Editor's note: **97 I.D. 159**

NGC ENERGY CO.

MONO POWER CO.

IBLA 88-498 Decided April 19, 1990

Appeal from a decision of the Colorado State Office, Bureau of Land Management, upholding a prior decision finding that drainage had occurred from lands within oil and gas lease C-17540, and providing for the assessment of compensatory royalties.

Vacated in part, reversed in part.

1. Oil and Gas Leases: Compensatory Royalty--Oil and Gas Leases: Drainage

Compensatory royalties accrue after the passage of a reasonable time following the date the lessee knew or should have known that drainage was occurring. In a common lessee context, the lessee who drills the offending well is in the best position to know that drainage is occurring. In such case BLM need not assume the initial burden of showing that the les-see knew or that a reasonably prudent operator should have known that drainage was occurring, as the common lessee is presumed to have knowledge of the drainage upon first production from its offending well. This presumption is rebuttable by the common lessee, who bears the ultimate burden of persuasion as to the date he had notice that drainage was occurring.

2. Oil and Gas Leases: Compensatory Royalty--Oil and Gas Leases: Drainage

Under the usual statement of the standard for prudent operation, the lessee is not obligated to drill an offset well unless there is a sufficient quantity of oil or gas to pay a reasonable profit to the lessee over and above the cost of drilling the well. The prudent operator standard applies to situations in which a leased Federal tract is being drained by a well oper-ated by a common lessee. In such cases, BLM has the burden of establishing that the leased Federal tract is being drained by the common lessee's non-Federal well, but need not prove as a part of its cause of action that a protective well would be economic. The burden of pro-ducing evidence and the ultimate burden of persuasion on this issue rest with the common lessee.

3. Oil and Gas Leases: Compensatory Royalty--Oil and Gas Leases: Drainage

No breach of a lessee's duty to prevent drainage will occur if the cost of drilling and operating an offset well is greater than the value of the recovered oil and/or gas. However, if a lessee can make a reasonable profit by drilling the well, he has a duty to prevent drainage by drilling a well. The prudent operator test is applied looking to the reasonably anticipat-able recovery from the offset well, rather than the oil and/or gas which would be lost if the well were not drilled.

4. Oil and Gas Leases: Compensatory Royalty--Oil and Gas Leases: Drainage

An oil and gas lessee is generally required to take such actions as would be prudent to protect his lessor from unnecessary losses due to drainage. The scope of this responsibility is not limited to drilling an offset well, but embraces all other actions a prudent operator might consider. Thus, if a prudent operator would unitize, it follows that a failure to do so would constitute a breach of the duty to protect the lessor from unnecessary loss due to drainage.

The concept of a duty to unitize is thoroughly compatible with the prudent operator standard governing a lessee's conduct and the viability of unitization is a factor to be considered when determining whether a lessee has discharged his duty to protect the leased premises from drainage. However, the lessee may always demonstrate that a prudent operator would

> not have formed a unit, that the lessee had unsuccessfully attempted to establish a unit, or that the costs of unitization would not leave him a profit.
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> When an offset well would not now be, and never would have been, profitable there is no legally defensible basis for requiring unitization. To require uniti-zation in such cases ignores economics and simple practicalities. Quite apart from any theoretical difficulties in justifying unitization, the uniti-zation of a producing property with a property that could not profitably be produced is virtually impossible. The operating and nonoperating interest owners of the producing property have no practical or economic reason for consenting to such unitization.

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OPINION BY ADMINISTRATIVE JUDGE MULLEN

NGC Energy Company (NGC) and Mono Power Company (Mono) have appealed from a May 5, 1988, decision of the Colorado State Office, Bureau of Land Management (BLM), upholding a prior decision that drainage had occurred from land within Federal oil and gas lease C-17540, and providing for the assessment of compensatory royalties. 1/

1/ In its answer to NGC's statement of reasons, BLM admits error in its decision holding NGC liable for drainage. NGC was not a common lessee and did not have notice of the alleged drainage until 2 months prior to lease expiration. See Consolidation Coal Co., 87 IBLA 296, 301 (1985), finding that, when two or more lessees have an undivided interest in a lease, they hold the lease as tenants in common and there is no agency relationship between them. Therefore, notice to one lessee does not bind another les-see unless the notified lessee has the authority to act for the other. We therefore vacate BLM's liability determination as to NGC and will not specifically address the issues NGC raised on appeal.

A brief history of lease C-17540 provides the necessary background for this appeal. Effective July 1, 1969, BLM issued lease C-8929 encompassing the SW¼, sec. 15, the N½ NW¼, sec. 28, and the N½ N½, sec. 29, T. 1 N., R. 103 W., sixth principal meridian, Rio Blanco County, Colorado, for a term of 10 years. Effective January 3, 1973, a portion of the land sub-ject to lease C-8929 (i.e., the N½ NW¼, sec. 28) was committed to the Bantu Ridge Unit, and the uncommitted remainder was segregated and assigned serial number C-17540. A portion of the land subject to lease C-17540 was then committed to the Taiga Mountain Unit effective November 7, 1978, the uncommitted acreage was again segregated, and the new lease was assigned a new serial number. Following this second unitization and segregation, lease C-17540 embraced 160 acres in the N½ N½, sec. 29, T. 1 N., R. 103 W., sixth principal meridian. Production under the unit extended the term of lease C-17540 beyond the end of its original term.

As a result of development drilling in sec. 20, T. 1 N., R. 103 W. (which was not within the Taiga Mountain Unit), BLM placed the acreage subject to lease C-17540 in an undefined addition to an undefined known geologic structure (KGS), effective December 29, 1982. Effective June 23, 1984, when the Taiga Mountain Unit automatically contracted, lease C-17540 was eliminated from that unit. The term of lease C-17540 was extended for 2 years from the date of elimination pursuant to 43 CFR 3107.4, and expired on June 23, 1986.

At all relevant times Coseka Resources (USA) Limited (Coseka) owned an undivided 50-percent interest, Mono owned an undivided 25-percent interest, and NGC owned the remaining undivided 25-percent interest in lease

C-17540. 2/ Coseka was the operator of the lease. Coseka and Mono also held interests in a lease of adjacent fee lands in sec. 20, T. 1 N., R. 103 W., sixth principal meridian. On December 29, 1982, Coseka com-pleted the Coseka 3-20-1N-103 Coors (3-20 Coors) well as a producing gas well in the SE¼ SW¼ of sec. 20, within its fee lease. 3/

By letter dated April 25, 1986, BLM notified lessees that it was conducting a statewide review of areas in which Federal leases might be drained by offset producing wells, including possible drainage of lease C-17540 by the 3-20 Coors well. After noting that the lease and regula-tions required lessees to protect the lease from drainage, BLM stated that, if lessees believed that drainage was not occurring or that an economic well could not be drilled, they should submit data supporting their position. Coseka responded by letter dated June 4, 1986, stating that, because most of lease C-17540 was in a separate fault block from the 3-20 Coors well, it was not being drained by that well. Coseka did admit that a portion of the lease, located in the NW¼ NW¼, sec. 29, fell within the same fault block and could be drained by the well, but stated that well spacing closer than 160 acres could not be justified, given the then current gas prices.

By letter dated July 31, 1987, BLM informed lessees that, based on preliminary geologic and engineering reviews, it had determined that the

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2/ NGC's interest was originally held by Pacific Transmission Supply Company (PTS). Effective Nov. 1, 1980, PTS assigned its interest to Natural Gas Corp. of California (an affiliate of NGC). This interest was reconveyed to PTS, effective Nov. 1, 1985. NGC obtained PTS' inter-est through merger.
3/ The successful completion of this well apparently triggered BLM's decision to include lands subject to lease C-17540 in the undefined KGS. See text supra.

lease was subject to possible drainage by the 3-20 Coors well. 4/ While recognizing that the lease had expired, BLM reminded lessees that, during the term of the lease, they had a duty to protect the lease land from drainage. BLM indicated that, if the lessees could not demonstrate that drainage had not occurred, using detailed engineering or geologic data, they would be assessed compensatory royalties from the date of first production from the 3-20 Coors well until the date of expiration of lease C-17540.

In a response dated September 21, 1987, Coseka submitted additional engineering and geologic data in support of its position that, at the most, minimal drainage had occurred, and that it would have been uneconomic to drill a protective well. Coseka explained its rationale for defining the extent of the reservoir and indicated that two wells, the 3-20 Coors and the Coseka 9-20-1N-103 Federal (located in the SE¼ NE¼, sec. 20, T. 1 N., R. 103 W.), were producing from the reservoir. Coseka concluded that the majority of lease C-17540 was nonproductive, and that the small quantity of hydrocarbons contained in the portion of the lease subject to possible drainage was insufficient to warrant an offset well.

By decision dated March 18, 1988, BLM determined that drainage had occurred from lease C-17540 and assessed compensatory royalty based upon 18.8 percent of production from the 3-20 Coors well between December 1982 and June 23, 1986. BLM did not specifically state the basis for its decision. However, a final geologic report dated March 3, 1988, and a final

4/ This letter superseded a July 23, 1987, letter. When the first letter was written, the author assumed that the lease was still in existence and requested plans for drilling a protective well.

engineering report dated March 9, 1988, appear to be the foundation for its determination.

The final geologic report dated March 3, 1988, was prepared by BLM based on Coseka's data. The drafters of this report agreed with the Coseka findings that: (1) only the NW¼ NW¼ of sec. 29 was capable of containing producible hydrocarbons; and (2) it was not economically feasible to drill a well on the lease. Having reached these conclusions, the author of the final geologic report concluded that compensatory royalties should be assessed.

The final engineering report dated March 9, 1988, also relied on data supplied by Coseka. In computing the drainage factor, the author of that report determined that the 3-20 Coors well would drain 53.1 acres of the reservoir, and that 10 of those acres were within lease C-17540. 5/ Based upon these findings, the drainage factor was determined to be 18.8 percent of the 3-20 Coors production.

Coseka, Mono, and NGC all sought state director review (SDR) of the BLM decision. Mono and NGC argued that the duty to protect against drainage did not arise until a reasonable time after BLM notification that drainage was occurring, and that BLM first notified them of the drainage in April 1986, less than 2 months prior to lease expiration. They contended that they had no obligation to drill a protective well or pay compensatory royalty because the lease expired before the passage of a reasonable time

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5/ The report found that the Coseka 9-20-1N-103 Federal well drained 121 acres of the same reservoir.

after BLM's notice. They further asserted that no compensatory royalty was due because a protective well would not have been economically justified, citing Board decisions holding that the prudent operator rule applies to Federal drainage cases. The prudent operator rule provides that a lessee is not required to drill a protective well or pay compensatory royalty if the protective well is not economically justified. NGC submitted an additional analysis demonstrating that the drilling of a protective well on the lease at any time after December 1982 would not have been profitable. 6/

Coseka's SDR submission included the arguments raised by Mono and NGC. In addition it argued that BLM's drainage determination was improper because BLM provided no geologic or engineering data to contradict Coseka's evidence that only a small amount of drainage was occurring from the Fed-eral lease, and no evidence that the drainage was sufficient to justify the assessment of compensatory royalties. Coseka further stated that it was operating under the protection of the U.S. Bankruptcy Code, and any assessment for compensatory royalty against it had been discharged because BLM had received notification and failed to file a claim.

In the May 5, 1988, decision, the State Director upheld the prior decision as to Mono and NGC, but found that Coseka's bankruptcy and subsequent reorganization precluded assessment of compensatory royalties against it. He identified two issues (in addition to the bankruptcy issue) raised in the SDR requests: (1) the notice requirement; and

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6/ In a separate submission, Coseka also provided further technical information bolstering its conclusion that the lessees would incur substantial losses if they were to drill a protective well on the Federal lease.

(2) the economic viability of a protective well. He found that the Board decisions cited by Mono and NGC were not controlling because they did not involve common ownership of the offending well and the drained Federal lease, and concluded that "IBLA never intended to require an economic test in cases involving common ownership." The State Director also determined that, in the common lessee context, "since the operator of the offending well is also a lessee of the offset tract, notification of the drainage situation is not necessary. The lessee has obviously been aware of the offset from the beginning, therefore notification is irrelevant in the case of common ownership."

The State Director agreed with the allegation that BLM had offered no contradictory evidence to refute lessees' data, stating that BLM had "no contention with Coseka's interpretation of the reservoir limits or with well performance," and acknowledged that the 18.8-percent drainage factor "was calculated using the drainage area as determined by volumetric analysis of the 3-20 Coors well and the bounded reservoir area under lease [C-17540]. The parameters utilized in this analysis were those which Coseka supplied." 7/ He further found that payment of compensatory royalties beyond the expiration date of the lease could extend the lease for as long as the offending well continued to produce and lessees tendered the compensatory royalties.

In its statement of reasons for appeal, Mono again asserts that, even though it is a common lessee, it is entitled to notification by BLM that

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7/ In the Final Engineering Report prepared for the SDR, BLM found that, in determining the volume per acre-foot of both the 3-20 Coors well and the drainage is occurring before incurring a duty to protect the lease against that drainage, and that the assessment of compensatory royalties can commence only after the expiration of a reasonable time following such notification. It alleges that the applicable regulations mandate that it be afforded the opportunity to drill a protective well to prevent drainage, and that BLM must provide notice of drainage and allow a lessee a reason-able amount of time in which to drill a protective well before it can assess compensatory royalties. Mono argues that compensatory royalties cannot be assessed because BLM advised it that drainage might be occurring less than 2 months prior to lease expiration thereby depriving it of its option to drill.

Mono further argues that the prudent operator rule should apply in the common lessee context, 8/ and that BLM has failed to find that drilling a protective well would have been economic or in accordance with good oil field practices. Mono asserts that this conclusion is supported by the evidence submitted to BLM, which clearly demonstrates that drilling on lease C-17540 would not have been economically justified. Mono concludes that no compensatory royalty should be assessed in this case, or, alternatively, that the Board should refer the case for a hearing to determine

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fn. 7 (continued)
Coseka 9-20-1N-103 Federal well, Coseka had incorrectly applied the recovery factor twice, and, therefore, Coseka's calculations were invalid. The State Director's decision does not mention Coseka's error on this point.

8/ Mono notes the following additional facts. In this case the owners of the offending well and the Federal lease are not all the same. Mono owns a smaller interest in the 3-20 Coors well (20 percent before payout and 12.5 percent after payout) than it does in the Federal lease (25 percent). It argues that it would defy common sense to assume that it would deliberately drain production from under the Federal lease by producing from a well in which it owns a smaller interest.

the existence of drainage and, if drainage occurred, the date from which compensatory royalty should be assessed.

In its response, BLM concedes that it was never economically feasible to drill a protective well on lease C-17540, but argues that this fact does not preclude BLM from assessing compensatory royalties in the common lessee context. BLM contends that a common lessee has a duty to unitize a lease being drained with other leases, including the offending well, even if a prudent operator would not drill a protective well, citing Williams v. Humble Oil & Refining Co., 432 F.2d 165 (5th Cir. 1970), cert. denied, 402 U.S. 934 (1971), a case decided under Louisiana law, in support of this contention. 9/ It asserts that, in common lessee drainage cases, the question is not whether the lessee could have drilled a profitable offset well, but whether the lessee has taken all reasonable steps to prevent drainage. BLM argues that these steps include unitization, forced pooling, or obtaining administrative relief from spacing orders. According to BLM, the imposition of this duty to unitize is necessary to prevent fraudulent drainage by circumventing the prudent operator rule.

[1] The applicable regulations governing drainage and compensa-tory royalty, 43 CFR 3100.2-2 and 43 CFR 3162.2(a), provide in part, respectively:

> Where lands in any leases are being drained of their oil or gas content by wells either on a Federal lease issued at a lower rate of royalty or on non-Federal lands, the lessee shall both drill and produce all wells necessary to protect the leased lands

9/ This argument was raised for the first time in the BLM answer.

> from drainage. In lieu of drilling necessary wells, the lessee may, with the consent of the authorized officer, pay compensatory royalty in the amount determined in accordance with 30 CFR 221.21.
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> (a) 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. The authorized officer may assess compensatory royalty under which the lessee will pay a sum determined as adequate to compensate the lessor for the lessee's failure to drill and produce wells required to protect the lessor from loss through drainage by wells on adjacent lands.

In Atlantic Richfield Co., 105 IBLA 218, 95 I.D. 235 (1988), and Atlantic Richfield Co. (On Reconsideration), 110 IBLA 200, 96 I.D. 363 (1989), this Board considered the drainage issue in the context of a common lessee. In our initial decision we discussed the principle that compensatory royalties commence upon the passage of a reasonable time following notice to the lessee that drainage is occurring. We held:

> In a common lessee context, the lessee who drills the offending well is in the best position to know that drainage is occurring. In such context, we find no reason for requiring BLM to assume the initial burden of going forward with evidence that the common lessee knew or that a reasonably prudent operator should have known that drainage was occurring. See Elliott v. Pure Oil Co., [10 Ill.2d 146, 139 N.E.2d 295 (1956)]. The common lessee shall be presumed to have knowledge of the drainage upon first production from its offending well. However, this presumption is rebuttable by the common lessee, who bears the ultimate burden of persuasion as to notice of drainage.

Id. at 226, 95 I.D. at 240. See also Cordillera Corp., 111 IBLA 61, 65-66 (1989). Thus, contrary to Mono's assertion, BLM is not barred from assessing compensatory royalties by its failure to notify it of the pos-sible drainage before April 1986.

[2] Under the usual statement of the prudent operator rule, even if drainage is occurring, the lessee is not required to drill an offset

well unless there is a sufficient quantity of oil or gas to pay a rea-sonable profit to the lessee over and above the cost of drilling the well. Nola Grace Ptasynski, 63 IBLA 240, 247, 89 I.D. 208, 212 (1982).

In Atlantic Richfield Co., supra at 224-25, 226, 95 I.D. at 239, 240, we determined that the prudent operator standard applies when a leased Federal tract is being drained by a well operated by a common lessee. In that case we also refined our determination regarding the proper burdens of proof in the common lessee context. In such situations, BLM has the burden of establishing that the leased Federal tract is being drained by the com-mon lessee's non-Federal well. However, it need not show, as a part of its cause of action, that a protective well would be economic. In the case of a common lessee, the burden of producing evidence and the ultimate burden of persuasion on this issue rest with the common lessee. Id. at 225, 95 I.D. at 239. See also Cordillera Corp., supra at 66.

[3] In Atlantic Richfield Co., supra, we also discussed the appropriate test of prudent operation to be applied in common lessee cases. We noted that, because the loss to the lessor is an economic loss, economics should govern the duty to drill. We held that if the cost of drilling and operating an offset well is greater than the value of the recovered oil and/or gas, there would be no breach of a lessee's duty to prevent drain-age. However, if a lessee can make a reasonable profit by drilling the well, the well should be drilled. We held that one must look to the reasonably anticipatable recovery from the offset well, rather than the oil and/or gas that would be lost if the well were not drilled when applying

the prudent operator test. Atlantic Richfield Co., supra at 226-27, 95 I.D. at 240-41.

In Atlantic Richfield Company (On Reconsideration), supra, we also considered the extent to which the prudent operator rule is applicable to drainage by a common lessee. In that decision we held that the prudent operator rule limits the duty of a common lessee to protect Federal lands from drainage, i.e., a common lessee must pay compensatory royalty on oil and gas that it drained from a Federal lease only if the reserves recoverable by a protective well on the Federal lease are sufficient to pay a reasonable profit over and above the cost of drilling and operating the well.

[4] BLM concedes that it would not have been economically feasible to drill a protective well on lease C-17540, because a protective well would not have produced sufficient oil or gas to recover the costs of drilling. That question is no longer in issue. Nevertheless, BLM now asserts that Mono must pay compensatory royalty because Mono had a duty to unitize the Federal lease with the offending lease, even though it had no duty to drill an offset well. On appeal BLM argues that appellant's obligation to seek unitization arises from operation of the prudent operator rule. In other words, since lessees are generally required to take such actions as would be prudent to protect a lessor from unnecessary losses due to drainage, the scope of the lessee's responsibility cannot be limited to drilling an off-set well, but must embrace all other actions which a prudent operator might consider.

As a general proposition, we do not find this formulation objectionable. Certainly, if a lessee unitized a lease rather than drilling an offset well, one could hardly say that the lessee did not fulfill the lease obligations merely because the regulations do not expressly state that unitization is an option. See, e.g., Cordillera Corp., supra at 65-66. By the same token, the failure to expressly delineate a unitization option in the regulations should not preclude a finding that a prudent operator would have unitized the lease. It follows that, if a prudent operator would unitize, a failure to do so would constitute a breach of the duty to protect the lease against drainage. As previously noted, in Nola Grace Ptasynski, supra, this Board found the prudent operator rule applicable to Federal leases.

Notwithstanding the fact that a failure to unitize would constitute a breach of the lessee's duty to protect the lease against drainage if a prudent operator would unitize, BLM's assertion of a duty to unitize in the face of a clear showing that an offset well could not be economically drilled is fraught with both legal and practical difficulties. This is particularly true in the instant appeal. In the first place, none of the court decisions BLM cites to this Board imposes a duty to unitize. The decision of the Fifth Circuit Court of Appeals in Williams v. Humble Oil & Refining Co., supra, on which counsel seems to rely for the broad assertion that it is not "unreasonable to require a common lessee to unitize a lease being drained with others [Reply at 7]," establishes no such absolute duty. Rather, this decision 10/ recognizes that the viability of unitization is

10/ The decision in Cook v. El Paso Natural Gas Co., 560 F.2d 978 (10th Cir. 1977), cited by BLM, is essentially premised on the conclu-
sion that the prudent operator rule does not apply at all in the common

a factor to be considered when determining whether a lessee has discharged his prudent operator duty to protect against drainage. Thus, the court noted:

> To require the lessee in certain circumstances to seek unitization will not place an unfair burden upon him. Indeed, the concept of a duty to unitize is thoroughly compatible with the "prudent administrator" standard governing his conduct with respect to other implied covenants. The lessee may always defend a suit based upon his failure to unitize by showing that a prudent operator would not have formed a unit or that he had attempted without success all reasonable means to establish a unit or that the costs of unitization would not leave him a profit. [Emphasis supplied.]

Id. at 174.

Thus, the Fifth Circuit expressly recognized that there was no absolute obligation to unitize, but that a lessee had the obligation to factor-in the possibility of unitization when carrying out its duties as a prudent operator. When an offsetting well is shown to be profitable, it makes eminent good sense that prudent lessees would consider unitiza-tion as a viable and practical alternative to drilling the offset well. 11/ However, when an offset well would not now be, and never would have been, profitable, we find no legally defensible basis for requiring unitization. Such an approach ignores economics and simple practicalities.

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fn. 10 (continued)
lessee situation. Indeed, on this point, rather than following the rationale of the Fifth Circuit, as suggested by BLM counsel, it is directly contrary to Williams v. Humble Oil & Refining Co., supra. In the Williams case, the requirement that a lessee consider unitization was directly derived from the prudent operator rule. The question of the applicability of the prudent operator rule in the common lessee situation was examined in Atlantic Richfield (On Reconsideration), supra. While Cook was not cited, the Board expressly rejected the theory that the prudent operator rule was inapplicable.

11/ This prudent operator requirement should not be limited to a common lessee. It would apply to all drainage situations.

In Nola Grace Ptasynski, supra at 251, 89 I.D. at 214-15, we addressed the economic basis of the prudent operator rule in the context of the obligation to drill an offset well to prevent drainage of leased lands:

> If the recoverable oil underlying the land where drainage is occurring is insufficient to support the cost of recovery, no intelligent landowner would make out-of-pocket expenditures to drill a well. The oil lost through drainage is not an economic loss to the landowner, because its attempted recovery would actually cost the landowner money. Thus, while in some con-ceptual sense the landowner has lost the oil drained, there has been no economic loss occasioned by the drainage. The landowner is no worse off than he was before the offending well commenced to drain his meager reserves, and considerably better off then he would be if he tried to recover them by drilling an offset well. A lessee should not be obligated to pursue a course of economic folly which a prudent owner would forego. [Emphasis in original, footnote omitted.]

These same considerations apply to an analysis of unitization in lieu of drilling an uneconomic offset well. When the owner of the property being drained seeks to compel unitization in such a situation, that party seeks compensation for oil or gas which could not be profitably produced. In short, it would be an attempt to share in proceeds properly appertaining to its neighbor's property, at its neighbor's expense, and with none of the risk its neighbor assumed when drilling the well.

As a practical matter, it is difficult to see how unitization could be accomplished in the situation now before us. 12/ The operator of a producing well would not normally be disposed to unitize with an adjacent property merely to permit the adjacent property owner an opportunity to

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12/ Forced pooling would not be an available option where, as in the instant case, the offending well was in one drilling unit and the land being drained in another.

share in the proceeds from the producing well. 13/ Thus, the unitization addressed in Williams v. Humble Oil & Refining Co., supra, was forced, and not consensual. 14/ This fact was expressly recognized by the court at page 174 of that decision.

Nor would the protection of correlative rights apply if, as in this case, the drained mineral owner's ability to drill a protection well is constrained only by economic realities and not by legal impediments. Cf. Sinclair Oil & Gas Co. v. Bishop, 441 P.2d 436, 446-47 (Okl. 1967) (imply-ing obligation to seek unitization where production from an existing well

would result in waste in violation of state conservation statues). 15/ Nor

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13/ While it is true that the adjacent mineral owner would be required to pay its aliquot share of production costs, it is also true that the owner of the drained mineral estate would not seek unitization if the owner expects that the allocated costs of production would be greater than the allocated share of the profits. If an absolute duty to unitize were applicable to both common and noncommon lessees, a situation could arise where an adjacent lessee would be required to unitize with land containing a nonprofitable well for the sole purpose of allowing his lessor to share in the royalty payments. See, e.g., Hardy, Drainage of Oil and Gas from Adjoining Tracts--A Further Development, 6 Nat. Res. J. 45, 57-58 (1966) (where an argument is made for precisely this result in the common lessee situation). Paradoxically, in this situation, the draining working interest owner would be happy to share his loss with the drained working interest owner. Such a result would, of course, be totally inconsistent with the entire prudent operator rule. That rule is clearly premised on the concept that the lessee should not be required to lose money solely for the purpose of permitting the lessor to obtain royalties.

14/ To the extent that the leases involved may contain pooling clauses, it is possible that imposition of an obligation to unitize on a common lessee would give rise to an obligation to pool the royalty interest of the draining lease and thus the consent of the nonparticipating owners (generally required under both voluntary and forced unitization) would be obtained. Although such unitization might technically be deemed voluntary, it would occur only when a common lessee is forced to take action it would otherwise avoid. Moreover, it forces the common lessee to take actions with respect to the drained royalty owner's interests which might be deemed violative of its duty of fair dealing. See discussion in text infra.

15/ Moreover, if legal impediments did exist, it seems difficult to jus-tify forced unitization to protect correlative rights when the adjacent mineral owner would not drill a protective well if afforded the opportunity.

is the prevention of the drilling of unnecessary wells implicated. Assuming rationality on the part of the drained mineral lessee, no additional wells would be drilled in any event.

The relationship of a lessee to the adjacent property owners will normally be of no consequence when considering the economics of unitiza-tion. The presence of a common lessee is relevant only because of the need to gain the consent of a specified percentage of the interest owners (operating and nonoperating) in the area to be unitized. 16/ This is the case for both voluntary and forced unitization. See generally Williams & Meyers, Oil & Gas Law § 913.5. Thus, quite apart from any theoretical difficulties in justifying unitization, it is virtually impossible to unitize a producing property with a property that could not be produced profitably under applicable spacing and drilling units. The operating and nonoperating interest owners of the producing property would have no practical or economic reason for consenting to such unitization.

In the "uncomplicated" common lessee situation, 17/ unitization would normally have no economic effect on the interests of the common lessee. The common lessee would still receive all net income less roy-alty payments. 18/ Indeed, the essential neutrality of unitization to the lessee's economic interests in such cases has been expressly recognized

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16/ Colorado requires approval of 80 percent of both the operating and nonoperating interests. See Colo. Rev. Stat. § 34-60-118(5) (1973).

17/ By using this phrase we expressly refer to a common lessee owning 100 percent of the operating interests in both tracts of land.

18/ The one obvious exception would be when the drained parcel has a nonoperating interests burden which is greater than that existing on the draining parcel. Another exception would be when the common lessee owns the entire mineral estate in the draining parcel.

and cited as supporting the imposition of the duty to seek unitization upon a common lessee. See Williams v. Humble Oil & Refining Co., supra at 174. However, this analysis conveniently overlooks the obvious fact that the benefits gained by the drained lessor are at the direct expense of the draining lessor. It could not be expected that a lessor of the draining parcel would favor unitization when faced with these economic realities.

It should be noted, however, that many oil and gas leases contain pooling clauses permitting the lessee to pool all mineral interests with-out the lessor's consent. 19/ It might be argued, therefore, that in such situations, the common lessee would be obligated to utilize this provision to pool the nonworking interest of his lessor (unitize) to protect the adjacent land from drainage. See, e.g., Hardy, Drainage of Oil and Gas from Adjoining Tracts--A Further Development, 6 Nat. Res. J. 45, 55-56 (1966). However, to accept this premise one must ignore the lessee's affirmative "fair dealing" obligation to the lessor of the draining land. See generally, Williams & Meyers, Oil & Gas Law § 420.2.

It does not take much imagination to envision a legal basis for a suit to enjoin a lessee from unitizing a producing lease with land which is not and was never capable of economic production, when a commom lessee is seeking unitization for the sole purpose of avoiding a possible conflict with

19/ Admittedly, most pooling clauses expressly limit the amount of acre-age with which the leased land may be pooled or unitized. See generally Williams & Meyers, Oil & Gas Law § 669.10. Thus, the discussion in the text assumes that this limitation would not be exceeded. If it is, the royalty interest owner's consent would be needed -- an unlikely event, as noted earlier in the text.

the lessor of the drained land. It is questionable whether this action represents a reasonable discharge of the common lessee's obligation of "fair dealing" with the lessor of the productive tract. The lessor of the draining land obtains absolutely no benefit when a common lessee's actions are based on the desire to avoid the possibility of liability to the lessor of the drained land rather than rational economic considerations. This issue would arise only when two parcels of land happened to have a common lessee. Therefore, until policy considerations, not now apparent, are shown to militate against having a lessee control adjoining parcels, there appears to be absolutely no theoretical justification for imposing a general obligation on a common lessee which would not be imposed if the parcels had been leased by separate entities. 20/

All of the difficulties we have discussed are compounded when there are multiple lessees rather than a single common lessee holding the entire operating interests in both tracts. In this case, one party owned inter-ests only in the drained tract, several entities held interests only in the draining tract, two parties owned interests in both tracts, and one of the two (Coseka, the operator under both leases) has since been discharged in bankruptcy of all further liability. Given the undisputed fact that an offsetting well would not be profitable, it is difficult to believe that there was even a remote possibility that unitization could have been effected by Mono. 21/

20/ This is not to say that there may not be a specific fact situation under which a common lessee should be held to a higher standard. Such special circumstance should be addressed if and when it arises. Clearly, no general rationale exists to justify such treatment in other than an exceptional case.

21/ Coors Energy Company owned an after-payout working interest of 33.5-percent in the producing fee lease. There would be no earthly

It may well be that the land which the United States leased has been, in some conceptual sense, drained of oil, but the United States has suffered no real economic loss as a result of that drainage. Such loss as might have occurred is simply damnum absque injuria. See generally Phillips Petroleum Co. v. Millette, 72 So.2d 176, 189 (Miss. 1954) (Ethridge, J., dissenting) ("Since appellees could not have gained by the production of oil from their lands, they could not lose by its subterranean drainage"). Counsel for BLM seeks to have us award the Government what is essentially a windfall, merely because its lessee had also leased the adjacent tract. Such action is not justified.

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 vacated in part and reversed in part.

R. W. Mullen
Administrative Judge

I concur:

James L. Burski
Administrative Judge

fn. 21 (continued)
reason for Coors to agree to unitization with the Federal tract and, therefore, no possible method to unitize the two leases under the Colorado statutes.