

Editor's Note: appeal filed Civ. No. 05-CV-042-B (D. Wyo. Feb. 9, 2005), rev'd and remanded (Feb. 17, 2006)

CORONADO OIL COMPANY

IBLA 2001-7

Decided November 30, 2004

Appeal from a decision by the Wyoming State Office, Bureau of Land Management, declaring noncompetitive oil and gas lease WYW-24093-A to have terminated due to cessation of production.

Affirmed as modified.

1. Mineral Leasing Act: Generally--Oil and Gas Leases:
Termination--Oil and Gas Leases: Well Capable of Production

Under the Mineral Leasing Act, if production ceases on a lease which is in an extended term by reason of production, the lease terminates by operation of law unless: (1) within 60 days after cessation of production, reworking or drilling operations are begun and thereafter conducted with reasonable diligence during the period of nonproduction; or (2) an order or consent of the Secretary suspending operations or production on the lease has been issued; or (3) the lease contains a well capable of producing oil or gas in paying quantities and the lessee places the well on a producing status within a reasonable time, not less than 60 days after notice to do so, and thereafter continues production unless and until the Secretary allows suspension.

2. Oil and Gas Leases: Drilling--Oil and Gas Leases: Termination--
Oil and Gas Leases: Well Capable of Production

A well capable of production in paying quantities generally requires a well which is actually in a condition to produce at the time in question. When production of oil and gas on a lease extended by production ceases because the well is producing

water and is no longer capable of producing oil and gas in paying quantities, a finding that the lease terminated by cessation of production will be affirmed when the lessee failed to initiate reworking or drilling operations within 60 days thereafter since the lessee is not entitled to notice and a further reasonable period of not less than 60 days to produce the well.

APPEARANCES: Brent R. Kunz, Esq., and Ian D. Shaw, Esq., Cheyenne, Wyoming.

OPINION BY ADMINISTRATIVE JUDGE GRANT

The Coronado Oil Company (Coronado) has appealed an August 17, 2000, decision by the Wyoming State Office, Bureau of Land Management (BLM), declaring its noncompetitive oil and gas lease (WYW-24093-A), which was in its extended term by reason of production, to have terminated effective April 24, 2000, due to cessation of production. The decision was issued based upon determinations that the last well on the lease, the Blume-Government No. 1, was no longer capable of producing oil or gas in paying quantities and that Coronado had neither commenced drilling operations to restore production nor exercised reasonable diligence in pursuing reworking operations designed to restore production.

The lease at issue was created as a separate and distinct lease effective July 1, 1970, by assignment of 100-percent record title interest to 113.51 acres of land in Lots 12-14, sec. 17, T. 45 N., R. 96 W., Sixth Principal Meridian, Hot Springs County, Wyoming, from lease WYW-24093. The parent lease had been issued effective June 1, 1970, for a term of 10 years "and so long thereafter as oil or gas is produced in paying quantities." See 30 U.S.C. § 226(e) (2000). Drilling operations for the Blume-Government No. 1 well were initiated on WYW-24093-A prior to its May 31, 1980, expiration date and carried out over the expiration date. After drilling reached a bona fide objective depth in a potentially productive zone, BLM held that the lease term had been extended for 2 years to May 31, 1982, by virtue of diligent drilling over the expiration date of the lease. 43 CFR 3107.1. Thereafter, based upon initial production, the U.S. Geological Survey issued a first production memorandum dated October 28, 1981, finding that the well was capable of production in paying quantities.

The extent of subsequent production from the lease well is unclear from the BLM case file, but appellant indicates that natural gas sales from the Blume-Government No. 1 well commenced on January 10, 1981, and that oil production began on February 15, 1981. (Statement of Reasons (SOR) for Appeal at 3.) Appellant indicates that at a time when the well was producing four to five barrels of

oil per day (BOPD) with approximately 3 percent water, a change occurred and on August 12, 1993, production dropped to an average of 1.61 BOPD with 51.4 percent water. Id. There is an indication in the record that the last production was obtained in August 1997. (Aug. 2, 2000, BLM memorandum from Worland Field Office Manager to Wyoming State Director.) Appellant states that as the well began producing 100 percent water, “a plan was devised to restore oil and gas production by aggressively pumping down the water” in the well. (SOR at 4.) Because the volume of water pumped to accomplish this would exceed the capacity of the water pit at the well site and because the water was relatively pure, appellant indicates it planned to obtain a water discharge permit from the Wyoming Department of Environmental Quality (DEQ). Id.

Subsequently, appellant received a May 5, 1999, order/letter from the Worland Field Office informing it that BLM’s records indicated that the lease did not contain a well capable of production in paying quantities. (SOR, Ex. B.) The order notified Coronado that, under 43 CFR 3107.2–2, it had 60 days from receipt to begin reworking or drilling operations on the lease and it was required to continue operations with reasonable diligence until production in paying quantities was restored. The BLM order further stated: “If the lease is not producing continuously, a reworking/drilling operation proposal is not submitted and operations commenced, or justification that the lease contains a well that is capable of production in paying quantities is not submitted within 60 (sixty) days from receipt of this letter the lease will automatically terminate.” The record shows that Coronado received the order on May 7, 1999. Thus, the 60–day period ended on July 6, 1999.

By a sundry notice dated July 6, 1999, appellant notified the Worland Field Office that it was preparing a water discharge permit application to be filed with DEQ which, when approved, would allow production with optimum recovery of the resource. (SOR, Ex. C.) By order dated July 23, 1999, the Worland Field Office returned the notice unapproved, explaining that it needed documentation showing that the permit was being actively pursued, noting that appellant had been working on a permit since May 1998. Id. at Ex. D. Hence, BLM informed Coronado that if it did not submit such documentation prior to August 6, 1999, or submit a reworking or drilling operation proposal and commence operations, or provide justification that the lease contains a well capable of production in paying quantities, and if the lease was not producing continuously, the lease would automatically terminate. Id.

On August 5, 1999, Coronado sent BLM by facsimile transmission a copy of an application for a water discharge permit which its consultant, Gene R. George & Associates, Inc., had prepared and mailed that day to the Wyoming DEQ. Id. at 6, Ex. E. The record does not show that BLM responded or took further action until

April 21, 2000, when it sent Coronado an order/letter requiring that, within 5 days, the company provide documentation showing that it had received the permit or that the delay in receipt was due to causes beyond its control. Id. at Ex. G. This order was received by appellant on April 24, 2000. Further, BLM informed Coronado that if the information was not received, or if it determined that the permit was not being diligently pursued, “the lease will be terminated by our letter dated May 5, 1999.” Id.

By facsimile transmission of April 28, 2000, Coronado sent BLM copies of two pages of its permit by the Wyoming DEQ (No. WYO039390), date stamped as having been received on March 6, 2000. Id. at Ex. F. The permit had been issued effective February 1, 2000, with an expiration date of midnight January 31, 2001. Coronado explained that its consultant was seeking to correct an error in the permit and that, when corrected, Coronado planned to “commence construction of the permitted facilities.” BLM replied by order/letter dated May 3, 2000, requiring Coronado to submit information showing why the permit was inadequate to allow the company to resume production on the lease and also documentation establishing that Coronado had requested a correction to the permit. Id. at Ex. G.

Coronado responded on May 9, 2000, by facsimile transmission. It submitted a May 8, 2000, letter from its consultant stating that the permit “contained an error, since it stated that it was valid for a two-year period,” although it carried an expiration date of January 31, 2001, and that the consultant had requested a correction. Id. at Ex. J. After receipt, the Worland Field Office informed Coronado by order dated May 17, 2000, that it did not believe that the company had been diligently pursuing a corrected permit because it had received its permit on March 6, 2000, but had not taken action to correct the permit until after it had received BLM’s April 21, 2000, order. Id. at Ex. K. BLM directed Coronado to “return the well to production prior to July 12, 2000,” and warned that, “if the well is not producing paying quantities as defined in our letter dated May 5, 1999, the lease will terminate.” Id. BLM also informed Coronado that no more extensions will be granted for returning the well back to production. Id.

The record does not indicate that Coronado took further action until June 17, 2000, when it transmitted to BLM a copy of what appears to be a proposed modified permit which would be effective August 1, 2000, and expire January 31, 2002. Id. at Exs. L, M. The cover sheet refers to a June 15, 2000, telephone conversation with the Worland Field Office and thanks BLM for granting “an extension of time from the 7-12-00 date to accommodate the Wyoming [DEQ] in their insistence on republishing and inviting public comment on the modified (error correction) NPDES water discharge permit.” Id. at Ex. M. An August 2, 2000, memorandum from the Worland

Field Manager to the Wyoming State Director confirms that Coronado was verbally granted an extension to August 1, 2000.

On July 25 and 27, 2000, Coronado submitted a copy of the proposed permit and a sundry notice to undertake construction of a produced water pit drain, a flow line into the Cottonwood Creek drainage, and erosion control measures. *Id.* at Exs. N, O, P. BLM personnel visited the site on July 31, 2000, and found the well to be pumping, the water pit full, the fill line valves to the tank battery closed, the heater treater unlit, and no oil being produced. Following the inspection, the Worland Field Manager sent a memorandum dated August 2, 2000, to the Wyoming State Director recommending that the lease be terminated due to cessation of production. On August 17, 2000, the Wyoming State Office issued the decision on appeal finding the lease terminated by cessation of production effective April 24, 2000.

On August 21, 2000, the Worland Field Office received another sundry notice from Coronado which had been signed the same day as the decision. The notice did not identify any operations that Coronado wished BLM to approve but provided a chronology of actions the company had taken. Among other matters, it states that on July 11, 2000, Coronado's environmental consultant visited the wellsite and laid out construction plans for the water discharge facility and that on July 19, 2000, Coronado had moved a rig onto the site and replaced the well pump with a larger pump. Coronado also reported that on August 15, 2000, it had noticed a gas blow at the wellhead and bubbling gas in the produced water pit along with flecks of oil and paraffin. The last item in the notice states: "Shut in well, pit is close to full. Will wait on Water Discharge permit and facilities construction approval." BLM accepted the notice for record purposes only.

On appeal, Coronado contends that BLM erred in concluding that the company:

had failed to diligently pursue a water discharge permit which would allow Coronado to bring the only well on lease No. WYW24093A (the Blume-Gov't #1 Well) into production in paying quantities and/or the erroneous conclusion that Coronado had failed to provide the BLM with information regarding its diligent efforts to obtain such a permit.

(SOR at 1-2.) Coronado quotes the statutory provision of the Mineral Leasing Act regarding termination of leases in their extended term by reason of production, 30 U.S.C. § 226(i) (2000), and asserts that such leases cannot be terminated for lack of production "so long as the lessee exercises 'reasonable diligence'" in bringing the

well back into production. (SOR at 14.) Coronado claims that it has “pursued approved operations with reasonable diligence in its attempts to bring the Blume-Gov’t #1 well back into production in paying quantities” and that BLM’s termination of its lease “while Coronado was exercising such reasonable diligence was improper and should be reversed by this Board.” *Id.* In support, Coronado discusses BLM’s orders and its responses, concluding that the facts establish that it “exercised reasonable diligence in its efforts to restore the Blume-Gov’t #1 well back to production status,” that the delay in doing so was caused by the Wyoming DEQ and not by Coronado, that the company was reasonably diligent in keeping BLM informed, and that it was reasonably diligent in complying with BLM’s requests and deadlines. (SOR at 19-21.)

Coronado also contends that under the terms of the Mineral Leasing Act governing termination of oil and gas leases in their extended term by reason of production, 30 U.S.C. § 226(i) (2000), a lease cannot be terminated until the lessee has been given notice and a reasonable time (not less than 60 days) to produce the well. Under the circumstances of this case in which delays were attributed to DEQ, appellant argues that the time allowed by BLM was not reasonable. (SOR at 21-23.) In addition, Coronado argues that BLM’s decision is contrary to the Copper Valley Machine Works, Inc. v. Andrus, 653 F.2d 595 (D.C. Cir. 1981), and several Board decisions which recognize that a lease is effectively suspended and does not terminate when circumstances beyond the lessee’s control preclude meeting lease obligations. (SOR at 23-26.) Coronado also notes that BLM has never approved the sundry notice it submitted on July 25, 2000. (SOR at 12, 18.)

[1] Under the Mineral Leasing Act, oil and gas leases are issued for a primary term of 10 years and so long after the end of that term as oil or gas is produced in paying quantities. 30 U.S.C. § 226(e) (2000). Thus, as a general rule, oil and gas leases in their extended term by reason of production terminate by operation of law when paying production ceases on the lease. 30 U.S.C. § 226(e) (2000); 43 CFR 3107.2-1; Great Western Petroleum and Refining Co., 124 IBLA 16, 24 (1992); Universal Resources Corporation, 31 IBLA 61, 65 (1977). The Mineral Leasing Act, however, provides certain exceptions to this automatic termination:

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 shall expire because operations or production

is suspended under any order, or with the consent, of the Secretary. 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 not be less than sixty days after notice by registered or certified mail, within which to place such well in producing status or unless, after such status is established, production is discontinued on the lease premises without permission granted by the Secretary under the provisions of this chapter.

30 U.S.C. § 226(i) (2000).^{1/} The alternatives defined by the statute were set forth long ago in Steelco Drilling Corp., 64 I.D. 214 (1957), and have been restated in numerous decisions of the Board:

Under the Mineral Leasing Act, as amended by the act of July 29, 1954, if production ceases on a lease which is in an extended term by reason of production, the lease terminated by operation of law unless: (1) within 60 days after cessation of production, reworking or drilling operations are begun on the lease and thereafter conducted with reasonable diligence during the period of nonproduction; or, (2) an order or consent of the Secretary suspending operations or production on the lease has been issued; or (3) the lease contains a well capable of producing oil or gas in paying quantities and the lessee places the well on a producing status within a reasonable time, not less than 60 days after notice to do so, and thereafter continues production unless and until the Secretary allows suspension.

Max Barash, 6 IBLA 179, 181-82 (1972); accord Great Plains Petroleum, Inc., 117 IBLA 130, 132 (1990); C & K Petroleum, Inc., 70 IBLA 354, 356 (1983); Michael P. Grace, 50 IBLA 150, 151-52 (1980); John S. Pehar, 41 IBLA 191, 192 (1979); Vern H. Bolinder, 40 IBLA 164, 167 (1979).

As a threshold matter we note appellant has not argued and the record does not indicate that BLM has consented to the cessation of production on this lease. Indeed, the focus of BLM's orders to Coronado has been the need to resume production. Accordingly, this exception to termination is not applicable to this case.

^{1/} The subsection was given its current form in 1960. Compare Ch. 644, 68 Stat. 583 (1954), with Pub. L. No. 86-705, 74 Stat. 781, 782 (1960). Prior to 1954, a lease extended by production did not terminate if "diligent drilling operations" were undertaken during a period of nonproduction. See Ch. 916, 60 Stat. 951 (1946).

[2] In resolving the issues raised by this appeal, we first address the question of whether there was a well capable of production in paying quantities at the time of cessation of production, in the absence of which, the lease terminated. While Coronado asserts that “BLM shut down a well which is indisputably capable of production in paying quantities” (SOR at 27), the statement appears to refer to potential for production as distinguished from present capability to produce.^{2/} In defining a well capable of production in paying quantities, the Department has focused on the evidence of the present capability of the well to produce:

The phrase “well capable of producing” means a “well which is actually in a condition to produce at the particular time in question.” United Manufacturing Co., 65 I.D. 206 (1958). In the absence of perforation of the well casing, a well has been held to be physically incapable of production and, hence, not capable of production in paying quantities. Arlyne Lansdale, 16 IBLA 42 (1974); United Manufacturing Co., *supra*. A well has been held not capable of production in paying quantities where substantial pumping of water from the well is required before oil could be produced in paying quantities. The Polumbus Corp., 22 IBLA 270 (1975). Further, a well has been held not capable of production in paying quantities where sandfracing operations were unsuccessful and the record indicated further efforts were needed to restore production, including hot oil treatment and swabbing the well. Steelco Drilling Corp., 64 I.D. 214 (1957).

Amoco Production Co., 101 IBLA 215, 221 (1988) (footnotes omitted). It appears from the record that the well has not been capable of production of oil or gas in paying quantities since production ceased in August 1997. Appellant acknowledges that the only possibility of returning the well to oil and gas production requires aggressively pumping down the water produced by the well which had reached 100-percent of production by the time the well stopped producing. Potential for production is not sufficient to satisfy the requirement of capacity for present production in paying quantities. The Polumbus Corp., 22 IBLA 270, 271-72 (1975). Thus, when it is clear that the presence of substantial quantities of water which must be pumped out are an impediment to the potential for production of oil or gas in paying quantities the Board has found that the existence of a well capable of production in paying quantities has not been shown. *Id.* at 273. Accordingly, we

^{2/} Thus, the focus of much of the brief is Coronado’s repeated assertions that it exercised reasonable diligence to restore production. *See* SOR at 13-14, 16, 19-20, 22, 26.

find no evidence has been presented to show the existence of a well capable of production in paying quantities.

Appellant contends it is entitled to a “reasonable time” (not less than 60 days) in which to place the well in a producing status. In this case in which significant delays have been encountered in obtaining necessary permits from DEQ, appellant argues a reasonable time should extend until after DEQ issued the corrected water disposal permit. This requirement of a reasonable time to produce a well under the third exception to automatic termination noted above is necessarily predicated upon the existence of a well capable of production in paying quantities on the lease. The well capable of production proviso is the only term of 30 U.S.C. § 226(i) (2000) which requires notice to the lessee. Merit Productions, 144 IBLA 156, 161 (1998) (Burski, A.J., concurring).^{3/} Because the well was not capable of producing in paying quantities as discussed above, Coronado was not entitled to a notice allowing it a reasonable time to place the well into producing status as required by the third proviso of the statute.

Appellant also invokes the first proviso of 30 U.S.C. § 226(i) to argue that it was reasonably diligent in its effort to bring the well back into production. That statutory proviso requires, however, that drilling or reworking operations be commenced within 60 days of the cessation of production and pursued diligently thereafter. When the term of an oil and gas lease has been extended by production and there is no well capable of production in paying quantities when production ceases, the lessee must initiate reworking or drilling operations within 60 days and continue the reworking or drilling operations with reasonable diligence to avoid termination. In such cases termination is automatic if BLM has not approved the suspension of operations and/or production. International Metals & Petroleum Corp., 158 IBLA 15, 20 (2002); Merit Productions, 144 IBLA at 158–59, 162; Daymon D. Gililand, 108 IBLA 144, 147 (1989); Universal Resources Corp., 31 IBLA at 66. Consequently, when the Blume-Government No. 1 well ceased to produce, it was Coronado’s obligation, if it wished to preserve its lease, to commence reworking or drilling operations within sixty days, as allowed by the statute’s first proviso, and to continue them with reasonable diligence until oil or gas was produced in paying quantities. In the present case, it is clear that appellant did not commence reworking operations until more than 60 days after the cessation of production from the lease well. Indeed, it was not until 60 days after receipt of BLM’s May 5, 1999, order/letter notifying Coronado that, according to BLM records, the lease contained

^{3/} But see 43 CFR 3197.2-2. BLM notified appellant that the record did not support the presence of a well capable of production no later than May 1999. (May 5, 1999, order/letter.)

no well capable of production in paying quantities, that appellant prepared to seek a water disposal permit. While the BLM order, like the regulation it is based upon, indicates that 60 days is allowed to commence reworking or drilling operations, such notice is ineffective to vary the terms of the statutory proviso and grant a new period to commence reworking or drilling operations in the absence of a well capable of production in paying quantities or consent by the Department to a suspension of operations or production.^{4/} International Metals & Petroleum Corp., 158 IBLA at 20-21 n.6; Merit Productions, 144 IBLA at 161-66. Accordingly, we are not called upon to decide whether appellant's efforts to obtain a well water disposal permit constituted reasonably diligent efforts to rework the well.

To the extent Coronado relies on Copper Valley and related precedents, they do not require a different conclusion. The court in Copper Valley found that when a lessee is precluded by the Department from pursuing development and operations for substantial periods due to seasonal restrictions on drilling, the restrictions are tantamount to an order suspending the lease and the lessee is entitled to an extension of the lease comparable to the period of the required suspension of operations. 653 F. 2d at 604-605. Coronado does not contend that BLM precluded it from undertaking operations, but that the Wyoming DEQ's "long delay" in issuing both the original and corrected permits did so. (SOR at 25-26.) Coronado does not offer any legal authority or analysis to support a conclusion that delay by the State agency can extend the term of a Federal lease and its argument can be rejected for this reason alone. See Sierra Club (On Judicial Remand), 80 IBLA 251, 264 (1984), aff'd sub nom. Getty Oil Co. v. Clark, 614 F. Supp 904 (D. Wyo. 1985), aff'd sub nom. Texaco Producing Inc. v. Hodel, 840 F.2d 776 (10th Cir. 1988); see generally, Harvey E. Yates, Co., 156 IBLA 100, 107-108 (2001). More compelling, the time when Coronado's application was pending before the Wyoming DEQ was long after the Blume-Government No. 1 well had ceased to produce, and after the 60-day period to commence reworking or drilling operations allowed by the first proviso of 30 U.S.C. § 226(i) (2000). Thus, Coronado's failure to pursue its plan to obtain a permit from the Wyoming DEQ until after receiving BLM's May 5, 1999, order would preclude a finding in its favor.

^{4/} The notice provision would be applicable to a well capable of production in paying quantities which was shut in with the consent of the Department for reasons such as lack of a pipeline or market for the oil or gas. Merit Productions, 144 IBLA at 161 n.5; Steelco Drilling Corp., 64 I.D. at 219 n.3.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the August 17, 2000, decision of the Wyoming State Office is affirmed as modified.

C. Randall Grant, Jr.
Administrative Judge

I concur:

Gail M. Frazier
Administrative Judge