Can the Government Keep Changing the Rules for its Existing Contracts?

In late 2014 and early 2015, I wrote about Century Exploration New Orleans, LLC's request for the U.S. Supreme Court to review the Federal Circuit's ruling regarding the validity of new bonding requirements. The case raised the issue of whether the government may impose new burdens on existing leases in the form of additional bonding requirements that made it cost-prohibitive for companies to operate existing leases they had received from the government in the outer continental shelf (OCS). When the Federal Circuit upheld the new requirements, I wrote: "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. " While Century sought review in the U.S. Supreme Court, it declined to hear the case. You can read my prior articles about this case here and here.

Now once again it appears that federal courts are faced with addressing the limits of the government's ability to undermine contracts with new laws and regulations. In April 2016, the D.C. Circuit upheld a district court's ruling that the United States Department of the Interior's Bureau of Safety and Environmental Enforcement (BSEE) could order Noble to plug and abandon a well that was drilled under the terms of a government lease, even though the government had already breached the terms of that lease. *Noble Energy, Inc. v. Jewell*, No. 15-5202, 2016 WL 3039397 (D.C. Cir. Apr. 29, 2016).

Noble contends that the D.C. Circuit panel (a set of three judges) erred in upholding that BSEE's determination that the regulations "operate independently from any lease agreement." Noble argues that Supreme Court precedent establishes a strong presumption that common law principles like discharge apply even in the face of laws and regulations that "invade" the common law. In short, Noble contends that it should have been discharged from any duty to plug and abandon the well because the government had already breached the terms of the lease. In most jurisdictions and under the common law, when one party breaches the terms of a contact, the non-breaching party is relieved of any further duty under that contract. Noble has now sought en

banc review of its appeal, which means that if a majority of all judges in regular active service (that is, non-senior judges) on the D.C. Circuit agree, then the entire eleven-member court will rehear the case and decide. In its petition for hearing en banc, Noble writes:

> En banc review is necessary to correct the panel's dismissal of the Supreme Court's clear instruction that common law principles are to be retained in positive law absent clear evidence of contrary intent, and ***to clarify the rights and obligations of the government's contractual partners operating offshore oil and gas leases that have long been held subject to the common law***.

Noble further argues that the panel's ruling basically gives the government unchecked power to avoid any consequences of its contractual breaches, so long as it can quickly issue rules and regulations to cover its tracks.

Century and Noble find themselves in very similar boats. Presumably after conducting due diligence and a cost-benefit analysis based on their belief of the terms they would be subject to, they entered into leases with the government. However, after the leases were executed, the government pulled the rug out from under their feet and essentially made the leases economically unviable for them. While there may very well be good rationales for the government's new rules and regulations, it is clear that even some of the most sophisticated operators are being caught off-guard by these actions. As incidents like these continue to occur, one has to believe that the risk will eventually become too great for many, and perhaps a majority of, potential lessees to engage in production on the OCS. Assuming the D.C. Circuit declines to rehear the case en banc, or does and agrees with the original panel, it would be very helpful to the industry for the Supreme Court to weigh in and address whether the government does or does not have the ability to regulate itself out of a contract and what obligations the other party will still be obligated to perform. Perhaps now that this issue has arisen again so soon after Century's case, the Supreme Court will appreciate the importance of weighing in. However, with the late Justice Antonin Scalia's seat still vacant, there is always the possibility that, even if the Supreme Court decides to hear the case, an evenly divided Court may simply kick the can down the road. We shall wait and see.