

CELSIUS ENERGY CO.

IBLA 92-32 Decided March 7, 1995

Appeal from decisions of the Colorado State Office, Bureau of Land Management, ordering segregation of oil and gas leases upon partial commitment to a new unit agreement and establishing terms for the resulting leases. COC11355 et al.

Reversed.

1. Oil and Gas Leases: Extensions—Oil and Gas Leases: Unit and Cooperative Agreements

A provision of 30 U.S.C. § 226(m) (1988) required that seven leases partially committed to a unit plan be segregated into separate leases; the resulting leases assumed the indefinite term of the parent leases that were held by production at the time of segregation.

APPEARANCES: Thomas C. Jepperson, Esq., Celsius Energy Company, Salt Lake City, Utah; Richard D. Tate, Branch of Minerals Adjudication, Colorado State Office, Bureau of Land Management, Lakewood, Colorado.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Celsius Energy Company (Celsius) has appealed from seven decisions of the Colorado State Office, Bureau of Land Management (BLM), dated September 9, 10, and 11, 1991, segregating oil and gas leases COC11355, COC12647, COC12733A, COC12735, COC12737, COC12739, and COC12747 upon partial commitment to the South Shale Ridge (Shallow) (SSR) Unit Agreement, COC52113X, and establishing terms for the resulting leases.

The seven leases were issued with effective lease dates ranging from September 1, 1970, to June 1, 1971. Before expiration of each lease's 10-year primary term, each lease was committed to a unit agreement and thereafter was held by production within a unit. Lease COC12739 was committed to the Roan Creek Unit Agreement (COC47677X) on November 21, 1979, and the remaining leases were committed to the Hancock Gulch Unit Agreement (COC47633X) on November 15, 1978. Before 1990, both the Roan Creek and Hancock Gulch units contracted down to participating areas. As a result, part of each lease was eliminated from a unit. When the SSR unit was formed on November 23, 1990, it encompassed the non-unitized portions

of the leases (except for COC12739, of which only part of the nonunitized land was committed to the SSR unit). Establishment of the SSR unit did not affect the boundaries or status of the older units.

After partial commitment of each lease to the new SSR unit, BLM found that the leases were segregated, and adopted a pattern that was followed for each case: the portion of each lease within the new SSR unit retained the serial number originally assigned to the parent lease and was identified thereafter by BLM as the "unitized base lease." The portion of each lease remaining within the older units (which continued in existence unaffected by the new unit) received a new serial number and was designated the "segregated non-unitized lease." BLM then held in each case that "segregation of the [segregated non-unitized lease] has the effect as of November 23, 1990, of eliminating the base lease from the [older] Unit Agreement area." This finding, said to have been compelled by the decision in Celsius Energy Co., 99 IBLA 53, 94 I.D. 394 (1987), was made in error, and requires that these decisions be reversed, as will be explained below, since it led to a finding inconsistent with a provision of the controlling statute, 30 U.S.C. § 226(m) (1988). BLM also made other determinations regarding payment of royalty and rental in each case that will be separately examined herein.

On appeal Celsius contends that BLM mistakenly applied a provision from the BLM Manual, H-3105-1 at 2-15 (exp. Sept. 30, 1991), in order to conclude that portions of the leases remaining in the older units had nonetheless been totally eliminated therefrom. Celsius points out that, under the Celsius decision (and pursuant to 30 U.S.C. § 226(m) (1988)), it is "[o]nly when leases are contracted completely out of a unit" that a 2-year lease extension is proper (Statement of Reasons at 11). Since that event did not occur in the case of any of these leases, it is concluded that BLM erred in finding that it had. According to Celsius, the mistake apparently occurred when the original lease number was transferred to those parts of the seven leases included in the new SSR unit. Both parties agree that the Celsius decision provides important precedent that influenced the decisionmaking in this case.

The 1987 Celsius opinion reviewed prior Departmental applications of provisions of the Mineral Leasing Act in 30 U.S.C. § 226(j) (1982) (now codified at 30 U.S.C. § 226(m) (1988)) controlling adjustment of lease terms affected by unit plans; Celsius found that the statute provided comprehensive and specific formulations that must be followed by BLM in such cases as these. Pertinently, the statute provides that "any such lease as to the nonunitized portion shall continue in force and effect for the term thereof but for not less than two years from the date of such segregation and so long thereafter as oil or gas is produced in paying quantities." 30 U.S.C. § 226(m) (1988).

Two situations involving the statute were considered by the Celsius opinion: cases where part of a lease was eliminated from a unit, and cases involving total elimination from a unit. See 99 IBLA at 62, 64, 94 I.D.

at 399, 400. Therein, we concluded that lease segregation did not occur when only part of a lease was eliminated from a unit. It was further determined that partial commitment of a lease to a unit caused segregation into two separate leases; upon segregation, the resulting leases became distinct and were administered independently. The statute assigned each resulting lease the term of the parent lease existing at segregation: if the parent lease were extended for an indefinite period by production at the time of segregation, both resulting leases would be extended by the same production that extended the parent lease. 99 IBLA at 63, 94 I.D. at 400.

The Celsius opinion then considered what happened when a producing lease was entirely eliminated from a unit and committed in part to another unit. In the resulting segregation, the committed lease retained the original lease number and the segregated lease was assigned a new number. It was concluded that a lease entirely eliminated from a unit should continue in effect for the original fixed term of the parent lease established at lease issuance (an event long past in the case of all these leases), but for not less than 2 years, and so long thereafter as oil or gas is produced in paying quantities. Regardless whether a lease is extended beyond its original term by production when it is totally eliminated from a unit, the Board stated, it is not held by production during the first 2 years after such elimination. 99 IBLA at 64, 81-83, 94 I.D. at 400-401, 410-11.

The use made by BLM of the 1987 Celsius opinion in order to reach the decision here under review was explained in Enclosure 2 to the decisions. After reviewing Celsius, BLM concluded that

[t]he essential question then is whether those leases committed to [SSR] Unit, which immediately prior to commitment embraced lands in the Hancock Gulch or Roan Creek Units, should be considered eliminated from the older unit, and thereby subjected to the implications of a definite two-year extension resulting from such elimination.

(Enclosure 2-2). BLM found "that such an elimination occurred instantaneously with the act of segregation." Id. It was stated that "[o]nce the segregation took place, the base lease no longer contained any lands or formations included within the contracted older unit." Id. The appellation "base lease" was used to describe "the lease for the lands committed to the newest unit," considered by BLM under guidance from the BLM Manual, to be the lease that was "to retain the 'original' serial number." Id. BLM then found that:

It seems obvious to us that a lease which was one moment committed to an older unit, even though some lands within the lease were not committed to such unit because they had earlier been eliminated, and the next moment contains no lands so committed because of the segregative effect of partial commitment (or assignment) has been somehow eliminated from the unit * * *.

(Enclosure 2-3).

[1] In the instant case, contrary to the quoted finding made by BLM, none of the seven leases under review was totally eliminated from the older units to which the leases were committed. This mistaken finding may have occurred, as Celsius contends, when an attempt to apply a BLM Manual instruction for lease numbering following initial unitization was applied to these leases although no part of them (except for COC12739) was outside a unit. (Celsius quotes the Manual instruction as stating that a "new serial number is to be assigned to the segregated (nonunitized) lease, and the base (unitized) lease is to retain its original serial number.") BLM Manual H-3105-1, at 2-15. Whether this instruction should have been applied in this case (and whether it was the cause of error) is problematic, since, for purposes of BLM's decision making, there was no leased land that was not in a unit after the SSR unit was created, the older units having been unaffected by creation of the SSR unit. Having nonetheless characterized those portions of the original lease as nonunitized for purposes of numbering the newly created leases, BLM then concluded that the leases were, in fact, totally excluded from a unit, a conclusion that is without foundation in the record, but is apparently based upon a misreading of our Celsius decision.

Instead, the record shows that the Hancock Gulch unit boundary contracted effective January 29, 1989, so that there was leased land both within and outside the unit area (see BLM Notice dated Nov. 15, 1989, stating that partially eliminated leases would not be segregated). The Roan Creek unit was contracted effective March 7, 1985, causing lease COC12739 to include land both within and outside the unit area (see BLM Notice dated Mar. 12, 1985 and BLM Notice dated Apr. 16, 1986, stating that partially eliminated leases would not be segregated). It was those lands outside the older unit areas that were committed to the SSR unit when BLM approved the unit agreement on November 23, 1990 (see BLM Letter of Approval). Segregation was made effective November 23, 1992 (see BLM Notice dated Aug. 21, 1991). We therefore find that these seven leases first experienced contraction within the two older units, resulting in partial elimination of leased lands but no lease segregation. Following this event, that part of the leased lands outside the older units was committed to the SSR unit and segregation of the parent leases (part which remained in the older units) took place. Because BLM's assumption that there was a total elimination from the older units was made in error, the resulting lease terms found by BLM must be reexamined.

Lease COC11355

This lease in secs. 12 and 13, T. 8 S., R. 99 W., sixth principal meridian, was segregated into leases COC11355 (157.99 acres) and COC52679 (49.32 acres). BLM concluded that lease COC11355 was not held by production upon segregation and, the land having been designated a known geologic structure (KGS) on August 9, 1984, would be liable for rental at the rate of \$2 per acre. BLM also held that lease COC52679 would be continued indefinitely because it was within Participating Area (PA) COC47633A of the Hancock Gulch unit. But because the parent lease at the time of lease

segregation was held by production attributed to the identified PA, the resulting leases shared that same indefinite term and were subject only to a royalty obligation so long as COC52679 continued within the subject PA. In addition, lease COC11355 is extended indefinitely by production established within the SSR unit on January 15, 1991.

Lease COC12647

Under circumstances similar to those in lease COC11355, this lease, embracing land within sec. 11, T. 8 S., R. 99 W., sixth principal meridian, was segregated into leases COC12647 (600 acres) and COC52680 (40 acres). BLM determined that lease COC12647 was in a fixed term without benefit of production and would be liable for rental at \$2 per acre since this land was classified KGS effective June 17, 1981, while lease COC52680 would be continued indefinitely by inclusion in PA COC47633A. Again, however, since the parent lease was held at the time of segregation by production attributed to the PA, the resulting leases became subject to the same indefinite term and royalty obligation as long as COC52680 continued within the PA. Further, lease COC12647 is also subject to an extension by production established within the SSR unit on January 15, 1991.

Lease COC12733A

Lease COC12733A in secs. 3, 6, and 8-10, T. 8 S., R. 98 W., sixth principal meridian, was segregated into leases COC12733A (1,198.06 acres) and COC52681 (80 acres). BLM incorrectly determined that while lease COC52681 was continued through participation in PA COC47633C, lease COC12777A had no claim upon that production. Both leases, however, continue indefinitely so long as COC52681 remains subject to the identified PA. Lease COC12733A is also continued indefinitely by a well thereon found capable of production on January 15, 1991, and by production allocated to sec. 8 through communitization agreement COC50829.

Lease COC12735

Lying within secs. 15, 16, 21, and 22, T. 8 S., R. 98 W., sixth principal meridian, lease COC12735 was segregated into leases COC12735 (2,360 acres) and COC52682 (200 acres). Both leases contain wells. Well 1-15, within lease COC52682, was in actual production at the time of segregation. Well 16-16, within lease COC12735, was not capable of production until December 17, 1990 (after segregation). Since the parent lease was held at the time of segregation by production attributed to PA COC47633C and by actual production from well 1-15, the resulting leases became subject to the same indefinite term. Also lease COC12735 is in an indefinite term due to production in the SSR unit and from well 16-16. Lease COC52682 may not, however, benefit from production from well 16-16 or the SSR unit, because such production did not benefit the parent lease.

Lease COC12737

This lease, embracing land within secs. 13, 14, 23, and 24, T. 8 S., R. 98 W., sixth principal meridian, was segregated into leases COC12737 (2,280 acres) and COC52683 (200 acres). As in lease COC12735, both resulting leases contain wells. Well 4-14 in lease COC52683 was in actual production at the time of segregation, while wells 1-14 and 4-13, on lease COC12737 were determined to be capable of production on March 7, 1990, and November 22, 1990 (before segregation). Therefore, leases COC52683 and COC12737 are in the same extended term as the parent lease, and are held by production from well 4-14 and through participation in PA COC47633C of the Hancock Gulch unit. Since wells 1-14 and 4-13 were not producing wells at segregation, any subsequent production will not benefit COC52683. Lease COC12737 is also in an indefinite term by production established in the SSR unit on January 15, 1991.

Lease COC12739

Situated in sec. 35, T. 8 S., R. 98 W., and secs. 1 and 2, T. 9 S., R. 98 W., sixth principal meridian, lease COC12739 was segregated into leases COC12739 (80 acres) and COC52685 (1,296.54 acres, of which only 80 acres are within the Roan Creek unit). BLM incorrectly determined that although lease COC52685 was continued through participation in PA COC47677B, lease COC12739 had no claim upon that production. Both leases are assigned the term of the parent lease, however, and continue indefinitely so long as COC52685 remains subject to the identified PA. Lease COC12739 is also extended indefinitely by production established within the SSR unit on January 15, 1991. BLM correctly determined that COC52685 was liable for rental on the nonunitized land therein at 50 cents per acre.
See 43 CFR 3103.2-2; Lease Agreement, Sec. 2(d).

Lease COC12747

Embracing land within secs. 12-15 and 24, T. 8 S., R. 99 W., sixth principal meridian, this lease was segregated into leases COC12747 (1,438.59 acres) and COC52686 (500.17 acres). The facts here are similar to those in lease COC11355 above. BLM determined that lease COC12747 would be liable for rental at \$2 per acre (the land was classified KGS as of June 18, 1981), and found that lease COC52680 would be continued indefinitely by participation in PA COC47633A. Nonetheless, the parent lease was held at the time of lease segregation by production in the PA. Accordingly, the resulting leases shared that indefinite term and royalty obligation so long as COC52686 remained within the PA. Further, lease COC12747 is also extended indefinitely through production established within the SSR unit.

It is therefore concluded that BLM misapplied 30 U.S.C. § 226(m) (1988) (as explained by the Board in Celsius), when establishing the tenure of seven oil and gas leases that were affected by unit plans. For all

seven leases committed to the SSR unit, BLM's conclusion that the term of each lease was not based upon production from the segregated lease is in error and must be reversed.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decisions appealed from are reversed as explained herein.

Franklin D. Amess
Administrative Judge

I concur:

Bruce R. Harris
Deputy Chief Administrative Judge

