MERRION OIL & GAS CORP.

IBLA 2004-248 Decided May 10, 2006

Appeal from a decision of the Acting Deputy State Director, Division of Lands and Minerals, Utah State Office, Bureau of Land Management, affirming, on State Director Review, a denial of a request to terminate the Clear Creek Unit. SDR No. UT-2004-1.

Affirmed.

1. Oil and Gas Leases: Extensions--Oil and Gas Leases: Termination--Oil and Gas Leases: Well Capable of Production

When a company alleging a mineral interest subject to a unit agreement requests that BLM terminate the unit based upon the assumption that there had been, in the past, long periods of non-production from the unit, termination is properly denied when (1) the unit agreement does not contain any provision for automatic termination, (2) unitized substances were produced in paying quantities from the unit following its creation, (3) the unit agreement provides that it shall remain in effect so long thereafter as diligent operations are in progress for the restoration of production or discovery of new production, and (4) the unit operator is engaged in such operations.

APPEARANCES: Tommy Roberts, Esq., Farmington, New Mexico, for Merrion Oil & Gas Corp.; Thomas W. Clawson, Esq., Salt Lake City, Utah, for Mid-Power Resource Corp.; and Jared C. Bennett, Esq., Office of the Regional Solicitor, U.S. Department of the Interior, Salt Lake City, Utah, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE ROBERTS

Merrion Oil & Gas Corporation (Merrion) has appealed from an April 16, 2004, decision of the Acting Deputy State Director, Division of Lands and Minerals, Utah State Office, Bureau of Land Management (BLM), affirming on State Director Review (SDR) a decision issued by the Chief, Branch of Fluid Minerals, Utah State Office, BLM, rejecting Merrion's request to terminate the Clear Creek Unit (Unit) in Carbon and Emery Counties, Utah. (SDR No. UT-2004-1.) The CC Unit Agreement (Agreement), approved effective January 1, 1957, covers a combination of Federal, State, and private oil and gas leases and fee simple interests, and encompasses 17,095.82 acres. Mid-Power Resource Corporation (Mid-Power) is the present majority working interest owner and designated Unit Operator. Merrion asserts ownership of minerals under private lands dedicated to the Unit.

On November 12, 2003, Mid-Power requested from BLM "a written notice of the current status of the Clear Creek Unit." The Chief, Branch of Fluid Minerals, Utah State Office, BLM, responded on November 19, 2003, that "the Clear Creek Unit is in Full Force and Effect." BLM concluded that, since "at least 2 wells within the unit area have been reworked and are now capable of producing unitized substances in paying quantities, * * * the unit agreement is in an effective status and in no jeopardy of termination at this time." [1/]

On January 21, 2004, Merrion filed its request to terminate the Unit with the Branch of Fluid Minerals, Utah State Office, BLM. Noting that it had only just been notified of the November status request and determination because of "an ongoing dispute with the Unit Operator," Merrion asserted that it should have been notified by BLM and provided an opportunity to participate. Merrion submitted information it felt the Unit Operator had not provided: The Unit has not produced in commercial quantities for at least 13 years; during that period, "diligent operations" were not continuously conducted for the restoration of production or discovery of new production; and the Unit is still not capable of producing in paying quantities. Merrion further alleged that the past and current Unit Operators had failed to provide BLM with data that, had it been provided, would have shown the Unit to be incapable of commercial production and argued that the Unit should be terminated pursuant to the specific language of the Unit Agreement.

[1/] By letter dated Oct. 27, 2003, Mid-Power filed with the Utah Department of Natural Resources two Sundry Notices for two separate wells within the Unit. Copies of the Sundry Notices were sent to the Moab District Office, BLM.

On February 13, 2004, the Acting Branch Chief affirmed the November 2003 determination, stating:

> Based on your request of January 14, 2004 our Moab Field Office has looked into the matter and reported to this office that the Unit Operator Mid-Power Resources has performed field work in the past year, including the re-working of some wells, consistent with the Plan of Operations filed with this office and approved in 2003. Production information from the Utah Division of Oil, Gas and Mining confirms that the Unit has maintained continuous production. Mid-Power Resources also has two Applications for Permit to Drill (APDs) pending with the U.S. Forest Service and the Bureau of Land Management, and awaiting the agencies' approval. [Emphasis added.]

On March 19, 2004, Merrion requested SDR, claiming that BLM's conclusion was erroneous and that the request for termination was improperly denied. [2/]

In its SDR Request, Merrion stated that under the Unit Agreement the Unit Operator is responsible for managing unit operations consistent with the terms, conditions, and provisions of the Unit Agreement, and that BLM is responsible for overseeing the actions and activities of the Unit Operator and assuring compliance. Merrion then asserted that the language of Section 20 of the Unit Agreement stipulates that the Unit terminates when the Unit is no longer producing in paying quantities (and restoration or discovery operations are not being pursued). See SDR Request at 2, quoting Unit Agreement, Sec. 20, at 16. In support of its contention that the Unit has failed to produce unitized substances in paying quantities, Merrion attached two exhibits, a chart depicting production rates for the Unit from 1976 through 2003, and an affidavit from George Sharpe, a Merrion employee, filed in conjunction with related civil litigation in the Seventh District Court of Utah. Merrion summarized the data and information set forth as follows:

> [I]n 1976, the Unit had three (3) wells producing in excess of 10,000 MCF per month in the aggregate. In May 1982, one of the wells was shut-in and has not been restored to production. In September 1994, another well was shut-in and has not been restored to production. Production rates in the Unit steadily and somewhat dramatically declined between May 1982 and September 1994, during which period

[2/] In addition, Merrion requested that BLM "give the Unit Operator 60 days notice to commence commercial production as specified in 43 CFR 3107.2-3." (Letter filed with BLM on Mar. 23, 2004.)

> of time the Unit Operator apparently did not initiate new operations for the discovery and/or production of unitized substances. By 1991, aggregate production from the Unit fell to approximately 100 MCF per month. From September 1994 until the present time, there has been only one (1) producing well within the Unit and that well has produced at the rate of approximately 30 MCF per month during that ten year period of time. In May 1996, a new well was drilled and completed in the Unit -- the first new drilling activity in the Unit in more than twenty years. It has never produced. In October 2001, two new wells were drilled in the Unit. One of those wells was completed in October 2003. There have not been any sales of natural gas from that well.

(SDR Request at 3.) Merrion argued that the Unit Operator has never filed evidence with BLM demonstrating that a production rate of 30 MCF per month is sufficient to satisfy the definition of "production in paying quantities" or, during the extended periods where production lagged, that it was attempting to rectify the situation. However, Merrion's statement of the Unit's history confirms the validity of the conclusion of the Acting Branch Chief that the Unit has maintained continuous production from 1976 through 2003.

With respect to BLM's decision affirming the status of the Unit, Merrion argued that BLM's reasoning was insufficient on two accounts: first, the Unit Agreement requires continuous production in paying quantities, not just production; and second, there were extended periods of time when production in paying quantities was absent and no efforts were made to reestablish production levels sufficient to satisfy the requirements. Id. at 3-4. Merrion questioned whether BLM had thoroughly analyzed the Unit's production history, rather than merely looking at what is presently happening. Merrion also addressed a notification issue brought to light by BLM's November letter, i.e., procedural steps precedent to termination of the Unit, and argued that, unlike the regulations relating to Federal oil and gas leases, the Unit Agreement does not require notification to the Unit Operator as a condition precedent to termination. Merrion asserted that when a failure to meet production standards exists, BLM should take action to terminate the Agreement. Id. at 5.

On April 12, 2004, Mid-Power responded, arguing that it has diligently conducted operations since being approved as Unit Operator in 2002, and that the notification requirement is indeed a condition precedent to termination.

In his decision issued April 16, 2004, the Acting Deputy State Director, Division of Lands and Minerals, affirmed the February 13 determination. He rejected Merrion's contention that the Unit terminated automatically because of the failure to produce quantities of unitized substances sufficient to pay for the cost of producing

from September 1994 until the present. With respect to the debated language in Section 20, he stated: "The question is not whether the Clear Creek Unit **produced** quantities sufficient to satisfy the 'production in paying quantities' requirement, but whether the Clear Creek Unit **could have produced** quantities sufficient to satisfy the 'production in paying quantities requirement.'" (SDR Decision at 2) (emphasis in original). He then stated: "The second part of the question is if the unit is no longer capable of 'production in paying quantities' has the unit operator made diligent efforts to restore production or discover new production." Id. The Acting Deputy Director affirmed the statement: "[S]ince [Mid-Power] has not been notified that the Unit is not capable of production in paying quantities, and we have received notice from them that at least 2 wells within the unit have been reworked and are now capable of producing unitized substances in paying quantities * * *, we must conclude that the unit agreement is in an effective status." Id. He further stated that even if the CC Unit is not presently capable of sufficient production, Mid-Power is currently working diligently to establish new production. Id.

Merrion has appealed, refuting what it considers to be the four reasons offered by the Acting Deputy Director to justify his decision. As to the production standard set forth in the Unit Agreement, i.e., that unitized substances "can be produced in paying quantities," Merrion contends that the clear and simple language found in Section 20 requires actual production in paying quantities. (SOR at 5.) Merrion asserts that BLM did not properly analyze the production history of this unit, or it would have found extended periods of time when there was an absence of production in paying quantities from the Unit and during which Mid-Power was doing nothing to reestablish production. Merrion rejects BLM's conclusion that the Unit Operator is diligently working to establish new production as a reason to declare the Unit in effect. Id. at 5-6.

In their respective answers, BLM and Mid-Power both argue that the language of Section 20 only requires the unit to be "capable" of producing unitized substances in paying quantities in order to perpetuate the Agreement and that actual production is not necessary. Both argue that Merrion failed to show that the purported low levels of production did not amount to paying quantities. They also argue that, according to the Agreement, even if the Unit ceased to produce in paying quantities, the Unit would continue if "diligent operations are in progress for the restoration of production or discovery or new production," and sufficient efforts were underway to restore production before Merrion requested termination. Mid-Power argues that BLM properly concluded that notification and an opportunity to show production was required before a declaration of termination.

[1] Disposition of this appeal is governed by the Unit Agreement. A unit agreement is a contract between the United States and participating parties for joint development and operation of an oil and gas field where substantial amounts of public lands are involved. Jack J. Grynberg, 88 IBLA 330, 333 n.4 (1985). "The owners of any right, title, or interest in the oil and gas deposits to be unitized are regarded as proper parties to a proposed agreement. All such parties must be invited to join the agreement." 43 CFR 3181.3. A unit agreement submitted to BLM "shall be approved by the authorized officer upon a determination that such agreement is necessary or advisable in the public interest and is for the purpose of more properly conserving natural resources." 43 CFR 3183.4(a); see, e.g., Chesapeake Operating, Inc., 149 IBLA 188, 202 (1999); Burlington Resources Oil & Gas Co., 148 IBLA 166, 169-70 (1999); Celsius Energy Co., 136 IBLA 293, 297 (1996).

While the applicable statute, 30 U.S.C. § 226(m) (2000), is written so as to grant the Department broad authority to approve unit agreements, there is nothing in the statute concerning the duration of such unit agreements or the conditions for terminating or continuing the unit. Similarly, the regulations at 43 CFR Part 3180, while containing a model unit agreement, expressly authorize variances where appropriate. See 43 CFR 3181.1. Even when the model unit agreement is utilized without variation, this does not represent the mandate of the regulations, but rather, the agreement of the parties. Thus, it is incumbent upon the Department to refer to the provisions of the Unit Agreement in interpreting assigned responsibilities. As stated in the BLM Manual: "Various forms of unit agreements have been approved over the years and, while many of the provisions have remained similar, important differences do exist. For this reason, the individual agreement must always be consulted." (Sec. 3180.06.A) (emphasis in original). With respect to termination of a unit, the BLM Manual states: "Termination. Automatic or voluntary termination is provided for in most unit agreements, but it is necessary to review the provisions of each agreement to determine the circumstances under which it may be terminated." (Sec. 3180.12.G.; see BLM Handbook (Unitization (Exploratory)) H-3180-1, at subsec. II.K (Termination) (using the same language).) Accordingly, BLM is directed to look to the language of the Unit Agreement to ascertain the prevailing conditions for termination.

Section 20 specifies the effective date and term, as well as termination, of the Unit Agreement:

> This agreement shall become effective as of January 1, 1957, * * * and shall remain in effect so long as unitized substances can be produced in paying quantities, i.e., in this particular instance in quantities sufficient to pay for the cost of producing same from wells on unitized land within any participating area established hereunder and,

> should production cease, so long thereafter as diligent operations are in progress for the restoration of production or discovery of new production and so long thereafter as the unitized substances so discovered can be produced as aforesaid; * * *. [Emphasis added.]

Merrion claims that the "can be produced in paying quantities" standard of the Unit Agreement requires actual production in paying quantities, and is not satisfied where unit production declines to "non-paying quantities" for an extended period of time. (SOR at 5.) BLM and Mid-Power counter that the necessary condition to continue the Unit in effect is that it be capable of producing in paying quantities, and that actual production is not necessary. Mid-Power argues as follows:

> The common and ordinary meaning of "can" is "capable" or "able to." Whereas "are," which is the present plural of "be," basically means "is." The verb phrases are not synonymous; they have distinct and different meanings. "Can be produced" means capable or susceptible to being produced, indicating the potentiality of being produced. "Are produced" requires more than a potentiality of production; it requires present production. The plain language of the parties' contract does not support Merrion's argument. Neither is Merrion's argument supported by prior IBLA decisions interpreting similar "capable of producing" language. On numerous occasions, the IBLA has recognized that the phrase "capable of producing in paying quantities" does not require actual production. *See e.g.*, John G. Swanson, 66 IBLA 200, 202 (1982); Impel Energy Corp., 71 IBLA 237, 240 (1983).
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> The contract language is plain, simple, direct, and unambiguous. The Unit Agreement remains "in effect so long as unitized substances can be produced in paying quantities . . . ." (Unit Agreement § 20, emphasis added.) The parties' intent is manifest. They agreed that a necessary condition to continue the Unit in effect is that the Unit be capable of producing in paying quantities. The express contractual condition does not require actual production; it only requires the existence of a well in a participating area that is able to produce in paying quantities.

(Mid-Power's Answer at 6.)

We are persuaded by Mid-Power's construction of the phrase "can be produced" as used in Section 20 of the Unit Agreement. [3/] In fact, we see no support for Merrion's argument that that phrase as used in Section 20 of the Unit Agreement means actual, present production. Even if the phrase is construed to mean actual production, as Merrion claims, the Agreement expressly provides that it remains effective "so long thereafter as diligent operations are in progress for the restoration or production or discovery of new production and so long thereafter as the unitized substances so discovered can be produced as aforesaid."

Section 20 of the Unit Agreement provides two ways it can "remain in effect": (1) "so long as unitized substances can be produced in paying quantities," and (2) "should production cease, so long thereafter as diligent operations are in progress for the restoration of production of discovery of new production and so long thereafter as the unitized substances so discovered can be produced as aforesaid." The Acting Chief, Branch of Fluid Minerals, evaluated Merrion's "request for termination" in accordance with the "should production cease" provision of Section 20. Consistent with guidance in the BLM Handbook on dealing with "cessation of production," he stated that the Unit was in effective status because Mid-Power "had not been notified that the Unit is not capable of production in paying quantities," and because BLM had "received notice from [Mid-Power] that at least 2 wells within the unit have been reworked and are now capable of producing unitized substances in paying

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[3/] The Unit Agreement contains several varying references to the "paying quantities" requirement. Section 9 of the Unit Agreement provides that "[i]nasmuch as wells capable of producing unitized substances in paying quantities * * * have already been drilled, tested, and completed within the unit area and production in paying quantities (to-wit: quantities sufficient to repay the costs of drilling, and producing operations, with a reasonable profit) is currently being taken therefrom, no initial test well shall be required under the terms of the unit agreement." (Emphasis added.) Section 10 provides that any plan of development and operation must "provide for the exploration of the unitized area and for the diligent drilling necessary for determination of the area or areas thereof capable of producing unitized substances in paying quantities * * *." (Emphasis added.) As to participation rights in the unit, Section 11 provides that the Unit Operator shall submit "a schedule, based on subdivisions of the public-land survey or aliquot parts thereof, of all unitized land then regarded as reasonably proved to be productive of unitized substances in paying quantities * * *." (Emphasis added.) Further, Section 11 provides that "[w]henever it is determined * * * that a well drilled * * * under this agreement is not capable of production in paying quantities and inclusion of the land on which it is situated in a participating area is unwarranted, production from such well shall * * * be allocated to the land on which the well is located * * *." (Emphasis added.)

quantities." In affirming the Acting Chief's decision, the Acting Deputy State Director assumed that even if the Unit is not capable of producing in paying quantities, Mid-Power "is currently diligently working to establish new production, * * * currently has two pending applications for permit to drill within the unit area," and had "completed the Ridge Runner 13-17 well in October of 2003."

The circumstances in this case are somewhat unique in that the Unit was capable of production at the onset, as stated in Section 9 of the Unit Agreement: "[W]ells capable of producing unitized substances in paying quantities from the Ferron sandstone have already been drilled, tested, and completed within the unit area and production in paying quantities (to-wit: quantities sufficient to repay the costs of drilling, and producing operations, with a reasonable profit) is currently being taken therefrom * * *." (Unit Agreement at 7.) Under that background, application of the phrase "so long as unitized substances can be produced in paying quantities" would logically give rise to the inference that this unit perpetuates until it is no longer producing. However, an addendum was added providing that "should production cease" the Unit may continue "so long thereafter as diligent operations are in progress for the restoration of production or discovery of new production * * *." See Unit Agreement, Sec. 20, at 16. This addendum covers the facts herein.

Whether unitized substances can be produced or whether diligent restoration or discovery operations are being pursued are factual determinations which must be made for the Unit to terminate under Section 20 of the Agreement. As noted, Merrion avers that, over the life of the Unit, conditions have prevailed for which termination was the proper conclusion. Merrion asserts that the Unit Agreement does not contemplate or permit "a scenario in which unit production rates decline to 'non-paying quantities' and remain there for extended periods of time during which no, or only nominal, efforts are expended by the Unit Operator to restore production in paying quantities or to discover new production in paying quantities." (SOR at 4.) Merrion contends that the Unit terminated under Section 20 of the Agreement because from 1994 to the present "extended periods of time have passed when the Unit was producing in non-paying quantities and the Unit Operator was doing absolutely nothing to rectify the situation to bring the Unit back into compliance with the production standard set forth in the Unit Agreement." Id.

Merrion's allegations focus on the history of the unit from 1991 to 2003 prior to its acquisition of the relevant mineral deed. Merrion complains that during this period, unit production was so low that it was "uneconomic," royalties were not paid, and there were long gaps in which no diligent efforts were made by then-operators to produce. We cannot discount these assertions or verify from the record what took place between 1991 and 2003. The difficulty in reversing BLM, however, is that the only way Section 20 could permit Merrion's requested outcome is if it contained an

automatic unit termination provision. This is Merrion's underlying presumption, though Merrion does not supply a date by which it thinks this should have happened. It merely complains that the events prior to its acquisition of a deed to mineral resources dedicated to the unit are such that BLM should find that the lease terminated at some point. Merrion may have a complaint against its predecessor-in-interest, from whom it acquired its deed, but it may not stand in the shoes of a predecessor to champion a right the predecessor did not timely raise. Likewise, that Merrion's predecessor-in-interest may have had a case against a former unit operator is not a sufficient basis for demonstrating that Mid-Power, the current operator (and one whom the record indicates has its own complaints against its seller), is not acting diligently. Nor would BLM be correct in terminating a unit based solely on the actions of an operator no longer in place, in the absence of express unit agreement language requiring that conclusion.

Assuming arguendo that the facts as presented by Merrion are true, we cannot now determine whether and at what time such past facts might have satisfied the criteria for termination of the Unit under Section 20 of the Agreement. Merrion states that it has had an "ongoing dispute" with Mid-Power concerning the status of the Unit. (Request to Terminate Unit, Ex. C to SOR, at 1.) However, the record does not contain any indication that Mid-Power, or its predecessors-in-interest, requested a written notice of the current status of the Unit prior to November 12, 2003, when Mid-Power requested a declaration as to status of the Unit. Moreover, there is no indication that at any time any other party of interest under the Agreement sought such a determination.

What the record does show, as summarized by Merrion, is that there was production at some level, or efforts to reestablish production, over the previous 13 years of the Unit. Merrion asks BLM, and now the Board, to declare that at some point the Unit Agreement ceased to be effective because production fell below what is required under Section 20, i.e., "unitized substances [could not] be produced in paying quantities," or that at some point "production cease[d]" and the Unit Operator was not engaged in "diligent operation * * * for the restoration of production or discovery of new production." This case is about whether BLM correctly applied Section 20 as of April 6, 2004, given the factual circumstances presently in existence. How, then, is BLM or this Board to apply Section 20 to a set of circumstances asserted to have existed at some point during the 13 years which are the subject of Merrion's complaint? We cannot endorse a process which results in making a determination as to the present status of a Unit Agreement based upon assumptions of past fact which cannot be verified in the record. We see nothing in the Agreement or in governing law which would have prevented the Unit Operator, or any interested

party, including Merrion's predecessor-in-interest, from requesting a determination as to the status of the Unit. In fact, this is what Mid-Power did. [4/]

As it noted in its decision, BLM is obligated under its guidelines to advise the Unit Operator should it conclude from available information that unitized substances may not be capable of production in paying quantities. BLM was not satisfied that such information was made available to it and therefore it has never addressed whether the process to obtain such a determination as the prerequisite to termination should have been pursued. See BLM Handbook H-3107-1. BLM further postulated that, arguendo, even if the Unit is not capable of production in paying quantities at this time, Mid-Power is currently diligently working to establish new production based upon the two pending applications for permit to drill and the completed Ridge Runner 13-17 well.

The record supports BLM's conclusion that the Unit has not terminated, and we will not set it aside absent a definite showing that the decision was in error. Merrion's difference in opinion on the interpretation of the available information is not sufficient to show error. See Benson-Montin-Greer Drilling Corp., 118 IBLA 8, 12 (1991).

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, we hereby affirm the decision on appeal.

James F. Roberts
Administrative Judge

I concur:

Lisa Hemmer
Administrative Judge

[4/] As to Merrion's objection that it was not notified of Mid-Power's request, we observe that Merrion in fact filed with BLM a request that the Unit be terminated, filed a request for SDR when receiving an adverse determination, and then filed an appeal with this Board upon receiving an adverse SDR decision. We find no basis upon which to fault BLM's response to Mid-Power's status request.