

UNIVERSAL RESOURCES CORPORATION ET AL.

IBLA 76-486

Decided June 23, 1977

Appeal from a decision of the Wyoming State Office, Bureau of Land Management, holding appellants' oil and gas lease (W-0311495) which had been extended by production to have terminated by operation of law for cessation of production.

Set aside and remanded.

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

An oil and gas lease in its extended term by reason of production terminates by operation of law when it is determined that the lease no longer has a well capable of production in paying quantities and no reworking or drilling operations are begun within 60 days after cessation of production. In this situation the lessee is not entitled to written notice and 60 days to place the well in a producing status.

2. Hearings--Notice: Generally--Oil and Gas Leases:  
Termination--Oil and Gas Leases: Well Capable of  
Production--Rules of Practice: Hearings

Upon a determination that production has ceased on an oil and gas lease in its extended term by reason of such production because the well on the lease is no longer capable of production in paying quantities, the lessees of record are entitled to notice and an opportunity to request a hearing on the issue of the productive capacity of the well where they have presented evidence raising an issue of fact regarding the status of the well.

APPEARANCES: Morris R. Massey, Esq., Casper, Wyoming, for appellants.

OPINION BY ADMINISTRATIVE JUDGE LEWIS

This appeal is brought by Morris R. Massey as attorney for the lessees of oil and gas lease W-0311495 1/ from a January 28, 1976, letter (decision) of the Wyoming State Office, Bureau of Land Management (BLM), holding appellants' oil and gas lease to have terminated effective July 31, 1975. The subject lease was extended beyond its primary term by reason of a producing gas well. The BLM decision was based on a report by the United States Geological Survey (Survey) of a determination on July 31, 1975, while the lease was in its extended term, that the wells thereon were no longer capable of producing oil or gas in paying quantities and that no approved operations to restore paying production were commenced within 60 days thereafter under 43 CFR 3107.3-1.

The principal contention raised by the appellants in their statement of reasons for appeal is that there was, as of July 31, 1975, a well on the lease capable of producing gas in paying quantities. In this situation, counsel asserts that appellants as lessees are entitled to a reasonable period of time (not less than 60 days) after written notice by registered mail within which to place the well in a producing status or prove capacity of the well for paying production under 30 U.S.C. § 226(f) (1970) and 43 CFR 3107.3-2. Counsel asserts that the required notice was not given to the appellants and that the decision holding the lease to be terminated in these circumstances is in error.

Appellants assert that they are prepared to assume their burden of proving the existence of a well capable of production in paying quantities. Counsel has submitted on appeal the affidavit of a petroleum engineer expressing the opinion that there was a well capable of production in paying quantities on the lease as of July 31, 1975. Appellants' counsel requests an evidentiary hearing before an administrative law judge pursuant to 43 CFR 4.415 on the issue of whether a well on the lease was capable of production in paying quantities on July 31, 1975.

Further, counsel requests that a production test of one of the wells on the lease be permitted at this time under the supervision of

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1/ Although neither the notice of appeal nor the statement of reasons filed herein were properly captioned to indicate the parties to the appeal, the decision below enumerates the lessees as follows: Universal Resources Corporation, Inexco Oil Company, Fluor Oil and Gas Corporation, Petroleum Resources Company, Rainbow Resources, Inc., Oil & Gas Futures, Inc., Waymon G. Peavy, and Amarillo Oil Company.

Survey. It is alleged that proof of current production capability would prove by inference the presence of a well capable of production in paying quantities on July 31, 1975, because no remedial work has been performed on the well since that date.

The record discloses that oil and gas lease W-0311495 was issued effective October 1, 1964, for a term of 10 years "and so long thereafter as oil or gas is produced in paying quantities." Gas was discovered on the leasehold on June 16, 1967, as a result of the drilling of the No. 1 Balta well. Based on this discovery, part of the land embraced in the subject lease was designated as being within a known geologic structure of a producing oil or gas field effective June 16, 1967. Another well, the Balta No. 1-A, was drilled on the leased land during the primary term of the lease and gas was also encountered in this well. Both wells were shut in during the primary term of the lease.

At the end of the primary term of the lease, an inquiry was made by the Survey as to the status of the wells in order to ascertain whether the lease term should be extended by production. A letter of October 15, 1974, was sent by the Survey to Inexco Oil Company (Inexco), which company had apparently been the operator of the wells on the lease. In response thereto, Inexco provided Survey with certain details of the results of flow tests run on the two wells and indicated that a contract providing for hookup of the gas wells to a gas pipeline and marketing of the gas was anticipated. Inexco further advised that Universal Resources Corporation (Universal) was the new operator of the wells. 2/

Survey responded to this information by letter dated November 15, 1974, to Inexco (copy to Universal) indicating that the lease would be extended on the basis of production in paying quantities:

Based on your data, it is hereby determined that lease W-0311495 is capable of production in paying quantities. This is conditioned on the assumption that these wells will be hooked up to the Mountain Fuel system [pipeline] and thereafter demonstrate production sufficient to pay operating costs.

On April 25, 1975, Survey sent a follow-up letter to Inexco and Universal reminding them that the determination that the lease was capable of production in paying quantities was conditioned upon the connection of the two wells to the pipeline and subsequent demonstration of commercial production. Universal responded with a letter

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2/ The records do not disclose that "Designation of Operator" forms were obtained by Survey from nonoperating lessees.

of May 12, 1975, to Survey in which it was acknowledged that Universal had taken over as operator on the lease, but further added that:

[W]e have definitely [sic] not arranged an agreement with Mountain Fuel to take gas from these wells. The problem is that with the small amount of gas in these two wells it has not been possible to get a pipeline company to connect these two wells.

Survey responded with a letter of May 20, 1975, to Universal indicating that in the absence of completion of a pipeline hookup, flow tests would have to be run on the wells to demonstrate the presence on the lease of a well capable of production in paying quantities in order to comply with the requirements for invocation of 43 CFR 3107.3-2. 3/ The Survey advised that:

Inability to demonstrate that these wells are capable of production in paying quantities by actual testing or by actual connection to the line, would lead us to the conclusion that lease W-0311495 is not capable of production in paying quantities and subject to termination.

This letter was followed by a letter of July 9, 1975, from Survey to Universal in which it was noted that no reply had been received to the prior letter with respect to the necessity of testing the shut-in wells or of connecting the wells to a pipeline. Survey stated that lessees of leases which are in their extended term by virtue of shut-in wells are required to test at least one well on the lease every year to confirm that the lease is still capable of production in paying quantities. It was thereupon demanded by Survey that the well or wells on the lease be tested within 30 days. Notice was given that failure to conduct the tests or negative results of such tests would result in a conclusion that

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3/ This is the regulation providing that no lease extended by production on which there is a well capable of production in paying quantities shall terminate because of failure to produce the well unless the lessee is given at least 60-days written notice to place the well in a producing status. Counsel for appellants contends this was an indication by Survey of the need for invoking the 60-day notice provision, but this is not the case. Survey explained in the letter of May 20, 1975, that well tests would have to be run, "In order to comply with 43 CFR 3107.3-2 and meet the obligation of being capable of production in paying quantities \* \* \*." Survey was simply stating that the continued extension of the lease term on the basis of production and the protection afforded the lessee by the cited regulation could not be sustained unless tests proved the presence of a well currently capable of producing gas in paying quantities.

the lease is not productive in paying quantities and a consequent recommendation by Survey that the lease be canceled.

A Survey memorandum of January 8, 1976, from the District Engineer to the Area Oil and Gas Supervisor discloses that the Engineer was notified by Alex Nash, a representative of Universal, on July 31, 1975, that "his preliminary tests showed the well had watered out." As a consequence of this report, Survey transmitted a memorandum dated January 12, 1976, to the State Director, BLM, indicating that lease W-0311495 was no longer capable of producing oil or gas in paying quantities after July 31, 1975, and that no approved operations to restore production were commenced within 60 days thereafter. This report, in turn, resulted in the decision of the BLM holding that the lease terminated, from which this appeal is brought.

Two essential issues are raised here. First, whether lessees of an oil and gas lease in its extended term by reason of production are entitled to written notice and a 60-day period to place the well on the lease in a producing status when production ceases because the well on the lease is no longer capable of production in paying quantities. A second question is whether notice to the lessees of record and an opportunity for a hearing is required prior to holding a lease extended by production to be terminated as a consequence of cessation of that production where evidence proffered by the lessee raises an issue of fact regarding the productive status of a well on the lease.

Noncompetitive oil and gas leases are issued for a primary term of 10 years and continue in force after the primary term for so long as oil or gas is produced in paying quantities. 30 U.S.C. § 226(e) (1970). An oil and gas lease in its extended term by reason of production terminates by operation of law when paying production ceases on the lease subject only to three exceptions provided by statute. Emily H. Oien, 25 IBLA 193, 196 (1976); Steelco Drilling Corporation, 64 I.D. 214 (1957).

No lease shall terminate for cessation of production if reworking or drilling operations are commenced on the land within 60 days after cessation of production. In addition, no lease shall expire because production is suspended with the consent or under the order of the Secretary. Finally, no lease on which there is a well capable of producing oil or gas in paying quantities shall expire because of the failure of the lessee to produce the well unless the lessee is given at least 60 days after receipt of written notice to place the well in production. 30 U.S.C. § 226(f).

No contention is raised by appellants that production was halted with the consent or under an order of the Secretary. Further, appellants have not alleged that reworking or drilling operations were

commenced within 60 days of July 31, 1975, when the Survey determined that production ceased. Therefore, appellants' case rests on the contention that there was in fact a well capable of production of gas in paying quantities on the lease as of July 31, 1975, so that the lease could not terminate without a 60-day written notice to the lessees to commence production.

[1] When it is determined that an oil and gas lease, in its extended term because of production, no longer has any well capable of production in paying quantities, the lease terminates by operation of law if no approved reworking or drilling operations are begun within 60 days after the cessation of production. Estate of Anna Aronow, 20 IBLA 344 (1975); Max Barash, 6 IBLA 179 (1972); 30 U.S.C. § 226(f). Moreover, where production ceases on an extended lease because the well is no longer capable of production in paying quantities, the lessee is not entitled to a written notice followed by a 60-day period in which to place the well on the lease in a producing status. Max Barash, supra; E. O. McGlothlin, A-30392 (September 15, 1965); see Steelco Drilling Corporation, supra. Accordingly, if the determination of the Survey with respect to the producing status of the well was correct, then appellants' rights have not been abridged by the action of the Survey and the decision below must be affirmed.

Appellants, however, raise an issue of fact by contending that the Balta No. 1-A well on the lease was in fact capable of production in paying quantities as of July 31, 1975. Appellants have submitted on appeal an affidavit of a petroleum engineer describing the results of tests run at the time the two wells were drilled and the procedures used in completing the wells. The affiant also stated his opinion as to the cause of the water in the well found on July 31, 1975, and the necessary procedures for repair. The engineer further ventured the opinion that the well was capable of production in paying quantities on July 31, 1975, without further remedial work regardless of the presence of water.

Peter I. Wold, II, 13 IBLA 63, 80 I.D. 623 (1973), is sufficiently analogous to the present case to cause the decision therein to be relevant here. That case involved an appeal by holders of coal prospecting permits from a decision of the BLM rejecting their applications for preference right coal leases. The right to a lease was contingent upon proof of discovery of coal in commercial quantities. 30 U.S.C. § 201(b) (1970). The decision of the BLM was based on a report of Survey to the effect that the records and information submitted by the permittee had failed to disclose a discovery of coal in commercial quantities on the land. On appeal, additional evidence regarding the existence of coal was submitted by the appellants. This Board held that before the applications are rejected on a finding that the factual condition prerequisite to the statutory right to a lease has not been met, the applicants are entitled to a hearing before an administrative law

judge pursuant to the provisions of the Administrative Procedure Act, 5 U.S.C. § 554 (1970). Peter I. Wold, II, supra at 625.

Similarly, it was held in Wolf Joint Venture, 75 I.D. 137 (1968), that where data submitted by the applicants for a preference right lease raises questions of fact as to the nature of the occurrence of the minerals in the deposits, the extent of the deposits, and the feasibility of development of the minerals in the deposits, a hearing should be granted the applicants in accordance with the Administrative Procedure Act at which the applicants as well as the Government may present evidence on the factual issues.

[2] Upon a determination that production has ceased on an oil and gas lease in its extended term by reason of production because the well on the lease is no longer capable of production in paying quantities, the lessees of record are entitled to notice and an opportunity to request a hearing on the issue of the productive capacity of the well where they have presented evidence raising an issue of fact regarding the status of the well. Cf. Joseph C. Sterge, 70 I.D. 375 (1963); Gwen Gaukel, A-29139 (February 6, 1963). This result is particularly compelling where the operator was the only party receiving notice from Survey of the necessity of proving the productive capacity of the well and the record fails to disclose that Survey obtained "Designation of Operator" forms from the non-operating lessees recognizing the operator as their agent.

Since Survey has not had the opportunity to review the evidence presented for the first time on appeal, it is appropriate that the case be remanded to the State Office for referral to Survey. Survey should permit a production test to be made on the existing well or wells on the lease by the appellants under the supervision of Survey within a reasonable period of time. If Survey determines, after review of the additional evidence submitted and/or the production test results, that there is no well capable of production in paying quantities on the lease, due notice shall be given to the lessees by the BLM State Office advising them of the basis of the determination and that they may request a hearing before an administrative law judge on the issue of the presence of a well capable of production in paying quantities. If a hearing is requested, the case shall be transmitted to the Hearings Division, Office of Hearings and Appeals, for assignment of a judge. 4/

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4/ If a hearing is held, the burden of going forward with the evidence and the ultimate burden of proof should fall upon the lessees who must establish the presence of a well capable of production in paying quantities. Cf. Peter I. Wold, II, supra at 626; Wolf Joint Venture, supra at 140.

It should be recognized that a well capable of producing oil or gas in paying quantities must actually be physically capable of such production at the time in question. The Polumbus Corporation, 22 IBLA 270, 271-272 (1975); Carl Losey, A-30153 (December 4, 1964); United Manufacturing Co., 65 I.D. 106, 112-113 (1958). Future expectations as to a well and present assessments regarding potential for production from a well based on inferences drawn from present data are to be distinguished from the present status of the well as capable of production in paying quantities. See The Polumbus Corporation, supra at 271-273.

"Paying quantities" has been defined as such quantities of oil or gas as will pay a profit to the lessee over and above the cost of operating the well and the cost of marketing the product. The Polumbus Corporation, supra at 271.

Information which is gathered at the time the well is drilled and tested which supports a conclusion at the time that there is a well capable of production in paying quantities may be superseded by later contrary data justifying a finding that production has ceased and that there is no longer a well capable of producing in paying quantities on the lease. See E. O. McGlothlin, A-30392 (September 15, 1965).

Accordingly, 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 set aside and the case is remanded for further action consistent with this decision.

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Anne Poindexter Lewis  
Administrative Judge

We concur:

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Martin Ritvo  
Administrative Judge

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Frederick Fishman  
Administrative Judge