OCS LEASE CONVEYANCING ISSUES -

AN UPDATE

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April 23, 2002

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I. INTRODUCTION

Ten years ago, this author delivered a paper to the Tenth Annual Advanced Oil, Gas and Mineral Law Course sponsored by the Oil, Gas, and Mineral Law Section of the State Bar of Texas,[1] concerning issues related to transfers of interests in oil and gas leases covering federal lands located on the Outer Continental Shelf ("OCS"). Since that time, there has occurred a significant evolution in the regulations relating to transfers of interests in OCS leases promulgated by the Minerals Management Service of the United States Department of the Interior ("MMS"), the agency to which the Department of the Interior ("DOI") has delegated responsibility for the administration of oil and gas activities on the OCS. Thus, it seems appropriate to revisit these issues in light of such recent regulatory developments.

In the first part of this paper, therefore, we will consider the operation of the Outer Continental Shelf Lands Act[2] ("OCSLA"), and its interaction with state laws relating to transfers of interests in OCS leases. This paper will then discuss, in turn, (i) the MMS Regulations relating to transfers of interests in OCS leases, (ii) the requisites for the approval by the MMS of transfers of interests in OCS leases, including the qualification requirements applicable to an assignee of an OCS lease, the formalities associated with such transfers, and the current and ever-evolving MMS bonding requirements, (iii) the issues related to the allocation of liability among assignors and assignees relative to the United States government resulting from such transfers of interest, and the MMS' recent efforts to resolve such issues, and (iv) finally, the filing requirements applicable to transfers of interests in OCS leases and other types of instruments affecting OCS leases, such as mortgages and other lien instruments.

II. LAW APPLICABLE TO OCS OPERATIONS

A. Outer Continental Shelf Lands Act

The OCSLA was enacted by Congress in 1953 to confirm the federal government's control over the OCS and to provide formally for the ordered development of its natural resources.[3]

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[1] See Pearson, OCS Lease Conveyancing Issues, 10TH ANN. ADV. OIL, GAS & MIN. L. COURSE, Paper S (State Bar of Texas 1992).

[2] 43 U.S.C. §§ 1331, et seq. (2001).

[3] See McCollam and Wiygul, Contract Actions and the Outer Continental Shelf Lands Act: Jurisdiction, Venue, and Applicable Law, 38 INST. ON OIL & GAS L. & TAX'N 3-1, 3-4 (1987) (hereinafter, "McCollam and Wiygul").

The OCSLA was a necessary companion to the Submerged Lands Act[4] ("SLA"), which was also enacted by Congress in 1953. Under the SLA, Congress vested in the coastal states ownership and control of all submerged lands lying beneath navigable waters out to the seaward boundaries of each of the coastal states.[5] Ultimately, the United States Supreme Court determined the seaward boundary of Louisiana to be located three miles from its coastline and the seaward boundary of Texas to be located three marine leagues from its coastline.[6]

Under the OCSLA, Congress vested in the United States jurisdiction and control over the subsoil and seabed of the OCS, defined to consist of all submerged lands that lie seaward and outside of the area of lands beneath navigable waters that were left to the jurisdiction of the states under the SLA.[7] Section 1333(a)(1) of the OCSLA defines the statute's coverage as follows:

> "The constitution and laws and civil and political jurisdiction of the United States are hereby extended to the subsoil and seabed of the Outer Continental Shelf and to all artificial islands, and all installations and other devices permanently or temporarily attached to the seabed, which may be erected thereon for the purpose of exploring for, developing, or producing resources therefrom, or any such installation or other device (other than a ship or vessel) for the purpose of transporting such resources, to the same extent as if the Outer Continental Shelf were an area of exclusive federal jurisdiction located within a state . . ."[8]

B. Administration of OCSLA

Under the OCSLA, the DOI is the primary federal agency charged with the administration and implementation of the OCSLA. The DOI fulfills its responsibilities in this regard through the MMS, to which the Secretary of the Interior has delegated most of the primary responsibilities relating to the OCS.

The MMS was created in 1982 out of various elements of the Bureau of Land Management of the DOI ("BLM"), the U.S. Geological Survey, and the Office of OCS Program Coordination.[9] Its responsibilities include most matters of concern to the federal government relating to the exploration and development of oil and gas on the OCS, including oil, gas and other mineral leasing activities, geological and geophysical exploration activities, oil and gas exploration and development operations, payment of royalties, and similar matters.

Although the MMS is headquartered in Washington, D.C., its responsibilities for most operational matters are delegated to its four regional offices which are, in turn, responsible for the administration of mineral exploration and production activities on the portions of the OCS located within each office's area of jurisdiction. MMS Regulations have divided the OCS into

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[4] 43 U.S.C. § 1301, et seq. (2001)

[5] 43 U.S.C. § 1311 (2001).

[6] United States v. Louisiana, 363 U.S. 1 (1960).

[7] 43 U.S.C. § 1331(a) (2001).

[8] 43 U.S.C. § 1333(a)(1) (2001).

[9] See Yeates, Residual Liability of Parties on the OCS, PETROLEUM LANDMAN ASSOCIATION OF NEW ORLEANS, LOUISIANA, OIL & GAS SEMINAR, BRECKENRIDGE, COLORADO at 5 (1992) (hereinafter, "Yeates").

four regions, each with a corresponding regional office: (i) the Gulf of Mexico Region, encompassing the entire Gulf of Mexico; (ii) the Alaska Region, covering the area offshore of the Coast of Alaska; (iii) the Pacific Region, encompassing the area offshore the Pacific Coast States of California, Oregon, Washington, and Hawaii; and (iv) the Atlantic Region, encompassing the area offshore the Atlantic Coast.[10] Because the MMS' Gulf Coast Regional Office encompasses the areas offshore Texas and Louisiana, the operation of that office is of the most interest in this discussion.

While a complete description of the organization of the MMS' Gulf Coast Regional Office is beyond the scope of this paper, it should be noted that mineral leasing and related activities, including environmental studies and assessments, in the Gulf of Mexico Region have been assigned to the Regional Office's Office of Leasing and Environment, Leasing Activities Section. For purposes of the matters discussed in this paper, the Adjudication Unit of the Office of Leasing and Environment is the most significant department in the MMS' Gulf Coast Regional Office. The Adjudication Unit issues OCS leases, maintains the active lease records relating to all OCS leases in the Gulf of Mexico Region, coordinates and administers Gulf of Mexico Region OCS lease sales in conjunction with the Sales and Support Unit, and receives, reviews, and approves all transfers of interests in OCS leases in that region.[11]

C. Laws of the Adjacent State

Although the OCSLA clearly states that federal law applies to the OCS, state law is also relevant as the result of Section 1333(a)(2)(A), which provides, in pertinent part:

> "To the extent that they are applicable and not inconsistent with this subchapter or with other federal laws and regulations of the secretary now in effect or hereafter adopted, the civil and criminal laws for each adjacent state, now in effect or hereafter adopted, amended, or repealed are declared to be the law of the United States for that portion of the subsoil and seabed of the Outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the state if its boundaries were extended seaward to the outer margin of the Outer Continental Shelf . . ."[12]

Section 1333(a)(2)(A) is not inconsistent with the provisions of Section 1333(a)(1), which provides that federal law applies to the OCS. Rather, Section 1333(a)(2)(A) adopts the laws of the adjacent states as surrogate federal law, to the extent that such state law is "applicable and not inconsistent" with applicable federal law. The concept of "applicable and not inconsistent" was first addressed definitively by the United States Supreme Court in Rodrigue v. Aetna Casualty & Surety Co.[13] According to the Supreme Court:

> "Since federal law, because of its limited function in a federal system, might be inadequate to cope with the full range of

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[10] See 30 C.F.R. § 256.52(b) (2001).

[11] See Waddell, OCS Leasing from A to Z, 48th MIN. L. INST. Paper ___, at 1 (LSU Paul M. Hebert Law Center 2001) (hereinafter, "Waddell").

[12] 43 U.S.C. § 1333(a)(2)(A) (2001).

[13] 395 U.S. 352, 89 S. Ct. 1835 (1969) (the "Rodrigue Case").

> potential legal problems, the [OCSLA] supplemented gaps in the federal law with state law through the 'adoption of State law as the law of the United States.' Under § 4, the adjacent State's laws were made 'the law of the United States for [the relevant subsoil and seabed] and artificial islands and fixed structures erected thereon,' but only to 'the extent that they are applicable and not in consistent with . . . other Federal laws.' It is evident from this that federal law is 'exclusive' in its regulation of this area, and that state law is adopted only as surrogate federal law."[14]

The key issue in determining the interplay of federal and state law under the OCSLA is, of course, the meaning of the phrase "applicable and not inconsistent" as used in Section 1333(a)(2)(A). In the foregoing language quoted from the Rodrigue Case, the Supreme Court states that the OCSLA supplemented "gaps in the federal law" with the adoption of state law as the law of the United States. The use of the concept of a "gap" in federal law as the triggering event for the applicability of state law under the OCSLA appears to be consistent with the legislative history of the OCSLA.[15]

The first treatment of this issue in the Fifth Circuit after the Rodrigue Case appeared in Continental Oil Co. v. London Steamship Owners Mutual Insurance Ass'n, Ltd.[16] In that case, a Liberian registered vessel collided with a drilling platform located on the OCS offshore Louisiana, and the platform owner filed suit against the Liberian vessel's insurer under the Louisiana Direct Action Statute. The specific issue before the court concerned whether the Louisiana Direct Action Statute would apply by operation of Section 1333(a)(2)(A) of the OCSLA when a "fully effective maritime right and remedy" was available to the platform owner.[17] Writing for the Fifth Circuit panel, Judge Brown concluded that "the deliberate choice of federal law [by the OCSLA], federally administered, requires that 'applicable' be read in terms of necessity - necessity to fill a significant void or gap [in federal law]."[18] According to the court, since no such gap existed, the Louisiana Direct Action Statute was not available to the platform owner.[19]

The test enunciated in the Continental Oil Case was followed consistently by the Fifth Circuit for a number of years.[20] Messrs. McCollam and Wiygul, in their superb discussion of these issues, argue that the test enunciated in the Continental Oil Case places paramount emphasis on the element of "applicability" and almost no emphasis on the "not inconsistent" language of Section 1333(a)(2)(A).[21] Differently stated, it seems that the concept of "not inconsistent" is subsumed within the concept of "applicability". If federal law applies, state law may not, by definition, apply. If there is no applicable federal law, however, state law is incorporated, by definition, as surrogate federal law.

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[14] Id. at 357, 89 S. Ct. at 1838. See McCollam and Wiygul, supra note 3 at 3-28 - 3-30.

[15] See, e.g., 99 Cong. Rec. 7164 (Senator Anderson, stating: "The real point is . . . that the language in section 4 provides that Federal laws and regulations shall be applicable in the area, but that where there is a void, the State law may be applicable . . . .")

[16] 417 F.2d 1030 (5th Cir.), cert. denied, 397 U.S. 911 (1969) (the "Continental Oil Case").

[17] 417 F.2d at 1035.

[18] Id. at 1036.

[19] Id.

[20] See McCollam and Wiygul, supra note 3 at 3-32, n. 100, and cases cited therein.

[21] Id. at 3-32, 3-33.

In 1990, however, Judge Brown, writing for the Fifth Circuit in Union Texas Petroleum Corporation v. PLT Engineering, Inc.[22], reformulated the foregoing test without reference to the "significant void or gap" analysis that he had authored in the Continental Oil Case. In holding that certain subcontractors of a pipeline engineering firm were entitled to assert liens under the Louisiana Oil Well Lien Act in connection with pipeline construction operations on the OCS, the Fifth Circuit stated the revised test as follows:

> "Rodrigue made clear that 'for federal law to oust adopted state law, federal law must first apply.' . . . But for adjacent state law to apply as surrogate federal law under OCSLA, three conditions are significant. (1) The controversy must arise on a situs covered by OCSLA (i.e. the subsoil, seabed, or artificial structures permanently or temporarily attached thereto). (2) Federal maritime law must not apply of its own force. (3) The state law must not be inconsistent with Federal law."[23]

Subsequent decisions of the Fifth Circuit have, without exception, applied the Union Texas Case's three-part test in determining whether state law provides the rule of decision in an OCSLA case.[24]

III. TRANSFERS PERTAINING TO OCS LEASES

A. Definitions

Prior to undertaking a discussion of the requisites of transfers relating to OCS leases, the MMS approval process, and the consequences of such transfers for the assignor and assignee, it is appropriate to review the relevant terminology. In the case of assignments of interests in oil and gas leases covering privately owned or state lands, the interests acquired by the assignee are referred to as "working interests", "leasehold interests", or interests in the "leasehold estate" created by the subject lease. The assignee of an interest in an OCS lease, on the other hand, will receive either a "record title" interest or an interest in the "operating rights" attributable to the subject lease.

MMS Regulations[25] do not define the terms "operating rights" or "record title". Those terms are, however, defined in the regulations pertaining to onshore federal lands.[26] The term "record title" is defined as "a lessee's interest in a lease which includes the obligation to pay rent, and the rights to assign and relinquish the lease. Overriding royalties and operating rights

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[22] 895 F.2d 1043 (5th Cir. 1990) (the "Union Texas Case").

[23] Id. at 1047.

[24] E.g., Demette v. Falcon Drilling Co., Inc., 253 F.3d 840, 844-45 (5th Cir. 2001); Hodgen v. Forest Oil Corp., 87 F.3d 1512, 1526 (5th Cir. 1996); Dupre v. Penrod Drilling Corp., 993 F.2d 474, 476 (5th Cir. 1993); Hollier v. Union Texas Petroleum Corp., 972 F.2d 662, 664 (5th Cir. 1992); Smith v. Penrod Drilling Corp., 960 F.2d 456, 459 (5th Cir. 1992). Interestingly, in Domingue v. Ocean Drilling & Exploration Co., 923 F.2d 393 (5th Cir. 1991), cert. denied, 502 U.S. 1033, 112 S.Ct. 874 (1992), decided at approximately the same time as the Union Texas Case, the Fifth Circuit appeared to ignore the first and third of the Union Texas Case's tests and, without mentioning the OCSLA or its possible applicability, determined the applicability of state law in that case based solely upon its conclusion that the contract in controversy was not "maritime" in nature. 923 F.2d at 396-98. In Hodgen, however, the Fifth Circuit rejected this interpretation of its decision in Domingue and reaffirmed the three-part Union Texas Case test as the proper method of analyzing whether state law applies in an OCSLA case. 87 F.3d at 1526.

[25] 30 C.F.R. §§ 250, et seq. (2001)

[26] 43 C.F.R. § 3100.0-5 (2001)

are severable from record title interests."[27] The same regulations define the term "lessee" as "a person or entity holding record title in a lease issued by the United States."[28] MMS regulations also define the term "lessee" as "the party authorized by a lease, or an approved assignment thereof, to explore for and develop and produce the leased deposits in accordance with the regulations in this part."[29]

The term "operating right" is defined in the federal onshore regulations as "the interest created out of a lease authorizing the holder of that right to enter upon the lease lands to conduct drilling and related operations, including production of oil or gas from such lands in accordance with the terms of the lease."[30] Correspondingly, the term "operating rights owner" is defined as "a person or entity holding operating rights in a lease issued by the United States."[31] A lessee also may be an operating rights owner "if the operating rights in a lease or portion thereof have not been severed from record title."[32]

Although the owners of both record title interests and operating rights clearly are entitled to conduct operations on an OCS lease, MMS regulations contemplate that these responsibilities may be delegated to a third party known as the "operator." Once again, MMS regulations do not define the term "operator." The federal onshore regulations, however, define the "operator" as "any person or entity, including, but not limited to, the lessee or operating rights owner, who has stated in writing to the authorized officer that it is responsible under the terms and conditions of the lease for the operations conducted on the leased lands or a portion thereof."[33]

Finally, the regulations pertaining to onshore federal lands define the term "transfer" as follows:

> ". . . any conveyance of any interest in a lease by assignment, sublease, or otherwise. This definition includes the terms: *Assignment* which means a transfer of all or a portion of the lessee's record title interest in a lease; and *sublease* which means a transfer of a non-record title interest in a lease, i.e., a transfer of operating rights is normally a sublease and a sublease also is a subsidiary arrangement between the lessee (sublessor) and the sublessee, but a sublease does not include a transfer of a purely financial interest, such as overriding royalty interest or payment out of production, nor does it affect the relationship imposed by a lease between the lessee(s) and the United States."[34]

Because the MMS Regulations make use of the foregoing terms, even though, with the exception of the term "lessee," MMS Regulations contain no specific definitions thereof, most practitioners believe that the quoted definitions from the federal onshore regulations are equally

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[27] 43 C.F.R. § 3100.0-5(c) (2001).

[28] 43 C.F.R. § 3100.0-5(i) (2001).

[29] 30 C.F.R. § 250.2 (2001).

[30] 43 C.F.R. § 3100.0-5(d) (2001).

[31] 43 C.F.R. § 3100.0-5(j) (2001).

[32] Id.

[33] 43 C.F.R. § 3100.0-5(a) (2001).

[34] 43 C.F.R. § 3100.05(e) (2001).

applicable in the context of OCS leases. Thus, under the foregoing definitions, the owner of operating rights is authorized to enter upon an OCS Lease to conduct drilling and related operations. The operating rights owner is subject, however, to having his interest extinguished if the record title holder fails to meet its lease obligations or chooses to relinquish the relevant lease.[35] Generally, only the record title holder is entitled to receive notices from the MMS regarding essential matters affecting the relevant lease and remains responsible for the fulfillment of all obligations of the lease, including the payment of royalties, rentals, and minimum royalties, the filing of reports, and the filing of requests for suspension of production.[36]

The operating rights owner may obtain a certain amount of protection from the acts and omissions of the record title holder if the operating rights owner is designated as the operator of the subject OCS lease. In all cases in which there are more than one owner of interests in an OCS lease, the owners must submit to the MMS a designation of operator prior to the commencement of operations thereon.[37] The operator's designation will be accepted by the MMS "as authority for the operator to act on behalf of [each lessee] and to fulfill [the lessee's] obligations under the [OCSLA], the lease, and the regulations in this part."[38]

The designation of an operating rights owner as operator of an OCS lease clearly would permit the operating rights owner to step into the shoes of the operator with respect to operations on the OCS lease governed by the provisions of Part 250 of 30 C.F.R. A strict reading of the quoted language from Section 250.143(b), however, indicates that the designated operator does not step into the shoes of the lessee or record title holder in its relationship with the MMS under the terms of the lease pertaining to matters such as the payment of royalties, which are governed by Subchapter A of 30 C.F.R., or the payment of minimum royalties, suspensions of operations or production, and lease termination, which matters are governed by Part 256 of 30 C.F.R. Thus, even when an operating rights owner is the designated operator of an OCS lease, he still must deal directly with the record title holder to protect himself from acts or omissions by the record title holder which could result in the termination of the OCS lease.

The designation of an operator is not a liability shield for the other co-lessees in an OCS Lease, however. The co-lessees of an OCS Lease (which include both record title owners and operating rights owners) are jointly and severally responsible for the fulfillment of the lessee's obligations under MMS Regulations, unless otherwise provided in those regulations.[39] Thus, if the designated operator fails to fulfill any of the lessee's obligations under MMS Regulations, the MMS may require all of the co-lessees in the affected OCS Lease to fulfill those obligations or other operational obligations under the OCSLA, the lease, or MMS Regulations.[40]

B. Applicable MMS Regulations

Section 1337(e) of OCSLA provides: "No lease under this subchapter may be sold, exchanged, assigned, or otherwise transferred except with the approval of the Secretary. Prior to any such approval, the Secretary shall consult with and give due consideration to the views of

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[35] 43 C.F.R. § 3100.0-5(e) (2001); cf. 30 C.F.R. §§ 256.62, 256.64, and 256.68 (2001).

[36] See 30 C.F.R. § 256.68 (2001); 43 C.F.R. § 3100.0-5(e) (2001).

[37] 30 C.F.R. § 250.143(a) (2001).

[38] 30 C.F.R. § 250.143(b) (2001).

[39] 30 C.F.R. §§ 250.146(a) and (c) (2001).

[40] 30 C.F.R. § 250.146(b) (2001).

the Attorney General."[41] The OCSLA does not otherwise deal specifically with transfers of OCS leases or interests therein.

All forms of OCS leases in use by the MMS contain a provision concerning transfers of interests in the lease substantially similar to the following provision, which is quoted from MMS Form 2005 (August 1986):

> Sec. 20. Transfer of Lease. The Lessee shall file for approval with the appropriate field office of the Minerals Management Service any instrument of assignment or other transfer of this lease, or any interest therein, in accordance with applicable regulations.

The applicable regulations appear in Subpart J of Part 256 of 30 C.F.R.

Under MMS Regulations, subject to the approval of the Regional Director of the MMS, ownership of the record title to an OCS lease or any undivided interest therein may be assigned in whole, or as to any officially designated subdivision, to any person qualified to be an owner of such an interest within the meaning of, and who provides the bond coverage required by, the MMS Regulations.[42] Any approved assignment shall be deemed to be effective on the first day of the lease month following its filing in the appropriate office of the MMS, unless, at the request of the parties, an earlier date is specified in the approval.[43]

All proposals to create or transfer a lease or an interest therein, or to create or transfer separate operating rights, subleases, or record title interests, must be filed for approval with the MMS within ninety days from the last date that a party executes the transfer agreement.[44] Each such filing should include two (2) copies of the instrument creating or transferring the interest, which must describe by officially designated subdivision the interest to be transferred or created and contain all of the terms and conditions applicable to such interest,[45] and should be accompanied by a signed statement concerning the transferee's citizenship and qualification similar to that required of an OCS lessee.[46] A separate instrument of assignment must be filed for each OCS Lease sought to be assigned. In the case of transfers of multiple leases to the same person, association, or corporation, one request for approval and one showing concerning the qualifications of the assignee will be sufficient.[47]

Each application for approval of any instrument of transfer required under MMS Regulations to be filed with the MMS must be accompanied by a nonrefundable filing fee currently set by the MMS at $185.00.[48] In the case of assignments covering all of the record title interest in an OCS Lease, the assignee must also furnish the bonds required under MMS Regulations at the time the request for approval of the assignment is filed.[49] If the assignment covers less than all of the record title interest in the subject OCS Lease and does not create a

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[41] 43 USC § 1337(e) (2001).

[42] 30 C.F.R. § 256.62(a) (2001).

[43] 30 C.F.R. § 256.62(c) (2001).

[44] 30 C.F.R. § 256.64(a)(2) (2001).

[45] 30 C.F.R. §§ 256.64(a)(1), (4) (2001).

[46] 30 C.F.R. § 256.64(a)(3) (2001).

[47] 30 C.F.R. § 256.67 (2001).

[48] 30 C.F.R. § 256.64(a)(8) (2001).

[49] 30 C.F.R. § 256.64(c) (2001).

separate lease, the assignee may, with the surety's consent, become a joint principal on the existing bond or other surety instrument in effect with respect to the OCS Lease at the time of the transfer.[50]

Transfers of "carried working interests, overriding royalty interests or payments out of production" do not require the approval of the MMS, but all instruments creating such interests must be filed with the MMS "for record purposes."[51] The current regulations on this point, promulgated as part of the 1997 Bonding Regulations discussed below in Section III.C.4 of this paper,[52] represent a departure from the treatment of this issue in prior regulations. Prior regulations provided that transfers of these types of interests required neither approval by nor filing with the MMS.[53] Transfers of any other document not required to be filed with the MMS under MMS Regulations that are "submitted [to the MMS] for record purposes" (such as mortgages and other lien instruments) are required to be accompanied by a non-refundable fee of $25.00 per OCS lease affected. The authorized officer of the MMS may reject the filing of these types of instruments at his discretion, however.[54]

Although transfers of operating rights may contain depth limitations under MMS regulations, the MMS will not, as a matter of policy, approve a transfer of a record title interest in an OCS lease that provides for a depth limitation. MMS regulations do permit, however, the subdivision of the leasehold estate in an OCS block into smaller, segregated tracts.[55] Thereafter, each segregated tract is treated as a separate and distinct lease for all purposes, including payment of royalty, minimum royalty, and rentals,[56] as well as lease maintenance by operations and production.[57] As a matter of policy, however, the MMS does not permit any such subdivision to be smaller than a quarter/quarter/quarter (1/4 of 1/4 of 1/4) of a block.[58]

C. MMS Approval

1. SIGNIFICANCE OF MMS APPROVAL

As discussed above in Section III.B. of this paper, transfers of record title interests and operating rights must be approved by the MMS before the transfer can become effective.[59] MMS Regulations further provide that "[the lessee], as assignor,[is] liable for all obligations that accrue under [its] lease before the date the Regional Director approves [the assignor's] request for assignment of the record title in the lease. The Regional Director's approval of the assignment does not relieve [the assignor] of accrued lease obligations that [the assignor's] assignee, or a subsequent assignee, fails to perform . . . [The assignor's] assignee

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[50] 30 C.F.R. § 256.64(d) (2001).

[51] 30 C.F.R. § 256.64(a)(1) (2001).

[52] 62 Fed. Reg. 27948 (May 22, 1997).

[53] 30 C.F.R. § 256.64(a)(1) (repeated).

[54] 30 C.F.R. § 256.64(a)(8) (2001).

[55] 30 C.F.R. § 256.68(a) (2001).

[56] Id.

[57] Id. 30 C.F.R. §§ 256.68(b) and (c) (2001).

[58] See, Waddell, supra note 11, at 41.

[59] 30 C.F.R. §§ 256.62(a) and (c), 256.64(a) (2001).

and each subsequent assignee are liable for all obligations that accrue under the lease after the date that the Regional Director approves the governing assignment."[60]

Beyond the language of Sections 256.62(d) and (e), there is little other statutory, regulatory, or judicial guidance regarding the effect of the MMS Regulations' requirement of MMS approval for transfers of record title interests and operating rights. Some practitioners argue that the approval process is merely ministerial in nature, so that if the relevant transfer complies with MMS Regulations, the MMS has no discretion concerning the approval of the transfer. In that case, the lack of MMS approval would not void the transfer. Other practitioners and many financial institutions, however, have taken the position that, in the absence of MMS approval, the transfer is void and of no effect. This position appears to be based less upon legal analysis and more upon the business analysis that the risks associated with operations on an OCS lease that has been transferred without MMS approval are too great in the absence of clearer statutory, regulatory, or judicial authority on the issue.[61]

The better view, and the one apparently most consistent with the quoted provisions from Section 256.62(d), is that the MMS approval process is relevant only for purposes of the relationship between the United States, as lessor under the OCS lease, and the assignor and the assignee of the relevant interest. Under this view, until the MMS approves a transfer, the assignor remains obligated with respect to all obligations under and relating to the relevant OCS lease. At the same time, the assignee appears not to be recognized as having any cognizable interest in or with respect to the OCS lease until MMS approval of the transfer. Upon approval, the transfer becomes effective retroactively as of the first day of the lease month following its filing with the MMS.[62]

This interpretation of the MMS Regulations is consistent with the approach taken by the federal onshore regulations, which provide, in pertinent part:

> The transferor and its surety shall continue to be responsible for the performance of all obligations under the lease until a transfer of record title or of operating rights is approved by the authorized officer. If a transfer of record title is not approved, the obligation of the transferor and its surety to the United States shall continue as though no such transfer had been filed for approval. . . .[63]

This position has also been followed consistently by the BLM in its administrative proceedings.[64]

Under this view, the assignee of a record title interest in an OCS lease prior to MMS approval has significant exposure. He is not permitted to exercise any rights of lease

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[60] 30 C.F.R. §§ 256.62(d) and (e) (2001).

[61] See Jaubert and Schully, An Introduction to Doing Business on the Outer Continental Shelf, 6TH ANNUAL GULF COAST LANDMAN'S INSTITUTE, NEW ORLEANS, LOUISIANA at 37-38 (1990) (hereinafter, "Jaubert and Schully").

[62] 30 C.F.R. § 256.62(c) (2001).

[63] 43 C.F.R. § 3106.7-2 (2001).

[64] E.g., Lyman J. Ipsen, 96 IBLA 398, GFS (O&G 46) (1987) (an assignee under an unapproved assignment has no interest in the onshore federal lease, and a later assignment by the assignee cannot be approved); Otis Energy, Inc., 52 IBLA 316, GFS (O&G 38) (1981) (an assignee under an unapproved assignment has "no cognizable interest" in the onshore federal lease). See Terrell, Assignments and Transfers of Interests, 1 LAW OF FEDERAL OIL AND GAS LEASES § 10.03[4] (Rocky Mtn. Min. L. Fdn. 2001) (hereinafter, "LAW OF FEDERAL OIL AND GAS LEASES").

ownership, including assumption of operations, and his interest is subject to the acts or omissions of the assignor which might result in the termination of the lease, which, in turn, would result in the disapproval of the assignment.[65]

The position of the assignee of an interest in operating rights prior to MMS approval is slightly different because, even after approval of the operating rights owner's transfer, the owner of the record title interest still remains primarily liable to the United States for the performance of most lease obligations.[66] Nevertheless, until his transfer is approved, the operating rights owner may not "enter upon the leased lands to conduct drilling and related operations, including production of oil or gas from such lands."[67] or otherwise exercise the rights and incidents of ownership associated with his interest.[68]

The absence of MMS approval of a transfer should not, however, affect the effectiveness of the transfer as between the assignor and the assignee. Although our research has failed to discover any cases which have considered these issues in the context of an OCS lease, the majority of the cases which have dealt with this issue in the context of federal onshore leases have held that an assignment may be effective and complete as between the assignor and the assignee immediately upon its execution even if it has not yet been filed with or approved by the BLM.[69] The rationale for these decisions is that the federal statutes and regulations do not govern the relationship between private parties, with the result that the interpretation of their contracts and the resolution of their disputes are left to state law.[70] This result should not change even if the MMS ultimately disapproves a transfer. In that event, the assignee should be able to exercise the rights available to it under its contract with the assignor and otherwise under applicable state law, including the right to impose a constructive trust upon the interest of the assignor to secure for the assignee the economic benefits of his bargain with the assignor.[71]

Based upon the foregoing discussion, it is clear that it is in the best interests of both the assignor and the assignee to take the steps necessary to assure the most rapid approval by the MMS of their transfer possible. The primary matters upon which the MMS focuses its attention in the approval process concern the qualification of the assignee to receive title to the interest to be transferred, the observance by the assignor and assignee of the requisite formalities for the instrument of transfer, and the compliance by the assignee with MMS bonding requirements.

2. QUALIFICATION

Assignees of interests in OCS leases must meet the same qualifications for holding an OCS lease as the original lessee.[72] According to MMS Regulations, mineral leases issued pursuant to the OCSLA may be held only by: (i) citizens and nationals of the United States; (ii)

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[65] Id., § 10.03[4] at 10-21.

[66] See 43 C.F.R. § 3100.0-5(e) (2001).

[67] See 43 C.F.R. § 3100.0-5(d) (2001).

[68] See Jaubert and Schully, supra note 61, at 39.

[69] Pan American Petroleum Corp. v. Gibbons, 168 F.Supp. 867 (D. Utah 1954); Isaacs v. DeHon, 11 F.2d 943 (9th Cir. 1926).

[70] Wallis v. Pan American Petroleum Corp., 384 U.S. 63, 86 S.Ct. 1310 (1966), on remand, McKenna v. Wallis, 366 F.2d 210 (5th Cir. 1966).

[71] See LAW OF FEDERAL OIL AND GAS LEASES, supra note 64, § 10.03[5] at 10-30.

[72] 30 C.F.R. § 256.62(a)(1) (2001).

aliens lawfully admitted for permanent residence in the United States; (iii) private, public, or municipal corporations organized under the laws of the United States or of any State or the District of Columbia or territory thereof; or (iv) associations of such citizens, nationals, resident aliens, or private, public or municipal corporations, States, or political subdivisions of States.[73] Otherwise, OCS leases may be acquired and held by non-resident aliens only through "stock ownership, holding or control in a present or potential lessee that is incorporated under the laws of the United States or of any State or territory thereof, and only if the laws, customs, or regulations of their country do not deny similar or like privileges to citizens or corporations of the United States."[74] OCS leases may not be acquired or held by minors.[75] The MMS may disqualify a party from acquiring new leases or receiving assignments of existing leases if the relevant party's operating performance is unacceptable under Section 250.135 of 30 C.F.R.[76]

MMS Regulations prescribe the documentation required to be submitted to establish the qualification of an OCS lessee or the assignee of an interest in an OCS lease.[77] Once all of the required qualification documentation submitted by a party to MMS has been reviewed and accepted, the MMS will assign to the now-"qualified" party a Gulf of Mexico OCS Regional Office ("GOM") company number, which will be that party's unique identification number in all of its dealings with the MMS until the company ceases to exist or its GOM company number is otherwise changed.[78]

3. FORMALITIES OF TRANSFER INSTRUMENT

Unlike the BLM, which has promulgated specific forms of assignment to be used for transfers of record title interests and operating rights in federal onshore leases,[79] the MMS has never promulgated a similar standard form of transfer instrument for OCS leases. Nevertheless, in March 1981, the BLM New Orleans Outer Continental Shelf Office, the predecessor to the MMS' Gulf of Mexico Regional Office, issued a pamphlet entitled "Guide to Document Preparation and Procedures Relating to Oil and Gas Leasing on the OCS." This pamphlet identified, among other matters, the formalities required by the BLM for transfers of interests in OCS leases. The MMS adopted and continues to adhere to the provisions of this pamphlet as periodically updated. All parties who are inexperienced in transfers of interests in OCS leases should obtain and become familiar with this pamphlet.

Under MMS Regulations, two items are required to be filed with the MMS to effect a transfer of an interest in an OCS lease: the instrument of transfer itself and an application for approval.[80] Both of these items must comply precisely with published MMS requirements, as well as unpublished MMS practices and procedures, for the relevant transfer to receive MMS approval. Specifically, the instrument of transfer must first identify the assignor and the assignee exactly as those parties appear in the MMS' lessee qualification records. Similarly, the parties executing the transfer on behalf of the assignor and assignee must be identified, and

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[73] 30 C.F.R. § 256.35(b) (2001).

[74] 43 C.F.R. § 3102.2 (2001).

[75] 43 C.F.R. § 3102.3 (2001).

[76] 30 C.F.R. § 256.35(c) (2001).

[77] See 30 C.F.R. § 256.46 (2001); Waddell, supra note 11 at 4-8.

[78] See Waddell, supra note 11 at 8.

[79] See, e.g., BLM Form 3000-3 (June 1988).

[80] 30 C.F.R. § 256.64(a) (2001).

must execute, the transfer instrument in exactly the same manner in which they are identified in the lessee qualification records.

Second, the interest to be transferred must be identified as either a record title interest or an interest in operating rights, and, if the relevant transfer covers only an undivided interest, the undivided interest must be expressed as a decimal with no more than five places. The only exception to the "5 decimal rule" arises when the transfer involves an interest in an older OCS lease in which undivided interests expressed as decimals with more than five places have been previously been conveyed. To avoid delays in the approval of such an assignment, however, it is prudent to seek pre-approval of such a transfer by the Adjudication Unit. The MMS will not approve any transfer which expresses the transferred interest as a fraction.[81]

Third, the transfer instrument should include a description of the OCS lease being transferred, including the OCS lease serial number, the OCS tract covered thereby, the OCS area within which such tract is located, and the OCS lease map on which such tract and area may be found. MMS Regulations define a "tract" as "a designation assigned solely for administrative purposes to a block or combination of blocks that are identified by a leasing map or official protraction diagram prepared by DOI."[82] A tract may not contain more than 5,760 acres, unless the MMS determines that a larger area is necessary to comprise a reasonable economic production unit.[83]

Because, as a general matter, the MMS does not approve transfer instruments in which the OCS lease is described on an exhibit, the description of the lease should be included in the body of the transfer instrument. While this procedure might initially seem burdensome in the case of transfers of multiple OCS leases, it is consistent with the MMS Regulations which require the filing of separate transfer instruments for each OCS lease transferred.[84]

MMS Regulations also require the transfer instrument to include "a statement signed by the transferee about the transferee's citizenship and qualifications to own an [OCS] leases" and shall contain all of the terms and conditions agreed upon by the parties thereto."[85] The requirements concerning qualification and citizenship are discussed above in Section III.C.2 of this paper. To the extent that the business arrangement between the assignor and the assignee includes other matters appropriate for inclusion in the transfer instrument (such as reservations of overriding royalty interests, production payments, or similar interests, a listing of the agreements to which the transfer is to be made subject, and the like), these matters should be dealt with at the end of the transfer instrument following the information concerning parties, quantum and type of interests conveyed, and lease description referred to above, and should not, if possible, appear on the first page of the transfer instrument. The MMS does not have the ability to verify this type of information and does not approve this portion of the transfer instrument.

In addition, the transfer instrument must be accompanied by an "application for approval," which may consist of a transmittal letter signed by an official of either the assignor or assignee, preferably the same person who executed the transfer instrument. This letter must be

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[81] See Waddell, supra note 11, at 41.

[82] 30 C.F.R. § 260.102 (2001).

[83] 30 C.F.R. § 256.28(a) (2001).

[84] 30 C.F.R. § 256.67 (2001).

[85] 30 C.F.R. §§ 256.64(a)(3) and (4) (2001).

accompanied by the requisite filing fee,[86] and should (i) include reference to the GOM company number of both the assignor and assignee, (ii) request the same effective date for the transfer instrument as is set forth therein, (iii) list all of the OCS leases to be affected by the relevant transfer instruments numerically or, when applicable, alpha-numerically according to their respective OCS lease numbers.[87] If the application for approval does not request an effective date for the transfer instrument, the transfer will be made effective as of the first day of the lease month following the filing of the transfer instrument with the MMS.[88] If the instrument of transfer is not executed by the assignee, MMS will require the application for approval to be signed by a representative of the assignee to assure that the assignee is willing to accept the lessee's responsibilities with respect to the affected OCS lease.[89]

4. BONDING REQUIREMENTS

The final matter of principal importance to the MMS in determining whether to approve a transfer of a record title interest or an interest in operating rights in an OCS lease is the compliance by the assignee with the MMS' bonding requirements.

a. Prior Regulations.

Prior to 1993, the surety bonds required of lessees and operators of OCS leases under Subpart I of Part 256 of 30 C.F.R. were fairly minimal. Under these regulations, prior to the issuance of an OCS lease, any bidder on the lease was required to post with the MMS a $50,000 corporate surety bond conditioned upon the bidder's compliance with the terms and conditions of the lease.[90] Alternatively, the bidder could post with the MMS a $300,000 corporate surety bond conditioned upon the bidder's compliance with the terms of all OCS leases held by the bidder in the OCS area in which the tract covered by the OCS lease to be issued was located.[91] The areas to which these "area-wide" bonds apply are the same areas to which the MMS has designated its regional offices.[92] Separate area-wide bonds were required for each OCS area. An operator's bond in the same amounts could have been substituted at any time for the lessee's bonds.[93]

These bond requirements were applicable not only to the original lessees under OCS leases, but to all assignees of interests therein as well, and the MMS treated the failure of such an assignee to comply with these bond requirements as grounds for disapproving a transfer of interest in an OCS lease to such an assignee.

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[86] 30 C.F.R. § 256.64(a)(2) (2001). See generally, Jaubert and Schully, supra note 61 at 40-44.

[87] See Waddell, supra note 11 at 39-40.

[88] 30 C.F.R. § 256.62(c) (2001).

[89] See Waddell, supra note 11, at 40.

[90] 30 C.F.R. § 256.58(a) (repealed).

[91] Id.

[92] See 30 C.F.R. § 256.58(b) (repealed). The four areas defined in these regulations are (1) the Gulf of Mexico, (2) the area offshore the Pacific Coast States of California, Oregon, Washington, and Hawaii, (3) the area offshore the Coast of Alaska; and (4) the area offshore the Atlantic Coast. Id. These four areas remain unchanged in the current bonding regulations. 30 C.F.R. § 256.52(b) (2001).

[93] 30 C.F.R. § 256.58(c) (repealed).

b. Current Regulations.

According to MMS estimates, the costs associated with the removal of smaller, comparatively lightweight platforms in the Gulf of Mexico can range up to $400,000 per structure. Average costs for the removal of all platforms and site clearance operations on lease sites in the Gulf of Mexico range from approximately $3.2 million in shallow water (zero to fifty feet in depth) to between $21 million and $90 million in deepwater (greater than 400 feet in depth).[94] Given these extraordinarily high levels of costs, the MMS has, in recent years, become increasingly concerned about the potential exposure of the United States to costs associated with lease abandonment on the OCS in the event of a default by a large number of OCS lease owners in the performance of lease abandonment, platform removal, and site clearance operations. At least one study conducted by the National Research Council for the OCS, covering all OCS regions, indicated the existence of potential exposure of the United States in this regard, under the system of surety bonds in effect prior to 1993, in an amount in excess of $8 billion.[95]

In an effort to deal directly with the indicated shortfall in total surety bond coverage, MMS issued a final rule in Docket RIN 1010-AB38 on August 27, 1993, which became effective on November 26, 1993, that amended Subpart I of Part 256 of Title 30 of the Code of Federal Regulations, to increase the amount of minimum surety bond coverage required by lessees, operators, and assignees prior to the commencement of exploration operations and/or development operations on the OCS.[96] On May 22, 1997, MMS issued an additional final rule in Docket No. RIN 1010-AB92, to become effective on August 20, 1997,[97] which restated the revised minimum surety bond regulations promulgated in the 1993 rule and addressed several additional issues relating to MMS supplemental bonding authority.

Under the 1997 version of the surety bond regulations (the "1997 Bonding Regulations"), two new tiers of mandatory surety bonds were added to the existing bonding requirements, which tiers become applicable when a lessee submits to MMS for approval either an Exploration Plan ("EP") or a significant revision thereto, a Development and Production Plan ("DPP") or a significant revision thereto, a Development Operations Coordination Document ("DOCD") or a significant revision thereto, or when a lessee submits a proposed assignment of an OCS lease to MMS for approval.[98]

A lessee is required to furnish and maintain with MMS an individual lease bond of $200,000 prior to or in association with the submission to MMS of an EP, or an assignment of a record title interest in an OCS lease subject to an approved EP, unless the lessee furnishes and maintains either a $1,000,000 area-wide exploration bond, or one of the $500,000 lease development bond or the $3,000,000 areawide development bond referred to hereinafter.[99] A lessee is required to furnish and maintain with MMS a $500,000 individual lease bond prior to or

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[94] Preamble to Final Rule, Surety Bond Coverage for Leasing of Sulphur or Oil and Gas in the Outer Continental Shelf (OCS), Docket No. RIN 1010-AB38, 58 Fed. Reg. 45255 (Aug. 27, 1993).

[95] See Adams, Recent Developments in Guaranteeing Performance of Lease Obligations by the Minerals Management Service, AMERICAN ASSOCIATION OF PETROLEUM LANDMEN - OCS WORKSHOP, Houston, Texas, at 2 (1992).

[96] 55 Fed. Reg. 2388 (Jan. 24, 1990), *correction* 55 Fed. Reg. 3603 (Feb. 2, 1990).

[97] 62 Fed. Reg. 27948 (May 22, 1997).

[98] 30 C.F.R. § 256.53 (2001).

[99] 30 C.F.R. § 256.53(a) (2001).

in association with the submission to MMS of a DPP or DOCD, or an assignment of a record title interest in an OCS lease subject to an approved DPP or DOCD, unless the lessee furnishes and maintains a $3,000,000 areawide bond.[100] When a lessee can demonstrate to MMS's satisfaction that the wells and platforms located on the relevant OCS lease can be abandoned and removed and site clearance operations can be conducted for an amount less than the $200,000 lease bond coverage required in connection with the filing of an EP, MMS may agree to reduce the amount of such lease surety bond accordingly.[101] As before, an operator's bond in the same amount as either of the foregoing lease bonds may be substituted at any time for the equivalent lessee's bond, but such substitution shall not relieve the lessee of its obligations to comply with the provisions of the applicable OCS lease.[102]

The 1997 Bonding Regulations leave unchanged the $50,000 individual lease bond initially required to be provided by, and the $300,000 areawide bond available to, successful bidders for OCS leases.[103] A successful bidder would be relieved of the obligation to post this individual lease bond, however, if the lessee furnishes and maintains the $300,000 areawide bond, the $1,000,000 areawide bond, or the $3,000,000 areawide bond referred to above.[104] The 1997 Bonding Regulations do not indicate, however, whether a lessee is relieved of its obligations to maintain the $300,000 areawide bond once such bond has been furnished to MMS if the lessee subsequently posts either the $1,000,000 areawide bond or the $3,000,000 areawide bond. A Letter to Lessees and Operators dated November 5, 1993, indicates, however, that it is MMS's position that a lessee is not obligated to maintain such $300,000 areawide bond if one of the larger areawide bonds is furnished and maintained.[105]

c. Forms of Bonds, Alternate Forms of Security.

All bonds furnished by a bidder, lessee, or operator pursuant to MMS Regulations must be on a form, or in a form, approved by MMS and, with respect to bonds submitted after November 26, 1993, must be issued by a qualified surety company certified by the U.S. Treasury as an acceptable surety on federal bonds and listed in the current U.S. Treasury Circular No. 570.[106] All bonds or other security furnished by a bidder, lessee, or operator must be payable on demand to the MMS, guarantee compliance with all of the relevant party's obligations under its OCS lease and applicable MMS regulations, and guarantee compliance with all obligations of *all* lessees, operating rights owners, and operators on the lease.[107]

The MMS may approve the submission of alternate types of security or collateral in lieu of surety bonds if MMS determines that the government's interests are protected to the same extent that such interests would be protected by a surety bond.[108] In this regard, MMS will accept, in lieu of a surety bond, U.S. Treasury securities with a negotiable value at the time of submission equal to the amount of the surety bond that would be required for the particular

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[100] 30 C.F.R. § 256.53(b) (2001).

[101] 30 C.F.R. § 256.53(c) (2001).

[102] 30 C.F.R. § 256.52(c) (2001).

[103] 30 C.F.R. § 256.52(a)(1), (2) (2001).

[104] 30 C.F.R. § 256.52(a)(3) (2001).

[105] Letter to Lessees and Operators, MMS LTL MS5421 (Nov. 5, 1993).

[106] 30 C.F.R. § 256.54(b) (2001).

[107] 30 C.F.R. § 256.54(a) (2001).

[108] 30 C.F.R. § 256.52(g) (2001).

activities and lease in question.[109] If Treasury securities or other alternative security are substituted for a surety bond, the lessee or operator is required to monitor the value of the alternative security. If the market value of the alternative security falls below the level of bond coverage required under the 1997 Bonding Regulations, the lessee or operator must pledge additional securities to raise the value of the securities pledged to the required levels.[110] The lessee or operator must authorize the Regional Director of MMS to sell all Treasury or other securities pledged in lieu of a surety bond and to use the proceeds when the Regional Director determines that the lessee or operator has breached its obligations under the 1997 bonding regulations.[111]

If the Regional Director determines that lessee or operator, or its surety, has refused or is unable to comply with any term or condition of an OCS lease, or defaults under one of the conditions under which the Regional Director accepted the applicable surety bond, the Regional Director may call for forfeiture of all or any part of the surety bond or other form of security.[112] To the extent that the value of the surety bond or alternative security is reduced for any reason, the lessee or operator is required to increase the amount of the bond or alternative security to the amount sufficient to meet the security required under the MMS Regulations.[113]

d. Supplemental Bonds.

MMS regulations also authorize MMS to require security in addition to such mandatory lease and areawide surety bonds in the form of a supplemental bond or bonds, or increased coverage of an existing surety bond, if MMS deems the additional security to be necessary to ensure compliance with the lessee's obligations under an OCS lease and MMS Regulations.[114] MMS is authorized to base its decision regarding the necessity for supplemental bonds on its evaluation of the ability of the lessee to carry out its present and future financial obligations as demonstrated by a number of factors, including (i) the lessee's possession of financial capacity substantially in excess of its existing and anticipated lease and other obligations, as evidenced by audited financial statements; (ii) the projected financial strength of the lessee based upon the estimated value of its existing OCS production and proven future reserves; (iii) the business stability of the lessee based upon five years of continuous oil and gas operations; (iv) the lessee's business reliability as evidenced by credit ratings and trade references; and (v) the lessee's record of compliance with laws, regulations, and lease terms.[115] Lessees may satisfy any supplemental bonding obligations imposed by MMS by the establishment of either a lease-specific abandonment account,[116] or the provision of an acceptable third party guaranty,[117] in each case in lieu of a surety bond.

Recently, the Regional Director of the MMS indicated that MMS intended to review the supplemental bonding requirements with respect to OCS wells more than twenty (20) years old. According to the Regional Director, assignments filed with the MMS for approval after

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[109] 30 C.F.R. § 256.52(f) (2001).

[110] 30 C.F.R. §§ 256.52(f)(1), 256.52(g)(1) (2001).

[111] 30 C.F.R. §§ 256.52(f)(2), 256.52(g)(2) (2001).

[112] 30 C.F.R. § 256.59 (2001).

[113] 30 C.F.R. §§ 256.52(e), (f)(1), (g)(1); 256.55; 256.58 (2001).

[114] 30 C.F.R. § 256.53(d) (2001).

[115] 30 C.F.R. § 256.53(d)(1) (2001).

[116] 30 C.F.R. § 256.56 (2001).

[117] 30 C.F.R. § 256.57 (2001).

February 21, 2002, may possibly trigger a new supplemental bonding assessment. In addition, the MMS intends to review the anticipated abandonment liability for all fields with wells older than twenty (20) years during the second quarter of 2002.[118]

D. Liability of Assignor and Assignee

The same conditions which have stimulated the MMS' concern about the potential exposure of the United States to lease abandonment liability substantially in excess of surety bond coverage also have stimulated significant controversy between the MMS and the oil and gas industry concerning the residual liability of an assignor for lease obligations (including well plugging and abandonment) arising after a transfer of interest in an OCS lease has been approved by the MMS and become effective. In the 1997 Bonding Regulations, the MMS took aggressive steps to resolve this issue in its favor.

Current MMS Regulations, which include the amendments accomplished under the 1997 Bonding Regulations, provide as follows:

> (d) [The assignor is] liable for all obligations that accrue under [its] lease before the date the Regional Director approves [the assignor's] request for assignment of the record title in the lease. The Regional Director's approval of the assignment does not relieve [the assignor] of accrued lease obligations that [the] assignee, or a subsequent assignee, fails to perform.
>
> (e) [The] assignee and each subsequent assignee are liable for all obligations that accrue under the lease after the date that the Regional Director approves the governing assignment. They must
>
> (1) Comply with all the terms and conditions of the lease and all regulations issued under the [OCSLA]; and
>
> (2) Remedy all existing environmental problems on the tract, properly abandon all wells, and reclaim the lease site in accordance with [applicable regulations].
>
> (f) If [the] assignee, or a subsequent assignee, fails to perform any obligation under the lease for the regulations in this chapter, the Regional Director may require [the assignor] to bring the lease into compliance to the extent that the obligation accrued before the Regional Director approved the assignment of [the assignor's] interest in the lease.[119]

MMS regulations continue by providing that an assignor does not "gain a release of any non-monetary obligation" under an OCS lease or MMS Regulations "by creating a sublease or

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[118] See Oynes, MMS Update, AMERICAN ASSOCIATION OF PETROLEUM LANDMEN - OCS WORKSHOP, Houston, Texas, at 5 (2002).

[119] 30 C.F.R. §§ 256.62(d), (e), and (f) (2001).

transferring operating rights",[120] or "a release from any accrued obligation" under the transferred OCS lease or MMS Regulations "by assigning [its] record title interest in the lease."[121]

The quoted MMS Regulations make clear that the liability of an assignee of an interest in an OCS lease commences with respect to obligations that accrue after the date on which the transfer instrument is approved by MMS, and that the continuing, or residual, liability of the assignor is limited to those obligations that accrue under the affected OCS lease after the date on which the MMS approves the transfer instrument. The key issue in this analysis then, is when does an obligation "accrue" under an OCS lease? In the 1997 Bonding Regulations, the MMS addressed this issue by amending its regulations concerning oil and gas operations in Part 250 of 30 C.F.R. to provide:

> (b) Lessees must plug and abandon all well bores, remove all platforms or other facilities, and clear the ocean of all obstructions to other users. This obligation:
>
> (1) Accrues to the lessee when the well is drilled, the platform or other facility is installed, or the obstruction is created; and
>
> (2) Is the joint and several responsibility of all lessees and owners of operating rights under the lease at the time the obligation accrues, and of each future lessee or owner of operating rights, until the obligation is satisfied under the requirements of this part.[122]

The quoted MMS Regulations represent the culmination of a decade-long effort by MMS to establish regulatory authority for the propositions that (i) co-lessees and operating rights owners are jointly and severally liable for compliance with MMS Regulations and the terms of their OCS leases with respect to non-monetary, operational obligations, and (ii) the assignor of an OCS lease remains responsible for all wells and facilities that were in existence at the time the assignor assigned its interest in the affected OCS lease until the relevant wells are plugged and abandoned, the facilities are decommissioned, and the site is reclaimed.[123] This issue had been brought into sharp focus for the MMS in the late 1980s and early 1990s as the MMS had sought ways to reduce the gap between potential lease abandonment liability on the OCS and its available surety bond coverage. MMS' prior regulations on this issue were less specific than the current regulations quoted above concerning the issue of when obligations "accrued" under an OCS Lease.[124] As a result, disputes had arisen between OCS oil and gas producers and the

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[120] 30 C.F.R. § 256.64(a)(5) (2001).

[121] 30 C.F.R. § 256.64(a)(6) (2001).

[122] 30 C.F.R. § 250.110(b) (2001).

[123] See Preamble to Final Rule, Surety Bonds for Outer Continental Shelf Leases, Docket No. RIN1010-AB92, 62 Fed. Reg. 27948-49 (May 22, 1997).

[124] Prior MMS Regulations provided that "[t]he assignor shall be liable for all obligations under the lease accruing prior to the approval of the assignment." 30 C.F.R. § 256.62(d) (repealed). Regarding the issue of assignee liability, such regulations provided that "[t]he assignee shall be liable for all obligations under the lease subsequent to the effective date of an assignment, and shall comply with all regulations issued under the [OCSLA] including the requirement to furnish surety bonds as specified in OCS leases and [applicable regulations]." 30 C.F.R. § 256.62(e) (repealed).

MMS concerning the timing of the accrual of such obligations.[125] As the MMS attempted to resolve these disputes, it is fair to say that its position on the issue of residual liability "evolved."

In a 1989 memorandum from the Associate Director for Offshore Minerals Management to the Regional Director, Gulf of Mexico OCS Region, the Associate Director reaffirmed the position previously taken by the MMS in correspondence to Amoco Production Company to the effect that, if the assignee of an OCS lease is unable to fulfill its lease abandonment obligations, DOI would not proceed against the original lessee-assignor to perform those functions. According to the Associate Director, "Once the Secretary's designee unconditionally approves the assignment of a lease, the assignee must be looked to for the fulfillment of 'all' obligations under the lease."[126] As late as 1991, the MMS continued to adhere to this position in correspondence approving an assignment of a record title interest, stating:

> Assignor shall be liable for all obligations under the lease which came into existence and required performance by regulation or order prior to the approval date of this assignment. To the extent Assignor has transferred his entire estate in the demised premises, assignor is released and discharged from obligations under the lease which come into existence subsequent to the approval date of this assignment.[127]

By 1993, however, the position of the MMS on the issue of residual liability had shifted dramatically.[128] The first formal statement by the MMS to OCS lessees and operators on this subject came in a Notice to Lessees dated October 6, 1993.[129] According to NTL No. 93-2N:

> The obligations to plug and abandon wells, remove platforms and other facilities, and to clear the seafloor of obstructions accrue when a well is drilled or used, a platform or other facility is installed or used, or an obstruction is created. These obligations continue until the procedures specified in 30 C.F.R. Part 250, Subpart G, Abandonment of Wells, are followed.
>
> Following MMS approval of the assignment of an OCS oil and gas lease, the assignor continues to be liable to DOI/MMS for the performance of these obligations with respect to wells, structures,

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[125] Many producers argued that if an existing obligation does not accrue until the time of its performance, then under MMS Regulations, an assignor would retain residual liability only for those lease obligations as to which the time of performance arose prior to MMS approval of the transfer. Under this analysis, well plugging obligations would not accrue until the relevant well had been determined no longer to be useful for lease operations, and platform abandonment obligations would not accrue until one year after the termination of the relevant lease. See Roberts, Residual Liability and the Disposition of Producing Properties, HOUSTON BAR ASSOCIATION OIL, GAS & MINERAL LAW SECTION Presentation, February 22, 1994, at 13 (hereinafter, "Roberts"). See generally Yeates, supra note 9.

[126] Unpublished Internal Memorandum dated November 6, 1989, from the Associate Director for Offshore Minerals Management to the Regional Director, Gulf of Mexico OCS Region, entitled "Responsibility of Assignors and Assignees."

[127] See Roberts, supra note 125, at 13.

[128] See generally, Roberts, supra note 125, 1; Poling, Emerging Issues in OCS Regulation, NATIONAL OCEAN INDUSTRIES ASSOCIATION, WASHINGTON, D.C. at 5-6 (April 10, 1991).

[129] NTL No. 93-2N (October 6, 1993) ("NTL No. 93-2N").

> or obstructions in existence and not plugged or removed at the time of the assignment. . . .
>
> The MMS looks first to the designated operator to perform these obligations. Should the operator be unable to perform the lessee's obligations to plug and abandon wells, remove platforms and other facilities, and clear the seafloor of obstructions, MMS will normally require any or all of the lessee(s) to perform the activities necessary to bring about compliance. If there is no lessee able to perform, MMS will require prior lessees who held the lease during or after the time when the facilities were installed or the obstructions created to perform those functions. The MMS is not authorized or funded to assume responsibility for these obligations.[130]

The MMS reiterated its position in this regard in the preamble of the amended surety bond regulations in 1993 stating, in particular, that its earlier conclusion that liability for the performance of well plugging and abandonment, platform removal, and site clearance operations passed to the assignee of an OCS lease was "erroneous" and "mistaken."[131] MMS' promulgation of the current regulations on this issue in 1997 represented the closing of the circle on this issue, at least for the time being.

IV. FILING AND RECORDING TRANSFERS OF INTEREST

The final matters to be considered in this paper concern the filing and recording requirements applicable to transfers of interests in OCS leases and other types of instruments affecting OCS leases, such as assignments of overriding royalty interests, production payments, and similar interests, and mortgages and other lien instruments.

A. Applicability of State Law under OCSLA

The regulations set forth in Subpart J of Part 256 of 30 C.F.R. appear clearly to establish the rights of assignees of record title interests and operating rights in OCS leases vis-a-vis the United States. Neither the OCSLA nor these regulations, however, address or establish the comprehensive mechanisms present in state law recording statutes that govern competing claims and priorities of ownership, lien rights, and other similar "private party" disputes. As discussed above in Section II.C of this paper, Section 1333(a)(2)(A) of the OCSLA adopts the laws of the adjacent states as surrogate federal law, to the extent that state law is "applicable and not inconsistent with applicable federal law" - that is, under the 5th Circuit's rationale in the Union Texas Case, if (i) the controversy affects a situs covered by the OCSLA, (ii) Federal maritime law does not apply of its own force, and (iii) applicable state law is not inconsistent with Federal law. Thus, in assessing whether state law regimes governing the recording of, and the effect of recording on, conveyances and other instruments pertaining to real property should be adopted as surrogate federal law with respect to the OCS, it must be determined whether the Union Texas Case's three-pronged test is satisfied on this point.

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[130] Id.

[131] Preamble to Final Rule, Surety Bond Coverage for Leasing of Sulphur or Oil and Gas in the Outer Continental Shelf (OCS), Docket No. RIN 1010-AB38, 55 Fed. Reg. 45255, 45257 & N. 1 (August 27, 1993).

It seems clear that the first two elements of the Union Texas Case's test are met. By definition, the issue of where to file and record transfers of interests in OCS leases pertains to a situs covered by the OCSLA. Further, our research has discovered no Federal maritime law that would apply of its own force to this issue. The remaining question, then, is whether state law would be inconsistent with Federal law on this point. That no such inconsistency exists may be seen by reviewing the recording statutes in effect in Texas. Under Texas law, an instrument concerning real or personal property may be recorded if it has been acknowledged, sworn to with a proper jurat, or approved according to law.[132] An instrument conveying real property may not be recorded unless it is signed and acknowledged or sworn to by the grantor in the presence of two or more credible subscribing witnesses or acknowledged or sworn to before and certified by an officer authorized to take acknowledgements or oaths, as applicable.[133] To be effectively recorded, an instrument relating to real property must be eligible for recording and must be recorded in the county in which a part of the property is located.[134] An unrecorded conveyance or other instrument pertaining to real property is binding on the parties to the instrument,[135] but a conveyance of real property, or an interest in real property, or a mortgage or deed of trust is void as to a creditor or to a subsequent purchaser for a valuable consideration without notice unless the instrument has been acknowledged, sworn to, or approved and filed for record as required by law.[136] An instrument that is properly recorded in the proper county is notice to all persons of the existence of the instrument.[137]

The following hypothetical is helpful in understanding the dilemma that would be faced by a court in an action to resolve competing claims of ownership or lien rights with respect to an OCS lease based upon nothing more than the regulations set forth in Subpart J of Part 256 of 30 C.F.R. Assume that A is the owner of record title to an OCS lease as reflected on an MMS approved assignment to A by the original lessee who had purchased the lease in an OCS lease sale on January 1, 2000. On June 1, 2000, pursuant to separate assignments, A conveys to X an overriding royalty interest in production from the OCS lease. X files its assignment of overriding royalty with the MMS but does not record such assignment in the records of the adjacent county. On January 1, 2001, A drills an oil and gas well on the subject lease. B participated with A in the drilling of the oil and gas well pursuant to a farmout agreement under which B is entitled to an assignment of operating rights in the subject lease upon the drilling and completion of the well as a producing well. On April 1, 2001, A delivers the assignment of operating rights to B, who files such assignment with the MMS, but the MMS rejects the assignment because of defects in form. In October 2001, B mortgages its interest in the subject lease to Bank, which files the mortgage in the MMS records, but not in the records of the adjacent county. Thereafter, A and B enter into a farmout agreement with C, pursuant to which C drills a test well on the west half of the OCS block covered by the subject lease in exchange for an assignment of 100% of the record title interest in the test well prior to payout and an undivided 75% record title interest in the remainder of the west half of the OCS block and the test well after payout. Obviously, C is aware of B's interest in the subject lease, but A and B fail to disclose to C the existence of the overriding royalty of X. The farmout agreement is executed and delivered on January 1, 2002, and C commences the drilling of the test well in February 2002. In March 2002, prior to the completion of the test well and the delivery of assignments to

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[132] TEX. PROP. CODE ANN. § 12.001(a) (Vernon 2001).

[133] TEX. PROP. CODE ANN. § 12.001(b) (Vernon 2001).

[134] TEX. PROP. CODE ANN. § 11.001(a) (Vernon 2001).

[135] TEX. PROP. CODE ANN. § 13.001(b) (Vernon 2001).

[136] TEX. PROP. CODE ANN. § 13.001(a) (Vernon 2001).

[137] TEX. PROP. CODE ANN. § 13.002 (Vernon 2001).

C, and prior to resubmission to and approval by the MMS of B's assignment from A, A files a voluntary petition in bankruptcy under Chapter 11 of the Bankruptcy Code.

Even with the MMS' adoption of a requirement that transfers of "carried working interests, overriding royalty interests, and payments of production" be filed with the MMS "for reward purposes,"[138] the resolution of the competing claims of the parties in the foregoing hypothetical appears to be impossible in any logical manner if resort is had only to the OCSLA and the regulations set forth in Subpart J of Part 256 of 30 C.F.R. The OCSLA and Subpart J simply do not deal with the issues necessary to resolve competing claims among parties when assignments have not been made or filed for approval, or when assignments in the chain of title have been filed with the MMS and are pending for approval, or when the relevant interest is not regarded as one for which MMS filing and approval is required.

As between A, B, and C, are the interests of B and C cut off by operation of Section 544 of the Bankruptcy Code? Does the filing of the overriding royalty assignment of X impart constructive notice of its existence, so that if C is able to obtain an assignment of interest under Section 541(d) of the Bankruptcy Code, C's interest would be burdened thereby? Does B's bank have secured creditor status?

Based upon the foregoing, we suggest that there clearly is no inconsistency between applicable state law and Federal law pertaining to these issues, so that the adoption of state law recording regimes as surrogate federal law is appropriate under Section 1333(a)(2)(A) of the OCSLA and the test enunciated in the Union Texas Case.

B. Effect of World Hospitality and Union Texas Cases

Our research has discovered some authority that recognizes the applicability of state law recording regimes to the perfection of mechanic's and materialmen's liens against onshore federal leases.[139] Prior to the Union Texas Case and the World Hospitality Case, however, our research failed to discover any judicial recognition of the applicability of such state law recording regimes in the context of OCS title matters. The prior case law that bears on this issue, all of which relates to the applicability to OCS leases of the Louisiana Oil Well Lien Act,[140] was inconclusive.[141]

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[138] See 30 C.F.R. § 256.64(a)(7) (2001).

[139] See O'Kane v. Walker, 561 F.2d 207 (10th Cir. 1977); Bolack v. Underwood, 340 F.2d 816 (10th Cir. 1965).

[140] La. R.S. §§ 9:4861, et seq. (2001).

[141] In St. Mary Iron Works, Inc. v. McMoRan Exploration Co., 802 F.2d 809 (5th Cir. 1986), the Fifth Circuit found that Louisiana law required filings in connection with the Louisiana Oil Well Lien Act to be made in the parish where the property in question was located in order to perfect a valid lien under such Act, but that there was no statutory means of filing when the property was located on the OCS. As a result, the plaintiff was held to have no lien. The Fifth Circuit withdrew this opinion based upon a subsequent Louisiana Supreme Court decision which held that the recording of a lien filing is not necessary for the existence of a lien under the Louisiana Oil Well Lien Act. 809 F.2d 1130 (5th Cir. 1987). See Louisiana Materials Co., Inc. v. Atlantic Richfield Co., 493 So. 2d 1141 (La. 1986). Conversely, one earlier Fifth Circuit decision and two more or less contemporaneous Louisiana Court of Appeal decisions upheld Louisiana Oil Well Lien Act liens against OCS leases, although the question of the lack of an expressed statutory filing mechanism for such liens with respect to OCS leases was not squarely presented in any of those cases. See Continental Casualty Co. v. Associated Pipe & Supply Co., Inc., 447 F.2d 1041 (5th Cir. 1971); Genina Marine Services, Inc. v. Arco Oil & Gas Co., 499 So.2d 257 (La. App. 1st Cir. 1986); Genina Marine Services, Inc. v. Mark Producing Co., 490 So.2d 1158 (La. App.3d Cir. 1986). A more recent unreported decision by the United States District Court for the Eastern District of Louisiana is more closely in point. In Brown & Root U.S.A., Inc. v. Prosper Energy Corp., Civ. No. 87-0343 (E.D. La. 1987), the plaintiff filed notices of lien claims under the Louisiana

1. THE WORLD HOSPITALITY CASE.

The issue of the applicability of state law recording regimes to OCS title matters was faced squarely for the first time in a reported decision in World Hospitality, Ltd. v. Shell Offshore, Inc.[142] In that case, the plaintiff, a provider of offshore catering services, filed mechanics' and materialmen's liens under the Texas Oil & Gas Lien Statute,[143] against an OCS lease offshore Texas. The plaintiff filed its liens both with the MMS and in the two Texas coastal counties located closest to the offshore block covered by the relevant OCS lease. The court held that the plaintiff's lien filing with the MMS was ineffective to perfect a mechanics' and materialmen's lien in favor of the plaintiff against the OCS lease under the terms of the Texas Oil & Gas Lien Statute, but that the plaintiff's lien filings in the two coastal counties complied with, and were sufficient to perfect its mechanics' and materialmen's lien under, such statute. In so holding, the court stated:

> Because Texas law applies to the perfection of a lien claim on the Outer Continental Shelf adjacent to Texas, to perfect its lien against Shell's lease World Hospitality is required to notify Shell and to file a lien claim affidavit in a real property records of the nearest county within six months of the last day labor and supplies were furnished. Tex. Prop. Code Ann. § 56.021 (1984); 43 U.S.C. § 1333(a)(2)(A).[144]

Arguing in support of its lien filing with the MMS, the plaintiff asserted that the MMS should be substituted for county filings because the local recording requirement forced lien claimants to guess about the correct seaward extension of the county lines, and the use of the MMS office for such filings would give those dealing with federal offshore leases a central filing office in which to search for such matters in each major region. In rejecting this argument, the court stated:

> Although this position has some logic, people interested in land titles are accustomed to the locations and methods of the local agencies, and more important, Congress has made the policy choice to use the counties, by which choice this court is bound.
>
> The holding here is that the filing by World Hospitality with MMS does not comply the Outer Continental Shelf Lands Act's importation of adjacent-state law to perfect a supplier's lien on an owner's mineral leasehold interest.[145]

Oil Well Lien Act against an OCS lease offshore Louisiana in five Louisiana coastal parishes and with the MMS. The lessees argued that the plaintiff's Louisiana Oil Well Lien Act lien would be valid only if it was recorded in the "mortgage records of the parish where the property is located" and that, because the OCS is not in any parish, there is no place where a valid lien could be recorded. In rejecting the lessees' contention, the district court stated that the Louisiana Oil Well Lien Act was the type of law that Congress had intended to supplement federal law on the OCS, and that the lessees' interpretation of the scope of the Louisiana Oil Well Lien Act therefore was "contrary to the Congressional mandate."

[142] 699 F. Supp. 111 (S.D. Tex. 1988).

[143] TEX. PROP. CODE ANN. §§ 56.001, et seq. (Vernon 2001).

[144] Id. at 113.

[145] Id. at 113-14.

No appeal was taken from the district court's judgment in this case.

2. THE UNION TEXAS CASE.

Two years later, the Fifth Circuit addressed the same issues in the context of OCS operations offshore Louisiana in Union Texas Petroleum Corporation v. PLT Engineering, Inc.[146] In the Union Texas Case, Union Texas Petroleum Corporation ("UTP") entered into an offshore construction contract with PLT Engineering, Inc. ("PLT"), pursuant to which PLT was to design, fabricate, and install a gas transportation system from a platform owned by UTP and others in Vermilion Block 137, offshore Louisiana, to a side tap in the Bluewater Pipeline owned by Columbia Gulf Transmission Company, located in Vermilion Area Block 225. In connection with the construction of such gas transportation system, PLT engaged a number of parties to perform labor and services and to furnish materials, equipment, and supplies (hereinafter, the "subcontractors").[147] PLT ultimately completed the pipeline, but, through communications with the subcontractors, UTP learned that PLT had not paid the subcontractors. Accordingly, UTP invoked the contractual provision that allowed it to withhold money from the amount due under its contract with PLT. UTP then instituted an interpleader action to enable PLT and the subcontractors to determine how the money should be allocated among them. Each of the subcontractors answered and filed counterclaims asserting liens. The subcontractors filed such liens both with the MMS and in the adjacent coastal parishes of Louisiana.[148]

The United States District Court for the Western District of Louisiana entered a judgment in favor of each of the subcontractors, holding that (a) the Louisiana Oil Well Lien Act was applicable in the present case; (b) federal admiralty law was not applicable; and (c) the subcontractors had complied sufficiently with the recordation requirements for their liens by their lien filings in the adjacent parishes and with the MMS. On appeal, the Fifth Circuit affirmed the district court's judgment and holding on all counts.[149]

After setting forth the three-pronged test relating to the adoption of the Louisiana Oil Well Lien Act as surrogate federal law in the present case, discussed above in Section II.A of this paper, the court rejected UTP's contentions that all of the subcontractors' contracts for the building and completion of the pipeline (a) called for services that were provided from vessels and by divers in the ocean, (b) were therefore not in areas covered by the OCSLA, and (c) were, instead, maritime in nature and thus subject exclusively to admiralty law.[150] The court held that the referenced activities were not, in fact, traditionally maritime, but rather were the subjects of oil and gas exploration and production that were within the scope of the OCSLA, so that the Louisiana Oil Well Lien Act was applicable.[151]

Then, after rejecting UTP's contention that the subcontractors were not persons entitled to assert liens under the terms of the Louisiana Oil Well Lien Act, the court rejected UTP's argument that the subcontractors' liens had not been properly filed within the meaning of the statute. Under La. R.S. 9:4862(a)(1), in order to preserve the lien privilege granted by the Louisiana Oil Well Lien Act, a notice of the lien claim or privilege "shall be filed for record and

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[146] 895 F.2d 1043 (5th Cir. 1990).

[147] Id. at 1045.

[148] Id. at 1046.

[149] Id.

[150] Id. at 1047.

[151] Id. at 1049.

inscribed in the mortgage records of the parish where the property is located." UTP argued that this requirement was not complied with because the well in question was located on the OCS. As such, the liens could not be recorded in the parish where the property was located because the property was not located in a parish. UTP cited the Fifth Circuit's first decision in the St. Mary Iron Works case in support of this proposition.[152]

The Fifth Circuit expressly rejected UTP's argument and the court's previous rationale in the first St. Mary Iron Works case, stating:

> If [La. R.S.] 9:4862 were to be read as UTP urges, to allow liens to be recorded only if the property is located on land in a parish, it would deny the subcontractors the protection of Louisiana law merely because their work was performed on the OCS rather than on shore. At the least, this would frustrate the Congressional intent behind OCSLA that state law operate as surrogate federal law on the OCS. It would anomalous to deny the liens here when a principle reason for adopting state law to apply as federal law on the OCS was to protect all those who perform activities including providing services and materials on the OCS.[153]

3. ANALYSIS.

The decisions in the World Hospitality Case and the Union Texas Case clearly stand for the proposition that, with respect to mechanics' and materialmen's liens asserted against OCS leases located offshore Texas and Louisiana pursuant to, respectively, the Texas Oil & Gas Lien Statute and the Louisiana Oil Well Lien Act, filing must be made in the appropriate records of the coastal counties adjacent to the OCS block covered by the affected OCS lease in question in order to perfect such liens. Lien filings pursuant to such statutes made solely with the MMS do not create valid liens thereunder. Based on these decisions, it also appears that it is unnecessary to make a lien filing at all with the MMS to perfect liens under these statutes. MMS regulations do not mandate any such filings and clearly give the MMS the power to reject the filing of documents that do not transfer record title interests or operating rights, or create or transfer carried working interests, overriding royalty interests, or payments out of production, in or from OCS leases.[154] If the state lien statutes incorporated into the OCSLA as surrogate federal law contain no mandate for such a filing with the MMS, there appears to be no other basis upon which such an MMS filing could be required.

We suggest, however, that there is no logical reason to limit the holdings in the World Hospitality Case and the Union Texas Case to the narrow issue of lien perfection under the Texas Oil & Gas Lien Statute and the Louisiana Oil Well Lien Act, and that it is entirely reasonable to treat the World Hospitality Case and the Union Texas Case as standing for the proposition that the Texas and Louisiana recording statutes are applicable as surrogate federal law to the OCS offshore Texas and Louisiana, respectively. If that is the case, in order to be validly recorded, all documents pertaining to title to OCS leases offshore Texas - including transfers of record title interests and operating rights, assignments of carried working interests,

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[152] Id. at 1051.

[153] Id. In so holding, the court cited with approval the district court decision in Brown & Root USA, Inc. v. Prosper Energy Corp. Civ. No. 87-0343 (E.D.La. 1987).

[154] 30 C.F.R. § 256.64(a)(8)(2001).

overriding interests, production payments, and other nonoperating interests, mortgages, deeds of trust, mechanics' and materialmen's lien filings, notices of lis pendens, judgment liens, and the like - should be recorded in the coastal counties or parishes adjacent to the OCS block covered by the relevant OCS lease in accordance with the provisions of the applicable recording statutes.

We are aware that many practitioners are of the view that county or parish filings of assignments of interests in OCS leases are unnecessary because MMS regulations expressly provide for the filing with the MMS of such documents.[155] It is clear that Subpart J of Part 256 of 30 C.F.R. establishes the rights of the parties to such a transfer of interest vis-a-vis the United States government. We submit, however, that such regulations do not contain a complete scheme for ordering the rights and priorities of competing owners of interests in OCS leases. Such regulations do not contain, for example, a provision equivalent to Section13.001(a) of the Texas Property Code which establishes the effects that the time of filing and the presence or absence of notice have on the priority of competing claims to real property interests. In the absence of this type of provision, we argue that, under the three-pronged test in the Union Texas Case, the incorporation as surrogate Federal law of state recording laws with respect to assignments of interests in OCS leases and other documents affecting ownership of real property is appropriate as well.

C. Which State? Which County or Parish?

Having concluded that it is both appropriate and necessary for an assignee of an interest in an OCS lease to record its title to the relevant OCS lease in the records of the adjacent county or parish, it then becomes necessary to determine which state, and which counties or parishes within that state, are adjacent to the OCS block in question.

1. DETERMINING ADJACENT STATES.

The OCSLA and the MMS regulations offer little guidance in this regard. Recall that Section 1333(a)(2)(A) of the OCSLA provides that to the extent that they are applicable and not inconsistent with Federal laws, the civil and criminal laws of each adjacent state were adopted as the law of the United States "for that portion of the subsoil and seabed of the Outer Continental Shelf and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the Outer Continental Shelf . . ."[156] Such provision continues as follows:

> . . . The President shall determine and publish in the Federal Register such projected lines extending seaward and defining each such area.[157]

Since the 1953 passage of the OCSLA, the President has never determined and published such projected lines. Nevertheless, there is some guidance available in this regard.

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[155] 30 C.F.R. §§ 256.62, 256.64 (2001). See Laperouse, Federal OCS Leases: Preparation of Title Opinions, Filing and Approval Requirements, PETROLEUM LANDMAN ASSOCIATION OF NEW ORLEANS, LOUISIANA, CONFERENCE ON OCS LEASES, BEAVER CREEK, COLORADO at 27-28. (1989) (hereinafter, "Laperouse").

[156] 43 U.S.C. § 1333(a)(2)(A) (2001).

[157] Id.

In Texas v. Louisiana,[158] the United States Supreme Court determined the lateral seaward boundary between the states of Louisiana and Texas out to the point of Louisiana's seaward boundary three miles from its coastline, and the boundary between Texas and the United States from that point out to the seaward boundary of Texas three marine leagues from its coastline. A Special Master appointed by the Supreme Court utilized, and the Supreme Court approved, reference to the median line, or equidistant principle, recognized by Article 12 of the 1958 Geneva Convention on the Territorial Sea and the Contiguous Zone.[159] The Supreme Court decision did not extend this boundary into the OCS beyond the seaward boundary of Texas. In the absence of action by the President, the simple extension of such boundary beyond that point into the OCS does not satisfy the express provisions of Section 1333(a)(2)(A) of the OCSLA. It seems unlikely, however, that, given the extremely protracted litigation that resulted in the Supreme Court's decision in Texas v. Louisiana, the President, in making the determination called for in Section 1333(a)(2)(A), would project such a boundary line into the OCS on a course different from that approved by the Supreme Court.

Absent a determination of the lateral seaward boundaries between two states by Presidential proclamation, judicial decision, or regulatory action by the MMS, the current governing approach to the resolution of this issue, at least in the Fifth Circuit, is that set forth in Reeves v. B&S Welding, Inc.[160] In Reeves, a case involving an action for damages sustained by a worker on an offshore gas production platform located in the High Island area offshore of Texas, the court was called upon to determine whether the OCSLA required Texas or Louisiana law to govern the claims of the injured worker. In determining that the gas production platform in question was "adjacent" to the State of Texas for purposes of Section 1333(a)(2)(A) of the OCSLA, the court analyzed all of the relevant evidence regarding the "adjacency" issue, which fell into four general categories: (i) the relative geographic proximity to Texas or Louisiana of the gas production platform; (ii) the treatment of the location of the platform by the relevant administrative agencies; (iii) prior judicial determinations; and (iv) projected boundaries between the affected states.[161] According to the court:

> It is enough that the record evidence before the district court confirms that Platform 342-B is closer to the Texas coast than the Louisiana coast, that the relevant federal agencies consider Platform 342-B to be off the Texas coast, that other courts have considered other High Island platforms to be adjacent to Texas, and that the boundary between Texas and Louisiana projected out into the Gulf in its original direction from the shore, places Platform 342-B within Texas waters. So does the line projected directly southward from the Texas three league territorial boundary.[162]

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[158] 426, U.S. 465, 96 S. Ct. 2155, reconsideration denied, 429 U.S. 810, 97 S. Ct. 47 (1976).

[159] [1964], 15 U.S.T. (pt. 2) 1606, T.I.A.S. No. 5639. 426 U.S. at 468-70, 96 S.Ct. at 2157.

[160] 897 F.2d 178 (5th Cir. 1990).

[161] Id. at 180.

[162] Id. The administrative agencies referred to by the court include the MMS, the Bureau of Land Management of the DOI, and the National Oceanic & Atmospheric Administration, and the Coast Guard. Id. at 179. The High Island area had previously been determined to be adjacent to the State of Texas under the OCSLA in Herbert v. Kerr-McGee Corp., 618 F.Supp. 767 (W.D. La. 1985), and J. Ray McDermott and Co. v. Fidelity & Casualty Co., 466 F.Supp. 353 (E.D. La. 1979). 897 F.2d at 180.

Subsequent decisions relating to this issue have followed the Fifth Circuit's analysis in Reeves.[163]

2. DETERMINATION OF ADJACENT COUNTIES OR PARISHES.

A similar type of problem exists with respect to determining which county or parish within a state is "adjacent" to the relevant OCS block. The OCSLA and the MMS regulations are silent on this point. Under these circumstances, we suggest that the incorporation as surrogate federal law of existing relevant state law is appropriate under the three-pronged test of the Union Texas Case.

Both Texas and Louisiana have enacted statutes which provide for the extension of the boundaries of the coastal counties and parishes from the coastline to the boundary of the OCS. The Louisiana statute[164] specifically describes the extension of the boundaries of the coastal parishes, while the Texas statutes[165] provide that the Commissioner of the General Land Office ("GLO") will locate and set the boundary lines between the coastal counties and cause plats showing the locations of such boundary lines to be filed and recorded in the offices of the county clerks of the coastal counties.[166] The GLO has confirmed that such plats have been prepared and are maintained in the Austin, Texas, office of the GLO. It is, however, unclear whether those maps have been provided to the offices of the county clerks of the coastal counties in Texas.

Under the principles of Section 1333(a)(2)(A) of the OCSLA, therefore, these sets of boundary lines should be extended into the OCS for purposes of adjacent county determinations. Fortunately, the Fifth Circuit concurred in this analysis and expressly adopted La. R.S. 49:6A as surrogate federal law in the Union Texas Case. In so holding, the court stated:

> The combination of both OCSLA and Louisiana law extend Vermilion parish beyond the location of the work done here. Louisiana law provides that, "the gulfward boundary of all said coastal parishes extend coextensively with the gulfward boundary of the State of Louisiana. LSA-R.S. 49:6. OCSLA adopts this state law and extends the boundaries of Vermilion parish to the outer limits of the OCS by providing that state law applies to the subsoil and seabed of the OCS and all artificial islands thereon "which would be within the area of the State if its boundaries were extended seaward to the outer margin of the Outer Continental Shelf . . . ." 43 U.S.C. §1333(a)(2)(A). Thus the

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[163] See Snyder Oil Corporation v. Samedan Oil Corporation, 208 F.3d 521 (5th Cir. 2000); Pittencrieff Resources, Inc. v Firstland Offshore Exploration Co. 942 F.Supp. 271 (E.D. La. 1996). It should be noted that, in the Snyder case, the Fifth Circuit made clear that Reeves endorsed an approach to the "adjacency" issue that considered all relevant evidence, and did not establish a strict four-pronged test for such a determination. 208 F.2d at 525. In rejecting the appellant's claim that geographic proximity should be dispositive in this determination, the court stated, "we cannot apply the formalistic test desired by Snyder, for neither logic nor authority allows this court arbitrarily to disregard all relevant evidence except that of geographic proximity." Id.

[164] La. R.S. 49:6A (2001).

[165] TEX. NAT. RES. CODE ANN. §§ 31.063 and 11.013 (Vernon 2001),

[166] See Laperouse, supra note 155, at 31-32.

> liens were actually filed in the parish where the property is located.[167]

Although the Union Texas Case applies only Louisiana law, there is no reason to believe that the court, if faced with similar facts applying Texas law, would reach a different result.

V. CONCLUSION

As the foregoing discussion indicates, the last ten years has seen the resolution of a number of the issues relating to transfers of interest in OCS leases that perplexed oil and gas producers and the MMS in the late 1980s and early 1990s. Current MMS Regulations have clarified the MMS' position on the residual liability of assignors of interests in OCS leases for the non-performance of operational obligations by the assignees of such leases. Regardless of whether the producer community agrees with the MMS' position in this regard, at least both parties have a clearer understanding of where they stand. The World Hospitality Case and the Union Texas Case remain established law, with the result that it has become accepted practice for transferees of interests in OCS leases either to require their assignors to provide, or to provide on their own behalf, fully recorded chains of title to the affected OCS leases in the records of the county or parish adjacent to the OCS block covered by such OCS leases.

MMS Regulations regarding lease bonding and supplemental bonding are more complex and sophisticated than ever, but producers should expect these regulations to continue to evolve. The one issue about which no action has been taken at any level of the Federal Government concerns the identification of the adjacent states and counties or parishes relative to different areas of the OCS. The best global solution for this issue would be for the President to determine and publish the state boundaries in accordance with the provisions of Section 1333(a)(2)(A) of the OCSLA and for the MMS to establish the boundaries between the coastal counties and parishes in a manner consistent with the state boundaries drawn by the President. As of the date of this writing, the author is aware of no action contemplated by either the White House or the MMS on this subject, so that, for the foreseeable future, oil and gas producers will be required to apply an analysis like that in the Reeves case in making their "adjacency" determinations.

[167] Union Texas Petroleum Corporation v. PLT Engineering, Inc., 895 F.2d 1043, 1051-52 (5th Cir. 1990).