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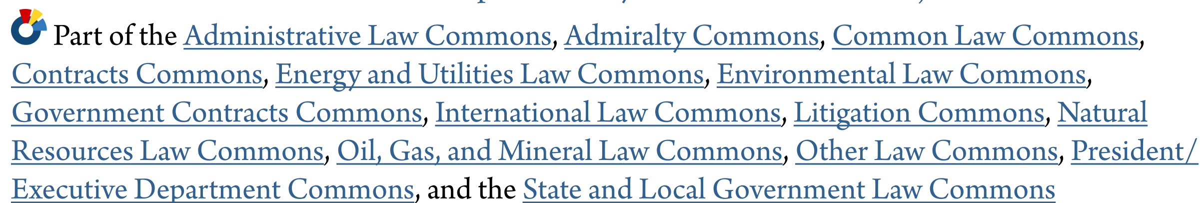
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OFFSHORE DRILLING: COMBATING REGULATORY UNCERTAINTY WITH CONTRACT LAW PROTECTION

ABSTRACT

Offshore drilling accounts for billions of dollars in tax revenue every year. It is a pillar of the energy industry and is crucial to the economy. A recent flurry of deregulation, accelerating with the arrival of the Trump administration, highlights the tremendous impact politics has upon the profitability of this sector. The Secretary of the Interior, under the direction of the President, wields the power to regulate and make determinations into where, when, and how private companies can drill offshore. These private companies have contracts with the government for the opportunity to produce and develop oil or gas on the outer continental shelf. The Note will examine whether a new act or regulation may constitute a breach of contract if the act or regulation makes production unduly burdensome and thus not feasible for a drilling venture. If production becomes unduly burdensome due to government intervention, then the contract may be breached. This could cause the company to lose billions of dollars in upfront costs and significant opportunity costs, and so private companies need protection from this contentious political battle over the United States' offshore resources. The suggested framework for this protection looks to a developing common law doctrine of offshore lease breaches and seeks to reconcile those opinions. Adopting this framework will allow parties to plan ex ante for future administration shifts and allow courts to more efficiently and predictably resolve disputes arising from newly passed legislation.

INTRODUCTION

In the first few months of his presidency, President Trump implemented an "America First" policy designed to promote the capture of offshore oil and gas resources in the United States.[1] President Trump put forward this strategy "in order to maintain the Nation's position as a global energy leader and foster energy security and resilience for the benefit of the American people."[2] The policy directs, *inter alia*, that the Secretary of the Interior: (1) revise the schedule of annual leases[3] to the maximum extent provided by law in certain offshore planning areas, (2) refrain from designating any new conservation sanctuaries, (3) revoke Executive Order

1. *See* Exec. Order No. 13,795, 82 Fed. Reg. 20815 (Apr. 28, 2017).
2. *Id.*
3. The Government annually reviews and issues leases of offshore lands; companies acquire these leases granting them the rights to rights to explore and develop oil. *See Oil & Gas Leasing on the Outer Continental Shelf*, BUREAU OF OCEAN ENERGY MGMT, https://www.boem.gov/uploadedFiles/BOEM/Oil_and_Gas_Energy_Program/Leasing/5BOEMRE_Leasing101.pdf (last visited Feb. 6, 2019).

13,754 of December 19, 2016 (Northern Bering Sea Climate Resilience),[4] (4) reconsider the Well Control Rule,[5] and (5) reconsider and rescind other prohibitive regulations, memoranda, and notices.[6] Furthermore, the "America First" policy removes regulations and safeguards put in place by previous administrations in furtherance of increasing energy production on federal lands and reducing reliance on imported energy.[7]

In the wake of Trump's inauguration, the Republican-controlled Congress adopted a similar spirit of deregulation. In December 2017, Congress approved a bill opening up oil and gas exploration in the 1.5-million-acre coastal plain of the Arctic National Wildlife Refuge (ANWR).[8] Congress passed the measure as part of its tax-reform package that President Trump signed into law on December 19, 2017.[9] This ended the thirty-seven-year ban on drilling in ANWR. This is significant because environmentalists consider ANWR one of the most pristine areas in the United States, as it is home to many exotic species and indigenous people.[10] Proponents of drilling in ANWR argue that drilling could create up to 130,000 jobs and up to $440 billion in government revenue.[11] Opening up ANWR to drilling remains highly controversial.

This is a dramatic shift from the Obama administration's energy policy that addressed climate change and focused on renewable energy.[12] The Trump administration has made a considerable effort to dismantle these energy regulations, and not just within the realm of offshore drilling. For example, on March 28, 2017, an Executive Order directed the

4. This Executive Order was signed by President Obama shortly before the Trump administration entered into power. The order created a "resilience area" stretching over 112,300 square miles. Furthermore, it withdrew 40,300 square miles in the of the Norton Basin from petroleum leasing. For more information, see *Obama Creates 'Resilience Area' to Protect Alaska's Bering Ecosystem*, CHI. TRIBUNE (Dec. 9, 2016, 9:56 PM), http://www.chicagotribune.com/news/nationworld/ct-alaska-bering-sea-protections-obama-20161209-story.html.

5. The Well Control Rule was enacted in 2016 and "updated requirements for equipment and operations for well control activities associated with drilling, completion, workover and decommissioning operations." *See* Well Control Rule, BUREAU OF SAFETY & ENVTL. ENF'T, https://www.bsee.gov/guidance-and-regulations/regulations/well-control-rule.

6. Exec. Order No. 13,795, 82 Fed. Reg. 20815 (Apr. 28, 2017).

7. *See id.*

8. Michael Collins, *Congress Moves to 'Drill, Baby, Drill' in Alaska's ANWR. Here's What You Should Know*, USA TODAY (Nov. 19, 2017), https://www.usatoday.com/story/news/politics/2017/11/19/congress-moves-drill-baby-drill-alaska-anwr-refuge-heres-what-you-should-know/874187001.

9. *See id.*; *see also* Thomas Kaplan & Alan Rappeport, *Republican Tax Bill Passes Senate in 51-48 Vote*, N.Y. TIMES (Dec. 19, 2017), https://www.nytimes.com/2017/12/19/us/politics/tax-bill-vote-congress.html.

10. Collins, *supra* note 8.

11. *Id.*

12. *See* Jeff Brady, *'America First' Energy Plan Challenges Free Market Realities*, NPR (Feb. 7, 2017, 4:01 PM), https://www.npr.org/2017/02/07/513905161/trumps-energy-shift-could-bring-higher-gas-prices-analysts-say.

Environmental Protection Agency (EPA) to dismantle the Clean Power Plan (CPP).[13] The CPP would have required states to substantially cut carbon dioxide emissions from existing power plants.[14] Another example is President Trump's withdrawal from the Paris Climate Agreement.[15] This agreement that would have led the United States to cut greenhouse gas emissions by as much as 28% from 2005 levels by 2025.[16] The purpose of these deregulations is to remove burdens on the energy industry to drive growth within the sector.[17]

Offshore drilling constitutes a massive sector of the energy industry and, as such, it is important that there is stability.[18] As energy companies react in response to the deregulation created by the Trump administration, uncertainty arises as to the profitability and risks of offshore drilling.[19] This uncertainty derives from the unknown actions that future administrations may take. While the Trump administration has ushered in a period of deregulation, what will the results be if past protections are reenacted? This is especially true regarding ANWR, as the region has been a hotbed of political contention for decades.[20] The core question which this Note explores is: when will government regulations interfere with company operations so substantially as to constitute a breach of the agreement between the government and energy companies? [21]

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13. Exec. Order No. 13,783, 82 Fed. Reg. 16,093 (Mar. 28, 2017).

14. *See* Israel Katz, *The Legal Climate on Climate Change: The Fate of the EPA's Clean Power Plan After Michigan and UARG*, 11 BROOK. J. CORP. FIN. & COM. L. 495, 495–96 (2017).

15. *See* Valerie Volcovici, *U.S. Submits Formal Notice of Withdrawal from Paris Climate Pact*, REUTERS, Aug. 4, 2017, 5:25 PM, https://www.reuters.com/article/us-un-climate-usa-paris/u-s-submits-formal-notice-of-withdrawal-from-paris-climate-pact-idUSKBN1AK2FM.

16. *See id.*

17. *See* Brady, *supra* note 12.

18. In 2016, 766,103 barrels of oil and 1,256,539,956 MCF of gas (an abbreviation denoting a thousand cubic feet of natural gas) were drilled from the Outer Continental Shelf (OCS); this production generated approximately $28 billion dollars based on the ratio of total revenue of the oil and gas industry for that year. *See MCF - Thousand Cubic Feet*, INVESTOPEDIA, https://www.investopedia.com/terms/m/mcf.asp (last visited Feb. 2, 2019) (providing an explanation of MCF); *Outer Continental Shelf Oil and Gas Production*, BUREAU OF SAFETY & ENVTL. ENF'T, https://www.data.bsee.gov/Production/OCSProduction/Default.aspx (last visited Feb. 2, 2019) (showing statistical data on the annual oil and gas production on the outer continental shelf); *U.S. gas and oil industry annual revenue 2010-2017*, STATISTA, https://www.statista.com/statistics/294614/revenue-of-the-gas-and-oil-industry-in-the-us/ (last updated Dec. 8, 2017) (showing a graph of oil and gas industry revenue in the United States from 2010 to 2017).

19. Companies lease land on the OCS (land which is in held in public trust) from the government to drill for oil and gas. *See also* Daniel Gross, *Businesses Are Finally Realizing That Trump Causes "Uncertainty"*, SLATE MAG. (Aug. 8, 2017, 5:10 PM), http://www.slate.com/articles/business/moneybox/2017/08/businesses_are_finally_realizing_that_trump_causes_uncertainty.html.

20. Collins, *supra* note 8.

21. As will be discussed throughout this Note, companies purchase leases from the Government in order to drill for oil and gas. These leases are subject to their provisions and a wide array of regulations. 16 U.S.C. § 1431 (1988).

The answer lies in contract law. Fundamentally, there is a relationship between the companies and the government, and at the heart of this relationship is a contract:[22] a bargained for exchange of mutual promises.[23] It is a basic tenant of contract law that a contract imposes a duty to perform on the promise.[24] According to the U.S. Supreme Court in the salient *Winstar* case, "[w]hen the United States enters into contract[ual] relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals."[25] The government cannot escape its obligations as a contractor.[26] Shifting administrations cannot impose regulations which materially breach contracts entered into by previous administrations.[27] This principle is especially important because, although the leases are typically for a five-year period, the leases have a provision which extends them "for as long as oil and/or natural gas is produced in paying quantities or approved drilling operations are conducted."[28] It is the natural role for contract law to provide stability in the murky waters of offshore drilling.

Part I of this Note explains the general regulatory framework concerning offshore drilling and the process which a company must complete before drilling for oil or gas. Part II analyzes how the courts have ruled when companies allege that new acts or regulations have breached their lease agreements. Part II then analyzes the *Century Exploration New Orleans, LLC v. United States*[29] ruling following the events of the Deepwater Horizon disaster and how the ruling of the U.S. Court of Federal Claims in that case may be problematic. Part III suggests a framework for determining whether there is a breach of contract and discusses what remedies are likely to result after a breach has occurred.

I. BACKGROUND ON LEASING ACTIVITIES PRIOR TO DRILLING OFFSHORE

In order to understand litigation arising from breaches of offshore leases, it is first necessary to understand the process an entity must endure to obtain a lease. Courts have opined that "the regulatory procedures and standards to which an Outer Continental Shelf (OCS) lease is subject stand as the 'gateway' through which a lessee must pass in order to exercise its

22. *See* Mobil Oil Expl. & Producing S.E., Inc. v. United States, 530 U.S. 604, 607 (2000).

23. RESTATEMENT (SECOND) OF CONTRACTS, ch. 1, §§ 1, 3 (AM. LAW INST. 1981).

24. *Id.* at § 2.

25. United States v. Winstar Corp., 518 U.S. 839, 895 (1996).

26. The government essentially waived its privilege of sovereign immunity when it entered into the contract; the government is bound as though it were a private individual. *See Winstar*, 518 U.S. at 895.

27. *Id.*

28. *Oil & Gas Leasing on the Outer Continental Shelf*, *supra* note 3.

29. *See* Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 157 (2013).

contractual right to the oil and gas contained within its lease."[30] The government holds offshore land in *jus publicum* and only allows a private company the opportunity to drill for oil and gas resources should it meet the government's rigorous standards. If this gateway is substantially narrowed through modification of the lease standards and procedures, then the lease will be materially breached.[31]

The Department of the Interior (DOI) governs the extraction of oil and gas from federal lands.[32] Offshore drilling takes place on the OCS. The OCS is all of the submerged land under federal control, which are all lands between three nautical miles and 200 nautical miles from the shore.[33] This land was claimed in 1945, when President Truman formally declared that "the Government of the United States regards the natural resources of the subsoil and sea bed of the continental shelf beneath the high seas but contiguous to the coasts of the United States as appertaining to the United States, subject to its jurisdiction and control."[34] Shortly thereafter, Congress enacted the Outer Continental Shelf Lands Act (OCSLA or the Act) in 1953.[35] Although it has since been amended, its principal purpose remains to "expedite exploration and development of the [OCS] in order to achieve national economic and energy policy goals, assure national security, reduce dependence on foreign sources, and maintain a favorable balance of payments in world trade."[36]

In the United States, oil and gas resources are privately owned as opposed to other countries where these resources are nationalized and owned solely by the government, despite the OCS being held in *jus publicum*.[37] The United States merely leases the land held in public trust to private entities.[38] Leasing activities are perpetuated by the OCSLA, with responsibility ultimately falling upon the Secretary of the Interior (the Secretary) who is responsible for the development and mineral exploration of the OCS.[39] The Act gives the Secretary the power to lease the OCS, and to "prescribe the rules and regulations as may be necessary" to carry out the OCSLA.[40] Accordingly, the DOI created agencies to carry out this mandate. In 1983, the Secretary created the Minerals Management Service (MMS) as the agency responsible for the leasing of OCS lands and for the supervision

30. Mobil Oil Expl. & Producing S.E., Inc. v. United States, 530 U.S. 604, 621 (2000).

31. Amber Res. Co. v. United States (*Amber Resources I*), 68 Fed. Cl. 535, 546 (2005).

32. *See id.*

33. 43 U.S.C. §§ 1301, 1331 (1986).

34. Proclamation No. 2667, 10 Fed. Reg. 12,303 (Oct. 2, 1945).

35. *See OCS Lands Act History*, BUREAU OF OCEAN ENERGY MGMT, https://www.boem.gov/ocs-lands-act-history/ (last visited Feb. 20, 2019).

36. 43 U.S.C. § 1802(1) (1978).

37. *See* Michael P. Joy & Sashe D. Dimitroff, *Oil and Gas Regulation in the United States: Overview*, WESTLAW UK (June 1, 2016), available at https://1.next.westlaw.com/9-525-1545.

38. *See id.*

39. 43 U.S.C. § 1344(a) (1978).

40. *See id.*

of operations after lease issuance.[41] In 2010, MMS was renamed the Bureau of Ocean Energy Management, Regulation and Enforcement (BOEMRE); then, later in 2011, BOEMRE was divided into the present day Bureau of Ocean Energy Management (BOEM or the Agency) and the Bureau of Safety and Environmental Enforcement (BSEE).[42]

The lease agreements contain provisions that restrict how oil and gas companies may use the leased lands.[43] Furthermore, the dozens of government agencies which regulate offshore drilling activities have authority to do so under the provisions bargained for in the leasing agreements.[44] These leases "entitle the lessee to explore, develop, and produce the oil and gas contained within the lease area, conditioned upon due diligence requirements and the approval of the development and production plan required by [the OCSLA]."[45] It is important to note that the government may cancel any lease or permit if, after a hearing, "continued activity pursuant to such lease or permit would probably cause serious harm or damage to life (including fish and other aquatic life), to property, to any mineral (in areas leased or not leased), to the national security or defense, or to the marine, coastal, or human environment."[46] Although the exercise of this power would be extremely unorthodox, it is specifically provided for by statute.[47]

The issuance of these contracts is a multistage process and it may take years before production begins.[48] Congress created four stages to the development of an offshore oil or gas well: (1) the Secretary develops five-year lease plan based on the nation's energy needs, (2) leases are sold to bidders at a competitive auction, (3) the lessees conduct exploration activities, and (4) the lessees engage in development and production activities.[49]

A. THE LEASE PLAN

In the life of an offshore well, the DOI must first prepare "a schedule of proposed lease sales indicating, as precisely as possible, the size, timing, and location of leasing activity which [the Secretary] determines will best meet national energy needs for the five-year period following its approval."[50] In developing these plans, the Secretary is required to consider

41. *See OCS Lands Act History*, *supra* note 35.
42. *See id.*
43. *See* Form BOEM-2005, § 1 (Feb. 2017), BUREAU OF OCEAN ENERGY MGMT, available at https://www.boem.gov/BOEM-2005/ (last visited Feb. 5, 2019).
44. *See id.*
45. 43 U.S.C. § 1337(b)(4) (1978).
46. 43 U.S.C. § 1334(a)(2)(A)(i).
47. *See* Amber Res. Co. v. United States (*Amber Resources II*), 73 Fed. Cl. 738 (2006).
48. *See* Sec'y of the Interior v. California, 464 U.S. 312, 337 (1984).
49. *Id.*
50. 43 U.S.C. § 1344(a).

"relevant environmental and predictive information for different areas of the [OCS]."[51] Finally, the Secretary must assure that the government receive "fair market value" for the lease, and "select the timing and location of leasing, to the maximum extent practicable, so as to obtain a proper balance between the potential for environmental damage, the potential for the discovery of oil and gas, and the potential for adverse impact on the coastal zone."[52] At this stage, environmental concerns and the need for energy production are balanced in accordance with the policies of the controlling administration.[53]

B. LEASE SALES

Pursuant to the Secretary's five-year plan, the leases are sold at a "competitive, sealed-bid auction."[54] The purchasers of these leases only gain the right to conduct "preliminary activities."[55] The activities consist of "OCS-geophysical and other surveys that do not involve seabed penetrations greater than 300 feet and that do not result in any significant environmental impacts."[56] The lessees do not acquire the right to do more after winning the bid; they only acquire the right to submit plans for exploration, development, and production.[57] The "preliminary activities" are to test the OCS, and, if suitable, to develop an Exploration Plan (EP). All preliminary activities must be approved by BOEM.[58] Finally, it is important to note that "the contract, in practice, amount[s] primarily to an *opportunity* to try to obtain exploration and development rights in accordance with the procedures and under the standards specified in the cross-referenced statutes and regulations."[59] Considering the high price of the bid, the speculative nature of the leased area, and the limited rights available to the purchaser, drilling offshore is prohibitively expensive for those without the deep pockets necessary to engage in this venture.[60]

51. 43 U.S.C. § 1344(a)(2).
52. *Id.* at § 1344(a)(3)–(4).
53. *See id.*
54. *See* Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 154 (2013).
55. *See* Sec'y of the Interior v. California, 464 U.S. 312, 337 (1984).
56. *Id.* at 338–39.
57. *See id.* at 339.
58. *See* N. Slope Borough v. Andrus, 642 F.2d 589, 594 (D.C. Cir. 1980); *See also* 30 C.F.R. § 551.2 (2013).
59. Mobil Oil Expl. and Producing S.E., Inc. v. U.S., 530 U.S. 604, 620 (2000) (emphasis in original).
60. *See How Do Average Costs Compare Among Various Oil Drillings Rigs?*, INVESTOPEDIA, https://www.investopedia.com/ask/answers/061115/how-do-average-costs-compare-different-types-oil-drilling-rigs.asp (last visited Feb. 15, 2019).

C. EXPLORATION PLAN

The third step is for the lessee to submit an EP to DOI.[61] The EP must be consistent with the coastal management plan of any affected state under the Coastal Zone Management Act (CZMA),[62] along with any other regulation required by the DOI.[63] DOI then reviews the EP and should the plan purport to cause any "serious harm or damage to life (including fish and other aquatic life), to property, to any mineral (in areas leased or not leased), to the national security or defense, or to the marine, coastal, or human environment];" if the harm cannot be avoided, then the plan cannot be approved.[64] If the EP is not approved, then the government must pay the lessee "either the fair value of its lease or the lessee's costs from the day its lease was acquired, whichever is less."[65]

Following approval and permission of the EP, the applicant can begin exploratory drilling of the OCS.[66] Exploratory drilling will typically consist of drilling several temporary wells.[67] A positive find leads to several more wells to verify the quality of the well before moving onto the next stage.[68] Exploration is essential when prospecting new areas to drill.[69] Exploratory drilling is used to confirm or deny the data gathered during preliminary activities.[70] An exploration well additionally allows for more effective drilling during the development stage. However, drilling several temporary wells is an expensive endeavor, and the lessee must invest significant capital in order to do so.[71]

D. PRODUCTION & DEVELOPMENT

The last stage involves developing and producing the oil or natural gas.[72] In this stage, the lessee must submit a Development and Production Plan (DPP). The lessee submits a DPP after it has uncovered a sufficient

61. *See* Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 155 (2013).

62. The CZMA gives "coastal states a voice in the regulatory approval of OCS lease activity occurring off of their coast." In doing so, coastal states can develop their own coastal management program (CMP) which must be federally approved. *See* Amber Res. Co. v. United States (*Amber Resources I*), 68 Fed. Cl. 535, 539 (2005).

63. For example, BOEM may issue notices which allow them to change the requirements of the lessees. *See* Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 152 (2013).

64. *See* 43 U.S.C. § 1334(a)(2)(A)(i) (2005); *see also* 43 U.S.C. § 1340(c)(1) (2005).

65. *Amber Resources I*, 68 Fed. Cl. at 535.

66. *See Century Expl.*, 110 Fed. Cl. at 155.

67. *See Get to Know the Drilling Industry*, MÆRSK DRILLING, http://www.maerskdrilling.com/en/about-us/the-drilling-industry (last visited Feb. 16, 2019).

68. *See id.*

69. *See Gas Exploration,* NATGAS.INFO, http://www.natgas.info/gas-information/what-is-natural-gas/gas-exploration (last visited Feb. 15, 2019).

70. *See id.*

71. *See* Merlin Flower, *Oil Drilling–an Expensive Business*, OIL-PRICE.NET, http://www.oil-price.net/en/articles/oil-drilling-expensive-business.php (last visited Feb. 15, 2019).

72. *See* Sec'y of the Interior v. California, 464 U.S. 312, 340 (1984).

amount of recoverable resources in the prior stages.[73] After the plan is approved, the operator can obtain drilling permits and drilling can begin.[74] There is a considerable amount of planning and work that goes into developing a well, and the price of the lease can be substantial.[75] The process takes years and must be supervised by several government agencies.[76] In light of the process a lessee must undergo before seeing a return on investment, the granting of an offshore lease cannot be an arbitrary process. Once a private company obtains a lease, and has invested capital, its investment should be protected.

II. THE EMERGING COMMON LAW OF OFFSHORE LEASE BREACHES

Since offshore operations are governed by leases issued pursuant to the OCSLA, principles of contract law apply.[77] As the Supreme Court explained in *Winstar*, "when the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals."[78] These leases contain a bargained for promise: the government promised these companies that they could explore for oil or gas and later recover the resources they find, provided that they follow the four stages of development and any applicable statutes and regulations to which they are subject per the lease agreement.[79]

Over the past few decades, when the value of a contract has been substantially impaired by a new act or regulation, lessees have pursued damages arising from a breach of contract.[80] A breach of contract claim requires "plaintiffs to demonstrate: (1) a valid contract between the parties; (2) an obligation or duty arising from that contract; (3) a breach of that duty; and (4) damages caused by the breach."[81] When the government attempts to subject the lessee to a new act or regulation, and in doing so denies the lessee "certain elements of the permission-seeking opportunities

73. Amber Resources was a series of cases that stretched on for many years. The cases that proved material for the development of common law in this sector are *Amber Resources I* and *Amber Resources II*. *See* Amber Res. Co. v. United States (*Amber Resources I*), 68 Fed. Cl. 535, 545 (2005); Amber Res. Co. v. United States *(Amber Resources III),* 87 Fed. Cl. 16 (2009).

74. *See Amber Resource I*, 68 Fed. Cl. at 545.

75. *See Top Ten Highest Bids on a Single Block for All Gulf Sales*, BUREAU OF OCEAN ENERGY MGMT., https://www.boem.gov/Top-Ten-Highest-Bids-on-a-Single-Block-for-All-Gulf-Sales/ (last visited Feb. 17, 2019).

76. *See Amber Resources I*, 68 Fed. Cl. at 535.

77. *See* Mobil Oil Expl. and Producing S.E., Inc. v. U.S., 530 U.S. 604, 609 (2000).

78. U.S. v. Winstar Corp., 518 U.S. 839, 895 (1996).

79. *See Mobil Oil*, 530 U.S. at 609.

80. *See generally Amber Resources I*, 68 Fed. Cl. 535 (2005) (providing a history of litigation arising from new acts and regulations).

81. San Carlos Irr. & Drainage Dist. v. United States, 877 F.2d 957, 959 (Fed. Cir. 1989).

that the contracts had promised," then a breach has occurred. In that case, the contract should be repudiated.[82]

Some general contract principles are important to remember when determining whether to repudiate a contract. If a contract is to be repudiated, the non-repudiating party is entitled "to restitution for any benefit that he has conferred on [the repudiating party] by way of part performance or reliance."[83] The Second Restatement of Contracts defines repudiation as a "statement by the obligor to the obligee indicating that the obligor will commit a breach that would of itself give the obligee a claim for damages for total breach."[84] A "total breach" is one that "so substantially impairs the value of the contract to the injured party at the time of the breach that it is just in the circumstances to allow him to recover damages based on all his remaining rights to performance."[85]

A. CASES PRIOR TO CENTURY EXPLORATION

In 1981, the Supreme Court addressed these issues in *Mobil Oil*. In *Mobil Oil*, the Supreme Court repudiated a lease and granted restitution to the plaintiff companies.[86] In that case, two oil companies paid $156 million (plus annual payments) to the Government in exchange for 10-year renewable lease contracts which provided them with rights to explore and develop oil off of the OCS.[87] MMS had initially concluded that a draft version of their EP would pass the OCSLA standard.[88] In 1990, two days before the companies' final EP was submitted, the Outer Banks Protection Act (OBPA) was enacted.[89] The OBPA prohibited the Secretary from approving any EP until an Environmental Sciences Review Panel reported that the Secretary had sufficient information to make approval decisions under the OCSLA.[90] Additionally, the Secretary was directed to not approve any Plan for thirteen months under any circumstances.[91] The companies filed suit, alleging, *inter alia*, that "the Government repudiated the contracts when it denied them certain elements of the permission-seeking opportunities that the contract had promised."[92]

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82. *Mobil Oil*, 530 U.S. at 604.
83. Restatement (Second) of Contracts § 373 (1981).
84. *Id.* at § 250.
85. *Id.* at § 243.
86. *Mobil Oil*, 530 U.S. at 605.
87. *See id.* at 609.
88. *See* Amber Res. Co. v. United States (*Amber Resources I*), 68 Fed. Cl. 535, 546 (2005).
89. The OBPA was enacted on August 18, 1990 and was later repealed in 1996. The companies' final EP was submitted two days after the enactment of the OBPA, a thirty-day deadline to approve the plan would then have commenced. *See Amber Resources I*, 68 Fed. Cl. at 545.
90. *See Mobil Oil*, 530 U.S. at 604.
91. *Id.*
92. *Id.* at 607.

Section 1 of the companies' leases subjected the lessees to those regulations issued pursuant to the OCSLA and incorporated "both those that were 'in existence upon the [leases'] effective date and those, promulgated in the future."[93] Under Section 1, the lease was subject to future regulations if those regulations were issued pursuant to the OCSLA and "provide[d] for the prevention of waste and conservation of the natural resources of the [OCS]."[94] Other statutes and regulations were incorporated in a "catchall provision."[95] The Supreme Court reasoned that the catchall provision of Section 1 had a temporal limitation and pertained only to statutes and regulations existing at the time of the creation of the lease; otherwise "the companies would have spent $158 million to buy next to nothing."[96] Considering that new OBPA regulations restricted approval of any plan to a period of at least thirteen months, the Court found this violated the lease provisions which required EPs to be approved within thirty days.[97] Therefore, the leases were written in such a way as to assure exemption from subsequent legislation such as the OPBA, and subjecting the leases to the OBPA was a breach of contract.[98] The Court then repudiated the contract and granted restitution for the $156 million the companies paid in return for the right to explore and develop the OCS.[99]

The U.S. Court of Federal Claims took a similar approach in *Amber Resources I*.[100] In 1990, Congress amended section 307(c)(1) of the CZMA.[101] This amendment and subsequent court decisions subjected the grant of an OCS lease to its requirements and mandated that lessees would have to comply with a federally mandated Coastal Management Program (CMP).[102] The court followed the *Mobil Oil* reasoning and found that the Section 1 "catchall provision" of the disputed lease also did not incorporate future statutory changes enacted, which were not pursuant to the OCSLA.[103] Furthermore, the court found that the "gateway" (the four-stage process) was substantially narrowed by the modification of the lease procedures, and, for those reasons, was a breach which constituted an

93. *Amber Resources I*, 68 Fed. Cl. at 546 (citing *Mobil Oil*, 530 U.S. at 615). Additionally, the lease in *Mobil Oil* was subject to two provisions of the Department of Energy Organization Act, however, this is not material for the purposes of this Note. *See id.* at 545.

94. Century Expl. New Orleans v. United States, 110 Fed. Cl. 148, 166 (2013).

95. *Mobil Oil*, 530 U.S. at 616.

96. *Amber Resources I*, 68 Fed. Cl. at 545.

97. *See Mobil Oil*, 530 U.S. at 620–21.

98. *See id.* at 624.

99. *See id.*

100. *See Amber Resources I*, 68 Fed. Cl. at 545.

101. *See generally* California v. Norton, 311 F.3d 1162 (9th Cir. 2002) (providing an in-depth discussion of this section of the CZMA).

102. A CMP allows states to develop its own program to regulate offshore drilling off its coast. *See Amber Resources I*, 68 Fed. Cl. at 539.

103. *Id.* at 547.

anticipatory repudiation of the plaintiff's lease agreement.[104] The court in *Amber Resources I* held that the plaintiffs were entitled to rescission and restitution, resulting in a return of approximately $1.1 billion in up-front bonus payments.[105]

Plaintiffs then brought suit again in *Amber Resources II* seeking "recovery of exploration and other costs [incurred] to develop the leaseholds."[106] This claim amounted to an additional $727 million in "sunk costs."[107] This case is important in the history of offshore lease breaches because it provides a framework to determine remedies for a breach. The plaintiffs did not bring their claim on an expectation theory of recovery, "presumably because proof to a reasonable degree of certainty would be difficult, given the speculative nature of the enterprise of drilling for oil and gas."[108] Plaintiffs also did not characterize their claim for sunk costs under a reliance theory of damages possibly because this would have left "room for the argument that the contract would not have been profitable, and hence, monies plaintiffs invested would have been lost even in the absence of a breach."[109] Plaintiffs instead opted to argue that restitution was the proper remedy to recover these sunk expenditures.

The court disagreed with this position.[110] The court first noted that "restitution . . . is a protean concept."[111] Restitution is the proper remedy when the plaintiff "has in reliance on the promise of the defendant conferred some value on the defendant."[112] This can be thought of as the prevention of unjust enrichment.[113] In contrast, a reliance interest is the proper remedy when "the plaintiff has in reliance on the promise of the defendant changed his position."[114] While both of these remedies incorporate the concept of reliance, restitution is more concerned with the conference of a benefit onto the defendant.[115] The court held that while the sunk expenditures were "foreseeable and incurred pursuant to the contract, they did not benefit the government in the same way as up-front payments."[116] Therefore, sunk expenditures are not recoverable under a restitution theory.[117]

104. Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 165 (2013).
105. *See* Amber Res. Co. v. United States (*Amber Resources II*), 73 Fed. Cl. 738, 740 (2006).
106. *Id.*
107. *Id.* at 741.
108. *Id.* at 740.
109. *Id.* at 745.
110. *See id.* at 758.
111. *Id.* at 742.
112. *Id.* at 744.
113. *See id.*
114. *Id.*
115. *See id.* at 744–46.
116. *Id.* at 746.
117. *Id.* at 758.

The court left open the possibility of recovery of sunk expenditures, but only if plaintiffs do so under a reliance theory.[118] To do so, the plaintiff must "demonstrate a causal connection between the breach and a net loss of the leases."[119] This case set a precedent for remedies in the breach of offshore leases. In the event of a breach, it is more than likely that the plaintiff will be able to repudiate the contract and receive restitution damages.[120] Should the plaintiff wish to recover sunk expenditures, the plaintiff must do so under a reliance theory.[121] This is problematic because it will be costly for the plaintiff to rebut the government's defense that the contract may not have been profitable; a plaintiff will need evidence as to the profitability of a contract should they attempt to recover sunk expenditures.[122]

B. THE PRINCIPAL CASE: *CENTURY EXPLORATION*

Following the Deepwater Horizon disaster in 2010, the government adopted a number of new requirements for drilling on the OCS.[123] The Deepwater Horizon disaster was a massive oil spill along the Gulf of Mexico.[124] In response to the disaster, the Secretary issued an order to cease all deep-water drilling activities and prohibited new permits;[125] this order stayed in effect until the closing of the Macondo well.[126] The DOI passed a number of new substantive regulations such as the Drilling Safety Rule (DSR)[127] and the Workplace Safety Rule (WSR).[128] Before the incident, in 2008, Century Exploration New Orleans, LLC (Century Exploration) had leased land on the OCS in order to drill.[129] In response to the post-Deepwater Horizon regulations, Century Exploration brought suit against

118. *See id.* at 757.
119. *Id.* at 742.
120. *See id.* at 744–46.
121. *See id.* at 758.
122. *See id.* at 745.
123. *See* Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 157 (2013).
124. *Id.*
125. *See id.* at 167.
126. In the Deepwater Horizon disaster, the drilling rig was named Deepwater Horizon. The well that was being drilled was the Macondo well. *See Macondo Prospect, Gulf of Mexico*, OFFSHORE TECH., https://www.offshore-technology.com/projects/macondoprospect/ (last visited Dec 27, 2018).
127. The Drilling Safety Rule has the following purposes: to enhance the classification of well-control barriers; to define testing requirements for cement; to clarify requirements for the installation of dual mechanical barriers; and to extend requirements for BOPs and well-control fluids to well-completions, workovers, and decommissioning operations. *See Drilling Safety Rule*, BUREAU OF SAFETY & ENVTL. ENF'T (2012), https://www.bsee.gov/site-page/index-9 (last visited Nov 21, 2018).
128. The WSR "require[d] each OCS operator to develop and implement a Safety and Environmental Management System (SEMS) for its operations." *See Century Expl.* 110 Fed. Cl. at 160.
129. *See generally* Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148 (2013) (providing an in-depth discussion of as to how and where the land was leased).

the U.S. government alleging breach of contract. Its claim was based on the allegation that the new measures unexpectedly changed the rules governing offshore activities and that this change rendered its contract commercially impracticable.[130] In analyzing the Court's ruling, this Note will consider the holding in regard to: (1) new regulations; (2) notices to lessees; and (3) the sovereign acts defense.

1. Regulations Enacted Post-Deepwater Horizon

The U.S. Court of Federal Claims in *Century Exploration* determined that neither the new requirements of the DSR nor the WSR breached the terms of the lease.[131] In so holding, the court reasoned that the decisions in *Amber Resources* and in *Mobil Oil* were based on a "preliminary determination that the leases at issue did not incorporate future statutory changes. Those cases did not hold, however, that the government assumes the risk of future regulations, at least not those issued under the OCSLA."[132] This interpretation suggests that lessees are subject to *any* future regulation so long as that regulation is issued pursuant to the OCSLA.[133] The plaintiffs argued that this interpretation would make their contract illusory.[134] However, the court reasoned that the lease was not illusory because the lease was only subject to future regulations issued pursuant to the OCSLA, which assured the plaintiffs with "a stable statutory regime under [their lease][135] . . . [and that] they assumed the risk of future regulatory changes within the context of that regime."[136] For these reasons, the Court held that none of the new regulations breached the lease.

This approach to the lessee's contracts makes sense in that the lessees are aware that they are subject to regulations enacted pursuant to the OCSLA. In the court's opinion, "Section 1 does not grant the government unfettered authority to change the rules during the game instead, its discretion is cabined by [the OCSLA]."[137] This regime still allows for lessees to achieve a substantial degree of certainty by allocating to them only those risks to which the lease is expressly subject (the OSCLA), while the government assumes the risks of all other future regulation.[138] However, this raises the issue of just how much the government can shift risks within this framework before the courts will find the shift to be substantial enough to warrant repudiation.

130. *See id.* at 152.
131. *See id.* at 167.
132. *Id.* at 165.
133. *See id.* at 165–67.
134. *See id.* at 167.
135. Form BOEM-2005, *supra* note 43, at § 1.
136. Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 166 (2013).
137. *Id.* at 165.
138. *See id.*

2. Questionable Legality of the Notice to Lessees

The most significant issue for the lessees was not the new regulations, but an updated bonding requirement pursuant to Notice to Lessees No. 2010-N06 (NTL-06).[139] In NTL-06, the DOI notified Century that its bonding requirement was *quadrupling* from $35 million to $150 million.[140] The modification to the bonding requirement was imposed by a "notification, an email, and a FAQ document," and so was not considered to be a regulation.[141] The court held that the new demand for the bonding requirement complied with the terms of the lease[142] because the DOI merely changed the worst-case scenario of a potential spill, which in effect moved the lessee into a higher category demanding a more expensive bond requirement.[143] The effect of this change was that Century could not pay for the updated bond requirement and lost the lease, along with a $23 million down payment.[144]

The section of the lease at issue was Section 8, which requires that the lessee "shall at all times maintain the bond(s) required by regulation prior to issuance of the lease."[145] Surely, this provision does not require a lessee to have the funds available for a higher bond requirement than was required at the signing of their lease; otherwise, why not simply require a lessee to post that higher bond? While the regulations regarding the bond requirement needed for a worst-case discharge have not changed—NTL-06 in fact moved the lessees into a higher category requiring this bond requirement—this is a *de facto* change to Section 8. The court seemed to recognize this flaw, concluding that even if "NTL-06 has in fact breached section 8 of the lease, the government is nonetheless protected from such a breach under the sovereign acts doctrine."[146] The court's ruling here is troubling because it appears to ignore the holdings of *Amber Resources* and *Century Exploration*. Even though the new bonding requirements were prohibitively expensive for Century, the court ruled that these requirements did not materially breach the underlying agreement.

139. The bonding requirement is essentially an amount of money set aside which may be used for cleanup in the event of an oil or gas discharge into the ocean, such as what occurred in Deepwater Horizon; the purpose of the bonding requirement is to ensure compliance with the lessee's obligations under the lease and applicable regulations. *Century Expl.*, 110 Fed. Cl. at 159.

140. *See* Todd Gaziano & Mark Miller, *The Need to Regulate What Constitutes A Federal Regulation*, FORBES (DEC. 12, 2014, 5:58 PM), https://www.forbes.com/sites/realspin/2014/12/12/the-need-to-regulate-what-constitutes-a-federal-regulation/#724df3512e5f.

141. *See id.*

142. *See* Form BOEM-2005, *supra* note 43, at § 8.

143. *See* Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 171 (2013).

144. *See* Gaziano & Miller, *supra* note 140.

145. The language in the current lease form may vary. *See* Form BOEM-2005, *supra* note 43, at § 8.

146. *Century Expl. New Orleans*, 110 Fed. Cl. at 172.

3. Sovereign Acts Doctrine

Finally, the *Century Exploration* court found that even if the lease had been breached, the sovereign acts defense would apply. This doctrine applies because the actions were "sovereign in nature—*i.e.*, they were public and general—and rendered the government's performance under

the lease not only impracticable, but legally impossible."[147] The Federal Circuit previously held that "the government-as-contractor cannot exercise the power of its twin, the government-as-sovereign, for the purpose of altering, modifying, obstructing[,] or violating the particular contracts which it had entered with private parties. Such action would give the government-as-contractor powers that private contracting parties lack."[148] The sovereign acts doctrine balances the Government's need to legislate with its obligation to honor its contracts.[149] It is the principle that "the government is not liable for breach of contract whenever it takes any generally applicable action in its sovereign capacity that *incidentally* frustrates performance of a contract."[150]

It is important to consider the implications of the Deepwater Horizon disaster in analyzing the court's *Century Exploration* decision. In April of 2010, a drilling rig named Deepwater Horizon exploded.[151] The resulting oil spill lasted several months and released 4.2 million barrels of oil into the Gulf of Mexico.[152] Michael Harbut, a professor at Michigan State University, claimed that, "exposure to organic solvents [solvents resulting from the oil spill and cleanup efforts] causes the same intellectual effect as lead poisoning."[153] The individuals who were most heavily exposed will "see chronic adverse health effects, including liver and kidney disease, birth defects, and developmental disorders. Over time, we'll see a bump in certain cancers that are related to industrial solvents, such as leukemia, lymphomas, and lung and skin cancers."[154] The spill was said to be a "'spill of national significance'—the first time in history that term has been used."[155]

It is unlikely that the sovereign acts doctrine will be a readily available defense in future cases, unless there were circumstances as significant as the Deepwater Horizon spill. This is because the case law provides that if the

147. *Id.* at 177.
148. *See* Yankee Atomic Elec. Co. v. United States, 112 F.3d 1569, 1575 (Fed. Cir. 1997).
149. *See id.*
150. *Century Expl. New Orleans*, 110 Fed. Cl. at 177 (emphasis added).
151. *See* Campbell Robertson & Clifford Krauss, *Gulf Spill Is the Largest of Its Kind, Scientists Say*, N.Y. TIMES (Aug. 2, 2010), http://www.nytimes.com/2010/08/03/us/03spill.html.
152. Linda Marsa, *6 years after Deepwater Horizon oil spill, thousands of people are still sick*, GRIST (Oct 10, 2016), http://grist.org/article/6-years-after-deepwater-horizon-oil-spill-thousands-of-people-are-still-sick.
153. *Id.*
154. *Id.*
155. Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 157 (2013).

purpose of the government's action is to "reliev[e] the government-as-contractor of its duties [, then those actions] are not sovereign in nature."[156] One explanation for the outcome is that the *Century Exploration* court was shocked at the disaster and decided public policy would be best served in allowing the government to exercise all its powers to prevent a spill of this magnitude from occurring again.

4. Aftermath of Century Exploration

Following the result of *Century Exploration*, commenters have said that "the Federal Circuit essentially allowed the government to rewrite the terms of a government contract through incorporated regulatory provisions."[157] This case raises a number of issues; while it seems that court correctly applied the sovereign acts defense, the court's other findings could prove problematic. The interpretation that the contract is subject to *any* future acts pursuant to the OCSLA makes the limits of the Government's power to impose new (perhaps substantively burdensome) regulations unclear, if not unlimited. This decision relies on the technicality that the Government only changed a factor in determining the bond requirement, which shifted the lessee into a cost-prohibitive category, but did not impose a new list of bond requirements.[158] To what extent the Government is allowed to shift factors such as those regarding the bond requirements remains unclear, and could result in substantial burdens for lessees. The following Section will recommend a standard approach to the breach of a lease that will promote consistency in the case law moving forward.

III. A FRAMEWORK FOR RESOLVING OFFSHORE LEASE BREACHES

Disputes that arise after the government enacts regulation constituting a material breach of contract are difficult to resolve. The cases involve mountains of facts and convoluted legal arguments, and litigation can drag on for years. Courts should return to fundamental contract principles and apply a test that accounts for the language of the lease and applies equity. This approach is two-pronged and asks: (1) whether the government action in question constitutes a breach of contract upon the terms of the agreement, and (2) whether the action materially alters the agreement by "narrowing the gateway" through which a lessee must pass to exercise the full

156. When "considering whether the alleged sovereign act is exclusively directed to aborting performance of government contracts, courts addressing the sovereign acts doctrine have looked to the extent to which the governmental action was directed to relieving the government of its contractual obligations." *Id.* at 178 (citing Conner Bros. Const. Co., Inc. v. Geren, 550 F.3d 1368, 1373 (Fed. Cir. 2008)).

157. Kyle R. Jefcoat, *The Federal Circuit's 2014 Government Contract Decisions*, 64 AM. U. L. REV. 807, 853 (2015).

158. *See Century Expl. New Orleans*, 110 Fed. Cl. at 171.

enjoyment of their rights.[159] If there is a breach, then repudiation of the contract is the appropriate remedy, although a plaintiff may argue further for reliance damages.[160] Unfortunately, there will be a substantial risk of litigation for companies involved in offshore drilling especially in more vulnerable areas (such as ANWR).[161]

A. DETERMINING WHEN GOVERNMENT ACTION CONSTITUTES A BREACH

The inquiry should first focus on whether the government directly violated the terms of the lease. This is a standard inquiry into whether there is a breach of contract. Essentially, if the Government "[broke] an important contractual promise, thereby 'substantially impair[ing] the value of the contract[s]' to the companies," then there is a breach and remedies are appropriate.[162] It is important under this prong of the framework to look to the language of the lease itself. Unfortunately, there is still ambiguity in the standard lease contracts.[163]

The issue of the catchall provision in *Century Exploration* has been exacerbated in the most current version of the standard lease available from BOEM.[164] As one commenter described it, "the broad language in Section 1 of the current lease form is even more expansive in scope than the language in the *Century* [*Exploration*] lease."[165] Specifically, the new lease form has a catchall provision which incorporates *all* future statutes and regulations, not just those issued under OCSLA.[166] The courts of *Mobil Oil* and *Amber Resources* opined that if the leases in those cases were subjected to "the

159. The full enjoyment first being an *opportunity* to try to obtain development rights in accordance with the agreed upon framework. *See* Mobil Oil Expl. & Producing S.E., Inc. v. United States, 530 U.S. 604, 620 (2000).

160. *See* Amber Res. Co. v. United States (*Amber Resources II*), 73 Fed. Cl. 738, 740 (2006).

161. Litigation risk is the risk that company may face lawsuits. *See generally* Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367 (2009).

162. *Mobil Oil*, 530 U.S. at 608.

163. *See* Form BOEM-2005, *supra* note 43, at § 1.

164. *Id.*

165. Dana E. Dupre, *What Makes the United States Offshore Leasing System So Special? A Primer on the Outer Continental Shelf Oil and Gas Lease*, 4 LSU J. ENERGY L. & RESOURCES 37, 41 (2015).

166. Section 1 of the most current standard lease contract states the following:

This lease is issued pursuant to the Outer Continental Shelf Lands Act of August 7, 1953; 43 U.S.C. 1331 *et seq.*, as amended, (hereinafter called "the Act"). This lease is subject to the Act, regulations promulgated pursuant thereto, and other statutes and regulations in existence upon the Effective Date of the lease, and those statutes enacted (including amendments to the Act or other statutes) and regulations promulgated thereafter, except to the extent they explicitly conflict with an express provision of this lease. It is expressly understood that amendments to existing statutes and regulations, including but not limited to the Act, *as well as the enactment of new statutes and promulgation of new regulations*, which do not explicitly conflict with an express provision of this lease may be made and that the Lessee bears the risk that such may increase or decrease the Lessee's obligations under the lease. (emphasis added)

See BOEM-2005, *supra* note 43, at § 1.

requirements of *any* statute or regulation created in the future, 'the companies would have spent [their money] to buy next to nothing.'"[167]

This change also undermines the main argument of the *Century Exploration* court for a broad interpretation of Section 1. Instead of Section 1 "creating a substantial degree of certainty for lessees" regarding allocation of risk, Section 1 now widens the scope and content of regulations to which the lessee is subject.[168] This shifts the allocation of risk entirely onto the lessees and provides the government with a "route of complete escape" from its contractual duties.[169] The government cannot walk away from its contractual obligations; a "route of complete escape" is "incompatible with the existence of a contract."[170] According to Corbin on Contracts:

> If what appears to be a promise is an illusion, there is no promise; like the mirage of the desert with its vision of flowing water which yet lets the traveler die of thirst, there is nothing there. By the phrase "illusory promise" is meant words in promissory form that promise nothing; they do not purport to put any limitation on the freedom of the alleged promisor, but leave his future action subject to his own future will, just as it would have been had he said no words at all.[171]

The possibility of non-performance is unacceptable in a contract.[172] Additionally, under the updated version of Section 1, the "government's power to terminate for convenience, allowing unlimited exculpation, is too broad."[173] In making Section 1 broader, companies may now have a defense that the lease itself was merely an illusory promise.

Alternatively, courts may interpret the requirements in the updated version of Section 1 as less demanding than in prior cases. The risk of regulatory change is an issue in government contracts.[174] When there is an allegation of a breach of contract due to a regulatory change, the initial burden is allocated to the Government because it is the Government that would be unable to perform on its promise.[175] The allocation of risk does not shift to the contractor when the language of the contract only requires

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167. Amber Res. Co. v. United States (*Amber Resources I*), 68 Fed. Cl. 535, 545 (2005) (quoting *Mobil Oil*, 530 U.S. at 616).

168. Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 165 (2013).

169. *Id.*

170. Torncello v. United States, 681 F.2d 756, 769 (Ct. Cl. 1982).

171. *Id.* at 769 (citing ARTHUR LINTON CORBIN & JOSEPH M PERILLO, 1 CORBIN ON CONTRACTS § 145 (1962)).

172. *Id.*

173. *Id.*

174. *See* Cardiosom, L.L.C. v. United States, 117 Fed. Cl. 526, 532 (2014) ("Risk-shifting language refers to contractual language that shifts the risk of regulatory change from the government to the contractor. The risk of regulatory change refers to the risk that Congress might pass a new statute, or an agency might promulgate a new regulation, that would prevent the agency from meeting its obligations, as promised under an existing contract with a private party."); *see also* United States v. Winstar Corp., 518 U.S. 839, 881 (1996).

175. *See Cardiosom*, 117 Fed. Cl. at 532.

the contracted parties to comply with applicable laws and regulations.[176] In *Winstar*, the Supreme Court held that the Government breached its contractual obligations, and in so holding rejected the Government's unmistakability defense.[177] *Winstar* "stands for the proposition that the government is still obligated to honor its contracts even if the governing regulations change."[178]

One way to solve the current uncertainty as to Section 1 is for BOEM to re-include language from the prior version of Section 1leases, because it allows for more certainty within the contract. [179] This prior version created a substantial degree of certainty for lessees because it "allocate[ed] to the government the risk of future statutory changes, while allocating to the lessee the risk of future regulations issued pursuant to a single statute, to which the lease [was] expressly subject."[180] This approach allows for a fair allocation of risk: it allows the government to regulate activity of the OCS to prevent waste and conserve natural resources as is its statutory duty under the OCSLA,[181] while companies would benefit from a stable statutory regime. Accordingly, under this framework, future regulations that are not issued pursuant to the OCSLA would breach the contract if the lessees were forced to comply. This Note recommends that BOEM rewrite the language of Section 1 to reflect the language used in the leases of *Mobil Oil* and *Amber Resources*.

The second prong of the approach is an equitable test to determine whether a breach has occurred. Courts have continued to affirm the reasoning in *Mobil Oil* that "under the contracts, the incorporated procedures and standards amounted to a gateway to the companies' enjoyment of all other rights" and so the test should be whether "[the regulation] significantly narrowed that gateway and therefore materially breached the plaintiffs' leases."[182] As discussed previously, the gateway is the comprehensive four-stages process of the development of an offshore oil or gas well. Considering that DPP approval requires a massive amount of work, it is clear that the gateway should be an important part of a court's analysis.

In determining whether the narrowing is substantial, a helpful inquiry is whether the government's action goes "to the root" or "essence" of the agreement between the parties,[183] or is "one which touches the

176. *Id.*

177. *Id.*

178. Admiral Fin. Corp. v. United States, 378 F.3d 1336, 1342–43 (Fed. Cir. 2004) (citing Winstar Corp., 518 U.S. at 869–70).

179. The re-included language would provide that the lease is only subject to future regulations issued pursuant to the OCSLA, as opposed to being subject to all future regulations.

180. Century Expl. New Orleans, LLC v. United States, 110 Fed. Cl. 148, 165 (2013).

181. *See* 43 U.S.C. § 1334(a) (2012).

182. *Century Expl. New Orleans*, 110 Fed. Cl. at 165.

183. Frank Felix Assocs., Ltd. v. Austin Drugs, Inc., 111 F.3d 284, 288–89 (2d Cir. 1997).

fundamental purpose of the contract and defeats the object of the parties in entering into the contract."[184] Under the Restatement, an important inquiry to determine "whether a failure is material is the extent to which the injured party will be deprived of the benefit which he reasonably expected from the exchange."[185] For example, if BOEM implemented a regulation with the clear goal of prohibitively burdening the lessees, this would defeat the object of the agreement and should be considered a material breach of contract. A regulation which imposes too much of a burden on the lessee should be invalidated by the court.

Under this second prong, courts should not treat the decision of the *Century Exploration* court that the new bonding requirements did not constitute a breach of contract as precedential. Under the very language of the Restatement, the new bonding requirement would be a material failure because *Century Exploration* was "deprived of [a] benefit . . . reasonably expected from the exchange."[186] Instead, courts should use *Century Exploration* as precedent only in the event of another disaster warranting the application of the sovereign acts doctrine.

B. WHAT REMEDIES ARE AVAILABLE?

Determining the adequate remedy for the aggrieved party will be one of the most contentious issues in these cases. Repudiation should be awarded in the event of a breach by the government which "substantially impairs the value of the contract."[187] As stated in *Mobil Oil,* after the plaintiff proves that a breach of contract occurred, "the Government must give the companies their money back" unless the companies waived their rights to restitution.[188] An injured party may also argue for reliance damages, although these damages are subject to the defense that the contract would have been unprofitable.[189] Because of the volatility of energy industry prices, it is highly unlikely that a court will award expectation damages because they are too speculative.[190] After *Amber Resources II*, companies that want to recover sunk expenditures (such as survey costs, exploratory drilling, etc.), must advance their claim under a reliance theory.[191]

The role of the reliance interest in damages is very clearly articulated by Lon Fuller and William R. Perdue:

> The plaintiff has in reliance on the promise of the defendant changed his position. For example, the buyer under a contract for the sale of land has

184. Ervin Const. Co. v. Van Orden, 874 P.2d 506, 510 (Idaho 1993).
185. RESTATEMENT (SECOND) OF CONTRACTS, § 241 cmt. b (AM. LAW INST. 1981).
186. *Id.*
187. *Id.* § 243.
188. Mobil Oil Expl. & Producing S.E., Inc. v. United States, 530 U.S. 604, 608 (2000).
189. *See* Amber Res. Co. v. United States (*Amber Resources II*), 73 Fed. Cl. 738, 745 (2006).
190. *See id.* at 740.
191. *See id.* at 746.

> incurred expense at the investigation of the seller's title, or has neglected the opportunity to enter other contracts. We may award damages to the plaintiff for the purpose of undoing the harm which his reliance on the defendant's promise has caused him. Our object is to put him in as good a position as he was in before the promise was made. The interest protected in this case may be called the reliance interest.[192]

As it applies to offshore leases, the principle is simple: if the government breaches the lease, then the government should provide the lessee with the amount of money which they spent in reliance on the contract. However, while the "assumption is that the injured party would at least have recovered his expenses . . . that assumption may be rebutted."[193] The government will have a defense that the damages should be capped at the point where there was no longer a return on investment.[194] The burden of proof will fall upon the government (as it is the breaching party) to prove non-profitability.[195] The litigation over reliance damages is likely to be highly contentious as it will concern millions, if not billions of dollars.[196]

Recovery of reliance damages will carry high litigation costs.[197] This is something which companies should be prepared for in the event they sue for repudiation of the contracts. This is an unfortunate aspect of operating in a high-risk field. Keeping awareness of these costs in mind, companies should avoid high-risk ventures (such as drilling in ANWR) unless they are fully prepared for the consequences of the venture. A new administration may pass regulations which breach a contract, and while the Government will have to pay repudiation, any claim advanced under a reliance theory will be subject to a costly rebuttal from the Government. Companies can reduce this risk by only investing in leases which show a high likelihood of earning potential and—should a lawsuit come about—by looking for opportunities to exit the lawsuit quickly in the form of a settlement.[198] One only needs to look at the near decade of litigation resulting from the *Amber Resources* line of cases to see that drawn out litigation is a lose-lose for the company's shareholders and for America's taxpayers.

192. Lon Fuller & William R. Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 54 (1936).

193. *Amber Resources II*, 73 Fed. Cl. at 746.

194. *See id.* at 747.

195. *See* Kizas v. Webster, 532 F. Supp. 1331, 1333 (D.C. Cir. 1983).

196. *See generally Amber Resources II*, 73 Fed. Cl. 738 (2006) (discussing the Amber Resources cases that concerned decades of litigation over millions of dollars).

197. *See generally* Jonathan T. Molot, A Market in Litigation Risk, 76 U. CHI. L. REV. 367 (2009) (discussing the high cost of drawn out and complex litigation).

198. William Dickerman, *Five Ways to Effectively Reduce the Cost of Litigation*, DICKERMAN & ASSOCIATES, http://www.dickermanlaw.com/en/legal-articles/22-5-ways-to-effectively-reduce-the-cost-of-litigation (last visited Dec. 25, 2017).

CONCLUSION

The future of offshore drilling is protean and uncertain. One only needs to look at the substantial changes which have occurred in the month of January 2019 as evidence. During that month, the Democratic Party regained control of the House of Representatives.[199] Almost immediately, on January 8, 2019, a group of House Democrats introduced bills which would substantially impede offshore drilling.[200] The bills would ban outright or place a ten-year moratorium on "offshore drilling in the Atlantic, Pacific[,] and Arctic oceans, as well as the eastern Gulf of Mexico."[201] This would reverse or substantially disrupt any lease sales which the Trump administration has introduced since the announcement of his "America First" policy. These dramatic changes highlight the need for stability within the industry. As regulations change and administrations shift, the government is still subject to the contracts which it has entered into in the past and it is bound as a private contractor.

The test articulated in this Note provides a clear approach to solve these expensive and complex disputes. Once again, the test is: (1) whether the government action in question constitutes a breach of contract upon the terms of the agreement, and (2) whether the action materially alters the agreement by "narrowing the gateway" through which a lessee must pass to exercise the full enjoyment of their rights. Applying this test will enable courts to more efficiently resolve disputes arising from the actions of shifting administrations and evolving national interests. This is crucial in the highly politicized environment which oil and gas companies operate, and in utilizing this framework contract law can be a stabilizing force in a sea of uncertainty.

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199. Timothy Cama, *Dems Introduce Bills to Block Offshore Drilling*, THE HILL (Jan. 8, 2019, 4:50 PM EST), https://thehill.com/policy/energy-environment/424418-dems-introduce-bills-to-block-offshore-drilling.

200. *See id.*

201. *Id.*

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