

BUTTES GAS & OIL COMPANY

IBLA 73-207

Decided September 25, 1973

Appeal from notice by Montana State Office that oil and gas lease Montana 071888 had terminated by operation of law for failure to pay advance rental timely.

Set aside and remanded.

Oil and Gas Leases: Unit and Cooperative Agreements

When an oil and gas lease is partially committed to an approved unit agreement, it will be segregated into separate leases, one containing only the land committed to the agreement and one containing only the land not so committed. Where only specific formations are unitized, as set forth in the unit agreement, and where these formations underlie only part of the lease, the segregation of the lease must necessarily be made along horizontal lines so as to exclude only the unitized formations of the parent lease from the segregated lease, regardless of whether and where production occurred on the original lease.

Oil and Gas Leases: Rentals! ! Oil and Gas Leases: Royalties

Where an oil and gas lease has been segregated horizontally, the holder of each resulting lease is liable for payment of rental and royalty based on the entire area included in the segregated lease, notwithstanding this may result in multiple payment of rental or royalty for the same land.

APPEARANCES: James R. Learned, Esq., Cheyenne, Wyoming, for appellant.

OPINION BY MR. HENRIQUES

On December 11, 1972, Buttes Gas & Oil Company (d/b/a BG&O Co.) filed a notice of appeal from a letter dated November 8, 1972, in which the Montana State Office, Bureau of Land Management, reiterated that oil and gas lease Montana 071888 had terminated automatically by operation of law July 1, 1972, for nonpayment of the advance rental due on that date [Pub. L. 555, Act of July 29, 1954, 30 U.S.C. § 188(b) (1970)], and that the lease could not be reinstated pursuant to Pub. L. 91-245 of May 12, 1970, 30 U.S.C. § 188(c) (1970).

Appellant contends the segregation of lease Montana 071888 from Montana 038485, following partial commitment to an approved unit agreement, could not deprive the segregated lease of the benefits of pre-existing non-unitized production to the derogation of the lessees, so that it was error for the local office to hold that lease Montana 071888 had terminated for failure to pay advance rental in a timely manner.

The question whether an oil and gas lease terminates for failure to pay advance rental timely depends upon the productive status of the leased lands. Resolution of this question in the case before us compels a thorough reexamination of the record as to the original lease Montana 038485, its record of production of oil or gas in paying quantities prior to commitment to the approved unit agreement alluded to by the appellant, the unit agreement itself, and the area included in the segregated lease Montana 071888. ^{1/}

The record shows that competitive oil and gas lease Montana 038485, embracing the SW 1/4 sec. 10, T. 11 N., R. 30 E., P.M., Musselshell County, Montana, was issued effective July 1, 1960, for a period of five years and so long thereafter as oil or gas is produced in paying quantities. The #1 well on lease Montana 038485

^{1/} Record title to lease Montana 071888 is held as follows:

Buttes Gas & Oil Company	Undivided 51.50%
Yvonne R. Famel	" 12.50%
R. B. Potashnick	" 6.00%
Margaret I. Stewart	" 6.00%
Charles O. Ryall	" 6.00%
Sagebrush Oilwells, Inc.	" 5.00%
Hayden B. Kline	" 4.00%
Charles H. Alberding	" 4.00%
W. Benton Harrison	" 3.00%
Frederick L. Bissinger	" 2.00%

was completed October 27, 1962, in the SW 1/4 SW 1/4 sec. 10, commingling production from the Tyler "Stray" sand with that from the Tyler "A" sand. The #2 well was completed November 22, 1962, in the NW 1/4 SW 1/4 sec. 10. The #3 well, drilled in the SE 1/4 SW 1/4 sec. 10 during 1963, was abandoned as a dry hole.

The Ragged Point Tyler "A" Sand Unit Agreement, 14-08-0001-8722, was approved by the Acting Director, Geological Survey, effective November 1, 1965, and includes the W 1/2 SW 1/4, SE 1/4 SW 1/4 sec. 10, T. 11 N., R. 30 E., P.M., within lease Montana 038485. The unit was formed to conduct secondary recovery and only the Tyler "A" sand was unitized. Pursuant to 30 U.S.C. § 226(j) (1970), the Montana State Office issued a decision November 23, 1965, notifying the lessees of lease Montana 038485 that the lands outside the unit area (the NE 1/4 SW 1/4 sec. 10) had been segregated into lease Montana 071888. The decision also stated "[t]he lease term for non! unitized competitive oil and gas lease MONTANA 071888 being in an indefinite status at time of segregation from base lease MONTANA 038485 will subsist for an undetermined period of time dependent upon allocated production from Tyler "Stray" Sands underlying lease MONTANA 038485, which are not unitized." A lease bond in the sum of \$ 1,000 was posted by the lessees of Montana 071888, pursuant to 43 CFR 3104.1(b).

In November 1965, the #1 well of lease Montana 038485 was worked over to separate the unitized Tyler "A" sand from the non! unitized Tyler "Stray" sand. Thereafter, the "Stray" sand was produced by pumping while water was injected into the "A" sand to promote the unitized secondary recovery operations.

Following its segregation from Montana 038485, the lease account for Montana 071888 was transferred from the Oil and Gas Supervisor, Geological Survey, to the Montana State Office, BLM, to be maintained as a rental account, with the annual rental rate of \$ 1 an acre in accordance with Schedule B, Rentals and Royalties, attached to lease Montana 038485. Rental for Montana 071888 was timely paid to the Montana State Office each lease year commencing with July 1, 1966, until July 1, 1972. Failure of the lessees to pay the rental due July 1, 1972, prompted the Montana State Office to serve notice on August 1, 1972, terminating the period of liability under the \$ 1,000 lease bond for Montana 071888 because the lease had terminated July 1, 1972.

The lessees thereafter contended to the Montana State Office that lease Montana 071888 was not subject to automatic termination for

nonpayment of annual rental on or before the lease anniversary date because the lease was in a producing status at the time of its segregation from Montana 038485, and that the non! unitized production from the Tyler "Stray" sand within the unitized area in Montana 038485 should inure to the benefit of Montana 071888. The Montana State Office obtained a report from the Oil and Gas Supervisor that Montana 071888 had been placed on a rental status June 30, 1966, and had enjoyed its extended term due to productivity of the parent lease, there being no drilling on Montana 071888 nor was it unitized with any production. Thereafter the Montana State Office denied reinstatement of Montana 071888 and this appeal followed.

The factual situation here presented is similar to that discussed in memorandum I-67-2085.4330 of March 15, 1968, from the Associate Solicitor, Division of Public Lands, to the Director, Bureau of Land Management, on the subject: "Nature of segregation of oil and gas lease partly committed to an approved unit agreement; W. C. McBride, Inc. et al., Wyoming 022669 etc." Briefly, McBride had several producing wells on lease Wyoming 022669, some from the Minnelusa formation and others from the Muddy (Newcastle) formation, but all of the wells were within the area contained in the Rocky Point Shallow Unit Agreement. Only those formations lying above the Minnelusa were committed to the Rocky Point Shallow Unit Agreement, so the production from the Minnelusa formation was not unitized. The land office had segregated the base lease on vertical lines, coinciding with the unit area boundaries, thereby segregating lease Wyoming 0324703 from non! unitized production from the Minnelusa formation within the unitized area of the Newcastle formation in lease Wyoming 022669. The segregated lease, Wyoming 0324703, thus became a lease dependent upon payment of rental instead of remaining subject to payment of royalty from production. The Associate Solicitor held that the only segregation permitted under 30 U.S.C. § 226(j) is segregation into separate leases of lands committed to the unit plan and lands not committed. The unit area contained only the unitized formations, i.e., the Newcastle and other formations lying above the Minnelusa formation. Thus, it was error, the Associate Solicitor said, for the land office to segregate the producing, but non! unitized, Minnelusa formation within the unit area from lands not within the unit area.

The Associate Solicitor indicated there should have been segregation into one lease of that portion of the original lease included within the unitized area, that is, the formations above the Minnelusa formation within the unit area, and into a separate lease of the

entire remainder of the original lease, including the portion underlying the unitized formations and the land outside the unit area boundaries. The segregated lease thus created would remain on a royalty basis because of the non! unitized production from the Minnelusa formation, and none of the segregated lease should have reverted to a rental status. The consequent horizontal segregation thus effected was deemed permissible under the provisions of section 17b of the Mineral Leasing Act (30 U.S.C. § 226(j)), and analogous to horizontal segregation by assignments as discussed in Continental Oil Company, 74 I.D. 229 (1967).

Consonant with the Associate Solicitor's memorandum, the Chief, Office of Appeals and Hearings, acting for the Director, Bureau of Land Management, in W. C. McBride, Inc., Wyoming 022669 etc. (March 29 1968), modified the land office decision segregating Wyoming 0324703 from Wyoming 022669, so that Wyoming 022669 retained only the unitized Newcastle and higher formations within the unitized area, and Wyoming 0324703 contained all non! unitized formations below the Newcastle formation within the unit area and all formations in the non! unitized area of the original Wyoming 022669. Each lease was deemed to be chargeable with payment of rental or minimum royalty for the entire surface area embraced therein, in accordance with the terms of the original lease Wyoming 022669, notwithstanding that this may result in multiple payment of rental or royalty for the same area.

So in the case before us now, it appears that the decision of November 23, 1965, reciting the segregation effected by approval of the Ragged Point Tyler "A" Sand Unit Agreement did not correctly apply the pertinent law. As none of the Tyler "Stray" Sand formation was unitized, the correct division of Montana 038485 was to retain only the Tyler "A" Sand formation within W 1/2 SW 1/4, SE 1/4 SW 1/4 sec. 10 in lease Montana 038485, as committed to the Ragged Point Tyler "A" Sand Unit Agreement, and to segregate into Montana 071888 the Tyler "Stray" Sand formation and all other formations in the W 1/2 SW 1/4, SE 1/4 SW 1/4 sec. 10, as well as all formations in the NE 1/4 SW 1/4 sec. 10. The decision of November 23, 1965, is so modified.

The production from the Tyler "Stray" Sand thus would be segregated into Montana 071888 so that the lease account should have remained with the Oil and Gas Supervisor for collection of royalty from the producing lease. Being a lease containing a producing oil or gas well, the segregated lease was not subject to the automatic termination provisions set forth in 30 U.S.C. § 188(b).

The case files will be remanded to the Montana State Office for consultation with the Oil and Gas Supervisor to ascertain whether any additional royalty is due to the United States, based on production from the Tyler "Stray" Sand applied to the 160 acres properly segregated into Montana 071888. Montana State Office also must call upon the lessees to replace adequate bond coverage for the producing lease Montana 071888.

Information in the file indicates that there has been no reported production from the Tyler "Stray" Sand under Montana 071888 for several months. A determination must be made by the Oil and Gas Supervisor whether the lease has terminated upon cessation of production, 43 CFR 3107.3-1, or if a notice under 43 CFR 3107.3-2 need be served before the lease may be considered to have expired.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the November 23, 1965, decision of the Montana State Office relating to leases Montana 038485 and 071888 is modified, the decision declaring 071888 to have terminated is set aside and the cases are remanded for further action in accordance with the views herein expressed.

Douglas E. Henriques
Member

We concur:

Frederick Fishman
Member

Joan B. Thompson
Member

