

INEXCO OIL CO.

IBLA 79-278

Decided February 13, 1980

Appeal from decision of Geological Survey, Reston, Virginia, dismissing appeal. GS-123(O&G), W-35689.

Reversed in part; affirmed in part.

1. Rules of Practice: Appeals: Dismissal -- Rules of Practice: Appeals: Timely Filing

The Board of Land Appeals will reverse a decision of the Geological Survey dismissing an appeal for failure to timely file an appeal within the time required by 30 CFR Part 290, from letter decisions assessing compensatory royalty in which no right of appeal was indicated, where appellant responded to the letter decisions and filed a timely notice of appeal to a subsequent decision issued by Geological Survey in which appellant was notified of its right to appeal.

2. Oil and Gas Leases: Drainage -- Oil and Gas Leases: Royalties

30 CFR 221.21(c) provides that an oil and gas lessee shall drill and produce from such wells as are necessary to protect the lessor from loss of royalty by reason of drainage or pay a sum estimated to reimburse the lessor for such loss of royalty. Where Geological Survey affords the lessee an opportunity to submit evidence as to why a paying well cannot be drilled and the lessee does not submit an adequate response, or drill the well, compensatory royalty is properly assessed.

APPEARANCES: W. F. Drew, Esq., Brown, Drew, Apostolos, Massey & Sullivan, Casper, Wyoming, for appellant.

OPINION BY ADMINISTRATIVE JUDGE LEWIS

Inexco Oil Company appeals from a decision of the Acting Director, Geological Survey (Survey), Reston, Virginia, dated February 16, 1979, dismissing its appeal of letter decisions requiring the payment of compensatory royalty on oil and gas lease W-35689. Survey had notified appellant that compensatory royalty was required by letters dated September 28, 1977; February 2, 1978; February 28, 1978; and April 13, 1978.

In its decision, Survey summarized the facts and chronology of events as follows:

The compensatory royalties were assessed against Inexco as lessee under federal oil and gas lease W-35689 on the basis of the estimated value of the drainage from the leasehold by well 2-33 located in the NE 1/4 NW 1/4 of section 33, T. 36 N., R. 69 W., 6th P.M., and by well 1-33 located in the NE 1/4 SW 1/4 of section 33. Lease W-35689 covers the SW 1/4 NE 1/4 of section 33.

With reference to well 2-33, Inexco was advised by a letter dated April 26, 1977, that:

Under the terms of your lease you have agreed to drill and produce all wells necessary to protect the leased land from drainage, or in lieu thereof, with the consent of the Supervisor, compensate the lessor in full each month for the estimated loss of royalty through drainage. Accordingly, adequate drainage protection must be provided * * *. If you contend that no offset protection is necessary, detailed engineering, geologic, and economic data should be furnished to justify this position.

In the absence of such drilling or justification, compensatory royalty, may be assessed, effective April 13, 1976, to provide some degree of protection for the government's interest. Compensatory royalty, if assessed, will be based on the estimated amount of drainage from the lease, the effective royalty rate, and the value of monthly production from the offsetting well. Such assessment, if made, will continue until adequate drainage protection has been accomplished for the lease.

A similar letter had been sent to Inexco on September 24, 1976.

By letters dated September 28, 1977, and October 6, 1977, the Area Oil and Gas Supervisor assessed compensatory royalties against Inexco based on 8 percent of the value of the production of wells 1-33 and 2-33, effective April 13, 1976, and October 17, 1975, respectively. Inexco was advised that it had failed to submit convincing evidence that a paying well could not be drilled on a legal location to protect lease W-35689 from drainage by wells 2-33 and 1-33. Inexco was also advised that the assessment would be terminated upon completion of a protective well on lease W-35689. [1]

On November 14, 1977, a protective well was completed on fee land in the NE 1/4 NE 1/4 of section 33; and, on March 22, 1978, a communitization agreement (NRM-1384) was approved for the NE 1/4 of section 33. The communitization agreement has an effective date of October 1, 1977.

The communitization agreement covers all rights to crude oil and associated natural gas producible from the Teapot formation underlying the NE 1/4 of section 33. The communitization agreement involved 80 acres of fee land and 80 acres of federally owned lands.

By a letter dated February 2, 1978, Inexco was advised that the compensatory royalty assessment would "not be waived." Inexco was further advised that the assessment had terminated on November 14, 1977, the date of completion of the well 1-33 in the NE 1/4 NE 1/4 of section 33.

By a February 28, 1978, letter, Inexco was advised that the compensatory assessment would "*** not be waived until an approvable communitization agreement has been submitted and approved ***."

By a letter dated April 13, 1978, Inexco was again advised:

Compensatory royalty was assessed against Federal lease W-35689 by our letter dated September 28, 1977, for the estimated value of drainage from the lease by wells 2-33 (NE 1/4 NW 1/4 sec. 33) and 1-33 (NE 1/4 SW 1/4 sec. 33) both in T. 36 N., R. 69 W.

1/ The file contains a letter dated October 11, 1977, in which appellant explains why compensatory royalty should not be assessed.

A protective well was completed November 14, 1977, in the NE 1/4 NE 1/4 sec. 33 and a communitization agreement (NRM-1384) was approved for the NE 1/4 sec. 33, on March 22, 1978.

The compensatory royalty assessment is hereby terminated November 14, 1977, the date that protection from drainage was provided.

In summary, the total compensatory royalty assessment is:

Eight (8) percent of the value of production of well 2-33 (NE 1/4 NW 1/4 sec. 33) times lease W-35689 royalty rate (12 1/2 percent) for the period April 13, 1976, to November 14, 1977, plus-

Eight (8) percent of the value of production of well 1-33 (NE 1/4 SW 1/4 sec. 33) times lease W-35689 royalty rate (12 1/2 percent) for the period October 17, 1975, to November 14, 1977.

* * * * *

By a May 11, 1978, letter Inexco was reminded that the Area Supervisor had previously ruled that the assessment would not be waived and that the assessment period terminated on November 14, 1977. The letter also noted that 30 CFR 221.66 and 30 CFR 290 provide for appeals to the Director.

In support of its appeal, Inexco alleges inter alia:

* * * * *

6. Under date of February 7, 1977, this Appellant prepared an authorization for expenditure wherein this Appellant agreed to pay its 25% share of the costs and expenses of drilling and completing a test well to the Teapot formation in the NE 1/4 NE 1/4 of subject Section 33. The oil and gas lessees in the E 1/2 NE 1/4 of said Section 33 declined, at that time, to drill a well in the aforementioned location because of its questionable geologic location. Therefore, this Appellant could not drill on its

lease because of the orders of the Wyoming Oil and Gas Conservation Commission, nor could this Appellant drill or cause to be drilled a well at the authorized location in the NE 1/4 NE 1/4 of said Section. *
* *

7. The NE 1/4 of Section 33, Township 36 North, Range 69 West, 6th P.M. is located on the eastern edge of the Well Draw Field. On November 14, 1977, a well was completed in the NE 1/4 of Section 33 in Township 36 North, Range 69 West, 6th P.M. in the Teapot formation. The well is an uneconomic well and the approximate \$408,515.00 which was expended in the drilling and completion of this well will not be recovered. This Appellant paid 25% of the cost and expense of drilling and completing this well.

WHEREFORE, for the reason that this Appellant was prohibited by orders of the Wyoming Oil and Gas Conservation Commission from drilling a test well to the Teapot formation in the SW 1/4 NE 1/4 of Section 33 Township 36 North, Range 69 West, 6th P.M.; because this Appellant could not drill on a lease owned by other parties at the approved location in the NE 1/4 NE 1/4 of said Section 33; and for the reason this Appellant did, under date of February 7, 1977, agree to pay its proportionate 25% of the cost of drilling a test well to the Teapot formation in the NE 1/4 NE 1/4 of said Section 33, and said well was not at that time drilled, because the owners of the oil and gas leasehold estate in the E 1/2 NE 1/4 of said Section 33, declined to participate in a well at a location in accordance with the orders of the Wyoming Oil and Gas Conservation commission, it is inequitable and unjust to assess this Appellant compensatory royalty.

In its decision Survey found that: 1) Appellant had not filed a timely notice of appeal within 30 days of receipt of the letter orders of September 28, 1977, and October 6, 1977, as required by 30 CFR 290.2 and 290.3, and therefore appellant must be deemed to have waived its appeal rights; 2) Even if the appeal had been timely filed, appellant waived its right to challenge the Area Supervisor's orders assessing compensatory royalties because appellant had failed to submit evidence to the Area Supervisor showing that the proposed offset well would not be a paying well.

In its statement of reasons, appellant contends that its notice of appeal to the Director was timely filed. Appellant points out that

because of the continuing correspondence between Survey and itself, neither considered any letter to be a "final order or decision" within the meaning of 30 CFR 290.2 until the letter of May 11, 1978, advising appellant for the first time of its right of appeal.

As for the substance of the appeal, appellant reiterates its contentions presented in its appeal to the Director, *i.e.*, that it was prohibited by orders of the Wyoming Oil and Gas Conservation Commission from drilling a test well in SW 1/4 NE 1/4 of sec. 33, and could not drill on a lease owned by other parties at the approved, authorized, and legal location in the NE 1/4 NE 1/4 of sec. 33.

Appellant referred to the following language in Survey's decision: "The Geological Survey has interpreted the regulations as not requiring the payment of compensatory royalties or the drilling of an offset well in a case where the lessee shows that such well would not be a paying well." Appellant contends that the best evidence of whether or not a well is a "paying well" is drilling the well and that the protective well which was drilled was not a "paying well."

[1] We shall first consider the procedural aspects of this case. The appropriate regulations for filing appeals to the Director, Geological Survey, are set forth in 30 CFR 290.2 and 290.3 and read as follows:

§ 290.2 Who may appeal.

Any party to a case adversely affected by a final order or decision of an officer of the Conservation Division of the Geological Survey shall have a right to appeal to the Director, Geological Survey, unless the decision was approved by the Secretary or the Director prior to promulgation.

§ 290.3 Appeals to Director.

(a) An appeal to the Director, Geological Survey, may be taken by filing a notice of appeal in the office of the official issuing the order or decision within 30 day from service of the order or decision. The notice of appeal shall incorporate or be accompanied by such written showing and argument on the facts and laws as the appellant may deem adequate to justify reversal or modification of the order or decision. Within the same 30-day period, the appellant will be permitted to file in the office of the official issuing the order or decision additional statements of reasons and written arguments or briefs.

(b) The officer with whom the appeal is filed shall transmit the appeal and accompanying papers to the Director, Geological Survey, with a full report and his recommendation on the appeal.

(c) The Director will review the record and render a decision in the case.

We find that appellant did not waive its right to appeal. Appellant's letter of October 11, 1977, written in response to Survey's letter orders of September 28, 1977, and October 6, 1977, meets the requirements of a notice of appeal. That is, it was filed in the office of the official issuing the decision within 30 days of service of the decision, and included reasons why compensatory royalty should not be required.

Subsequent to the initial orders, Survey continued to send letters to appellant requiring compensatory royalty and appellant continued to respond. It was not until May 11, 1978, that Survey informed appellant of its right to appeal, approximately 8 months after the first letter order had been issued. Appellant filed a notice of appeal to this decision within the time required. It does not seem reasonable for Survey to extend to appellant the opportunity to appeal and then dismiss its appeal for failure to appeal the letter orders. All facts considered, we find that appellant took appropriate measures to preserve its right to appeal.

[2] Regarding the substance of the appeal, we find that appellant is required to pay compensatory royalty.

30 CFR 221.21(c), the regulation dealing with compensatory royalty, provides as follows:

The lessee shall drill diligently and produce continuously from such wells as are necessary to protect the lessor from loss of royalty by reason of drainage, or, in lieu thereof, with the consent of the supervisor, he must pay a sum estimated to reimburse the lessor for such loss of royalty, the sum to be computed monthly by the supervisor.

By letters of September 24, 1976, and April 26, 1977, Survey notified appellant that there may be a drainage problem on the subject lease and required appellant to submit plans for communitizing the area, and drilling a protective well in the NE 1/4 NE 1/4 of sec. 33. Survey stated that if appellant decided not to drill, it must submit convincing economic, geologic, engineering or other evidence that the well should not be drilled. On September 28, 1977, Survey sent appellant another notification and informed appellant that compensatory royalty would be assessed for the estimated value of the drainage since appellant had neither commenced drilling a protective well nor submitted acceptable evidence that a protective well could not be drilled. (A technical correction to the assessment letter was made by letter of October 6, 1977.)

In its letter of October 25, 1976, to Survey, appellant stated that "[t]he location in the NE 1/4 NE 1/4 sec. 33 is scheduled to be

drilled in the first quarter of 1977." This information did not answer Survey's request that appellant submit convincing economic, geologic, engineering or other evidence that the well should not be drilled. Since the adequate information was not submitted and no protective well had been drilled, Survey properly assessed the compensatory royalty.

Appellant objects to the following statement in Survey's decision:

It might also be noted that, contrary to Inexco's suggestion, under the regulations, the obligation to pay compensatory royalties does not depend on whether state spacing laws would permit the drilling of an offset well. Cf. Kirkpatrick Oil and Gas Company, 81 I.D. 162 (1974). Nor does such obligation hinge on whether the working-interest-owners of adjoining land agree to pay their proportionate share of drilling costs.

Appellant seeks to distinguish the case in issue from Kirkpatrick Oil and Gas Company, *supra*, by pointing out that the Kirkpatrick case involved a question of whether the Department of the Interior was obligated to approve a communitization agreement covering 640 acres in conformity with the spacing established by the Oklahoma Corporation Commission. Appellant points out that in its case, the communitization agreement was approved and therefore the cited decision is inapplicable. Also appellant points out that the question is not whether the interest owners of adjacent land agree to pay their proportionate share of the costs, but rather that appellant could not enter the lands to drill. Survey correctly cited the Kirkpatrick case for comparison purposes. In that case the Board noted that the Federal Government is under no obligation to accede to spacing orders issued under a state's police powers for conservation purposes, when the responsible Federal official feels that it would not be in the public interest. Kirkpatrick Oil and Gas Company, *supra* at 166. The fact that they could not enter the leased land of the other parties does not relieve appellant of responding with the proper information to Survey's request. The same may be said of appellant's assertion, subsequent to the drilling of the well, that it was not a paying one. The language of the regulation is clear -- that the lessee shall drill such wells as are necessary to protect the lessor from loss of royalty by reason of drainage or pay compensatory royalty. Survey afforded appellant an opportunity to show why such a well could not be drilled. When a proper response was not submitted, Survey assessed the royalty.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, that part of Survey's decision dismissing the appeal is reversed, and that part of the decision requiring compensatory royalty is affirmed.

Anne Poindexter Lewis
Administrative Judge

We concur:

Frederick Fishman
Administrative Judge

Joan B. Thompson
Administrative Judge

