

STOVE CREEK OIL INC.

IBLA 2001-250

Decided July 1, 2004

Appeal from a decision of the Wyoming State Office, Bureau of Land Management, declaring Federal oil and gas lease terminated due to cessation of lease production. WYW053431.

Affirmed.

1. Oil and Gas Leases: Noncompetitive Leases--Oil and Gas Leases: Termination

A Federal oil and gas lease in its extended term by reason of production is properly deemed terminated by operation of law upon cessation of production if the lessee does not initiate reworking or drilling operations within 60 days of the cessation of production and fails to establish that the lease contains a well capable of production in paying quantities.

APPEARANCES: David Kimball, Evanston, Wyoming, for appellant.

OPINION BY ADMINISTRATIVE JUDGE HEMMER

On behalf of Stove Creek Oil Inc. (SCO), David Kimball appeals from a March 5, 2001, Decision of the Wyoming State Office, Bureau of Land Management (BLM), declaring Federal oil and gas lease WYW053431 terminated due to cessation of lease production. The Decision follows a 60-day notice of the BLM Kemmerer Field Office (KFO), dated July 27, 2000, providing the lessee 60 days in which to commence reworking or drilling operations on the lease. According to the March 5, 2001, decision, while SCO had plugged one well, no effort was made to rework or drill from two remaining wells on the lease. Accordingly, the decision concluded that the lease had terminated as a matter of law effective September 25, 2000.

Lease WYW053431 is located on portions of secs. 24 and 26, T. 15 N., R. 119 W., 6<sup>th</sup> Principal Meridian, Uinta County, Wyoming. The lease was issued, for a primary term of 5 years and so long thereafter as it produced in paying quantities, on July 1, 1957, and immediately assigned to Big Piney Oil and Gas Company (Big

Piney), with both the lease and assignment effective September 1, 1957. Records for the ensuing decades show that operators drilled wells and produced from the lease, and ultimately the term of the lease was extended by virtue of a well capable of production in paying quantities therefrom.

For purposes relevant here, in April 1991 BLM issued a notice to Big Piney that the lease would terminate for cessation of production and provided Big Piney 60 days in which to, *inter alia*, produce from the lease. (Dec. 12, 2000, BLM letter to SCO.)<sup>1/</sup> Thereafter, Big Piney assigned record title to the lease to SCO effective October 1, 1991. (Assignment of Record Title to Stove Creek Oil Inc., approved Sept. 30, 1991.) Subsequently, the Wyoming State Office advised SCO that the lease terminated as of December 31, 1991. According to BLM, SCO appealed and the parties entered into an agreement in 1993 in which SCO would “pump their wells once every two weeks. This did not happen.” (Dec. 12, 2000, BLM letter to SCO.)<sup>2/</sup>

Subsequently, BLM issued a letter to SCO advising the company of its lease responsibilities. (May 19, 1992, letter from BLM, Rock Springs District Office, to Richard Sather, SCO.) BLM stated then that it had advised SCO of the obligations to produce in paying quantities in relation to termination of another SCO lease:

We expect Stove Creek Oil to comply with the regulations outlined in 43 CFR 3160 and the lease terms specified in Lease No. WYWO53431. Our letter of May 7, 1992, outlined in detail the extensions that were granted to Stove Creek Oil concerning the termination date for Lease No. WYW34001. Producing a couple of barrels of oil on a one-time basis \* \* \* would not have saved Lease No. WYW34001. The lease had to have been capable of production in paying quantities before its termination date.

According to BLM, SCO reported no production from the lease through 1996. During 1994 and 1995, BLM advised SCO on at least three occasions to plug and abandon its wells. At this juncture Kimble purchased SCO from Richard Sather, and promised to clean up environmental contamination at the lease site. According to BLM, three wells from the lease produced a total production of 317 barrels of oil between 1989 and 1999, or an average of 31.7 barrels per year (approximately 2.5 barrels per month). The wells stopped producing altogether in July 1999. (Dec. 12, 2000, BLM letter to SCO.)

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<sup>1/</sup> The ensuing discussion regarding lease termination issues during the early 1990s is taken from various statements of lease history in subsequent documents. Many of the contemporaneous documents from this time period do not appear in the record.

<sup>2/</sup> We cannot verify that an appeal was submitted to the Board.

The record demonstrates the BLM and Kimball had a number of conversations and communications regarding the lease after July 1999. BLM conducted a lease inspection on September 10, 1999, during which BLM petroleum engineer John Breitmeier and another employee visited and photographed the site. They found and variously photographed leaking tanks, wells unconnected to pipeline, nonworking rigs, junk on the site, and a barrel in a creek bed. The memorandum of the site visit indicates that the total production from 1988 through June 1999 was 311 barrels of oil, which would yield approximately \$600 per year to cover all lease expenses including an annual inspection and enforcement expense of \$82.

According to a telephone log dated September 13, 1999, Kimble advised BLM that he hoped to do some well work, including to reenter and fracture or acidize the wells. “To quote him he ‘will be able to ‘cheap’ the job’.” (Sept. 13, 1999, telephone record.) “He stated he would like to maybe get to it next spring if he could round up the money.” Id. Breitmeier stated that he

expressed concern about the overall economic viability of the project. [Kimble] said he had 170 bbl of oil in the tank ready to sell soon. This represents 2 years worth of production. This at best would bring \* \* \* \$3291 after our royalties but before taxes and operating expenses. I stated that this did not seem adequate even to make the repairs much less perform the frac jobs on three wells or show a profit.

Id. Breitmeier concluded that “the field is being run as a hobby rather than a viable business.” Id.

Breitmeier met with Kimble on September 17, 1999. Kimble promised to remove pipes across the creek and conduct various actions to secure the site and correct environmental problems on the lease before winter. He agreed to bring the wells into producing status in the spring at a rate of five barrels per day. (Meeting notes, Sept. 17, 1999.) Breitmeier states that he advised Kimble that “production after the frac must be truly economic, *i.e.*, pay expenses, put money back towards abandonment \* \* \*.” Id. (remainder of quote undecipherable). Kimble stated that he sold the “last oil for \$17.14” per barrel. Id. A monthly report of operations for three wells on the lease (the Govt #1, the Federal #3, and Federal #4) showed “0” in the production category for each lease, and that Kimble had sold 144 barrels of oil “on hand.” (Nov. 2, 1999, Monthly Report of Operations.)<sup>3/</sup>

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<sup>3/</sup> Assuming these two documents regarding sale of oil and price are related, SCO received \$2,468.16 for the sale of 144 barrels of oil produced over a 2-year period, prior to payment of royalties, rental, taxes or any operation costs.

Apparently at that meeting, Kimball also submitted a “Stove Creek Proposal,” dated September 17, 1999, setting forth his plans for bringing at least the Federal #3 well back into production, starting “immediately.” (Sept. 19, 1999, Stove Creek Proposal at 1, 2.) Though the proposal contains no discussion of planned activities on the Govt #1 or Federal #4 wells, SCO asserted that it would produce five barrels of oil per day from each of the three wells, totaling 15 barrels daily and 300 barrels monthly for a monthly yield of \$4,500. According to this document, SCO’s monthly costs would be \$3,513, permitting SCO to devote \$987/month toward completion costs of \$14,000, with an ultimate payout within 14.2 months.

This plan was not effectuated within the ensuing 9 months. On July 27, 2000, BLM issued SCO a letter by certified mail stating that monthly reports of operations indicated that none of the three wells had produced within the past 12 months. (July 27, 2000, BLM 60-day notice to SCO.) BLM provided SCO 60 days in which to rebut that conclusion with “corrected production data.” BLM further stated:

We have determined this lease is not capable of producing in paying quantities. Under 43 CFR 3107.2-2, a lease, which is in its extended term because of production in paying quantities, shall not terminate upon cessation of production if, within 60 days thereafter, reworking or drilling operations are commenced on the leasehold, and are conducted with reasonable diligence during the period of nonproduction. You are allowed 60 days from receipt of this letter within which to restore production to the leasehold in paying quantities. If you do not restore sustained economic production, the lease will automatically expire, and you will be compelled to plug the wells.

\* \* \* [I]f you believe the well is capable of producing in paying quantities (sufficient to pay the day-to-day operating costs, including rental and/or minimum royalty on a sustained basis), you must submit to this office (within 60 days of receipt of this letter) detailed and specific plans for promptly restoring this well to a producing status and you must begin executing this plan.

Id. BLM advised SCO that, if any of the three wells was not so capable of production, SCO must submit a Notice of Intent to Abandon with respect to that well, or a Sundry Notice requesting Temporarily Abandoned Status “with adequate, detailed economic and engineering justification” and a “successful pressure integrity test.” Id.

On September 26, 2000, SCO submitted a response to BLM’s July 27, 2000, 60-day notice. SCO agreed that the Federal #3 well “has been tested and found to be noneconomical” and submitted a sundry notice to plug and abandon that well.

(Sept. 26, 2000, SCO response to BLM 60-day notice.) With respect to the other wells, SCO stated: “Plan to move on to Gov #4 & #1 pull rods & tubing and test as per Sundry Notice enclosed.” Id. Nonetheless, SCO’s explanation of the status of those wells directly conceded that SCO had done nothing with respect to the other two wells to comply with the September 1999 Stove Creek Proposal, other than engage in discussions with other operators during the summer of 2000.

Discussion: Last fall in my meeting with John Breitmeier I presented a plan that included a plan to frac these wells. In order to add to the limited data on these wells I talked with some of the older operators of these wells and other shallow wells in the area and found that a clean out with a sand pump often significantly increased production with some wells production holding up for sufficient time to be feasible and support the feasibility of stimulation treatments thus the change in [plans] and the use of the sand pump.

Over the summer I had the opportunity to work for and observe other shallow well producers in the area. Information learned there supports the conclusion obtained from sand pumping - that potential production in the upper zone wells like #3 are very limited.

The potential of Govt. #1 and Federal #4 are unknown at this time, as I have produced them and know that they are capable of sustained limited production, it is likely that they are producing from lower zones. No downhole maintenance has been perform[ed] for over 20 years, thus the unknown potential. Testing for sustained production takes time, however I understand that as per BLM regulations wells need to either be economically producing or plugged.

As the BLM has requested not to blade road and to limit the surface damage it is not feasible to conduct workover operations during wet or deep snow periods. There for I’m proposing to work over wells as condition permit however if wells are not economically producing by August 1, 2001 be ready to start plugging and lease reclamation operations.

Id. at 1-2.

Also on September 26, 2000, SCO submitted a Sundry Notice for the “1 GOVT” well, proposing to

1. Pull rods and tubing

2. Clean well, check bottom, test production with a sand pump, if well shows potential with sand pump place well on pump and test.
3. If test warrants design treatment from step 2.

Kimball signed this notice on September 25, 2000. SCO submitted an identical Sundry Notice for the Federal #4 well, also dated September 25, 2000.

BLM disapproved the sundry notices for the Govt #1 and Federal #4 wells. On December 12, 2000, the BLM KFO Field Office Manager issued a letter directing SCO to plug and abandon all three wells. The letter stated the history of the lease. With respect to SCO's agreements in September 1999, KFO stated:

You claimed that the work could not all be completed prior to winter snows, which would make access impractical. A compromise was reached whereby you agreed to secure the wells and remove the leaking piping at once, and restore production (if possible), beginning as soon in spring 2000 as weather would allow. Reference to past records shows access to the site was (at worst) only impracticable from mid-October to the end of April. As it happened, the winter of 1999-2000 was a remarkably open and mild one, where access was only impractical for a few days (at most). Note that the BLM did not stop your production, which had already ceased two months earlier due to the workover on the Federal #3 well.

By your own admission, "no downhole maintenance has been performed for over 20 years" on the Govt. #1 and Federal #4 Wells. Stove Creek Oil has had seven of those years in which to perform the workovers, and you personally have had four years.

The 60 days since our letter of September 25, 2000 was adequate time to test all three wells. You state in your letter "that potential production in the upper zone wells like #3 are very limited," which appears to be true. However your contention that "it is likely that they (Wells #1 and #4) are producing from lower zones has no merit. According to our records, the Federal #3 and #4 Wells are both just over 300 feet deep, hence there is no lower zone in the #4 well. True, the Govt. #1 Well was originally drilled to 1223 feet, but was plugged back to 900 feet. Furthermore, on review of the original geologic reports, the production from the Govt. #1 Well appears to be from a siltstone zone at 230-250 feet. This would be why the later #3 and #4 Wells were only drilled to about 300 feet. The production in all three

wells was from fractured shales or siltstones that show no real economic potential. Further delay to August 1, 2001 is not warranted.

(Dec. 12, 2000, letter from BLM KFO Field Office Manager to Kimball at 2.)

On December 27, 2000, Kimball submitted a response to BLM's notice to plug and abandon. In this letter, Kimball states that SCO "was not aware of an urgency to increase production on these wells \* \* \*." (Jan. 2, 2001, letter from SCO to BLM at 1.) He blames the delay in work on BLM's alleged failure to permit him to grade a road and approve a sundry notice for a tank construction. "Had timely approval been obtained it is probable that all the wells could have been tested." Id. at 2. He states that he did not have time to test the wells and proffers that "the sundry notices were set on to run the time out." Id. With respect to the Govt #1 and Federal #4 wells, SCO asserts that there is "still a possibility" that they could be "economical producers[.] I have information that there is a producing zone between 240 and 310." Id.

On March 5, 2001, the Wyoming State Office, BLM, issued the challenged decision entitled Lease Terminated by Cessation of Production. The decision states much of the above history, and concludes that the "term of lease WYW053431 is exhausted and the lease is held to have terminated by cessation of production effective September 25, 2000."

On behalf of SCO, Kimball appealed. The notice of appeal stated:

The reason that the lease was not produced over the past year was that I was not able to obtain approval to test Stove Creek #3 and to install a new gathering system after having to call to get approval to test #3 and to start construction of a new gathering system. Upon receiving approval a new tank was constructed and #3 was tested and found not capable of producing in paying quantities. Request permission to plug #3 and test the other two wells, permission was granted to plug #3 however permission was not granted to test the other 2 wells. It is possible that wells 1 & 2 would be economical producers and should be tested for if they are plugged with out testing possible national resources will be lost.

(Notice of Appeal.) Presumably, in its notice SCO meant to refer to the Govt #1 and Federal #4 wells.

It is clear that Kimball is unfamiliar with the requirements of the Mineral Leasing Act (MLA), 30 U.S.C. § 226(e) (2000), which control this case. An explanation of statutory and regulatory terms under that statute answers this appeal.

[1] The MLA authorizes issuance of oil and gas leases on public lands. A competitive oil and gas lease is issued for a primary term and continues so long after its primary term as oil or gas is produced in paying quantities. 30 U.S.C. § 226(e) (2000); 43 CFR 3120.2-1 (primary term). A lease which has not been extended by either production or diligent drilling on the last day of the lease period automatically expires by its own terms at the end of the lease period. The MLA provides express consequences for leases on which a well capable of production in paying quantities has been drilled:

No lease issued under this section which is subject to termination because of cessation of production shall be terminated for this cause so long as reworking or drilling operations which were commenced on the land prior to or within sixty days after cessation of production are conducted thereon with reasonable diligence, or so long as oil or gas is produced in paying quantities as a result of such operations \* \* \*. No lease issued under this section covering lands on which there is a well capable of producing oil or gas in paying quantities shall expire because the lessee fails to produce the same unless the lessee is allowed a reasonable time, which shall be not less than sixty days after notice by registered or certified mail, within which to place such well in producing status.

30 U.S.C. § 226(i) (2000) (emphasis added).<sup>4/</sup>

For leases held by production on which production then ceases BLM has implemented this statutory provision at 43 CFR 3107.2-2.

A lease which is in its extended term because of production in paying quantities shall not terminate upon cessation of production if, within 60 days thereafter, reworking or drilling operations on the leasehold are commenced and are thereafter conducted with reasonable diligence during the period of nonproduction. The 60-day period commences upon notification from the authorized officer that the lease is not capable of production in paying quantities.

43 CFR 3107.2-2.

A concurring opinion in Merit Productions, Inc., 144 IBLA 156 (1998), analyzed the statutory and regulatory provisions:

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<sup>4/</sup> This provision was enacted in 1954 and appeared at 30 U.S.C. § 226(f) until 1987, when it was recodified in identical form.

It has been consistently held since the onset of adjudications involving this provision that the statute consists of three separate mandates. See, e.g., Great Western Petroleum and Refining Co., 124 IBLA 16, 24 (1992); Great Plains Petroleum, Inc., 117 IBLA 130, 132 (1990); Michael P. Grace, 50 IBLA 150, 151-52 (1980); Max Barash, 6 IBLA 179, 182 (1972); Steelco Drilling Corp., 64 I.D. 214, 217 (1957). The first part is the general mandate, and it provides in essence that, where cessation of production occurs on a lease in an extended term by reason of production, the lessee has 60 days to commence reworking or drilling operations, in which case the lease will be extended so long as those operations are conducted with reasonable diligence or, alternatively, so long as oil or gas is produced in paying quantities as a result of those operations. This provision applies to all Federal oil and gas leases in an extended term by reason of production unless superceded by one of the subsequent two provisions. Moreover, it is important to point out that there is no notice requirement applicable to the first mandate. A lease terminates automatically upon cessation of production unless prior to or within 60 days thereafter reworking or drilling operations are commenced and continued with reasonable diligence thereafter.

144 IBLA 160-61 (Burski, J., concurring) (footnotes omitted).

There is no question or debate that production on the wells on the lease ceased no later than 1999. Within the ensuing 60 days after production ceased, the lessee did not “commence reworking or drilling operations, in which case the lease [would] be extended so long as those operations are conducted with reasonable diligence.” Accordingly the lease “terminated automatically upon cessation of production” without such activity within 60 days. Lease WYW053431 must be found to have terminated “by operation of law.”

The statutory and regulatory requirement prohibits a lease from expiring if a well is “capable of production.” This Board has recently analyzed this requirement.

A well is considered capable of production in paying quantities when it is physically capable of producing a sufficient quantity of oil and/or gas to yield a reasonable profit after the payment of all the day-to-day costs incurred after the initial drilling and equipping of the well, including the costs of operating the well, rendering the oil or gas marketable, and transporting and marketing that product. Abe M. Kalaf, 134 IBLA 133, 138-39 (1995); Amoco Production Co., 101 IBLA 215, 221-22 (1988). Productive capability must be determined as of the date the lease is deemed to have terminated by operation of law by reason of cessation

of production, absent a well capable of paying production, and cannot be based on future expectations. Abe M. Kalaf, supra at 139, 141; American Resources Management Corp., 40 IBLA 195, 202 (1979); The Polumbus Corp., 22 IBLA 270, 271-73 (1975). If BLM determines that a well is not capable of production in paying quantities, the party challenging that determination bears the burden of proving, by a preponderance of the evidence, that it is capable of production in paying quantities. Abe M. Kalaf, supra at 139.

International Metals & Petroleum Corp., 158 IBLA 15, 22 (2002).

SCO has done nothing in its notice of appeal to meet this burden. Nor does SCO suggest any well has been economic, or capable of yielding a reasonable profit for over a decade. SCO did nothing between its acquisition in 1991 of record title for the lease and the filing of its notice of appeal that would constitute “reworking or drilling operations which were commenced on the land prior to or within sixty days after cessation of production” as required by the MLA. 30 U.S.C. § 226(i) (2000). SCO conceded as much in its September 26, 2000, letter submittal to BLM. Further, whether or not BLM was even obligated under the MLA to permit SCO another 60 days after SCO’s long period of failure to produce in paying quantities, see Merit Productions, Inc., 144 IBLA 160-61 (concurring opinion), it provided such a notice in full compliance with BLM regulatory requirements at 43 CFR 3107.2-2.

In a letter submitted to the Board on July 12, 2002, requesting the status of this case, Kimball asked “when do I submit my side of the appeal.” Board regulations at 43 CFR 4.412 require that an appellant submit its statement of reasons within 30 days of submitting the notice of appeal. On the other hand, a lessee is entitled to notice and an opportunity to request a hearing on the issue of the productive capacity of a well if the lessee has presented evidence raising an issue of fact regarding the status of the well. Daymon D. Gililland, 108 IBLA 144, 147 (1989).

We wish to stress that even though Kimball appears to be operating under a misunderstanding as to Board procedures, in light of SCO’s admissions in its September 26, 2000, filing with BLM, SCO could not establish an issue of fact with regard to productive capacity of any well on the lease. Even conceding, if we had the record to support it, that BLM had not permitted SCO to grade a road or had delayed 84 days in approving a sundry notice, the MLA and BLM rules require for a lease for which the term is extended by production, that when the lessee ceases production it must begin to rework or drill a well within 60 days in order to bring the lease back into production. In its 2000 filing, SCO conceded that it had not done so and had not meant to do so. In its earlier proffered proposal to BLM, SCO had agreed to begin such operations in the spring of 2000, in deference to a generous acquiescence by BLM to permit SCO to avoid statutory compliance during the winter. Nonetheless,

SCO conceded that with respect to the Govt #1 and Federal #4 wells, the extent of its compliance was to converse with other operators during the summer of 2000, before asking for another year in which to comply. Thus, to the extent SCO complains that BLM allegedly delayed approval of road grading or a sundry notice for the Federal #3 well, SCO does not suggest, nor would the record support any allegation, that SCO would have, but for BLM's actions, actually commenced reworking or drilling operations within 60 days of the 60-day notice.

We recognize that SCO is operating on the financial margins and cannot afford the operations needed to comply with the MLA. But this does not cut in favor of a second chance at compliance. A Federal lease in place for 4 decades is not an opportunity to prospect for oil and gas. It has a specified statutory term which can only be extended by production. When production ceases, the lease term ends by operation of law. Thus, any sympathy we may have for SCO's need to operate on the "cheap" only reaffirms the lack of a well capable of producing in paying quantities. To meet that test, the well must support production to cover operating costs. Thus, no issue of fact exists here to justify a further pleading or hearing at this juncture.<sup>5/</sup>

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

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Lisa Hemmer  
Administrative Judge

I concur:

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C. Randall Grant, Jr.  
Administrative Judge

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<sup>5/</sup> BLM declared the lease terminated on Sept. 25, 2000, 60 days after sending the July 27, 2000, 60-day notice. We note, however, that the day should be 60 days after receipt of that notice by SCO. This date is not revealed in this record as it does not contain a certified mail receipt card for that document.