



INTERIOR BOARD OF INDIAN APPEALS

Clark Operating Services, Inc. v. Acting Muskogee Area Director,  
Bureau of Indian Affairs

29 IBIA 109 (02/29/1996)



# United States Department of the Interior

OFFICE OF HEARINGS AND APPEALS  
INTERIOR BOARD OF INDIAN APPEALS  
4015 WILSON BOULEVARD  
ARLINGTON, VA 22203

CLARK OPERATING SERVICES, INC.

v.

ACTING MUSKOGEE AREA DIRECTOR, BUREAU OF INDIAN AFFAIRS

IBIA 95-114-A

Decided February 29, 1996

Appeal from a finding that an oil and gas lease had expired for failure to produce in paying quantities.

Affirmed.

1. Indians: Mineral Resources: Oil and Gas: Generally

When the Bureau of Indian Affairs determines that a marginally productive Indian oil and gas lease is no longer producing in paying quantities, a lessee which disputes the Bureau's determination bears the burden of coming forward with information upon which profitability can be calculated, particularly including information relating to its operating costs.

APPEARANCES: Alan B. Clark, Okmulgee, Oklahoma, for appellant; Alan R. Woodcock, Esq., Office of the Field Solicitor, Tulsa, Oklahoma, for the Area Director.

## OPINION BY CHIEF ADMINISTRATIVE JUDGE LYNN

Appellant Clark Operating Services, Inc., seeks review of an April 12, 1995, decision issued by the Acting Muskogee Area Director, Bureau of Indian Affairs (Area Director; BIA), concluding that Oil and Gas Lease No. 503-7463 (69415), Creek Tribe of Oklahoma (lease), had expired by its own terms for failure to produce in paying quantities. For the reasons discussed below, the Board of Indian Appeals (Board) affirms that decision.

The lease, which was executed on July 11, 1978, by the Creek Tribe of Oklahoma as lessor and Geological Services of Tulsa as lessee, covered approximately 100 acres in sec. 18, T. 18 N., R. 13 E., Tulsa County, Oklahoma. The term of the lease was "5 years from and after approval hereof by the

Secretary of the Interior and as much longer thereafter as oil and/or gas is produced in paying quantities from said land" (Lease Paragraph 1). The lease was approved by the Area Director on September 21, 1978.

Through several assignments approved on different dates, the lease came to be held by Alan B. Clark. <sup>1/</sup>

Information provided to the Area Director by the Minerals Management Service (MMS) in February 1995 showed that 72 barrels of oil had been produced from the lease from March 1994 through February 1995. Using this information, on March 2, 1995, the Area Director notified appellant of the reported production figures and stated that "[i]t has been administratively determined to give you a period of 15 days from issuance of this notice to show cause why we should not proceed with the expiration of the lease."

Appellant responded by letter dated March 13, 1995, stating:

I have done rework completion on each of 3 wells on above described lease. The oil produced in 1994 was used to frac and complete each well for artificial stimulation. Since the completion two of the three wells have responded adequately. The total production daily is 2 bopd and 5 bpd of salt water. Hopefully, this will increase to 5-7 bopd.

As you are aware I have had several conversations with [name omitted] of the sale of the Creek Nation lease. If you or any of the Departments of the B.I.A. are interested in purchasing this lease I would be more than happy to entertain a minimal offer. I own 100% of the working interest so this would be an easy transaction. Thank you for being patient on our monthly reports.

By letter dated April 12, 1995, the Area Director notified appellant that the lease had expired by its own terms for failure to produce oil and/or gas in paying quantities. The Area Director stated:

In your response to our letter of March 2, 1995, \* \* \* you advised that the oil produced in 1994 was used to frac and complete each well for artificial stimulation. The Bureau of Land Management advised that you did not submit a Sundry Notice nor were you given permission to use the production for such activity. Furthermore, the lease terms do not allow for perpetuation of the lease by producing oil and using the oil for operation of the wells. The contractual requirement is that to extend the

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<sup>1/</sup> Although nothing in the administrative record or appellant's filings clearly shows the relationship between Clark and appellant, for purposes of this decision, the Board assumes that appellant is a corporate entity created by Clark.

lease beyond the primary term, oil and/or gas must be produced in paying quantities. Royalties must also be paid.

Appellant appealed to the Board. Appellant and the Area Director filed briefs. 2/

### Discussion and Conclusions

Appellant admits that "there is no record of production sold in the last twelve months" (Opening Brief at unnumbered 2), but contends that it can prove that oil was produced in paying quantities. As proof of this, it submits Monthly Report of Operations, MMS-3160, for the months of June 1994 through April 1995, showing a total production of 142 barrels of oil during that period. Appellant explains that it used oil from the storage tanks to frac the wells on the lease in an attempt "to release paraffin from the tubing string down hole inside each well." Id. It states that its "position is that although no oil was sold in a one year period there was however, production made by these wells. It was not my understanding that I need to fill out Sundry Notices prior to hot oil flow lines or clean tubing strings on flow lines." Id.

Appellant thus alleges that there has been production from the lease. This, however, is not the question. The question is whether there has been production in paying quantities. Based upon the information provided by MMS, the Area Director determined that minimal production had been reported, no production had been sold, and no royalties had been paid to the lessors. In his March 2, 1995, letter, the Area Director gave appellant an opportunity to show that production in paying quantities had occurred. Appellant, rather than providing any information upon which the Area Director could determine that the alleged production actually constituted production in paying quantities, responded that it had used oil to frac the wells and was interested in selling the lease.

Appellant repeats the same contentions on appeal.

The Board knows of no statutory or regulatory definition of the term "production in paying quantities" that applies to the lease in this case,

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2/ Several months after briefing had been concluded in this case, the Board received a motion from "Appellant, Clark operating Services, Inc., by and through its assignee of record, Robert A. Rumley" seeking to file a supplemental brief. In support of the motion, Rumley attached an Assignment of Mining Lease from Alan B. Clark to Robert A. Rumley, dated June 8, 1995.

By order of Nov. 20, 1995, the Board denied the motion on the grounds that the request was untimely; Rumley had offered no explanation for his tardiness in showing interest in the appeal; and, because the assignment was not approved by BIA, Rumley had not shown that he had a legally cognizable interest in the lease.

and no such definition has been cited to it. <sup>3/</sup> Neither is the term defined in the lease.

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<sup>3/</sup> BIA proposed regulations in 1983 which would have defined "paying quantities." 48 FR 31978 (July 12, 1983). Proposed 25 CFR 225.32(b), Duration of Leases, would have provided that

"[w]here an oil and gas lease specifies a term of years and 'as long thereafter as oil and gas are produced in paying quantities' or similar phrase, the term 'paying quantities' shall mean: That quantity of recovered oil and gas which produced during the fiscal year of the contract, a profit to the operator, over and above the total cost of extraction (exclusive of exploration), processing, and handling to the point of sale; all rents and royalties (exclusive of overriding royalties and production payments) paid under the contract; all salaries and expenses directly related to such extraction, processing, and handling; all taxes incident thereto, except tribal severance taxes; all depreciation on salvageable production equipment; all administrative expenses so attributable, such as business licenses, repair of equipment, and transportation."

The proposed regulations were published as final at 52 FR 31916 (Aug. 24, 1987), and were scheduled to take effect on Sept. 23, 1987. The preamble stated at 52 FR 31926:

"A large number of commentators objected to the definition in paragraph (b) of 'paying quantities' \* \* \*. The basis for the objections was \* \* \* that the definition is unnecessarily complex and includes expenses which should not be considered. The commentators urged that the BIA either revise this provision to eliminate a definition of 'paying quantities,' or adopt the definition used in federal oil and gas leases on public lands. The BIA has decided to include the definition found in the regulations for federal lands which has been in effect for several years."

25 CFR 225.32(b) was changed to read:

"Where an oil and gas or geothermal lease specifies a term of years and 'as long thereafter as oil and gas or geothermal resources are produced in paying quantities' or similar phrase, the term 'paying quantities' shall generally mean: Lease production of oil and/or gas or geothermal resources of sufficient value to exceed direct operation costs plus the cost of lease rentals or minimum royalty."

A notice deferring the effective date of the final regulations until Oct. 24, 1987, was published at 52 FR 35702 (Sept. 23, 1987). However, in response to continued concern over the rulemaking, BIA withdrew the final rules and republished them as proposed rules at 52 FR 39332 (Oct. 21, 1987).

The regulations were again repropoed at 56 ER 58734 (Nov. 21, 1991) with substantial revisions and reformatting. In this publication, proposed 25 CFR 211.27 and 212.27 dealt with the duration of leases on tribal and allotted lands, respectively. "Paying quantities" was no longer defined in either section, nor was it defined among the general definitions in proposed sections 211.3 and 212.3. The preamble did not mention the removal of the definition of "paying quantities."

The comment period on proposed 25 CFR Parts 211 and 212 was reopened at 57 FR 40298 (Sept. 2, 1992), but no final rules have been published.

However, in the body of law governing private and Federal oil and gas leases, there does seem to be general basic agreement at least as to the starting point of a definition of "production in paying quantities" as it relates to the habendum clause in an oil and gas lease. <sup>4/</sup> As stated in 32 Rocky Mtn. Mineral Law Institute § 14.05 (1986),

[p]aying quantities is uniformly defined (except in Louisiana) as that amount of production that would return a profit, however small, to the lessee over lifting or production costs, even though the cost of drilling, completing, and equipping the well might never be repaid. [<sup>5/</sup>]

Accord, Hininger v. Kaiser, 738 P.2d 137 (Okla. 1987); Yates Petroleum Corp., 67 IBLA 246, 89 I.D. 480 (1982); 3 Williams and Meyers, Oil and Gas Law, § 604.6 et seq. (1995); 8 Williams and Meyers, Oil and Gas Law, "Production in paying quantities," 864-65 (1995) ; Annotation, Meaning of "Paying Quantities" in Oil and Gas Lease, 43 ALR3d 8 (1972).

The Rocky Mountain article continues:

When production has declined to marginal levels or has become sporadic, courts apply either (1) an "objective approach" or (2) a "subjective approach." Under the former, paying quantities is determined by a mathematical calculation of profitability. Under the latter approach, the standard is whether or not a prudent lessee would continue to operate the lease for a profit and not for speculation.

Although all jurisdictions which have addressed the question, except Kansas, have now embraced the subjective approach, both approaches remain relevant. In effect, in all such jurisdictions, a two-prong test is now used: first, the objective standard is applied and, second only if a profit is not found is the subjective standard then utilized. [<sup>6/</sup>] [Footnotes omitted.]

In Benson-Montin-Greer Drilling Corp. v. Acting Albuquerque Area Director, 21 IBIA 88, 108 I.D. 419 (1991), aff'd Benson-Montin-Greer Drilling Corp.

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<sup>4/</sup> Other definitions for the term are used in different contexts. These definitions are not relevant here.

<sup>5/</sup> The simplicity of this definition is deceptive. It is clear from even a cursory overview of the subject that there is little overall consistency in the determination of what is to be included in the calculation of profitability.

<sup>6/</sup> But see 3 Williams and Meyers § 604.6: "Although some early cases emphasized that the question was one of the good or bad faith of the lessee, the test appears to be an objective rather than a subjective one." (Footnotes omitted.)

v. Lujan, No. CIV-92-210 SC-LFG (D.N.M. Jan. 13, 1993), the Board observed that the rules developed for non-Indian oil and gas leasing may not be applied mechanically to Indian oil and gas leases. It held that

any tests for paying quantities [derived from the body of law governing non-Indian oil and gas leasing] would require analysis, in the context in which they are sought to be applied, to ensure that there is no conflict with the overriding principles of Federal law governing oil and gas leases of Indian land.

21 IBIA at 96, 98 I.D. at 424. In Benson-Montin-Greer, the appellant sought to persuade the Board to adopt the "objective" and "subjective" tests described in the above quotation. The Board found it inappropriate to employ these tests in the case of a lease, such as those at issue in Benson-Montin-Greer, which had been periodically shut in. 21 IBIA at 103, 98 I.D. at 427.

In this case, the lease has not been shut in, but production has been marginal. Arguably, the above-described "paying quantities" analysis has more relevance here than it did in Benson-Montin-Greer. For purposes of this case, however, the Board finds that it need not address the ultimate parameters of a definition of "paying quantities" applicable to marginally productive Indian leases, because there is no evidence at all--by any test or analysis--that appellant received even a minimal profit from the lease.

[1] The Board concludes that a lessee which disputes a BIA determination that a marginal lease is no longer producing in paying quantities cannot sustain its burden of proving the error in the BIA decision merely by showing that there has been production. The lessee must support its assertion that such production is "in paying quantities." The burden is on the lessee to come forward with information allowing a calculation of profitability. At a bare minimum, the lessee must submit information concerning its operating costs. Furthermore, under the circumstances of this case, in which the oil produced was not sold, the lessee must also provide some evidence of the value of the production. <sup>7/</sup>

Appellant has at no time during this proceeding provided any information concerning its operating expenses, or tending to establish the value

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<sup>7/</sup> The Area Director contends that the value of any oil produced cannot be used to arrive at a determination that there was production in paying quantities because appellant violated 25 CFR 213.24 by failing to pay royalties on the production and violated 25 CFR 213.30 and 213.31 by failing to seek and obtain permission from the Area Director or the Bureau of Land Management to use the production on the lease. Because it is not necessary to the disposition of this case, the Board does not here decide whether appellant violated these regulatory provisions or whether production without sales, either under the circumstances of this case or in any case, constitutes "production in paying quantities" for purposes of the habendum clause in an Indian oil and gas lease. Compare Annotation, § 12, with Annotation, § 13, 43 ALR3d at 85-103.

of the oil produced. In the absence of such information, there is no basis upon which the Board can hold that any production constituted "production in paying quantities."

Therefore, pursuant to the authority delegated to the Board of Indian Appeals by the Secretary of the Interior, 43 CFR 4.1, the April 12, 1995, decision of the Acting Muskogee Area Director is affirmed.

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//original signed

Kathryn A. Lynn  
Chief Administrative Judge

I concur:

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//original signed

Anita Vogt  
Administrative Judge