of the balance of 560 acres, for those Formations and with the same well density in place for the 640-acre drilling and spacing unit in sec. 36. The approximate 560-acre drilling and spacing unit would consist of the NE $\frac{1}{4}$ NE $\frac{1}{4}$, NW $\frac{1}{4}$ NW $\frac{1}{4}$, S $\frac{1}{2}$ N $\frac{1}{2}$ and S $\frac{1}{2}$ of sec. 36. No agreement, such as a CA, had been established for the 640-acre drilling and spacing unit. The basis for BBC's application was the fact that the Hilton Lease did not authorize pooling by the lessee into units greater than 40 acres. 2013 SDR Decision at 2. By letter dated April 23, 2010, BLM protested BBC's application and recommended to the COGCC "the formation of a communitization agreement covering Section 36, as directed under COGCC Order, with an effective date being the spud date of well Hilton #36-21D that has been drilled in the 640-acre drilling and spacing unit."¹ BBC subsequently withdrew its March 10, 2010, application for vacatur of the spacing unit.

On May 19, 2010, BBC applied to the COGCC for a pooling order to pool all nonconsenting interests in the 640-acre drilling and spacing unit established for sec. 36. A decision on this application was continued, based on a related application submitted by the Hiltons. BBC withdrew its request for a pooling order prior to issuance of a final decision by COGCC. *Id.* at 3.

On July 28, 2010, the Hiltons filed an application with the COGCC to vacate the drilling and spacing unit in sec. 36. By letter dated August 30 2010, BLM filed a protest to the application, as did BBC and WPX. Effective October 21, 2010, the COGCC dismissed the Hiltons' application with prejudice for lack of standing. The Hiltons appealed the matter to Denver District Court, which also determined that the Hiltons lacked standing and granted motions to dismiss filed by COGCC, BBC, and WPX. *See Gene R. Hilton and Mary J. Hilton v. Colorado Oil and Gas Conservation Commission, Bill Barrett Corporation, and WPX Energy Rocky Mountain, LLC [Hilton v. COGCC]*, Case No. 2010CV9841 (Feb. 26, 2013). The Court found that the Hiltons, as mineral interest owners, had not shown that the COGCC's denial of their applications to vacate the existing drilling and spacing unit caused an injury in fact, and that they did not have a legally protected interest in initiating a COGCC hearing to vacate the drilling unit and spacing unit.

On December 21, 2010, WPX applied to the CRVFO for a CA covering sec. 36, to which the Hiltons objected. Hilton Combined Response to BLM's and WPX's Opposition to Stay and Statement of Reasons (SOR) (Hilton Combined Response and SOR), Ex. 4. By letter to the CRVFO dated January 8, 2011, the Hiltons argued, *inter alia*, that "BLM does not have the authority to approve the communitization

¹ We have reviewed the COGCC Orders in the record and find no provision directing "the formation of a communitization agreement covering Section 36."

agreement that would alter fee lease terms'; approval of the communitization agreement 'directly impacts Hilton's minerals by allocating production that underlies Hilton's Lands to other owners, effectively converting Hilton royalties to third parties'; and approval of the communitization agreement is inconsistent with BLM policy and [M]anual and not in the public interest." SDR Decision at 3 (quoting Hilton Letter to CRVFO dated Jan. 8, 2011). By letter to the CRVFO dated January 18, 2011, WPX responded to what it characterized as "inaccurate statements" in the Hiltons' letter, specifically disputing the Hiltons' arguments and questioning the standing of the Hiltons to object to approval of a CA requested by a Federal oil and gas lessee. BBC also sent a letter to the CRVFO, dated January 13, 2011, echoing the WPX letter.

On August 22, 2011, the CRVFO denied WPX's request for approval of the CA based on its conclusion that Federal lease COC-58668 can be independently developed in conformity with an established spacing pattern and therefore that the CA was not in the public interest. WPX requested SDR, asking the CSO to remand the CRVFO decision with instructions to the CRVFO to approve the CA subject to any necessary clarification that WPX's working interest in the NW $\frac{1}{4}$ NE $\frac{1}{4}$ and NE $\frac{1}{4}$ NW $\frac{1}{4}$ of sec. 36 is communitized and the Hilton royalty interest is not communitized. WPX based its request for SDR on three arguments: (1) CRVFO denial of the CA is based on a factually incorrect state drilling and spacing unit size; (2) approval of the CA is authorized by Federal regulation and is in the public interest; and (3) BLM is estopped from taking a position contradictory to its earlier protest to BBC's COGCC application to vacate the 640-acre drilling and spacing unit.

The CSO issued a decision on November 10, 2011 (2011 SDR Decision), in which it overturned the CRVFO decision, concluding that the CRVFO had denied WPX's request for communitization based upon an incorrect "understanding that the applicable state spacing was 40 acres" 2011 SDR Decision at 4. The CSO remanded the case to the CRVFO for reconsideration, "based upon the 640 acre spacing established for Section 36 by the COGCC in Order Nos. 191-8 and 191-10." *Id.* at 3. The CSO stated:

The lands in question have an established well-spacing and well development program through the applicable COGCC Order, with concurrence from the BLM. In fact, the BLM had protested to the COGCC when an application was filed to vacate the drilling and spacing unit. Both private and [F]ederal mineral interests have been committed and are affected. Federal lease No. COC-58668 cannot be independently developed and operated in conformity with the COGCC order.

Id. at 6. The Hiltons appealed that Decision to this Board, and WPX intervened. BLM and WPX filed motions to dismiss for lack of ripeness. By Order dated June 27, 2012,

the Board dismissed the appeal because BLM had not yet issued an appealable decision.

On November 30, 2012, the CRVFO issued a decision approving the CA for sec. 36, effective July 27, 2009. The CRVFO determined “that the Federal lease or leases as to the lands committed to the attached agreement cannot be independently developed and operated in conforming with the well-spacing program.” Determination–Approval–Certification dated Nov. 30, 2012 (Hilton Combined Response and SOR, Ex. 2). The Hiltons requested SDR of the CRVFO’s approval decision.

On June 14, 2013, CSO affirmed the CRVFO’s determination on the basis that “Section 36 has an established well-spacing and well development program through the applicable COGCC orders, with concurrence from BLM.” 2013 SDR Decision at 8. The CSO again stated that “Federal lease No. COC-58668 cannot be independently developed and operated in conformity with the COGCC order.” *Id.*

On appeal, the Hiltons argue that the 2013 SDR Decision should be reversed. They argue that “the CA is not authorized or necessary because the Federal Lease included in the communitized area can be independently developed and operated in conformity with an established well spacing and development program without communitization”; BLM has misconstrued the relevant provisions of the Colorado Oil and Gas Conservation Act, Colo. Rev. Stat. §§ 34-60-101 to 129 (2013), “reaching inaccurate conclusions regarding the need for communitization, ‘validating wells,’ and the development rights established by the [COGCC] Orders”; the unconventional CA does not adhere to the written guidelines and procedures” for communitization set forth in BLM Manual § 3160-9– Communitization; the “CA will not serve the public interest”; and that the Hiltons are necessary parties to the CA. Hiltons’ Combined Response and SOR at 7.

II. THE LEGAL FRAMEWORK

[1] Section 17(m) of the Mineral Leasing Act (MLA) provides a two element test for determining whether communitization is proper:

When separate tracts cannot be independently developed and operated in conformity with an established well-spacing or development program, any lease, or a portion thereof, may be pooled with other lands, whether or not owned by the United States, under a communitization or drilling agreement providing for an apportionment of production or royalties among the separate tracts of land comprising the drilling or spacing unit when determined by the Secretary of the Interior to be in the public interest, and operations or production pursuant to such an agreement

shall be deemed to be operations or production as to each such lease committed thereto.

30 U.S.C. § 226(m) (2012) (emphasis added).

The implementing regulation is more succinct but embodies the two element test for communitization:

When a lease or a portion thereof *cannot be independently developed and operated in conformity with an established well-spacing or well-development program*, the authorized officer may approve communitization or drilling agreements for such lands with other land, whether or not owned by the United States, upon a determination that it is *in the public interest*.

43 C.F.R. § 3105.2-2 (emphasis added).²

A. *Spacing, Pooling, and Communitization*

We begin by defining the terms “spacing,” “pooling,” and “communitization.” Despite language to the contrary in the SDR Decision, spacing and pooling are separate matters. Well spacing is the regulation of the number and location of wells over an oil or gas reservoir. WILLIAMS AND MEYERS, MANUAL OF OIL AND GAS TERMS 1243 (12th ed. 2003) (WILLIAMS AND MEYERS). The COGCC has the authority within Colorado to set spacing requirements and to create drilling units to prevent waste, protect correlative rights, or avoid unnecessary drilling of wells. Colo. Rev. Stat. § 34-60-116(1). A spacing order “shall permit only one well to be drilled and produced from the common source of supply on a drilling unit, and shall specify the location of the permitted well thereon.” *Id.* § 34-60-116(3). However, the COGCC may “permit additional wells to be drilled within the established units in order to prevent or assist in preventing waste or to avoid the drilling of unnecessary wells, or to protect correlative rights.” *Id.* § 34-60-116(4).

Pooling is the bringing together of small tracts sufficient for the granting of a well permit under applicable spacing rules. WILLIAMS AND MEYERS 850. The COGCC may approve voluntary pooling, or may order force-pooling, of separately owned tracts within a drilling unit. *See* Colo. Rev. Stat. § 34-60-116(6). If a spacing unit

² All Federal wells must be drilled in conformity with an acceptable well-spacing program. 43 C.F.R. § 3162.3-1(a). An acceptable well-spacing program is “one which conforms to a spacing order or field rule issued by a State Commission or Board and accepted by the authorized officer.” *Id.* An operator, at its election, may drill wells in conformity with any system of well spacing affecting the field or area which is authorized and sanctioned by applicable law or by the authorized officer. *Id.* § 3162.2-1(a).

contains tracts smaller than the spacing unit, then to facilitate drilling, the state commission may pool those tracts, allow exceptions to the spacing order, or provide for the drilling of additional wells within the spacing unit at a certain density.³ See WILLIAMS AND MEYERS 143-44. Because pooling is not the only method by which smaller tracts within a spacing unit may be separately developed, establishment of a spacing unit does not automatically compel cooperative development.⁴

Although a state commission may issue both spacing and pooling orders that cover a Federal tract, a state pooling order cannot force-pool Federal tracts without the agreement of the Secretary. *Kirkpatrick Oil & Gas Co. v. U.S.*, 675 F.2d 1122, 1125 (10th Cir. 1982) (“no state-ordered forced pooling would bind the government without the Secretary’s consent”); *Kennedy & Mitchell, Inc.*, 68 IBLA 80, 83 (1982) (“Congress has preempted from the state regulation of communitization or drilling agreements affecting Federal oil and gas leases. . . . [U]ntil [a] communitization agreement [is] approved . . . each Federal oil and gas lease . . . [has] to stand by itself.”). Nevertheless, states may still issue force-pooling orders that cover Federal tracts—they simply do not bind the Federal tracts until the Secretary agrees by issuing a CA. See BLM Manual, 3160-9—Communitization (Communitization Manual) 3160-9.11F.

“Communitization” is the Federal expression of, and synonymous with, pooling; it is not the equivalent of a spacing order. WILLIAMS AND MEYERS 187. Communitization, under the Federal regulations, is simply pooling where Federal or Indian lands are involved. *Id.* Establishment of a spacing order does not erase lease boundaries within the spacing unit, nor does it automatically compel separate lessees or fee owners to engage in cooperative development. Although a spacing order traditionally defines an area that can be economically produced by a single well, a state commission may create exceptions that allow sufficient optional drilling and well density to allow separate tracts to be developed independently. Colo. Rev. Stat. § 34-60-116(4).

B. The Meaning of “Independently Developed”

As noted above, section 17(m) of the MLA, 30 U.S.C. § 226(m) (2012), provides that BLM may approve a CA when separate tracts cannot be independently

³ Well density is the ratio between the number of wells drilled in a field and the field’s acreage. WILLIAMS AND MEYERS 1240.

⁴ Communitization is often inappropriately conflated with unitization, which is the consolidation of leaseholds covering a common source to conduct unified development for an efficient extraction of hydrocarbons. Angela L. Franklin, *Communitization Agreements in the 21st Century*, FEDERAL ONSHORE OIL AND GAS POOLING AND UNITIZATION, 3-1 to 3-2 (ROCKY MTN. MIN. L. FOUND. (2006)); WILLIAMS AND MEYERS 850, 1206.

developed and communitization is in the public interest. Whether or not a lease is capable of being independently developed is a threshold issue.

The MLA does not provide a definition of “independently developed,” and the parties disagree on the meaning of the term and its application in this case. On May 13, 2014, the Board issued an Order noting that “[t]he parties fundamentally disagree on whether or not the Federal tract in this case can be ‘independently developed,’ but none of the parties have adequately supported their interpretations of the term ‘independently developed’ in the MLA.” Order, IBLA 2013-192 (May 13, 2014), at 4. The Board directed the parties to file supplemental briefs in which they were to address, *inter alia*, the proper interpretation of the term “independently developed.”

In its Supplemental Brief, BLM asserts that “[o]nce a spacing unit is validated,” by the drilling of a well, “it cannot be vacated,” and that “the drilling and spacing unit must remain intact from that point forward, unless all appropriate parties agree to any future changes.” BLM Supplemental Brief at 4. BLM asserts that “[t]he CA operates as the [F]ederal endorsement of the COGCC drilling and spacing unit.” *Id.* at 5. According to BLM, “[t]he establishment of spacing essentially provides that a lease(s) within an area covered by the spacing agreement cannot be independently developed.” *Id.* at 6. BLM states that the issuance of a spacing order that includes separately-owned or operated tracts, and a Federal lease, automatically renders the Federal lease incapable of independent development.

BLM explains that “[t]he circumstances that cause a tract to change status from capable of being independently developed to incapable of being independently developed are *fact specific*.” BLM Supplemental Brief at 7 (emphasis added). BLM asserts that “[o]ne situation that causes a tract to change status includes a spacing order that is large enough to encompass the separate tracts in question, which is the situation here.” *Id.*

In arguing that the Federal tract at issue cannot be independently developed, BLM further claims that “the [F]ederal acreage within Section 36 is comprised entirely of a No Surface Occupancy (NSO) stipulation,” and “[a]s such, the [F]ederal acreage cannot be independently developed and needs to conform to state spacing which includes the Hilton acreage.” BLM Supplemental Brief at 7.

WPX posits that “[w]hether a [F]ederal lease, or portion thereof, can be ‘independently developed’ is a case-by-case determination that turns on: (1) the well-spacing program governing the lease acreage; and (2) the site-specific facts and circumstances affecting development of the area proposed to be communitized under the CA.” WPX Supplemental Brief at 2. WPX asserts that BLM must “consider whether the lease can be ‘fully developed,’” meaning whether the lessee can “drill and develop ‘all the oil and gas,’” when deciding whether the lease can be independently

developed. *Id.* at 8. WPX also cites prevention of waste and protection of correlative rights as important matters that spacing units are meant to address. *Id.* at 10.

WPX asserts that a Federal lease cannot be independently developed if there is a producing well on non-Federal land within the spacing unit. WPX states that in Colorado, “[w]hen a well-spacing order exists, COGCC has made the factual determination that the unit size and shape is appropriate to promote the efficient and economical development of a common pool, and will assist in preventing waste, avoiding unnecessary wells, and protecting correlative rights.” WPX Supplemental Brief at 10. WPX claims that “[o]nce a producing well has been drilled on private mineral lands within a drilling and spacing unit, a [F]ederal lease in the unit becomes incapable of independent development.” *Id.* at 10-11. WPX suggests that the only alternative regime is to “base the ‘independent development’ determination on optional well density” which it considers an “absurd[] . . . position.” *Id.* at 6.

WPX argues that “[t]he treatment of the optional 10-acre well density permitted by the COGCC as a de facto spacing pattern ignores the requirement to protect correlative rights.” WPX Supplemental Brief at 6. WPX contends that “once a drilling unit with 640-acre spacing is established and encompasses a [F]ederal lease, that [F]ederal lease can no longer be developed independently of the other leases in the unit, regardless of optional density, without harming correlative rights.” *Id.* (citing Colo. Rev. Stat. § 34-60-116(1) and (6)). Further, WPX states that “regardless of the allowable density of optional wells, the [F]ederal lease cannot be developed independently in Section 36 in accordance with the current spacing order that established a 640-acre drilling unit, a conclusion explicitly reached by the State Director.” WPX Answer at 8.

The Hiltons assert that a Federal lease cannot be independently developed when circumstances dictate that the tract must be pooled. Hilton Supplemental Brief at 3-4. Such circumstances might include a spacing order that provides a non-optional drilling pattern, or prohibits more optional drilling beyond the wells that already exist in the spacing unit, which would prevent the Federal lessee from conducting sufficient drilling to develop the Federal lease. *Id.* at 8-10. They might also include unavoidable drainage, waste, or harm to correlative rights. *Id.* at 10-13. The Hiltons provide a discussion of several factual scenarios where communitization would be appropriate, none of which in their view applies to their situation. Later in this opinion, we more fully examine the Hiltons’ framework for determining whether a Federal tract can be independently developed.

The Supplemental Briefs filed by BLM, WPX, and the Hiltons appear to agree on one point, and not much else, *i.e.*, whether separate tracts can or cannot be independently developed in conformity with an established well-spacing or development program depends upon the facts of the given case. The only relevant fact in this case, as far as BLM and WPX are concerned, appears to be that the

Hilton 36-21D well was successfully drilled, by definition rendering the Federal lease incapable of independent development. We think WPX provided an accurate and succinct framing of the issue: “Whether a [F]ederal lease, or portion thereof, can be ‘independently developed’ is a case-by-case determination that turns on: (1) the well-spacing program governing the lease acreage; and (2) the site-specific facts and circumstances affecting development of the area proposed to be communitized under the CA.” WPX Supplemental Brief at 2. However, WPX nullifies that portion of its definition that refers to the “well-spacing program governing the lease acreage” by its assertion that “regardless of the allowable density of optional wells, the [F]ederal lease cannot be developed independently in Section 36.” WPX Answer at 6. WPX appears not to recognize that the COGCC determined that a development program based on 10-acre density “will assure a greater ultimate recovery of gas and associated hydrocarbons,” and that “the ten (10) acre density wells would produce economically recoverable gas that would otherwise not be produced. Order 191-8, ¶ 28; *see also* Order 191-10, ¶ 25.

As we emphasize, the “well-spacing program” in this case is not synonymous with the 640-acre drilling and spacing unit approved by COGCC, as posited by BLM and WPX, but must take into account the 10-acre well drilling option approved by the COGCC in Order Nos. 191-8 and 191-10. The Hiltons make a persuasive case that the option for 10-acre well drilling renders Federal lease COC-58668 capable of independent development. BLM’s SDR Decision sets forth the rules on communitization, as found in the MLA, the Department’s regulations, the Communitization Manual, and Colorado law, but provides little more than the conclusory statement that Federal lease COC-58668 cannot be independently developed and that communitization is in the public interest. We conclude that the Hiltons are correct that defining “well-spacing program” in this case should include a consideration of the 10-acre drilling option approved in the COGCC Orders. There is evidence that the single Hilton well will not suffice for recovering the oil and gas in the 640-acre drilling and spacing unit. In fact, as noted, the COGCC approved optional 10-acre drilling based upon its finding that such a program will assure a greater recovery of hydrocarbons. BLM provided no consideration of whether, in the interest of conservation and maximizing recovery of oil and gas in sec. 36, additional wells should be drilled, as approved in the COGCC Orders. The CRVFO concluded that Federal lease COC-58668 could be independently developed, but the CSO, in its 2011 and 2013 SDR Decisions, reached the opposite conclusion, with no meaningful analysis.

III. ANALYSIS

A. *Whether Federal Lease COC-58668 Can Be Independently Developed*

As we discuss below, the record in this case does not support the CSO’s conclusion that Federal lease COC-58668 cannot be independently developed. There

is considerable evidence tending to show the opposite. We are not convinced that the drilling of a single well on a 640-acre area containing several tracts automatically renders the Federal lease incapable of independent development under section 17(m) of the MLA. The CSO is not at liberty to invoke the provision of the COGCC's Orders that recognizes the drilling and spacing unit to be 640 acres and attribute no significance to the purpose of those Orders, which was to approve BBC's application for optional well drilling on a 10-acre basis. The "established well-spacing or development program" referred to in section 17(m) of the MLA must take into account such optional well drilling, particularly when approved by the COGCC in order to "produce economically recoverable gas that would otherwise not be produced," and would "assure a greater ultimate recovery of gas and associated hydrocarbons." Order 191-8, ¶¶ 28, 29; see Order 191-10, ¶ 25.

The Hiltons argue that the CA violates the express terms of section 17(m) of the MLA, 30 U.S.C. § 226(m) (2012). They state that "[c]ommunitization typically is used to combine 'small tracts [of acreage] so that sufficient acreage is controlled in order to meet the minimum well-spacing requirements.'" Hilton Combined Response and SOR at 8 (citing *Communitization Agreements in the 21st Century*, Chapter 3). They state that "[t]he purpose of pooling is to create 'sufficient acreage to receive a well drilling permit under the relevant state or local spacing laws and regulations,'" and that "[t]he objective of communitization is to provide for the development of separate tracts which could not be independently developed or operated in conformity with well spacing patterns established in the area or by order of the state regulatory agency." *Id.* at 8-9 (quoting *Kysar v. Amoco Production*, 93 P.3d 1272, 1277 (N.M. 2004)).

The Hiltons contend that the CSO affirms the "basic principles of communitization," with an "additional twist." Hilton Combined Response and SOR at 9 (emphasis added). They argue that in both the 2013 SDR Decision now on appeal and in its prior 2011 SDR Decision, the CSO added the reference to "spacing" as an additional justification for the [Deputy State] Director's decision." *Id.* They assert that "[n]o legal authority exists for the Director's deviation from the statutory standards and published guidance on an ad hoc basis." *Id.* They state that the CSO improperly "justifies CA approval by stating 'the terms and conditions have been modified to account for the dispute provided by Hilton.'" *Id.* at 11 (quoting 2013 SDR Decision at 8). In the Hiltons' view, "[t]he result is an unconventional form of CA to intentionally cover the Hilton Well and the fee lands in which Hilton owns a mineral interest, while at the same time excluding the Hilton lease." *Id.* They claim that this assertion of "discretion to mediate private interests, and approve a CA without royalty owner's signatures in this manner," is not authorized by the MLA or the Communitization Manual. *Id.*

WPX argues that "[i]t is the 640-acre spacing unit, not 10-acre well density, that controls for purposes of determining whether the [F]ederal lease in Section 36

can be ‘independently developed.’” WPX Supplemental Brief at 5. WPX bases this contention on the reference in the MLA to a “well-spacing” program, not well density. *Id.* (quoting 30 U.S.C. § 226(m) (2012)); 43 C.F.R. § 3105.2-2. According to WPX, to “base the ‘independent development’ determination on optional well density—would mean that no [F]ederal tract larger than the optional well-density area would ever qualify as *incapable* of independent development because a well could always, theoretically, be drilled in the [F]ederal tract.” *Id.* at 6. WPX states that “[t]he absurdity of this position is evident given that [F]ederal mineral leases are rarely issued in tracts this small.” *Id.* WPX concludes that “as a matter of law, policy, and practice, in determining whether a [F]ederal tract can be independently developed in conformity with an established well-spacing program, BLM considers the spacing unit as a whole, not some smaller portion based on optional well densities that may or not be available.” *Id.*

WPX also argues that “[t]he importance of spacing units, as opposed to optional well densities, is underscored by Colorado law.” WPX Supplemental Brief at 6. In particular, WPX emphasizes that “[s]pacing units are established by the COGCC to prevent waste, avoid drilling unnecessary wells, and protect correlative rights in a common pool so that the pool as a whole ‘will be efficiently and economically developed.’” *Id.* (quoting Colo. Rev. Stat. § 34-60-116(1), (2)). WPX posits that “[t]he size and shape of the spacing unit (640-acres in this case), is specifically tied to these purposes—i.e., the COGCC has determined that cooperative development of 640-acre tracts will best promote ‘the efficient and economical’ development of the pool.” *Id.* WPX adds that “the size of the unit cannot be changed without a COGCC order determining that the change is necessary to ‘prevent or assist in preventing waste or to avoid the drilling of unnecessary wells, or to protect correlative rights.’” *Id.* (quoting Colo. Rev. Stat. § 34-60-116(4)); *see also* BLM Supplemental Brief at 6-7; 2013 SDR Decision at 7-8.

Obviously, the parties do not agree on what is meant by “established spacing pattern.” The Hiltons claim that the spacing pattern established in the pertinent COGCC Orders includes the 10-acre well drilling option. BLM and WPX contend that the only well that is, or will ever be, relevant is the single well that validates the 640-acre drilling and spacing unit established by COGCC. In this scheme, additional wells may be drilled, but they would not affect the 640-acre drilling and spacing scheme “validated” by the single well. They reject the notion that the “established well spacing and well development program” includes the option for drilling additional wells on a 10-acre spacing basis as approved in the COGCC Orders.

We conclude that WPX and BLM err in failing to consider the relevance of optional 10-acre drilling to whether the Federal lease in this case can be independently developed. The Hiltons state that they are “not now, and [have] never claimed, that the Federal lease should be pooled or communitized on a 10 acre basis as WPX seems to suggest.” Hilton Combined Response to BLM and

WPX Supplemental Briefs (Hilton Response to Supp. Briefs) at 4. Rather, they emphasize that they have “consistently pointed out the Federal lease in question *can and should be developed independently* on a lease basis.” *Id.* They state that “if the leases are independently developed, and additional wells are bottom-holed on the ten acre density basis, the development ultimately would accomplish the very purpose of the COGCC Orders without violation of correlative rights or waste of the resources.” *Id.*

In looking at COGCC Order No. 191-8, we see that the 640-acre drilling and spacing unit for sec. 36 was established prior to February 22, 1994. The COGCC issued Order No. 191-8 in response to BBC’s November 22, 2004, application “for an order to increase the number of wells which can be optionally drilled into and produced from the Williams Fork Formation . . . to the equivalent of one Williams Fork Formation well per 10 acres for certain lands,” including sec. 36. Order No. 191-8 at 1. In granting BBC’s application, the COGCC made the following findings:

28. Testimony and exhibits presented at the administrative hearing show that drilling ten (10) acre density wells in the application area will yield an economic rate of return acceptable to BBC, and that the ten (10) acre density wells would produce economically recoverable gas that would otherwise not be produced.

29. The above-referenced testimony and exhibits show that the proposed density will allow more efficient drainage, will prevent waste, will not violate correlative rights and will assure a greater ultimate recovery of gas and associated hydrocarbons.

Id. at 7.

In Order No. 191-10, the COGCC similarly approved BBC’s request to “increase the number of wells which can be optionally drilled and produced from the Iles Formation . . . to the equivalent of one Williams Fork Formation well per 10 acres for certain lands,” including sec. 36. Order No. 191-10 at 1. The COGCC made the following finding:

25. [T]he proposed density will allow more efficient drainage, will prevent waste, will not violate correlative rights and will assure a greater ultimate recovery of gas and hydrocarbons from the Iles Formation that may not be drilled without utilizing the same density and well locations as Williams Fork Formation wells.

Id.

We see merit in the Hiltons' argument that "the content of the Orders should guide any determination of whether the Section 36 leases can be developed consistent with an 'established well-spacing or development program' without communitization." Hilton Combined Reply to BLM and WPX Answers (Hilton Combined Reply) at 4 (quoting 30 U.S.C. § 226(m) (2012)). We further find it inarguable that "[t]he COGCC Orders recognize a development program based on the ten acre density bottom-hole locations." *Id.* Those Orders establish the right to locate a bottom-hole for Williams Fork or Iles Formation wells anywhere on lands subject to the Orders, including sec. 36, based on established densities, provided the well is no closer than 100 feet from the boundaries of the drilling unit or a section line where 10-acre density is established, and 400 feet from boundaries where 10-acre density is not allowed. Order No. 191-8 at 7-10; Order No. 191-10 at 8-11. The Orders recognize a single surface well location for each quarter-quarter section for all of the subject lands, spaced or unspaced. There is no mandate for pooling. Order No. 191-8 at 10; Order No. 191-10 at 11. Whether we refer to the Orders as establishing 10-acre well spacing or well density, the point is that additional wells may be drilled on the basis of one well per 10-acres of lands covered by the Orders. Neither BLM nor WPX has explained why sec. 36 cannot be developed on a lease basis consistent with the COGCC Orders.

BLM and WPX argue that once a well has been drilled in an established spacing unit, the unit has been "validated" by production, and thus an "established well-spacing pattern or program" exists. WPX Supplemental Brief at 10; BLM Supplemental Brief at 4; 2013 SDR Decision at 8. WPX argues further that "[o]nce a producing well has been drilled on private mineral lands within a drilling and spacing unit, a [F]ederal lease in the unit becomes incapable of independent development." WPX Supplemental Brief at 10-11. We find nothing in the BLM's Communitization Manual that compels, or even supports, this conclusion.

The CSO acknowledged provisions of the Communitization Manual, which it purported to follow, which state:

The BLM usually will require operators of Federal and Indian leases to adhere to the well spacing and well location requirements established by the appropriate State regulatory bodies, while reserving the right to impose different requirements in those instances where adherence to a State's requirement is considered not to be in the public interest or in the interest of Indian lessors.

Communitization Manual 3160-9.06.D. The CSO explained that "[i]f BLM chooses to require a lessee to diverge from a COGCC order, then sufficient justification must be provided to that lessee to allow ample argument to the COGCC to terminate the applicability of the requirements of the order to the involved Federal (and Fee) mineral estate." 2013 SDR Decision at 7. Having stated this rule, the CSO proceeds to "diverge" from the COGCC Orders without providing "sufficient justification" for

doing so. The CSO does not take into account the provisions of the COGCC Orders that allow for optional 10-acre well drilling, and the implications of such optional drilling in determining whether the Federal lease can be independently developed. The CSO merely states that “this case does not contain sufficient justification to require the lessee to depart from the COGCC order.” *Id.* at 8.

The Hiltons challenge the CSO’s interpretation of the Communitization Manual, which they state “contains the written guidance and policies for Federal communitization, both justifications for communitizations and nonjustifications.” Hilton Response to Supp. Briefs at 15. They argue that the “BLM Manual recognizes that communitization is not a tool of convenience for an operator to accomplish cost and revenue sharing,” which they state is contrary to the CSO’s “position regarding the allocation of drilling costs with an expectation of revenue as a justification for communitization.” *Id.* at 16 (citing 2013 SDR Decision at 8). They assert that “WPX’s predecessor in interest has stated that Section 36 has been voluntarily pooled for cost sharing purposes,” and that therefore “WPX can allocate costs and working interest revenues according to their voluntary agreement without communitization, and royalties can be paid on a contributed Lease basis.” *Id.* at 16 (citing Hilton Force-Pooling Application ¶ 5).

The Communitization Manual states as its policy the following: “Communitization agreements *may be approved* when a lease or a portion thereof cannot be independently developed and operated in conformity with an established well spacing or well development program.” Communitization Manual 3160-9.06.A. (emphasis added). As with section 17(m) of the MLA and the implementing regulation at 43 C.F.R. § 3105.2-2, approval of a CA is discretionary. Pertinent to the COGCC Orders that apply in the present case, the Communitization Manual states that “[a]s a general guideline, communitization will not be authorized when a single Federal lease or unleased Federal acreage can be fully developed and still conform to *an optional . . . pattern* established by State order.” *Id.* 3160-9.1.11.A.1 (emphasis added). “If the Federal tract cannot be independently developed and there are a number of spacing options, the authorized officer should require the one that is in the best interest of the Federal Government, i.e., the one that provides the largest Federal participation.” *Id.* The CSO cites to the Communitization Manual but provides no acknowledgement of the “optional . . . pattern” approved in COGCC’s Orders.

The ramification of the COGCC’s approval of optional well drilling to bottom-hole locations on every 10 acres in sec. 36 is obvious: communitization is generally not authorized when Federal leases can conform to optional drilling patterns. The Hiltons rightly assert that “the operator of the Federal lease could seek and obtain a COGCC drilling permit for any well drilled on the Federal lease consistent with the optional ten acre density locations (regardless of the size of spacing unit), just as was done for the Hilton well.” Hilton Combined Response at 16-17.

We have noted that on May 19, 2010, BBC applied to the COGCC for an order to pool all nonconsenting interests in the 640-acre drilling and spacing unit established for sec. 36, but that BBC withdrew this application prior to a final decision by the COGCC. See 2013 SDR Decision at 3. A decision on this application to force-pool the mineral interests was continued based on the understanding that COGCC's Hearing Officer would issue pre-hearing recommendations in the matter. On November 30, 2010, the Hearing Officer issued such recommendations, noting that "[a] primary purpose of [BBC's] application is to involuntarily pool the non-cost-bearing royalty interests of [the Hiltons] in the drilling and spacing unit." Hearing Officer Recommendation (Hilton Combined Response and SOR, Ex. 7) at 1. In recommending denial of BBC's application to force-pool the mineral interests in the spacing unit, the Hearing Officer found that geologic and engineering data support drilling according to the COGCC Orders without communitization. The Hearing Officer's findings support the Hiltons' position:

B. A pooling order must be made upon terms and conditions that are just and reasonable. [Colo. Rev. Stat.] § 34-60-116(6). In this situation, it does not seem just or reasonable for the Commission to force pool 640 acres where:

(i) *geology and engineering demonstrate that not more than 10 acres are drained by a single well;*

(ii) *the only well completed in the spacing unit is on the Hiltons' property;*

(iii) *the Commission may permit additional wells to be drilled within the spacing unit to prevent waste or to protect correlative rights.* [Colo. Rev. Stat] § 34-60-116(4); C.R.S.;

(iv) *the Hiltons negotiated (and its lessee agreed to) a limiting pooling clause after the establishment of the 640-acre drilling and spacing unit; and*

(v) *all working interest owners have contractually agreed to jointly conduct operations to develop the Williams Fork and Iles Formations in the unit.*

Id. at 2 (emphasis added). The COGCC Orders depicted the Williams Fork and Iles reservoirs as discontinuous, with 10-acre drilling resulting in the greatest recovery. Order No. 191-8, ¶¶ 21-29; Order No. 191-10, ¶¶ 19-26. We agree with the Hiltons that "the COGCC staff recommendation makes clear Section 36 need not be pooled to be developed according to the COGCC orders." Hilton Combined Reply at 3.

In the August 22, 2011, decision by the CRVFO that was overturned by the CSO in the 2011 SDR Decision, the CRVFO denied WPX's application for a CA. The CSO held that the CRVFO's decision was improperly based upon an "understanding that the applicable state spacing was 40 acres and concluded lease COC-058668 can be independently developed and therefore the CA is not in the public interest."

2011 SDR Decision at 3; *see also* 2013 SDR Decision at 4. However, in looking at the CRVFO's Record of Decision (ROD), we see that the Program Manager's denial of the CA was based upon other factors not mentioned by the CSO. The ROD includes a section captioned "Meetings on Decision" that provides a summary of the considerations that led to denial of the CA. In this ROD, the CRVFO stated:

During the meeting the discussion centered on whether or not Federal lease COC58668 could be independently developed. We looked at maps of the area and surface ownership looking at potential drilling pad sites. 540 acres of the section's surface is owned by the State of Colorado and is part of the Garfield Creek State Wildlife Area which has a No Surface Occupancy clause in the lease stipulations. There exist only two plots that are not State owned surface, the 40 acre private surface in the southwest corner and the 60 acre BLM surface in the northeast corner. *Both of these plots offer potential drilling sites to access the [F]ederal minerals under the State lands. . . . The most attractive looking locations for pads would be the two 40 acre plots of non-state surface within section 36 or location in section 31, T6S, R90W and section 35, T6S, R91W using directional drilling to access the Federal lease.* Portions of the Federal lease could also be accessed from an existing pad location (KP23-25) and an old abandon[ed] pad location (BC31-3).

CRVFO ROD, Aug. 22, 2011 (Hilton Request for SDR, Feb. 19, 2013), at 2 (emphasis added). The Program Manager concluded that "Federal lease COC58668 could be independently developed without inclusion in CA COC 75098," and that "it would not be in the Public Interest to approve the CA and therefore subject the BLM to legal actions that would most likely be filed . . . on behalf of [the Hiltons]." *Id.* at 3.

We disagree with BLM and WPX that once the Hilton Well was drilled, validating the 640-acre drilling and spacing unit, the Federal Tract was automatically rendered incapable of independent development. The CSO noted in its protest to vacatur of the 640-acre drilling and spacing unit: "Since production and the corresponding proceeds have already been obtained they must be subject, now and in the future, to the current drilling and spacing unit provisions ordered by the COGCC and allocated to the mineral estates within the drilling and spacing unit." Letter from CSO to COGCC dated Apr. 23, 2010 (WPX Motion to Dismiss and Answer, Ex. 3), at 3. The CSO stated further that "[t]he recommended solution to this situation . . . is the formation of a communitization agreement covering Section 36 . . . with an effective date being the spud date of well Hilton #36-21D that has been drilled in the 640 acre drilling and spacing unit." *Id.* at 3. Perhaps this recommendation was based upon BLM's view that the validation of the 640-acre spacing unit dictated approval of a CA, because such validation means that the Federal lease cannot be independently developed in accordance with that established spacing unit. However, neither BLM nor WPX has demonstrated as a legal or factual matter that its

conclusion necessarily follows from the drilling of a single well in the 640-acre drilling and spacing unit. Again, as the CSO recognized in its protest, “BLM has an obligation to ensure that [F]ederally-owned minerals will be efficiently developed so that optimum recovery will be realized.” *Id.* at 2. We are not convinced that the CA in this case meets that objective, given our review of the record as it relates to the COGCC’s approval of BBC’s 10-acre well drilling option.

BLM and WPX focus upon the fact that the COGCC has approved a 640-acre spacing and drilling unit, and maintain that the option for 10-acre well drilling is not relevant to a determination of whether the Federal lease can be independently developed. The Hiltons argue that “the Hilton Well did not ‘validate’ the spacing unit requiring either pooling or communitization,” under either the Colorado statute or COGCC rules. Hilton Combined Response and SOR at 12. The COGCC’s Orders reflect the finding that “drilling on a ten-acre basis ‘will allow more efficient drainage, will prevent waste, will not violate correlative rights and will assure a greater ultimate recovery of gas and associated hydrocarbons.’” *Id.* (quoting Order No. 191-8, ¶ 29; Order No. 191-10, ¶ 25). To view the drilling of the Hilton Well as the only factor to consider in determining whether the Federal Tract can be independently developed is misguided, particularly in light of the COGCC’s recommendation that BBC’s application for force-pooling of sec. 36 mineral interests be rejected on the basis that pooling would not be “just or reasonable.” Hilton Combined Response and SOR, Ex. 7 at 2.⁵

One of the arguments advanced by WPX and BLM in support of the CA is that Federal lease COC-58668 is subject to a No-Surface-Occupancy stipulation for all of the Federal lands in sec. 36, except the NE $\frac{1}{4}$ NE $\frac{1}{4}$ and NE $\frac{1}{4}$ NW $\frac{1}{4}$, and in the absence of the CA, WPX would be limited to developing the Federal lease by directional drilling from surface locations in the NE $\frac{1}{4}$ NE $\frac{1}{4}$. WPX Supplemental Brief at 9. WPX states that, by contrast, communitizing the entire sec. 36 spacing unit would

⁵ The Hiltons assert that the 1991 Memorandum of Understanding (MOU) between BLM and the COGCC does not require pooling or communitization in this case. In their view, the MOU defines a process that allows BLM to “weigh-in on COGCC decisions that impact Federal Lands,” and that “[t]he MOU respects BLM authority and discretion to manage oil and gas activities on *public lands* in the *public interest*, while the COGCC retains jurisdiction over fee lands.” Hilton Combined Response at 15 (citing *Fred E. Payne*, 159 IBLA 69, 75 (2003)). They object to the “Director want[ing] to manage *private lands* solely for the public benefit, actions not sanctioned by the Mineral Leasing Act or the MOU.” *Id.* The MOU between BLM and the COGCC contains procedural and jurisdictional provisions for decisions relating to drilling and spacing units and pooling. Under the MOU, BLM has the opportunity to protest any proposal to the COGCC and if it chooses not to do so, the decision of the COGCC is construed as reflecting BLM’s concurrence in that decision. MOU (Hilton Combined Response and SOR, Ex. 9) at 3-4.

allow “the location of a second well pad in the Boulton Lease Area in the SW4SW4, providing access by directional drilling to much of the remaining Federal oil and gas that is not accessible to drilling from the NE4NE4 of Section 36.” WPX Supplemental Brief at 10. WPX infers that this additional directional drilling access is evidence that the Federal lease cannot be “fully independently developed” in the absence of the CA, even though optional ten-acre well density is permitted in Section 36.” *Id.*

The Hiltons challenge the premise of WPX’s surface limitation argument. They argue that “WPX’s assertions are contrary to WPX’s plans for development in the area.” Hilton Combined Reply at 5. They submit a copy of the Surface Use Agreement (SUA) dated February 7, 2013, between WPX and Colorado Parks and Wildlife (CPW), the owner of the surface overlying much of COC-58668, that WPX filed with the COGCC in connection with several recently filed applications for permits to drill (APDs) as evidence of surface access. This SUA undermines the argument advanced by WPX and BLM that the Federal Tract is incapable of independent development due to surface limitations.

The SUA, which covers the sec. 36 communitized lands, provides:

1. SURFACE USE. CPW consents to the construction, installation and maintenance of access roads, Drill Sites and pipelines, for the Wells, including all appurtenances related to drilling, production and completion operations, including other facilities at the general locations depicted in the attached Appendices C and D and described further in this paragraph.

SUA (Hilton Combined Reply, Ex. 1) at 1-2; *see also* Hilton Combined Response and SOR at 2. The Hiltons note that the “SUA contains comprehensive controls to manage surface use, provides for damage payments and includes mitigation obligations for seven new Drill Sites, and the expansion of five additional Drill Sites, together with facilities to provide for the efficient development of the mineral resources along Garfield Creek and Baldy Creek.” *Id.* (citing SUA, ¶ 2.B, at 4).

The SUA provides for a 9-acre Drill Site located near the center of sec. 36 on CPW-owned surface. The Hiltons note that the sec. 36 Drill Site is identified as KP 23-36 and described on page 3 of the SUA. The Hiltons state: “While WPX has not been forthcoming, at least to Hilton, regarding the SUA, the provisions for surface use and access in Section 36, and the Section 36 Drill Site that provides a centralized location to directionally drill the Section 36 [F]ederal minerals[,] undermines WPX’s contention that surface access limitations require communitization.” Hilton Combined Reply at 6; *see* WPX Answer at 9. Indeed, the Hiltons further state that “the approved location for the KP 23-36 Drill Site has been identified and included in the list of Drill Sites reviewed with mitigation values assigned and signed off on by

Colorado Parks and Wildlife, the surface owner as well as the State agency charged with protection of wildlife, the very basis for the NSO provisions attached to COC-58668.” Hilton Combined Response to Supp. Briefs at 3. The Hiltons state that “[t]he SUA maps previously provided also show the proposed KP 23-36 Drill Site is in close proximity to the WPX pipeline route, and the existing access road (County Road 328) at a location that will minimize surface intrusion and impact to wildlife, all consistent with the goals articulated by the Director.” *Id.* at 4.

[2] The SDR Decision on appeal states that “Federal lease No. COC-58668 cannot be independently developed and operated in conformity with the COGCC spacing order.” 2013 SDR Decision at 8. However, the CSO provides no factual analysis to support this conclusion. The record includes documentation that shows otherwise. The SDR Decision provides little indication that BLM gave serious consideration to whether or not the lease could be independently developed. There is no evidence that BLM considered whether WPX could, or attempted to, obtain drilling permits in conformance with the COGCC Orders. There is no evidence that BLM analyzed the record evidence as to whether waste or drainage would occur if the Federal lease is developed separately from the Hilton tract. *See* Hearing Officer Recommendation (Hilton Combined Response and SOR, Ex. 7), at 2. We deem it appropriate to set aside the CSO’s Decision and remand the matter to BLM for its consideration of the evidence we have discussed that supports the conclusion that Federal lease COC-58668 is capable of independent development.

B. Whether the CA is in the Public Interest

[3] Whether a communitization agreement is in the public interest under section 17(m) of the MLA, 30 U.S.C. § 226(m) (2012), depends on whether it provides for the efficient recovery of the maximum quantity of hydrocarbons from the communitized pool, and furthers the goals of proper development and the prevention of waste. We conclude that there are questions raised by the Hiltons, and manifested in the record, as to whether the subject CA will meet those objectives.

In the Bibliography to the Communitization Manual, BLM cites *Kirkpatrick Oil and Gas Company*, 15 IBLA 216, 81 I.D. 162 (1974). In *Kirkpatrick*, the Acting Director, Geological Survey, affirmed the refusal by the Regional Supervisor to approve a 640-acre CA embracing Kirkpatrick’s lease. In affirming the Acting Director’s decision, the Board stated: “This really is a question of whether one oil well can efficiently drain a 640-acre tract. Nevertheless, we are of the opinion that a communitization agreement, embracing an entire 640 acres, would not adequately drain that area.” 15 IBLA at 227, 81 I.D. at 167. The Board agreed with the Acting Director that “640-acre spacing for the oil production shown in this case is inadequate for efficient recovery of maximum quantity of oil from the pool.” *Id.*, 81 I.D. at 168. The Board addressed the “broad and ephemeral” concept of public interest, stating that the Acting Director’s decision “was based on the public interest

in attaining optimal development of energy resources.” *Id.* The Board stated that “[p]erceptions of optimum conditions may differ, but given the facts of this case, we agree with the Acting Director that a 640-acre communitization agreement would not further the goals of proper development and the prevention of waste.” *Id.* at 228, 81 I.D. at 168.

In the present case, the COGCC approved a 640-acre drilling and spacing unit for sec. 36. As in *Kirkpatrick*, one well has been drilled. There is evidence in the record, discussed previously in this opinion, indicating that optimal recovery in sec. 36 could be obtained with 10-acre drilling and spacing. We are not advocating a group of 64 CAs based on 10-acre spacing, a proposition that WPX rightly calls absurd. See WPX Supplemental Brief at 6. However, the COGCC approved optional drilling on a one well per 10-acre basis premised on its finding that such a program “would produce economically recoverable gas that would otherwise not be produced” and would “assure a greater recovery of gas and associated hydrocarbons.” Order No. 191-8, ¶¶ 28, 29); Order No. 191-20, ¶ 25. We conclude that approving the CA on the basis of the 640-acre drilling and spacing unit, without consideration of the 10-acre well spacing option approved in the COGCC Orders, is not in the public interest.

In this connection, we note that the Hiltons assert that the “single well in the 640 acre tract . . . is not sufficient to produce the oil and gas from the Williams Fork and Isles formations,” and that “[t]he limited royalty benefit from the single Hilton Well should be weighed against the fact that communitization is not required to develop the Federal lands.” Hilton Combined Response and SOR at 18. In fact, they contend that “[r]eserves are at risk based on CA approval that discourages development, a result that is not in the public interest.” *Id.*

The Hiltons argue that one reason for pursuing the CA, with the necessary implication that the Federal lease cannot be independently developed, is that it confers the “ability to hold an arguably precariously existing 1,020 acre Federal lease by production.” Hilton Combined Response and SOR at 22. Their argument is supported by the CRVFO’s 2011 decision denying WPX’s application for a CA for sec. 36. It was brought to the CRVFO’s attention that Federal lease COC-58668 was set to expire February 28, 2007, but was committed to another CA (COC-70802) on January 10, 2007, with an effective date of September 30, 2003. The obligation well for COC-70802 was the McBurney #8-12 well, which was drilled in 2003 and immediately shut-in, with “no known attempt . . . to place the well into production.” CRVFO 2011 ROD (Hilton Request for SDR (Dec. 27, 2012)) at 3. The Program Manager stated:

As the McBurney #8-12 is the only well on the CA and there is no well on Federal lease COC58668, it is being held by a well incapable of production. Since the McBurney #8-12 well appears to be able to

produce in paying quantities but is incapable of producing due to the lack of pipeline connection, . . . CA COC 70802 should most likely have been terminated January 2009 with lease COC58668 expiring January 2011, the CA COC75098 then would most likely have been a [moot] issue.

Id. The Hiltons “recognize[] the appeal of a conclusion that the Federal lease in Section 36 cannot be independently developed.” Hilton Combined Response and SOR at 22. Approval of CA COC 75098 serves to extend the Federal lease by production from the Hilton Well. They state that this “convenient conclusion . . . should not override what the COGCC has stated about the development of this specific spacing unit.” *Id.* They conclude that “[p]ooling is not required because the Commission can permit additional wells within the spacing unit consistent with the [COGCC] Orders without pooling or communitization.” *Id.*

We agree, therefore, on remand, upon determining whether Federal lease COC-58668 can be independently developed, BLM should also re-examine whether communitization is in the public interest. A conclusion by BLM that well drilling pursuant to the one well per 10-acre option will maximize recovery of hydrocarbons, and that the Hilton Well is not adequate for producing hydrocarbons from the 640-acre drilling and spacing unit, as found by the COGCC in Order Nos. 191-8 and 191-10, would point toward a finding that communitization is not in the public interest.

C. *Whether the Hiltons are Necessary Parties*

[4] Regulation 43 C.F.R. § 3105.2-3(a) provides that a CA must be signed by all necessary parties. BLM’s Communitization Manual provides further that a non-Federal royalty interest owner must either sign the agreement, be force-pooled by a State order, or be signers of a lease that already contains a force-pooling provision.

The CSO held that the CA “does not need to be signed by all parties.” 2013 SDR Decision at 8. The CSO cited to 43 C.F.R. § 3105.2-3(a), which it stated provides that the CA need “be signed by or on behalf of all *necessary* parties.” *Id.* The CSO states that the Hiltons are not necessary parties, “since WPX, as CA operator, has obligated, by stating in writing to the CRVFO and through modification of the appropriate language in the CA, that the Hiltons, as basic royalty interest holders, are an uncommitted interest in the CA, will honor the conditions of the Hilton Lease, and will provide lease royalties on an undiluted basis.” *Id.* He adds that “[t]he correlative rights of all parties are involved, and the objection by one party does not invalidate the spacing unit and effect forfeiture of correlative rights protection of the other parties.” *Id.*

The Hiltons respond that BLM's rationale for not deeming them to be necessary parties "is the BLM's unilateral determination that WPX, as a private leaseholder, can substitute a promise to comply with the Hilton lease for the BLM Manual's signature obligation." SOR at 19. The provision to which the Hiltons refer is found in the Communitization Manual at 3160-9.1.11.F, which provides that "[a]ll lease royalty owners under non-Federal leases *must* execute the agreement, unless such interests have been effectively pooled by State order, a pooling clause in the Lease or other pooling agreement." The Hiltons argue that "neither the regulations nor the CA Manual provide for 'uncommitted' royalty owners." SOR at 19. They emphasize that the CA treats the working interest and royalty interest differently, and "it effectively segregates the fee ownership, subjecting Hilton minerals to CA terms for an indefinite term, over [their] express objection." *Id.* at 20.

In *Daniel T. Davis*, 142 IBLA 317 (1998), the Board construed 43 C.F.R. § 3105.2-3(a) in the context of an appeal by an oil and gas lease operator who argued that he was authorized by the operating agreement to sign a CA on behalf of current working interest owners. BLM held that the operator did not have such authority, and the Board affirmed. The Board noted that the regulation does not define the term "necessary party." However, the Board was guided by ¶ II.A. of the Model Form of a Federal Communitization Agreement (Model Form), included as Appendix 1 to the Communitization Manual, which provides "[t]he operator of the communitized area and all owners of record title and working interests in Federal leases as reflected by current records must execute the agreement." The Board found that "the term necessary parties is reasonably construed to include the working interest holders as BLM has done in the Manual and in this case." *Davis*, 142 IBLA at 322 (citing *Mobil Producing Texas & New Mexico, Inc.*, 115 IBLA 164, 169 (1990)). The Board was not "prepared to say that an operating agreement could not confer authority on the operator to sign a communitization agreement 'on behalf of' the other necessary parties to a communitization agreement." *Id.* (citing Communitization Manual 3160-9.11.F.). The Board concluded that the subject operating agreement did not grant the operator that authority.

Neither BLM nor WPX has pointed to any provision in an operating agreement or other document that confers authority on WPX or any other interest holder to execute a CA that is or should be binding on the Hiltons. The Communitization Manual 3160-9.11.F., provides:

Generally, the operator should be required to submit a communitization agreement signed by all necessary parties for the authorized officer's approval, even if the area has been force-pooled by State order. *Non-Federal royalty interest owners must either sign the agreement, be force-pooled by a State order, or be signers of a lease that already contains a force-pooling provision.* However, a communitization agreement signed

by the operator and complete in all respects, except for signatures of all working interest and royalty owners, may be accepted and approved by the authorized officer when a State order force-pooling such interests in the lands in question is also submitted. [Emphasis added.]

The Board in *Davis* recognized that provisions of the Communitization Manual are not promulgated as a regulation, do not have the force and effect of law, and are not binding on the Board, but stated that “where BLM adopts agency-wide procedures that are reasonable and consistent with the law, the Board will generally uphold their application.” 142 IBLA at 322. BLM offers no justification for not following its own policy as stated in the Manual, and the Hiltons make a convincing argument that the terms of the CA affect them as royalty interest holders. We see no reason for not following the Communitization Manual provisions in this case, and conclude that the Hiltons are necessary parties to the disputed CA.

In addition to the Model Form provision cited by the Board in *Davis*, ¶ II.C. of the Model Form makes clear that the Hiltons are necessary parties to the CA. That paragraph provides that “[a]ll basic royalty owners under non-Federal leases must execute the agreement, unless such interests have been effectively pooled by State order, a pooling clause in the lease, or other pooling agreement.” Model Form, ¶ II.C. The paragraph states that “[e]vidence of such pooling should be furnished and made a part of the agreement if such owners do not execute the agreement.” *Id.*

Other than to state that the CA has been modified, with appropriate language added, to ensure that WPX will honor the conditions of the Hilton Lease, and will provide lease royalties on an undiluted basis, the only rationale the CSO offers for not deeming the Hiltons necessary parties under 43 C.F.R. § § 3105.2-3(a) is the need to protect “[t]he correlative rights of all parties involved.” 2013 SDR Decision at 8. The CSO states that “the objection by one party does not invalidate the spacing unit and effect forfeiture of correlative rights protection of the other parties.” *Id.* We have seen that the Hearing Officer recommended against granting BBC’s application to force-pool the mineral interests in sec. 36, and that BBC withdrew its application prior to COGCC’s final decision. Approving the CA over the Hiltons’ objection appears contrary to the Communitization Manual, and the CSO has offered no meaningful explanation for its action. In the absence of a State pooling order, a pooling clause in the Lease, or other pooling agreement, the Hiltons, as “basic royalty owners under non-Federal leases must execute the agreement.” Model Form, ¶ II.C. The CSO cites to the Communitization Manual as authority for its Decision, but neglects to explain why BLM’s own policy, as reflected in the Manual, does not control in this case.

WPX asserts that the Hiltons are not necessary parties because “BLM’s approval of the CA will in no way affect, alter, or jeopardize the terms and conditions of the Hilton Lease”; the “Hiltons have no vested interest in whether or not the CA is

approved”; and “WPX is not attempting to pool the Hilton lease.” WPX Motion to Dismiss and Answer at 14. The terms of the CA provide that “the royalty share of production under Tract II Lease 6 [the Hilton Lease] shall be allocated, calculated and paid on a lease basis rather than a communitized basis,” and “[t]he lessor of [T]ract II [L]ease 6 is not entitled to royalty on production from Tract I [the Federal lease], Tract III or Tract II, Leases 1 through 5 [privately owned mineral interests].” CA at ¶ 5. The Hiltons interpret these provisions of the CA to mean that “production from the Federal tract and the Tract II Fee Lands will not be considered production from Hilton tract, and excludes Hilton from participation in the royalties from the balance of the CA,” but that “BLM is . . . entitled to share in the royalties from the Hilton Tract.” Hilton’s SDR Request dated Dec. 27, 2012 (2012 SDR Request) at 5. The Hiltons conclude that “[t]he resulting CA royalty allocation decreases the net revenue interest in the Hilton Tract minerals, while increasing the net revenue interest in the Federal Tract minerals.” *Id.*

The Hiltons have argued that “WPX has agreed to this royalty allocation because it allows WPX to rely upon production from a single well to hold a far larger Federal lease, and effectively negates any development obligation under the recognized ten (10) acre well densities.” 2012 SDR Request at 5. They conclude that “the CA creates a contractual relationship where the benefit of an additional royalty accrues to the BLM, while at the same time eliminating Hilton’s ability to lease the lands in the future should the Hilton Lease expire.” *Id.* at 6.

The CSO asserts that “the disputes by Hilton concerning the basic royalty and terms of the Hilton Lease were considered and discharged through the modified terms and conditions of the CA.” 2013 SDR Decision at 9. We see the record differently, as do the Hiltons. The effect of the CA is to “dilute Hilton’s underlying mineral interest in the [Hilton Tract] from 50% down to 6.25% over Hilton’s objection.” Hilton Combined Reply at 9. The “disputes by Hilton” may have been considered by BLM, but to say that they have been “discharged” is not an accurate characterization of the record. To force the Hiltons to abide by the terms of the CA, which undeniably affects their 50% fee interest in the minerals in the Hilton Tract, is contrary to the Communitization Manual, 3160-9.1.11.F., which states clearly that “[n]on-Federal royalty interest owners must either sign the agreement, be force-pooled by a State order, or be signers of a lease that already contains a force-pooling provision.” None of these situations applies to the Hiltons’ royalty interest.

IV. CONCLUSION

BLM may only approve a CA in this case if it finds both that the Federal Tract cannot be independently developed and that communitization is in the public interest. For the reasons set forth herein, we conclude that approval of the CA in this case is based upon an inadequate consideration of key evidence in the record that supports a finding that the Federal Tract can be independently developed and that

communitization is not in the public interest. We therefore set aside the CSO's SDR Decision and remand the matter for further action.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the SDR Decision is set aside and the case is remanded to BLM for action consistent with this decision.

_____/s/
James F. Roberts
Administrative Judge

I concur:

_____/s/
Amy B. Sosin
Administrative Judge