



INTERIOR BOARD OF INDIAN APPEALS

McCann Resources Inc. v. Acting Eastern Oklahoma Regional Director,
Bureau of Indian Affairs

48 IBIA 84 (11/03/2008)

Petition for Reconsideration dismissed:
50 IBIA 217



United States Department of the Interior

OFFICE OF HEARINGS AND APPEALS
INTERIOR BOARD OF INDIAN APPEALS
801 NORTH QUINCY STREET
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ARLINGTON, VA 22203

MCCANN RESOURCES INC.,)	Order Affirming Decision As Modified
Appellant,)	
)	
v.)	Docket No. IBIA 07-31-A
)	
ACTING EASTERN OKLAHOMA)	
REGIONAL DIRECTOR,)	
BUREAU OF INDIAN AFFAIRS,)	
Appellee.)	November 3, 2008

McCann Resources Inc. (MRI or Appellant) appealed to the Board of Indian Appeals (Board) from a September 12, 2006, decision (Decision) of the Acting Eastern Oklahoma Regional Director, Bureau of Indian Affairs (Regional Director; BIA). The Regional Director upheld a decision of the Superintendent, Osage Agency, BIA (Superintendent), determining that Gas Mining Lease No. 14-20-G06-3138 had terminated for lack of production. We affirm the decision on the grounds that the lease expired by its own terms by August 2001. The records of production and royalty payment for 1999 through 2004 show gas production for only one month in 2001. While MRI claims that it began to make sales of casinghead gas in 2005 produced from an oil well on an oil mining lease covering lands also subject to its gas lease, such sales cannot resuscitate a lease that had already expired.

Background

On February 28, 1962, the Osage Tribe of Indians of Oklahoma issued, with the approval of the Secretary of the Interior, "Blanket Oil Mining Lease" No. 14-20-0406 (Domes Oil Lease). The Domes Oil Lease was issued to lessees of lands covering the E¹/₂ of section 9 and the W¹/₂ of section 10, T. 26 N., R. 10 E., Osage County, Oklahoma. *See* Domes Oil Lease, "whereas" clause; 1961 Unit Operating Contract. The lease gave the lessees the "exclusive right to extract, pipe, store, and remove oil" from "all the oil deposits" on the leasehold for a term of 5 years "and as long thereafter as oil is produced in paying quantities." Domes Oil Lease Section 1. Section 12 stated that all "casinghead gas" produced from any oil well on the leasehold is subject to royalty; casinghead gas "shall

belong to the oil lessees” when used for development operations, and if it is not utilized for such purposes it “shall belong to the gas lessee.”¹ *See also* 25 C.F.R. § 183.14 (1962).

On July 23, 1973, the Osage Tribe issued Gas Mining Lease No. 14-20-G06-3138 (Domes Gas Lease), with Secretarial approval, to KWB Oil Property Management, Inc. (KWB), for the E½ of section 9, T. 26 N., R. 10 E., Osage County, Oklahoma. Domes Gas Lease section 1 gave the lessee a right to mine gas from the leased land for a term of 5 years and “as long thereafter as gas is produced in paying quantities.” In section 3(i), the lessee agreed “[t]o abide by and conform to any and all regulations of the Secretary now or hereafter in force, all of which regulations are made a part of this lease; Provided, That no regulations hereafter approved shall change the term or the rate of royalty herein specified” *See also* 25 C.F.R. § 183.18 (1973).

MRI ultimately acceded to lessee status, by assignment, for both the Domes Oil Lease and the Domes Gas Lease. MRI received an assignment conveying a 10% interest in the Domes Gas Lease on December 2, 1998, and the remaining 90% interest on October 18, 2003. Both assignments were subsequently approved by BIA.²

The record contains a May 3, 2001, order issued to Duke Energy Field Services, LP (Duke), as buyer, and signed by Mark McCann, President, MRI, as “owner” and “seller,” authorizing Duke to take possession of gas produced from the SW Dome Lease or Unit No. 52010019. Gas Division Order for “SW Dome Lease,” “Meter 52010019.” This order appears to relate to gas produced from one or more oil wells for unitized oil leases, including Domes Oil Lease “0406.”³ BIA approved the order on May 23, 2001.

¹ Casinghead gas is “gas produced from an oil well as a consequence of oil production from the same formation.” 25 C.F.R. § 226.1(i). This definition was included in applicable regulations in 1974, 39 Fed. Reg. 22254 (June 21, 1974), consistent with longstanding oil well operating terms. A 1968 treatise defines “casinghead gas” as “[n]atural gas rich in oil vapors . . . usually collected, or separated from the oil, at the casing head.” *A Dictionary of Mining, Mineral, and Related Terms* (1968 ed.), at 180. The “casing head” is the “fitting attached to the top of casing *on an oil well to separate oil from gas*” *Id.* (emphasis added).

² The record does not indicate the date of assignment of the Domes Oil Lease, or contain documentation supporting any of the assignments. Because BIA does not dispute the asserted assignments to MRI, we accept the asserted facts as true.

³ An attachment to this order showed that “US Crude Ltd, DBA Crude Oil Recovery
(continued...) ”

In early 2005, the Osage Agency, BIA, examined lease records for the Domes Gas Lease and concluded that “there are no gas wells on the subject lease. This is a 320 acres Gas Lease with no gas division orders and no gas production.” Memorandum from BIA Realty Specialist to BIA Supervisory Petroleum Engineering Technician, Osage Agency, Mar. 1, 2005. The Realty Specialist noted that the land was “within the SW Domes Unit that has a gas division order for casinghead gas” from an oil well. *Id.* Attached to this memorandum are annual lease statements showing monthly royalty payment and production reports for the lease for the calendar years 1999-2004. These statements show that the relevant lessee had submitted reports for a total of 11 months during a 72-month period from 1999-2004; the most recent report was submitted on August 27, 2001, for production in July 2001. The reports revealed that gas was produced and gas royalties were paid from the lease during only one of the 72 months, August 2001, in the amount of \$324.47 for 1381 mcf (thousand cubic feet) of gas. No other royalty was paid and no other gas production was reported.⁴

By letter dated March 8, 2005, the Superintendent notified MRI that the Domes Gas Lease was “beyond the primary term and can only be in effect as long as [g]as is produced in paying quantities.” Noting “no reported production on this lease,” the letter gave MRI 15 days to “show cause why we should not proceed with the termination of the subject lease. This is not intended to allow you additional time to establish production; but is to provide an opportunity . . . to present information that may help prove that the subject lease has . . . been producing in paying quantities.” *Id.*

MRI responded by letter dated March 21, 2005. The letter did not allege that the lease had been producing gas in paying quantities. Instead, it explained what MRI had done or was doing to establish production. MRI’s counsel explained that since April 2004, MRI had posted \$10,000 in bonds and sought approval of the assignment of the gas lease from BIA.⁵ MRI referred to an appeal related to the lease.⁶ It asserted that between April and

³(...continued)

Inc.,” owned 75% of the SW Dome Leases 5201–19, and MRI owned a .0833333% interest in the leases.

⁴ For two months in 2001, reports asserted royalty credits of \$2.20 and \$0.01, respectively.

⁵ As noted above, the 90% interest assignment took place between the assignor and the assignee MRI in 2003. The April 2004 reference is to the date BIA both approved the assignment and also rescinded a cancellation of the Domes Gas Lease. *See* note 6, *infra*.

⁶ MRI makes several references to this appeal. Both the Domes Oil Lease and the Domes
(continued...)

December 2004, MRI had “repaired lines and equipment damage[d] or removed” during the pendency of the appeal. *Id.* at 2. MRI asserted that at one time there had been a “prior Gas Sale and Purchase agreement between Duke Energy and predecessor to U.S. Crude, Ltd. and MRI.” *Id.* Duke’s natural gas pipeline had been sold to Scissortail Energy, and MRI “finally persuaded Scissortail to purchase under the prior gas purchase and sale agreement until proper documentation could be supplied to it,” commencing approximately January 2005. *Id.*

By certified mail, the Superintendent responded to MRI’s counsel that the “lease can not be held and will be terminated,” enumerating three reasons:

1. There are not any gas wells on this lease.
2. Last reported production was August, 2001, which we believe was casing head gas off of a[n] oil well since there were no gas wells on this lease at the time.
3. Letter dated March 21, 2005, did not present information providing that subject lease has, in fact, been producing in paying quantities.

Mar. 23, 2005, letter from Superintendent to MRI counsel John R. Horst, P.A.⁷ By letter dated March 25, 2005, the Superintendent advised MRI that BIA had inspected the lease, and that, pursuant to 25 C.F.R. § 226, it “has been terminated inasmuch as the lease is beyond its primary term and is not producing.”

By letter to BIA dated April 5, 2005, MRI requested copies of inspection reports and, by letter dated April 6, it requested a hearing regarding the termination. A document in the record shows production from the Lane No. 1-A well, identified by type as an “oil well,” located in the SE 1/4 of section 9, drilled by KWB in 1981. The next document that appears in the record is the September 12, 2006, Decision of the Regional Director which is the subject of this appeal. The Decision makes clear that the parties engaged in written

⁶(...continued)

Gas Lease are stamped “Cancelled, Osage Indian Agency, Pawhuska, OK, Feb. 10, 2003.” Handwritten on the oil lease are the words “rescind cancellation, 3/11/04.” The same appears on the gas lease, “eff[ective] 4/12/04.” According to pleadings submitted to the Regional Director by MRI, the cancellations and appeal related to the prior owner’s failure to maintain a bond. This issue was resolved at BIA’s level.

⁷ Letters sent to MRI by certified mail at its address of record were returned unclaimed.

and/or oral communications, but no documentation of these communications is supplied in the record.⁸

The Regional Director issued several conclusions assertedly affirming the Superintendent's letter, but actually or potentially modifying it. First, the Regional Director explained that the lease should have terminated by its own terms on September 4, 1978, because by then it was past its primary term and no production from any gas well had been reported. Decision at 1. Acknowledging that BIA had approved assignments to MRI, the Regional Director stated that this action could not change the fact that MRI had failed to show production after the assignments were approved. *Id.*

Second, the Regional Director described production reports from 1985-96 (supplied apparently to BIA by MRI in its Brief in support of its appeal) referring to "combination oil and gas wells," but concluded that "there are no gas wells on the lease and the only gas produced was casinghead gas." Decision at 1. The Regional Director stated that "casinghead gas is not considered natural gas since it is associated with crude petroleum oil." *Id.*

Third, the Regional Director asserted that "the last reported gas production is from the Lane No. 1-A well, which is an oil well." Decision at 2. She then examined definitions of an oil well and a gas well, found in 25 C.F.R. § 226.1(m). These definitions, added in 1990, 55 Fed. Reg. 33114 (Aug. 14, 1990), define a "gas well" as one which either "[p]roduces natural gas not associated with crude petroleum oil at the time of production" or "[p]roduces more than 15,000 standard cubic feet of natural gas to each barrel of crude petroleum oil from the same producing formation." Decision at 2, quoting 25 C.F.R. § 226.1(m). Because MRI had supplied no data to show that the Lane No. 1-A oil well was a "gas well" within the meaning of section 226.1(m), she concluded that the lease terminated for lack of production from a gas well. *Id.*

⁸ The record supplied by the Regional Director also failed to contain other relevant documents, including the Blanket Oil Lease (supplied by Appellant) and Appellant's Notice of Appeal and Statement of Reasons filed in support of MRI's appeal to the Regional Director from the Superintendent's decision (provided to the Board at the request of its legal assistant). *See also* n. 2, *supra*. The Regional Director is reminded that the record must contain *all* documents reviewed and considered by him in the course of a decision — even if duplicative of other records — as well as certain categories of documents that must be included regardless of whether they were actually considered or relied upon. *See* 43 C.F.R. § 4.335(a); *Tuttle v. Acting Western Regional Director*, 46 IBIA 216, 227-28 n.15 (2008).

Fourth, the Regional Director denied MRI's "verbal and written requests" to BIA to combine the Domes Gas Lease and Domes Oil Lease, pursuant to 25 C.F.R. § 226.15(e). Explaining that this regulation "allows the lessee owning both an oil and gas lease covering the same acreage . . . to convert such leases to a combination oil and gas lease," she refused to do so since the two leases were not coextensive. Decision at 2. Concluding that MRI failed to provide evidence of production from a gas well or a factual basis to support a finding that gas was produced in paying quantities, she affirmed the Superintendent's decision.

MRI appealed to this Board. MRI argues that the Regional Director's application of the 1974 and 1990 regulations, specifically the definitions of casinghead gas, oil well, and gas well, amount to a change in the lease "term." Appellant argues that section 3(i) of the Domes Gas Lease prohibits the application of subsequent regulations if the effect would alter the term of the lease. *See also* 25 C.F.R. § 181.18(i) (1973), and 25 C.F.R. § 226.5 (no amendment to a regulation in place when the lease was issued can "operate to affect the term of the lease"). MRI reasons that the Regional Director's conclusion that there is no gas well producing on the lease, based upon the definition of gas well added in 1990, must be reversed. MRI argues that it submitted "monthly settlement statements" for February and March 2005, which the Regional Director allegedly ignored. In support of its appeal, MRI moves to supplement the record with "monthly oil and gas production reports for the months of February, 2005 through November, 2006," showing gas production in paying quantities. MRI argues that whether production derives from an oil well or a gas well is irrelevant because it is the lessee on both leases. MRI also claims that it was entitled to a hearing under section 18 of the Domes Gas Lease, which requires notice and a hearing before the Secretary voids the lease for a violation of the terms and conditions of the lease. *See* Domes Gas Lease section 18 ("Forfeiture"). Finally, MRI argues that the Regional Director misread the regulation at 25 C.F.R. § 226.15(e) in refusing to convert its leases to a combination oil and gas lease.

BIA submitted an Answer Brief in support of the Decision. It denies having received the February and March 2005 reports, and opposes the inclusion of any documentary evidence of 2005-06 production submitted by MRI. BIA argues that such information cannot be relevant to a lease that was already terminated. MRI submitted no Reply Brief.

Discussion

Appellant bears the burden of proving error in the decision. *Tallgrass Petroleum Corp. v. Acting Eastern Oklahoma Regional Director*, 39 IBIA 9 (2003). Unsupported assertions concerning BIA's decision are insufficient to carry this burden of proof. *See King v. Eastern*

Oklahoma Regional Director, 46 IBIA 149, 153 (2007). When the issue is nonproduction from an oil and/or gas lease, Appellant bears the burden to show that production did, in fact, occur, *Clark Operating Services, Inc., v. Acting Muskogee Area Director*, 29 IBIA 109, 114 (1996), or that any period of non-production was excusable, *Oxley Petroleum v. Acting Muskogee Area Director*, 29 IBIA 169, 171 (1996). We conclude that Appellant has not carried its burden and affirm the decision as modified to conclude that the lease expired of its own terms no later than August 2001.

When an oil and gas lease is issued for a primary term and so long thereafter as oil and gas is produced in paying quantities, the lease in its extended term expires when production ceases. *Dyck v. Acting Eastern Oklahoma Regional Director*, 35 IBIA 250, 251 (2000). This principal applies as well to an oil lease or a gas lease. *Tallgrass Petroleum Corp.*, 39 IBIA at 9 (oil lease). Expiration occurs by operation of law and not by any action taken by BIA. *Magnum Energy, Inc. v. Eastern Oklahoma Regional Director*, 38 IBIA 141, 142 (2002). Thus, BIA does not “cancel” or terminate a lease which expires of its own terms. *Dyck*, 35 IBIA at 251, citing *Benson-Montin-Greer Drilling Corp. v. Acting Albuquerque Area Director*, 21 IBIA 88, 94-95, 98 I.D. 419, 423 (1991), *aff’d*, *Benson-Montin-Greer Drilling Corp. v. Lujan*, No. CIV-92-210 SC-LFG (D.N.M. Jan. 13, 1993).⁹ It follows that production or nonproduction is determinative of whether the lease is in an extended term; nonproduction is not a lease violation and does not trigger lease cancellation or forfeiture procedures. *Tallgrass Petroleum Corp.*, 39 IBIA at 11.

In the case of the Domes Gas Lease, MRI does not dispute a lack of production for a period of years. BIA gave MRI an opportunity to show that evidence of nonproduction was mistaken. MRI did not provide such evidence, and in its pleadings before the Regional Director conceded that “[p]rior to January, 2005, there was no recent product of gas” from the lease.” Statement of Reasons submitted to Regional Director at 4.¹⁰ Nor did MRI meet its burden of showing that nonproduction was excused. MRI explained a delay between April 2004 to January 2005 due to a pipeline that was inoperable. In its Opening Brief, at 4 n.1, MRI also asserts that during the pendency of an appeal, which we understand to have taken place in 2003, the wells were “shut down.” In its Statement of Reasons to the Regional Director, MRI explained that flowlines had been damaged during this period by

⁹ Section 17 of the Domes Gas Lease describes termination as a right of the lessee, for which it submits an application in order to surrender its lease.

¹⁰ The Regional Director’s decision asserts that MRI submitted records showing production between 1985 and 1996 and denies that she received any production records from MRI for any time thereafter.

fire and theft. Statement of Reasons at 4-5. Even excluding the period after 2003, MRI does not dispute that, and simply fails to explain why, the lease basically ceased gas production in 1999, with only a single month's production in July 2001. MRI made an effort to resurrect an expired lease by taking action to reconnect a disabled pipeline in 2004, for wells it concedes were "long dormant," *id.* at 5; these efforts bore fruit in 2005.¹¹ The Regional Director was correct to conclude that such events cannot resuscitate an expired lease. Therefore, we affirm the Regional Director, modifying the Decision to explain that the lease expired of its own terms no later than August 2001.

We reject Appellant's argument, pursuant to section 18 of the gas lease, that it was entitled to notice and a hearing with respect to a violation subjecting it to lease cancellation. The lease expired due to admitted nonproduction, facts fully within the knowledge of the lessee. There was no violation of the terms and conditions of the lease and thus section 18 of the gas lease is inapplicable.

Our decision to affirm as modified makes it unnecessary to address some of the parties' arguments, but we briefly explain why we do not otherwise affirm the Regional Director's decision. First, the Regional Director's comment that the lease should have expired in 1978 is not verifiable on the record before us. Second, we reject her assertion that casinghead gas is not "gas." While she understood that casinghead gas derives from an oil well, it does not follow that natural gas flowing out of a casinghead is not gas. *See A Dictionary of Mining, Mineral, and Related Terms* (1968 ed.) at 180.

That said, we need not resolve here whether casinghead gas production from an oil well could hold the Domes Gas Lease during its extended term. The Regional Director implicitly concluded that the lease could only be held during its extended term by production

¹¹ MRI seeks to supplement the record with "settlement reports" and records of oil and gas sold between 2005 and 2006. Though documents not considered by BIA are not part of BIA's administrative record, the Board may permit parties to supplement the record so long as opposing parties have an opportunity to respond, and BIA did so here. *Brown v. Navajo Regional Director*, 41 IBIA 314, 316 n.2 (2005). We do not consider MRI's submissions as relevant to our disposition of the case. MRI submits the reports to show that after 2005 it was producing gas. But the data is not probative of MRI's claim it produced gas from the Domes Gas Lease because the reports' association with the Domes Gas Lease is ambiguous. The oil reports refer to lease "0406 8351," thus presumably Domes Oil Lease No. 14-20-0406. But the gas production sheets refer to Osage Contract No. 3024-05, with no apparent relation to Domes Gas Lease No. 14-20-G06-3138. Whatever the source, gas produced in 2005-06 cannot resurrect a gas lease which expired in 2001.

from a gas well and, citing the definitions of oil and gas wells in 25 C.F.R. § 226.1(m), the Regional Director noted that any production that was documented for the lease was from an oil well. Appellant claims that these definitions cannot apply under section 12 of the lease or 25 C.F.R. § 226.5 because to do so would change the lease “term” by terminating it during its extended term. Appellant thus disputes the Regional Director’s determination that production of gas cannot derive from an oil well under current rules, and asserts in any event that production, whether from an oil well casinghead or a gas well, can hold the gas lease. We need not analyze whether casinghead gas would be sufficient to hold the Domes Gas Lease in its extended term because the Domes Gas Lease expired of its own terms no later than 2001 and thus could not be resuscitated by gas production from whatever source initiated in 2005.

We reject MRI’s claim that current rules do not apply because they post-date the 1973 issuance of the lease and change the “term” of the lease. The lease plainly incorporates all future regulations, except those which change the lease “term” or royalty provision.¹² Domes Gas Lease Section 12; 25 C.F.R. § 226.5. MRI took both lease assignments fully aware of all regulations expressly incorporated into the lease and in place at the time. MRI cannot claim lack of knowledge of the lease terms, the rules, or their meanings. Moreover, the definitions of casinghead gas, gas wells, and oils wells did nothing to change the 5-year primary term of the lease, or the fact that the lease could continue in extended term only so long as gas was produced in paying quantities. It is MRI, not BIA, that would change the 5-year primary lease term to start it anew, after the lease expired. Nothing in the prior or current rules or in the lease itself permits such an amendment.

Appellant argues that it does not matter whether the gas is produced from gas wells or oil wells because MRI is the lessee on both the Domes Gas Lease and the Domes Oil Lease. We reject the notion that whether MRI acts as oil lessee or gas lessee is of no matter to BIA. Applicable rules establish procedures to follow when an oil well is drilled on a gas

¹² Language subjecting mineral lessees to regulations “now or hereafter” in effect is found in standard lease provisions for Indian and Federal lands. *See, e.g., Dawn Mining Co. v. Portland Area Director*, 20 IBIA 50, 56 (1991). The application of subsequently promulgated rules pursuant to such a clause in a Federal oil and gas lease has been upheld by Federal courts. *E.g., Nexen Petroleum U.S.A., Inc. v. Norton*, 2004 WL 722435 at 6-8 (E.D. La. Mar. 31, 2004). By contrast, where a lease expressly asserted that no subsequently promulgated rule could “operate to affect the terms and conditions of the lease,” a Federal court recognized that the lease expressly prohibited application of subsequent regulations affecting royalty valuation. *United States v. Wichita Indus., Inc.*, 390 F.Supp. 1154, 1155 (W.D. Okla. 1974).

lease, or visa versa; the well is to be transferred to the proper lessee subject to cost reimbursement. 25 C.F.R. § 226.25. And section 11 of the Domes Gas Lease requires the gas lessee immediately to notify the oil lessee upon drilling an oil well; it must permit the oil lessee to “take over such well,” subject to cost reimbursement. These provisions thus refute MRI’s claim that whether the gas lease is subject to production from a gas well does not matter because it is lessee on both leases. To the contrary, lessees are obligated to ensure appropriate attribution of a well to the correct lease so that the lessor can determine whether the lessee is diligently developing its lease, and issue new leases if not. We reject any suggestion that MRI can assign production from one lease to the other to avoid diligent development requirements in sections 1 of the two leases.

Finally, MRI argues that 25 C.F.R. § 226.15(e) permits consolidation of its leases and, effectively, that the rule is mandatory. That rule states: “The lessee owning both an oil lease and gas lease covering the same acreage is authorized to convert such leases to a combination oil and gas lease.” 25 C.F.R. § 226.15(e). BIA argues that the rule precludes combining two leases that do not cover the exact same acreage. We need not choose between these points of view for the simple reason that the Domes Gas Lease expired some years before the alleged request was made. We will not reverse the Regional Director for failing to combine an oil lease with a gas lease that had already expired on its own terms.

Therefore, pursuant to the authority delegated to the Board of Indian Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Board affirms the Regional Director’s September 12, 2006, decision, modifying that decision to conclude that the Domes Gas Lease expired of its own terms no later than August 2001.

I concur:

_____/ / original signed
Lisa Hemmer
Administrative Judge*

_____/ / original signed
Debora G. Luther
Administrative Judge

*Interior Board of Land Appeals, sitting by designation.