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Supreme Court Asked to Review New Bonding Requirements for Existing OCS Leases

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Century Exploration New Orleans, LLC has asked the U.S. Supreme Court to weigh in on an issue that could have profound implications for companies with oil and gas leases on the outer continental shelf (OCS)—more specifically, on the power of the government to issue new regulations that impose additional burdens on existing oil and gas leases from the government.

In response to the Deepwater Horizon incident in 2010, the federal government issued new regulations generally increasing the bond amount requirements that oil and gas lessees under the Outer Continental Shelf Lands Act (OCSLA) must post with the federal government for oil spill financial responsibility (OSFR) to address "worst case discharges" of oil from the lease. Under these new regulations, Century's bond requirements skyrocketed from $35 million to $150 million.

The statutory basis for these regulations is critical because section 1 of the federal government's lease form provides that the lease is subject only to *existing* law and regulation, except that the government may change regulatory requirements under OCSLA "for the prevention of waste and conservation of the natural resources of the Outer Continental Shelf." The government contends that it was issuing these new regulations under OCSLA rather than under the Oil Pollution Act (OPA). Century is seeking review of a decision by the Federal Circuit upholding these new regulations and rejecting Century's argument that the lease provisions prohibit the government from applying these new regulations to leases issued before these new regulations were issued.

Century sued the United States in the federal Claims Court and argued that the federal government improperly imposed these new regulatory requirements under OPA and thus breached the contract. But the government maintained that these new regulations were issued instead under OCSLA and thus that the new regulations could properly be applied Century's existing lease. The court dismissed Century's case and ruled that the government did not breach the contract. On appeal, the Federal Circuit affirmed. Century has now asked the Supreme Court to review the case. *See Century Exploration New Orleans, LLC v. United States*, 110 Fed. Cl.

148 (2013), *aff'd*, 745 F.3d 1168 (Fed Cir. 2014), *petition for cert. filed*, No. 14-459 (U.S. Oct. 17, 2014).

In determining which statute the government acted under, the Federal Circuit noted that OCSLA was enacted "to ensure that a 'vital national resource reserve held by the Federal Government for the public good' would be 'made available for expeditious and orderly development, subject to environmental safeguards, in a manner which is consistent with the maintenance of competition and other national needs,'" whereas OPA was enacted in response to the Exxon Valdez oil spill and is designed to govern all oil spill prevention, clean up, and compensation in the nation's navigable waters.

The Federal Circuit ultimately concluded that the government acted pursuant to OCSLA, not OPA, and therefore did not breach the lease. The court specifically noted that, while the new regulation concerned blowout protection, an issue clearly within the ambit of OPA, OCSLA also authorized the government to take these same actions.

Pointing to Supreme Court precedent, the court noted that "the mere existence of government authority to act under OCSLA does not immunize the government from regulatory liability." Nonetheless, for two reasons, the court concluded the government did in fact act pursuant to OCSLA and thus did not breach the lease. First, the court noted that a notice to the lessees about the new regulations identified an OCSLA provision as its source of authority. Second, this notice "did not change the text of the relevant OPA regulation … [but instead] merely changed the way an OCSLA regulation incorporates an OPA calculation"; further, "for three out of the four alleged alterations to the worst case scenario requirement, it is not even clear that the original requirement was an OPA requirement." These statements could be construed to suggest that the federal government is entitled to presumption that it acted pursuant to OCSLA. Concluding that the government acted pursuant to OCSLA, the Federal Circuit held that there was no breach.

As Century highlights in its petition for certiorari, this opinion has a wide-ranging reach as thousands of OCS leases with the federal government contain identical language. If the Federal Circuit's decision stands, oil and gas companies will have to think long and hard before entering into new OCS leases or in obtaining assignments of existing OCS leases. When assessing the financial risks for OCS leases, companies naturally build foreseeable regulatory requirements into their economic models. Although leases like the one between Century and the federal government subject the lessee to future regulations imposed pursuant to OCSLA, the lease also specifically precludes the federal government from further burdening the lessee with new regulations under any other statute.

The Federal Circuit has let the exception swallow the rule. By permitting the federal government to prevail merely by citing an OCSLA provision, even though the new regulation is clearly and more directly within the scope of OPA, the Federal Circuit has effectively created a great deal of uncertainty concerning the true value of the lease bargained for. It is not hard to imagine that this broad view of the federal government's power and discretion could engender reticence on the part of many oil and gas companies about entering into new leases with the government or taking assignments of existing leases; any such reticence in turn would discourage offshore production. Even if these new requirements do not scare off the industry majors, smaller independent oil companies—who now account for the vast portion of companies operating on the shallower OCS shelf—cannot bear the same risks.

So we now wait to see whether the Supreme Court will grant review and provide clarity on how far the government may stretch OCSLA to impose burdens on lessees that were neither contemplated nor reasonably foreseeable and whether the federal government is entitled any sort of presumption that imposed regulations are made pursuant to OCSLA. Even if the Supreme Court allows the Federal Circuit's decision to stand, the Court's review would provide guidance to companies operating on the OCS and allow them to make more informed and financially sound decisions.