

SANTA FE ENERGY RESOURCES, INC., ET AL.

IBLA 96-85 Decided February 10, 1997

Appeal from a decision of the New Mexico State Office, Bureau of Land Management, holding a competitive oil and gas lease to have expired upon the running of its primary term. NMNM 77017.

Affirmed.

1. Oil and Gas Leases: Drilling—Oil and Gas Leases: Expiration—Oil and Gas Leases: Extensions

The extension of an oil and gas lease is properly denied where actual drilling operations, within the meaning of 43 CFR 3100.0-5(g), were not being diligently conducted over the expiration date of the lease, as required by 30 U.S.C. § 226(e) (1994) and 43 CFR 3107.1.

APPEARANCES: William D. Patterson, Esq., Midland, Texas, for appellants.

OPINION BY ADMINISTRATIVE JUDGE BURSKI

Santa Fe Energy Resources, Inc., and Maralo, Inc., have appealed from a decision of the New Mexico State Office, Bureau of Land Management (BLM), dated October 11, 1995, holding that competitive oil and gas lease NMNM 77017 expired upon the running of its primary term in the absence of actual drilling operations being conducted over the expiration date of the lease. We affirm.

As originally issued, the subject oil and gas lease bore an effective date of September 1, 1988, with a 5-year term ending on August 31, 1993. The running of its primary term, however, was suspended at appellants' request, effective August 1, 1993, in accordance with the provisions of 43 CFR 3101.4-2. See Order of Aug. 25, 1993. BLM approved this suspension based on the conclusion of the Carlsbad Resource Area Office that it would be unable to process and approve two applications for a permit to drill (APD) filed on July 23, 1993, with sufficient time to permit the commencement of well pad construction and spudding of either of the proposed wells prior to the expiration date of the lease. See generally, Nevdak Oil & Exploration, Inc., 104 IBLA 133 (1988); William C. Kirkwood, 81 IBLA 204, 207-08 (1984). The order suspending operations and production specified

that the suspension would terminate either on the first day of the month in which the lessee was notified in writing that neither of the APD's would be approved or on the first day of the month in which actual operations were commenced after approval of one of the APD's.

An APD for the C.F. "4" Federal No. 1 well was eventually approved on June 27, 1995. Operations under this APD commenced in July and the well was spudded on July 16, 1995. Accordingly, under the August 25, 1993, order, the suspension of operations and production terminated effective July 1, 1995, and the lease term recommenced with an expiration date of July 31, 1995. The well completion report, dated August 10, 1995, indicated that total depth (6,860 feet) was reached on July 29, 1995, and that the well was dry.

In a letter dated September 28, 1995, the Assistant District Manager of the Roswell District Office, BLM, first reviewed the history of the suspension and noted that, subsequent to ultimate approval of the APD, operations on the well "were commenced during July 1995 and the well was completed as a dry hole on July 29, 1995, and was subsequently plugged on July 30, 1995." Based on the foregoing time line, the letter concluded that, inasmuch as no drilling operations were being conducted over the end of the primary term, *i.e.*, July 31, 1995, the lease was considered to have terminated as of that date. ^{1/} Thereafter, by formal decision dated October 11, 1995, the New Mexico State Office essentially affirmed this analysis and held that lease NMNM 77017 had expired upon the running of its primary term on July 31, 1995. Appellants thereupon sought review by this Board and also requested that consideration of their appeal be expedited since the efficacy of any 2-year extension which they might obtain would be vitiated if they were not provided sufficient time to undertake further operations on the leasehold. We hereby grant expedited review.

Before the Board, appellants assert that, contrary to the BLM findings, drilling operations were being conducted over the expiration date of their lease. Appellants describe their activities on the lease as follows:

Maralo diligently prosecuted the drilling of the Well in a manner that anyone seriously looking for oil or gas could be expected to make in the area, given knowledge of geologic and other pertinent facts. The well was drilled to a depth sufficient to test not only the Delaware Mountain group, but the Bone Springs formation as well. After running logs and

^{1/} Technically, leases expire upon the running of their primary term, unless otherwise extended. See 30 U.S.C. § 226(e) (1994). Leases terminate either upon the failure to pay annual rental on or prior to the anniversary date of the lease (see 30 U.S.C. § 188(b) (1994)) or, alternatively, upon the cessation of production and the failure to commence reworking or redrilling operations within 60 days. See 30 U.S.C. § 226(f) (1994).

examining pertinent information gained during the drilling process, Maralo and Santa Fe decided on or about July 30, 1995, to plug and abandon the Well as a dry hole.

Immediately following the parties' decision, the Well was plugged in due course in accordance with applicable regulations and accepted industry practice. Plugging was finally completed on August 1, 1995, one day following the expiration of the Lease term, with the capping of the Well and welding into place of the "dry hole marker", as required by applicable federal and state regulations. The rig used to drill the Well left the location on August 5, 1995.

(Statement of Reasons (SOR) at 2).

Appellants contend that the plugging and abandonment of a well, as described above, is an integral part of "actual drilling operations" within the meaning of 43 CFR 3107.1 and that plugging and abandonment constitute the "completion" of a dry hole just as completing and equipping a well for production constitutes the "completion" of a productive well. They argue, therefore, that the lease should have been extended for 2 years since actual drilling operations were being conducted over the end of the lease term. Id. For the reasons set forth below, we cannot agree.

[1] Section 17(e) of the Mineral Leasing Act, as amended, 30 U.S.C. § 226(e) (1994), provides, in relevant part, that "[a]ny lease issued under this section for land on which * * * actual drilling operations were commenced prior to the end of its primary term and are being diligently prosecuted at that time shall be extended for two years and so long thereafter as oil or gas is produced in paying quantities." This provision establishes two separate requirements as a precondition for earning the extension provided. First, "actual drilling operations" must have been commenced prior to the end of the primary term. Second, these operations must be being diligently prosecuted at the end of the primary term.

Most appeals which have arisen with respect to this provision have dealt with aspects of the first requirement. Thus, there have been a number of cases in which the Board has explored what constitutes "actual drilling operations" in the context of determining whether or not qualifying activities commenced prior to the end of the lease's primary term. See, e.g., Nevada Oil & Exploration Co., supra at 140 (rig present but no drilling occurring held not qualifying); Estelle M. Wolf, 37 IBLA 195, 197 (1978) (site preparation and attempts to move a drilling rig onto lease which were frustrated by a blizzard held not qualifying); Burton W. Hancock, 31 IBLA 18, 19 (1977) (untimely commencement of drilling as a result of mechanical mishaps and inclement weather held not qualifying); Inexco Oil Co., 20 IBLA 134, 139 (1975) (preliminary steps towards drilling held not qualifying); Michigan Oil Co., 71 I.D. 263 (1964) (site preparation and grading held not qualifying).

While there have, indeed, been a few cases which have explored the second prong of the statutory mandate, viz., the diligent prosecution of actual drilling operations over the end of the primary term, the overwhelming majority of these cases have involved questions as to the diligence with which drilling operations have been pursued. Thus, the Board has held that various actions of a lessee occurring subsequent to the expiration date of a lease failed to exhibit the necessary diligence so as to earn the extension provided by the statute, even though drilling operations were being conducted over the end of the primary term. See, e.g., Christian F. Murer, 78 IBLA 172 (1983) (failure to penetrate potentially productive horizons); Classic Mining Corp., 37 IBLA 338 (1978) (drilling only 200 feet in depth); D.L. Cook, 20 IBLA 315, 317 (1975) (failure to expeditiously carry forward with drilling after expiration date of the lease); Thelma M. Holbrook, 75 I.D. 329 (1968) (well drilled only to 46 feet in depth).

The instant case, however, involves no post-expiration date challenge to appellants' diligence. Rather, the question presented is whether appellants' drilling program, which was admittedly diligently prosecuted, had, in fact, been completed prior to the expiration date, which was the situation addressed in Mobil Producing Texas & New Mexico, Inc., 99 IBLA 5 (1987). If such is the case, there can be no extension since the statute clearly requires that actual drilling operations must be under diligent prosecution "at the end of [the lease's] primary term." The answer to this question requires the examination of relevant regulatory provisions relating to drilling operations.

Initially, we note that the Department's regulations define "actual drilling operations" as including "not only the physical drilling of a well, but the testing, completing or equipping of such well for production." 43 CFR 3100.0-5(g). There is no allegation that physical drilling or testing of a well was occurring over the end of the primary term or that such well as had been drilled was being equipped for production. Rather, as noted above, appellants assert that the plugging and abandonment of a well are part of the completion of a dry hole and, as such, constitute "actual drilling operations" within the meaning of the regulatory definition. There are, however, a number of problems with this analysis.

First of all, as a matter of grammatical construction, the regulatory definition embraces the "completing or equipping of such well for production." (Emphasis supplied.) Since dry holes are not completed "for production," completion of a dry hole would, arguably, never qualify under this regulatory definition for an extension under section 17(e).^{2/} We

^{2/} Of course, it would make no difference whether a producible well or a dry hole is drilled so long as the physical acts of drilling the well are in progress over the end of the primary lease term or, alternatively, testing of the well is on-going. The problem which the text deals with arises only in those situations in which the physical drilling of the well and the testing of the formation have been concluded with negative results as of the expiration date of the lease.

need not, however, rely solely on grammatical inferences to support this interpretation. On the contrary, such an interpretation is buttressed by the Department's traditional understanding of this provision.

In Estelle Wolf, *supra*, for example, the Board restated the regulatory definition, pointing out that "those parts of 'actual drilling operations' not part of the physical penetration of a drill bit into the ground are the activities which take place after the well hole has been drilled into a producible formation." Id. at 200. This interpretation is underscored by the very form which appellants filed in this case. Entry No. 17 of the standard "Well Completion or Recompletion Report and Log" (Form 3160-4) requests information on the "Date compl. (Ready to prod.)". Not only does this entry clearly presuppose that completion of a well in this context entails completion of a producing well, it is equally apparent that appellants understood this to be the case since the form they submitted had this entry marked "N/A," *i.e.*, not applicable. Given both the grammatical structure of 43 CFR 3100.0-5(g), as well as the traditional approach which the Department has pursued, the phrase "completing of such well" should be interpreted as referring to post-drilling actions undertaken with respect to a producible well.

Moreover, as a more general matter, while appellants assert that "Maralo and all other operators in the area view the plugging process, including the capping of the well and the placing of the dry hole marker, as a part of the completion of a dry hole," no support for this assertion can be gleaned from any of the Federal and State court cases which have attempted to define the term "completed well" or the phrase "completion of a well" in the context of a "dry hole." Indeed, we have been unable to discover a single case discussing this issue in which it has even been suggested that a dry hole is not "completed" until it has been plugged and abandoned. ^{3/}

It is important to note that the terms being discussed, *i.e.*, dry hole, completed well, and completion of a well, are, in the oil and gas

^{3/} We would also point out that, while appellants assert in their SOR that "plugging" continued over the expiration date, they do not contend that cement was being poured at that time. Rather, appellants merely note that "[p]lugging was finally completed on August 1, 1995, one day following the expiration of the Lease terms, with the capping of the Well and welding in place of the 'dry hole marker', as required by applicable federal and state regulations" (SOR at 2 (emphasis supplied)). Contrary to appellants' assertions, however, plugging is generally defined as "[t]he sealing off of the fluids in the strata penetrated by a well, so that the fluid from one stratum will not escape into another or to the surface. This is usually accomplished by introducing cement or MUD (*q.v.*) into the hole." Manual of Oil and Gas Terms, Williams & Meyers, 649 (6th ed. 1984). Capping of a plugged dry hole and the placement of a dry hole marker is certainly required on Federal leases, but this is part of the abandonment process, not the plugging process.

field, terms of art with particularized meanings which, at times, vary depending upon the context. For example, a "dry hole" is not merely a well which has proven to be unproductive of hydrocarbons. Rather, it is a "completed" well which is not productive. ^{4/} Thus, in Lerblance v. Continental Oil Co., 437 F. Supp. 223, 229 (E.D. Okla. 1976), the Court held that a well which, owing to drilling difficulties, was plugged and abandoned above its targeted formation was not a "dry hole" within the meaning of an operating agreement, because, in the absence of the penetration of a potentially producible formation, the well could not be deemed to have been "completed" as a dry hole. ^{5/}

The term "completion of a well," while not necessarily partaking of an exact meaning, does mean "more than mere completion of drilling. At the least it means the cleaning out of the well after reaching a specified depth, or the shooting of the well if there is doubt as to whether it is a producer or nonproducer." Manual of Oil and Gas Terms, Williams & Meyers, 146 (6th ed. 1984), citing Totah Drilling Co. v. Abraham, 328 P.2d 1083, 1090 (N.M. 1958).

As the foregoing might suggest, a "completed well" is not merely a well in which drilling has terminated but one which has been "drilled to the extent that either oil or gas has been found, or is not likely to be found in paying quantities, by drilling deeper, or drilled to that reasonable depth at which the product in paying quantities was usually proven to exist in that particular location." Smith v. Hayward, 193 F.2d 198, 200-201 (C.C.P.A. 1951). Similarly, in Barrett v. Ferrell, 550 S.W.2d 138, 142 (Tex. Civ. App. 1977), the Court noted that, absent other express provisions in a contract, "the driller will be held to have completed the well when he has drilled the well to the depth necessary to find oil or gas in paying quantities, or to such a depth as in the absence of such oil or gas would reasonably preclude the probability of finding oil or

^{4/} We recognize that, in the context of determining whether or not the drilling of a dry hole will excuse or liquidate rental payments under a lease as a "completed well," there exists a split in authority as to whether a dry hole can be deemed to be a "completed well." See generally 3 Williams & Meyers, Oil & Gas Law § 614.1(3). As a general matter, however, it is well established that, in order to be a "dry hole," the well must be a "completed well." Thus, the Manual of Oil and Gas Terms, Williams & Meyers, 255 (6th ed. 1984), defines a dry hole as "[a] completed well which is not productive of oil and/or gas (or which is not productive of oil and/or gas in paying quantities)."

^{5/} The Court's conclusion that the well was not a "dry hole" was critical in determining that the operator had not violated the terms of the operating agreement by failing to obtain approval of working interest owners prior to plugging and abandoning a dry hole. Id. at 228-29. We note that this entire discussion by the Court presupposes the existence of a dry hole, i.e., a completed well, before plugging and abandonment occurs.

gas at a further depth." See also Seale v. Major Oil Co., 428 S.W.2d 867, 869 (Tex. Civ. App. 1968); Braun v. Mon-O-Co Oil Corp., 320 P.2d 366, 371 (Mont. 1958).

While there have been a number of cases exploring the concept of "well completion" as it relates to producing or producible wells, we have discovered only two decisions which have directly addressed the question of the point in time at which a "dry hole" may be said to have been "completed." In the earlier of these two decisions, Niles v. Luttrell, 61 F. Supp. 778 (W.D. Ky. 1945), the Court held that a well had been "completed" as a dry hole "after it had been acidized without result." Id. at 779. The Court made this determination, notwithstanding the fact that there were subsequent sporadic attempts to obtain production from the well as well as testimony of witnesses that the well might, at some future date, be made productive, opining that "after August, 1941, when the drilling through the upper and lower Sunnybrook sands and through the pencil cave strata had been completed without satisfactory result, it would be extreme to hold that this well did not present a dry hole, within the understanding of the parties and the meaning of the lease." Id. at 780.

In the later case, LeBar v. Haynie, 552 P.2d 1107 (Wyo. 1976), the Court distinguished the situation before it from Niles v. Luttrell, supra, concluding that the drilling of a well to a depth of 6,744 feet in the Lewis horizon, setting casing to 6,719 feet, and the subsequent release of the drilling rig did not evidence the "completion" of a dry hole. This determination, however, was made on the totality of the record which included the subsequent procurement of two different rigs which were moved onto the well site and the fact that, within 3 months from the date of removal of the first rig, the well was completed as a producer in the Teapot formation at a depth of 7,115 feet. In distinguishing the Niles case from the situation before it, the Wyoming Supreme Court noted that "[p]aramount is that [in Niles] the well was never drilled any deeper, nor was any intention to drill the well deeper ever asserted—unlike in this case." Id. at 1112.

While the Niles and LeBar cases indicate that there may be some controversy in determining the point at which a dry hole has been completed in those situations in which subsequent events might arguably support an inference of a continuation of interest in further development of a well, the instant case presents no such conflict. Thus, appellants freely admit that, upon an examination of the drilling logs, they decided, on or about July 30, 1995, to plug and abandon the well as a dry hole (SOR at 2). At that point in time, there can be no question that the dry hole had been completed. Admittedly, there remained the duty to plug and abandon the well. But the actions of plugging and abandoning the well are independent of, and necessarily follow in time, the completion of the well as a dry hole. Thus, even if we were to construe the regulatory phrase "completing of such well for production" as embracing the completion of a dry hole, the dry hole was completed prior to the running of the primary term and, therefore, "actual drilling operations" were not being conducted over the

end of that term as required by section 17(e) of the Mineral Leasing Act, 30 U.S.C. § 226(b) (1994). See Mobil Producing Texas & New Mexico, Inc., supra.

In view of the foregoing, we must conclude that the determination of the New Mexico State Office that Federal oil and gas lease NMNM 77017 expired upon the running of its primary term on July 31, 1995, was correct.

Therefore, 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 affirmed.

James L. Burski
Administrative Judge

We concur.

Bruce R. Harris
Deputy Chief Administrative Judge

C. Randall Grant, Jr.
Administrative Judge

Gail M. Frazier
Administrative Judge

David L. Hughes
Administrative Judge

Will A. Irwin
Administrative Judge

R.W. Mullen
Administrative Judge

ADMINISTRATIVE JUDGE KELLY DISSENTING:

I respectfully dissent. Regulation 43 CFR 3100.0-5(g) defines "actual drilling operations" as "not only the physical drilling of a well, but the testing, completing or equipping of such well for production." Citing Mobil Producing Texas & New Mexico, Inc., 99 IBLA 5 (1987), the majority holds that even if the foregoing language includes the completion of a dry hole, the lease at issue cannot be extended because appellants were not drilling or testing on the anniversary date, but were plugging and abandoning the well.

The majority's holding is based on its interpretation of the phrase "completing of such well" as referring only to those post-drilling actions relating to a producible well. The majority bases its interpretation on the grammatical structure of 43 CFR 3100.0-5(g), as well as the traditional approach of the Department.

Neither 43 CFR 3100.0-5(g) nor Departmental precedent specifically address the question presented in this appeal. Thus, the grammatical structure of the regulation is not limited to the narrow interpretation given it by the majority. Moreover, none of the Board's decisions cited by the majority address the issue here. For example, while the Board's decision in Mobil is cited in support of the majority's holding set forth above, that case involved a well which was plugged and abandoned 7 days prior to the expiration of the lease.

In the absence of clear precedent, 43 CFR 3100.0-5(g) should be construed in a manner consistent with its purpose. That purpose, as noted by appellants, "is to prevent a lessee from obtaining an extension by simply 'going through the motions' with no real intent of finding production" (Statement of Reasons at 2). In the case at hand, that purpose is not served by construing the foregoing regulation in a manner which penalizes a diligent lessee because it completed testing 1 day prior to the expiration date of the lease.

Accordingly, I would hold that under 43 CFR 3100.0-5(g), diligent plugging and abandonment of a dry hole constitute "actual drilling operations." Since the appellants were engaged in such operations on the anniversary date of the lease, I would reverse BLM's decision.

John H. Kelly
Administrative Judge

We concur:

James L. Byrnes Franklin D. Amess
Chief Administrative Judge

Administrative Judge

