



TWO BAY PETROLEUM, INC.

166 IBLA 329

Decided September 2, 2005

Editors Note: Appeal Filed, No 2:05-CV-2335-MCE-JFM (E.D. Cal) aff'd Two Bay Petroleum v. US Dept of the Interior, 2007 WL 2028192 (July 10, 2007)



United States Department of the Interior
Office of Hearings and Appeals
Interior Board of Land Appeals
801 N. Quincy St., Suite 300
Arlington, VA 22203

TWO BAY PETROLEUM, INC.

IBLA 2003-306

Decided September 2, 2005

Appeal from a decision of the California State Office, Bureau of Land Management, declaring oil and gas lease CACA 25325 to have terminated by cessation of production.

Affirmed as modified.

1. Oil and Gas Leases: Generally–Oil and Gas Leases:
Production–Oil and Gas Leases: Termination

A noncompetitive oil and gas lease has a primary term of 10 years, and shall continue so long after its primary term as oil or gas is produced in paying quantities. 30 U.S.C. § 226(e) (2000). When production ceases on an oil and gas lease which is in an extended term by reason of production, the lease will terminate unless (1) within 60 days after cessation of production reworking or drilling operations are begun on the lease and thereafter conducted with reasonable diligence during the period of nonproduction, or so long as oil or gas is produced in paying quantities as a result of such operations; (2) an order or consent of the Secretary suspending operations or production on the lease has been requested and issued; or (3) the lease contains a well capable of producing oil or gas in paying quantities and the lessee places the well on a producing status within a reasonable time of not less than 60 days after notice to do so and thereafter continues production unless and until the Secretary allows production to be discontinued.

2. Oil and Gas Leases: Extensions–Oil and Gas Leases: Production–Oil and Gas Leases: Termination

When the record provided by BLM does not establish when a well produced oil, the value of that production, or the associated costs and expenses thereof, because that information was not submitted by the lessee to BLM or MMS as required by applicable regulations, and the information submitted by appellant on appeal is not supported by actual production, operations, or metering data it has or should have in its possession, appellant's motion for a hearing is properly denied, as there is no material issue of fact that cannot be resolved on the record before us.

3. Oil and Gas Leases: Extensions–Oil and Gas Leases: Production–Oil and Gas Leases: Termination

When none of the circumstances set forth in the Mineral Leasing Act, 30 U.S.C. § 226(i) (2000), that could save a lease in its extended term from termination because of cessation of production materializes in the 60 days following cessation of production, the lease terminates by operation of law effective as of the date production ceased, not 60 days after appellant receives the notice BLM has chosen to give lessees under 43 CFR 3107.2-2.

APPEARANCES: W. Ervin James II, Esq., Pasadena, California, for Two Bay Petroleum, Inc.; Nancy S. Zahedi, Esq., Office of the Regional Solicitor, U.S. Department of the Interior, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE PRICE

Two Bay Petroleum, Inc. (Two Bay) has appealed a May 5, 2003, decision by the California State Office, Bureau of Land Management (BLM), declaring oil and gas lease CACA 25325 to have terminated by cessation of production effective October 11, 2002.^{1/} Lease CACA 25325 has a single well, the Ptasynski-Federal 56-3

^{1/} The decision was mailed to Two Bay's address of record. It was returned to BLM as undeliverable. BLM re-mailed the decision to a different address, where it was
(continued...)

well, completed in the Vaqueros C zone. Two Bay timely appealed.^{2/} With its appeal, Two Bay petitioned for a stay of the decision and requested a hearing on the question of whether the lease is capable of producing in paying quantities. The stay request was denied by order dated September 17, 2003.

On July 26, 2002, the Bakersfield Field Office (BFO) issued a notice to Two Bay finding that the Ptasynski-Federal 56-3 well had been in “non-producing status for more than three years.” (Reply Ex. N.) BLM allowed Two Bay 60 days, “but not later than October 11, 2002,” to perform one of five actions: if the well was capable of production (1) return the well to production and notify BLM; (2) submit justification for BLM to approve shut-in status; (3) assign the lease to a party willing to operate the well; and if the well was not capable of production (4) request approval to recomplete the well in another zone; or (5) request permission to plug and abandon it. The BFO explicitly cautioned Two Bay that the lease was in its extended term and would expire on its own terms if the company did not within 60 days restore production in paying quantities or initiate diligent work to that end. The notice was mailed, return receipt requested, to Two Bay at its address of record. According to the parties, Two Bay signed the receipt on August 23, 2002. (Answer at 7, 13; Reply Ex. A at 6.)

^{1/} (...continued)

received by Two Bay on June 2, 2003. We note in passing that the failed delivery to Two Bay’s address of record would have sufficed, and that BLM had no obligation to seek an alternative delivery address as it did. 43 CFR 1810.2(a).

^{2/} The decision here appealed is the second issued by the State Office addressing the status of the lease. A previous decision dated May 11, 2000, notified Two Bay that the lease had expired on Nov. 30, 1999, at the end of its primary term of ten years, because it was not producing oil or gas in paying quantities and drilling was not being conducted at the end of the term. On appeal (docketed as IBLA 2000-328), the Board granted a stay of the decision. The Feb. 28, 2001, stay order noted that Two Bay had made factual assertions relevant to the issue of whether the Ptasynski-Federal 56-3 well, the only well on the lease, was capable of production on the expiration date. That order also pointed out that BLM’s decision did not include a finding that the well was not capable of production and that 30 U.S.C. § 226(i) (2000) and 43 CFR 3107.2-3 provide that a lease “on which there is a well capable of producing oil or gas in paying quantities” does not expire for failure to produce “unless the lessee is allowed a reasonable time, which shall be not less than 60 days after notice * * * within which to place such well in producing status.” By order dated Jan. 22, 2002, the Board granted BLM’s request that the case be remanded and on Feb. 22, 2002, BLM vacated its decision and reinstated the lease.

The BFO's notice also informed Two Bay of its right to request review by the California State Director as provided by 43 CFR 3165.3. The record on appeal does not indicate that Two Bay did so. Instead, by letter dated August 7, 2002, the company informed the BFO that its consulting engineer was on vacation and, upon his return, would file an Application for Permit to Drill (APD) for test well 47-3 and a Sundry Notice to complete the 56-3 well in the "B" sand, and would also formally reply to the notice. (Reply Ex. M.)^{3/}

By letter dated September 24, 2002, Two Bay informed the BFO that its engineer, upon returning from vacation, had obtained other employment. With the letter, Two Bay submitted a version of the Sundry Notice it had previously filed on September 26, 1999, but bearing the date of September 24, 2002, seeking to perforate a different horizon.^{3/} The BFO approved the Sundry Notice by letter dated October 2, 2002, requiring that Two Bay initiate the workover of the well by October 11, 2002, and that the well be put into production no later than October 31, 2002. (Reply Ex. P.)

At some point, Two Bay submitted a Sundry Notice dated October 15, 2002, "to verify the start-up of production for well #56-3 on Oct. 10, '2002'." The Sundry Notice further stated:

We are producing into a 500 bbl. Enclosed frac tank adjacent to the well. * * * The production is pipelined directly to the tank. No other pipes connect to the well or the tank. * * * This tank will be used for production purposes only. The sale of this oil will result from commingling the production from #56-3 well with the production of the Morales Canyon wells [another lease held by appellant] which produce into a frac. tank at that well site. The oil will have to be

^{3/} The return receipt is not in the case file, but it is obvious that, as of Aug. 7, 2002, Two Bay had actual notice of the contents of the July 26, 2002, notice, well before the date it reportedly signed the receipt. It thus appears that the date of Oct. 11, 2002, afforded Two Bay more than 60 days to act. Given our ultimate conclusion that production terminated well before 2002, however, any error in the date on which the 60-day period expired is of no consequence.

^{4/} In the Apr. 1, 1992, APD, the proposed drill depth was 4000'. The Apr. 20, 1993, Well Completion or Recompletion Report indicates that the 56-3 well was drilled to a total depth of 3413' and began producing at the 2670' - 2700' interval. The Sundry Notice submitted on Sept. 24, 2002, proposed to perforate the uphole interval at 2202' - 2165'.

trucked to this site. * * * The production from all of these wells will be based on individual flow meters for each well or on a test tank production test. * * * [Emphasis per original.]

BLM approved this Sundry Notice on November 26, 2002. By letter dated November 26, 2002, BLM informed Two Bay that it had approved the request to commingle production, subject, however, to the requirements that production from each well was to be measured and sampled prior to commingling, and that a well test report was to be submitted annually.

A well test was scheduled for October 30, 2002. That test was terminated due to mechanical problems and inconclusive results, but was completed the next day. (Reply Ex. T.) A number of inspections ensued, beginning in November and concluding in February 2003.

By memorandum dated April 1, 2003, the BFO communicated to the Deputy State Director, Energy and Minerals, its determination that the 56-3 well was not capable of production in paying quantities and recommended that he issue a decision terminating the lease effective October 11, 2002, “due to cessation of production (43 CFR 3107.2-2) and that the lease does not contain a well capable of producing in paying quantities * * *.” (Memorandum at 2.) Based on the history of the inspections after October 11, 2002, the memorandum stated:

Because the Company has not proceeded diligently to restore production on this lease and since the rates from the sporadic production over the last 5 months have been extremely low, the BFO has determined that the operator is not in compliance with the requirements of the 60-day notice. We have determined that this well/lease is NOT capable of producing in paying quantities and therefore has expired under it’s [sic] own terms effective 10-11-02.

Id.

The State Office’s May 5, 2003, decision accepted the BFO’s determinations:

Based on a report from our [BFO,] CACA 25325 does not contain a well capable of producing oil and gas in paying quantities and that [sic] the subject lease has expired under its own terms effective October 11, 2002. No production in paying quantities was established within the 60 days allowed under 43 CFR 3107.2-2. Accordingly, the lease term is

term [sic] and Federal oil and gas lease CACA 25325 is hereby declared terminated by cessation of production, effective October 11, 2002. [^{5/}]

(Decision at 1.)

On appeal, Two Bay states that it was not aware of the BFO's April 1, 2003, memorandum until it received a copy as an attachment to the State Office's decision. That decision, Two Bay contends, was "based on faulty and incomplete information." (Statement of Reasons for Appeal (SOR) at 3.) In particular, Two Bay claims that the BFO failed to obtain information about the value of the well's production and operating costs and, correspondingly, argues that BLM's memorandum fails to make a proper determination as to whether the well is capable of producing in paying quantities. (SOR at 3-5.) Two Bay provides statements from its president, David J. Hanson, and from its contract lease operator that address the lease's productive capacity. (SOR Exs. A and B.) It contends that those statements "demonstrate that the lease was and is capable of producing in paying quantities" and show that the BFO's April 1, 2003, measurements of oil in the storage tank were incorrect due to a gauging error. (SOR at 5.)

Two Bay disputes a number of statements in the BFO's memorandum, asserting that the well was put into production in September 2002 and generally produced until April 3, 2003, after which 162 barrels of oil were removed from the storage tank by truck. (SOR at 6.) Two Bay also disagrees with the memorandum's statement that the company was not diligent in undertaking reworking operations to restore production from the lease and argues that its activities constituted reworking operations that served to preserve the lease during periods of nonproduction as provided by 43 CFR 3107.2-2. (SOR at 6-7.)

BLM's Answer describes the events that led to issuance of its May 5, 2003, decision, including inspections conducted by BLM personnel and the BFO's July 26, 2002, notice. Based on those inspections, BLM contends that the well produced only about five barrels of oil between mid-October 2002 and mid-January 2003. (Answer at 9-10.) BLM acknowledges that 162 barrels of oil were removed from the lease storage tank on April 12, 2003, but contends that Two Bay has neither submitted run tickets to BLM nor "submitted any of the required monthly reports to MMS on oil production, or paid any royalties to MMS for production from well 56-3." (Answer at 10-11, 17.) Invoking section 17(i) of the Mineral Leasing Act (MLA), 30 U.S.C. § 226(i) (2000), and International Metals & Petroleum Corp., 158 IBLA 15, 20 (2002), BLM argues:

^{5/} See n.3 *ante*.

If Two Bay's lease was extended by production initiated on November 29, 1999, and there was no well capable of producing in paying quantities on the lease, then Two Bay had 60 days from when production ceased to initiate reworking or drilling operations with reasonable diligence to avoid termination. Any production from well 56-3 ceased after December 30, 2000, and BLM's inspections showed that Two Bay ceased production for more than 60 days without initiating reworking or drilling operations. By the time BLM issued the July 26, 2002 notice, well 56-3 had been down for about a year and a half. Therefore, if well 56-3 was not capable of production in paying quantities when production ceased in January, 2001, then the lease terminated by operation of law prior to the July 26, 2002 notice.

(Answer at 12-13, footnote omitted.)

Alternatively, BLM also argues that its July 26, 2002, notice provided Two Bay the 60-day period required by the MLA and 43 CFR 3107.2-3 and that the Ptasynski-Federal 56-3 well was not producing when the period ended. (Answer at 13-14.) BLM further argues that the October 31, 2002, well test "cannot support a finding that the well was capable of producing in paying quantities, absent independently verifiable cost information." (Answer at 15.) In addition, BLM argues that the well was not physically capable of production and did not produce oil until after January 13, 2003, when a BLM inspector observed a rig chemically treating the well. (Answer at 16-17.) Finally, BLM criticizes Two Bay's estimated costs of operating the well as vague, unsubstantiated, and understated. (Answer at 17-18.)

On September 17, 2004, Two Bay filed a "Motion to File Reply and Supplemental Statement of Reasons in Response to Answer" (Reply).^{6/} Two Bay's motion to file its Reply brief is granted. The Board has reviewed the Reply and has

^{6/} Two Bay had previously notified the Board by letter dated Nov. 20, 2003, that it was preparing a Reply to BLM's Answer and would request an extension of time to submit it. At that time, BLM opposed allowing Two Bay to file the document and an extension of time to do so. BLM has renewed its opposition, contending that the motion is untimely and the Reply brief should be struck. (Opposition to "Motion to File Reply and Supplemental Statement of Reasons in Response to Answer" and Motion to Strike Supplemental Statement of Reasons in Response to Answer as Untimely at 1-2.) If the Board did not reject the Reply, BLM stated that it wished to respond. *Id.* at 2.

concluded that this appeal can be decided on the record, pleadings, and evidence before it without a further response from BLM.

[1] Under the MLA, 30 U.S.C. § 226(e) (2000), a noncompetitive oil and gas lease has a primary term of 10 years. Each lease “shall continue so long after its primary term as oil or gas is produced in paying quantities.” See 43 CFR 3107.2-1. That section of the MLA further provides 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.”

In § 226(i), the MLA provides:

No lease issued under this section which is subject to termination because of cessation of production shall be terminated for this cause so long as reworking or drilling operations which were commenced on the land prior to or within sixty days after cessation of production are conducted thereon with reasonable diligence, or so long as oil or gas is produced in paying quantities as a result of such operations. No lease issued under this section shall expire because operations or production is suspended under any order, or with the consent, of the Secretary. No lease issued under this section covering lands on which there is a well capable of producing oil or gas in paying quantities shall expire because the lessee fails to produce the same unless the lessee is allowed a reasonable time, which shall not be less than sixty days after notice by registered or certified mail, within which to place such well in producing status or unless, after such status is established, production is discontinued on the leased premises without permission granted by the Secretary under the provisions of this chapter.

30 U.S.C. § 226(i) (2000).

This provision had its genesis in the amendments of July 29, 1954 (1954 amendments), as described in Steelco Drilling Corp., 64 I.D. 214 (1957), the Department’s first decision interpreting those amendments.^{2/} Prior to July 29, 1954, the only provision of the MLA that would have prevented expiration of the lease in the circumstances presented was section 17: “a lease ‘upon which there is production during or after the primary term shall not terminate when such production ceases if

^{2/} The current version of § 226(i) (2000) is almost identical to the language of subsection (1) of the July 29, 1954, Act. See Steelco, 64 I.D. at 217.

diligent drilling operations are in progress * * * during such period of nonproduction.” Id. at 216. The 1954 amendments established “three distinct and separate sets of conditions or circumstances in which a lease will not expire even though production has ceased and the lease is in an extended term by reason of production.” Id. at 217.

The reasoning in Steelco has been applied many times since. See, e.g., Max Barash, 6 IBLA 179, 181-82 (1972); Great Plains Petroleum, Inc., 117 IBLA 130, 132 (1990); C & K Petroleum, Inc., 70 IBLA 354, 356 (1983); Michael P. Grace, 50 IBLA 150, 151-52 (1980); John S. Pehar, 41 IBLA 191, 192 (1979); Vern H. Bolinder, 40 IBLA 164, 167 (1979). The Board has addressed individual aspects of § 226(i) as well. See Coronado Oil Co., 164 IBLA 309, 323 (2005) (third condition contemplates a lease containing a well capable of production, but production has been deferred because of lack of pipelines, roads, or markets for the gas, such that lessees are afforded notice and a reasonable period in which to place the well in producing status); Coronado Oil Co., 164 IBLA 107, 114 (2004) (“we first address the question of * * * whether there was a well capable of production in paying quantities at the time of cessation of production, in the absence of which, the lease terminated”), and cases cited; Merit Productions, 144 IBLA 156, 158-59 (1998), and cases cited, and Merit Productions, 144 IBLA at 160-61 (Burski, A. J., concurring) (whether under the MLA a lease subject to the first condition is entitled to the 60-day notice afforded by 43 CFR 3107.2-2); Great Plains Petroleum, Inc., 117 IBLA 130, 132 (1990) (where, after notice that BLM does not consider the lease to have a well capable of producing oil or gas in paying quantities, the lessee fails to present any evidence establishing the well’s current potential production and fails to produce, the lease is properly declared to have terminated on account of the cessation of production); Amoco Production Co., 101 IBLA 215, 221-22 (1988) (describing the criteria that demonstrate a well capable of producing oil or gas in paying quantities).

The record clearly shows Two Bay had ceased production at some point well before the BFO’s July 26, 2002, notice was issued. Hanson admits as much: “After the 56-3 well was returned to production in November, 1999, the well was operated on propane for a little over a year and produced over six hundred barrels of oil at an average production rate of just under 2 barrels a day.” (Reply Ex. A at 4.) He further acknowledges: “In December 2000, the well was shut-in because of the uncertain status of the lease and pending an installation of electrical power.” Id. Hanson goes on to describe the company’s subsequent plans and actions, but notably does not assert that production ever was resumed between January 2001 and July 2002. Id. at 5-6. Hanson’s admissions are consistent with the information maintained by the Minerals Management Service (MMS), presumably reported by Two Bay, showing that the last production occurred in December 2000. That information, a report of

Monthly Production by Well, was generated by MMS on August 6, 2003 (MMS 2003 Report), in response to BLM's request for information. Two Bay has not provided the date when production ceased, but only 7 days of production in December 2000 were reported to MMS.

As explained above, BLM issued a May 11, 2000, decision declaring the lease terminated as of November 1999. That decision was appealed, stayed by the Board, and ultimately set aside and remanded to BLM in February 2002. *See* n.2 *supra*. During the pendency of that appeal, Two Bay "drilled the 'Morales Canyon' #2 test well on [its] adjoining Lease CACA16474." (Reply Ex. A at 5.) Hanson sheds more light on Two Bay's activities between February 2001 and July 2002:

Two Bay's appeal being upheld, we resumed preparations to explore the possibilities and establish the value of the seven North Cuyama oil reservoirs. Our plans on the subject lease called for gun-perforating the "B" sand in the * * * 56-3 well and drilling a test well on the 47-3 location to confirm that the 56-3 well was a "new field discovery". In preparation, we had purchased an expensive retrievable bridge-plug to isolate the lower "C" sand in the 56-3 well from the upper "B" sand, which we planned to test. We had also sent a letter to [the BFO] informing them that * * * we would file a Sundry Notice to gun-perforate the Vaqueros "B" sand and submit an Application to Drill the * * * 47-3 test well. * * *

Before we could implement our plans, we received a 60 Day Notice from the BLM Bakersfield office (dated July 26, 2002, but received by Two Bay on August 23, 2002) requiring us within 60 days to put a well on production or initiate diligent work to that end, or to take certain other specified actions, or face termination of the subject lease again. * * *

On September 24, 2002, we submitted a Sundry Notice to the [BFO] for the recompletion of the 56-3 well in the "B" sand in the anticipation that new production could be established at a rate that would not be subject to question * * *. [^{8/}] If the recompletion was unsuccessful in the "B" sand, we would still be able to return the well to

^{8/} Two Bay states that it filed an APD to drill the 47-3 well on Nov. 29, 2002, which was subsequently approved. (SOR, Ex. A at 1.) Neither the APD nor the letter of approval is in the record before us.

production from the “C” sand. ^{9/} The [BFO] approved this Sundry Notice in a letter dated October 2, 2002, but the BLM imposed the following conditions: * * * This set of conditions was obviously unachievable. Given the arbitrary requirement that the well be on production within less than a month after the recompletion had been approved, it was impossible to meet BLM’s capricious nine (9) day deadline for commencement of operations.

Id. at 6-7; see Reply at 29, 36-37. ^{10/} As stated above, the company filed a Sundry Notice “to verify the start-up of production for well #56-3 on Oct. 10, ‘2002’.”

To refute the first of the two conclusions underlying the decision appealed, that production ceased, Two Bay points to two periods when it claims the well produced oil and gas: December 1999 to December 2000, when the 56-3 well produced 643 barrels of oil (Reply at 18; see Reply at 3, 21), and mid-September 2002 to mid-April 2003. Two Bay has provided reports of monthly production costs and reports submitted to the California Division of Oil, Gas & Geothermal Resources (CDOGGR) to support its contentions and conclusions. (Reply at 3, 18; see Reply Ex. A at 11, 15, Exs. B, C.) The 643 barrels produced in the December 1999 to December 2000 period are not material, however, because the period at issue is the period following cessation of production sometime in December 2000. We therefore

^{9/} We note, however, that the BFO’s July 26, 2002, notice stated that a Sundry Notice requesting approval to recomplete the well could be submitted “[i]f a well (as presently completed) is **not** capable of production in ‘paying quantities’, but production can be obtained from an uphole zone(s).” (Reply Ex. N at 2, emphasis per original.) In contrast, the alternative of returning the well to production was described as appropriate “[i]f this non-producing well is physically and mechanically capable of production in ‘paying quantities’.” Id. at 1.

^{10/} Two Bay’s complaint that it lacked sufficient time is not well-founded. The time it was given is directly attributable to the lateness of the date on which it chose to submit the Sundry Notice. Moreover, by comparing the 1-year period allowed in an APD for a lease not involved in this appeal (Reply Ex. A at 7), Two Bay implicitly acknowledges that certainly weeks, if not months, ordinarily would be required to recomplete the 56-3 well in the “B” sand. The company obviously would not have had adequate time to take action, given the lateness of its request, even if BLM had approved the Sundry Notice on the spot.

need not sift through the questions raised by the evidence regarding those volumes. ^{11/}

As to the period following BLM's notice, the parties seem to agree that 162 barrels of oil were removed from the 56-3 well production tank on April 12, 2003. Two Bay asserts production began either in September 2002 (according to Hanson) or on October 10, 2002 (according to the October 15, 2002, Sundry Notice) and continued through mid-April 2003. BLM contends, however, that these volumes were not produced until after January 13, 2003. In its SOR, Two Bay acknowledges that the production occurred "since the first of the year." (SOR at 6.) Based on an unspecified date early in January in its SOR, Two Bay claims production 75 days out of approximately 90 established a rate of 2.16 barrels of oil per day, constituting production in paying quantities. See SOR Ex. A at 2 and Ex. B. ^{12/} Perhaps

^{11/} Were we reviewing the evidence relative to the period between December 1999 and December 2000, we would begin by noting that, although the absence of monthly reports was noted in the Sept. 17, 2003, order denying a stay, they are not part of the record BLM submitted on appeal, and neither party has provided them to supplement the record. See 43 CFR 3162.4-3. Two Bay did not submit a first production report or a 5-day notice of the start of production, in violation of 43 CFR 3162.4-1(c). Two Bay provided a copy of a Mar. 17, 2001, letter (unsigned) from its Comptroller to MMS, written to correct production reports submitted in 2000. According to that letter, a former bookkeeper had been unaware that production had been suspended late in January 2000, and had erroneously continued to report 2 barrels per day throughout 2000. The quantities reported to CDOGGR and those shown on MMS' 2003 Report differ from the bookkeeper's description of them. Significant additional questions about the number of days the 56-3 well may have produced are raised by other documents in the record and by Two Bay's submissions and statements.

With respect to the period between January 2001 and July 26, 2002, BLM inspected the well three times. Its Apr. 2, 2001, report contains no notation regarding either production or the status of the well. The next report, dated July 17, 2001, contains a notation that the "[t]ank was below the suction valve and well was disconnected from tank and down." The final report was dated June 26, 2002, and it includes a note regarding "facility diagram," item 10, "none submitted - well does not produce" and for accuracy of the diagram, item 10.A, "no approved sales facilities."

^{12/} Two Bay did not specify sales prices, but estimated, apparently based upon production of 2.16 barrels per day for 30 days, a yield of \$1500 to \$2000 per month, and without explanation or verification, states that "the cost of operations and
(continued...)

recognizing that its statement confirms BLM's contention that production occurred after January 13, Two Bay retreats in its Reply, claiming instead that 72 of the 162 barrels were "produced between October 2002, and the end of 2002." (Reply at 18 n.5.) Two Bay thus explains that the well produced the 162 barrels "during 100 days of operation between October, 2002 and March 2003—an average daily rate of 1.62 barrels." (Reply at 18.) The figure of 72 barrels appears to come from Ex. E to Two Bay's Reply, which is a typed list of numbers of barrels produced and a price per barrel during October 2002 through March 2003. These numbers also appear in Ex. L, which consists of eight pages of a spreadsheet with entries purporting to show production and sales from the wells on Two Bay's two leases and a cover statement by Two Bay's bookkeeper.

Because neither the record provided by BLM nor the exhibits submitted by Two Bay include copies of any monthly production reports submitted to MMS, BLM, or the CDOGGR for the 162 barrels, the figures found on the eight pages are unsupported. We observe, however, that the list of varying production and sales figures for each month is contrary to the assertion that the 162 barrels were removed from the storage tank on April 12, 2003, and sold in a single transaction. See Reply Exs. G, H. Those sales figures do not square with Hanson's statement that "Two Bay received \$24.57 per barrel when it sold the 162 barrels." (Reply Exs. A at 15, E, L.) Attributing a definite quantity of production to each month is also contrary to Two Bay's response to a dispute regarding the use of Lease Automatic Custody Transfer devices. In response to BLM's suggestion that the devices should have been used, Two Bay states that BLM neither provided the devices nor requested that Two Bay provide them, and further states that production "is measured at the time of shipment to Two Bay's sale tank." (Reply at 22, quoting Ex. I; see Answer at 5 n.5.) In addition, the number of days reported on the spreadsheets do not agree with the monthly lists. Compare Ex. D with Ex. L.

In response to BLM's second conclusion, that the lease does not contain a well capable of production, Two Bay makes much of the well test that was attempted on

^{12/} (...continued)

minimum lease royalty averages \$500 per month." (SOR Ex. A at 2.) The company lists monthly expenses as \$150 per month for propane (\$5.00 per day), \$300 for labor, \$100 for equipment maintenance, and an average minimum royalty of \$87.50, for a total of \$637.50. (SOR Ex. C.) Two Bay's Reply does not discuss the relationship between these figures and the list of expenses in Exs. B and D or otherwise discuss the costs of operating the well. Moreover, no production or operations reports or data of any kind were submitted to confirm production in 2002 or the early part of 2003 to which these costs or expenses might relate.

October 30 and completed on October 31, 2002, challenging the manner in which it was conducted and the accuracy of BLM's extrapolations regarding a daily production rate. Specifically, the parties have disputed whether the test results overstate any expected production because they include "flush production." (Answer at 8; Reply at 17-19.) Two Bay argues that "intermittent pumping" represents "good oil field practice for the efficient operation of low-volume wells capable of producing in paying quantities." (Reply at 19.) Whether the results of the well test on October 31, 2002, are viewed as "flush production" or are indicative of "intermittent pumping," and whether the test is deemed to indicate a production rate of 1.25, 1.38, 1.62, or 2.16 barrels per day, it is undisputed that the test revealed a "high water cut (99%)" affecting confidence in any extrapolation, and that the Ptasynski-Federal 56-3 well cannot produce oil on a sustained basis, whatever the rate.^{13/}

The more important point is that the BFO decided to delay its paying quantity determination until after the well had operated for a period of time, so as to eliminate doubt about the well test. Thus, the conclusion that the well was not capable of producing in paying quantities was not alone predicated on the admittedly inconclusive well test results, but on the results of the nine inspections that ensued between November 20, 2002, and February 6, 2003:

On 11-20-02 the BLM inspector found the well down and no production in the tank. On 11-21-02 the BLM inspector found the pumping unit to be going up and down but no measurable fluids in the tank. On 12-12-02 the BLM inspector returned to measure the cumulative produced fluids. He found the unit down again and a contract pumper working on the pumping unit. On 12-19-02 the BLM inspector witnessed the pumping unit going up and down but, once again, but [sic] no measurable fluids were found in the tank. On 01-13-03 the BLM inspector witnessed a "pulling unit" on the well for the purpose of treating it with a de-waxing chemical. On 01-14-03 the BLM inspector and the Supervisory PET [Petroleum Engineering Technician] gauged the tank and found approximately 10.5" of water and 1" of oil, which equates to less than 5 barrels of oil over a 3 month period or 0.05 barrels of oil per day. At this rate, the well is obviously incapable of producing in paying quantities.

On 01-23-03 the BLM inspector returned to find the pumping unit belts thrown off and the well down. On 01-30-03 the BLM inspector

^{13/} On the test date, the well "pumper expressed concern that the well 'pumps off easily.'" (BFO's Apr. 1, 2003, Memorandum to the Deputy State Director at 1.)

witnessed the replacement of the belts and start-up of the unit only to discover a hole in the tank at drain valve #2 on the south end of the tank. The well was then shut-in. On 02-06-03 the BLM inspector witnessed the contract pumper attempt to patch the hole but the patch failed. The well was left down.

(BFO's Apr. 1, 2003, Memorandum to the Deputy State Director at 1-2.) These statements are confirmed by the inspection reports in the record, and tend to be supported by photographs of the well.

In response to the specifics of those inspections, Two Bay argues that the BLM inspector incorrectly gauged the tank in the November and December inspections, but provides no basis for that assertion. Any questions suggested or raised by the findings in the inspection reports presumably would be answerable by reference to production, royalty, or operational reports, or by the separate flow metering on which permission to commingle production from Two Bay's two leases was conditioned. Again, however, according to MMS' 2003 Report, the last production reported by Two Bay was for December 2000, when the well produced 7 days, and produced 53 barrels of oil, some gas, and 64 barrels of water. If Two Bay possesses any actual or more reliable production or operations data to the contrary, it has not offered or provided it in this proceeding or satisfactorily explained its failure to report any such information as required by applicable statute or regulations.^{14/} Nor has it produced actual sales and cost data that would demonstrate that any such production constitutes paying quantities. We find that the record more than adequately supports BLM's findings that production ceased and that lease CACA 25325 does not contain a well capable of producing oil or gas in paying quantities.

[2] As discussed, the record provided by BLM does not establish when the Ptasynski-Federal 56-3 well produced oil, the value of that production, or the associated costs and expenses thereof, because that information was not submitted by Two Bay to BLM or MMS as required by implementing regulations, or, apparently, to CDOGGR. Nor is the information submitted by Two Bay, unsupported by actual production, operations, or metering data it has or should have in its possession, sufficient to create an issue of fact regarding whether the well is capable of producing in paying quantities. In the absence of reliable evidence relative to actual production volumes, Two Bay's motion for a hearing is denied, as there is no material issue of

^{14/} BLM's efforts to induce the company to comply with applicable regulations governing well status and production reporting are well-documented in the record. See, e.g., letters from BLM to Hanson dated Jan. 28, 2002; Jan. 16, 2002; Sept. 20, 2001; Aug. 23, 2001; Aug. 2, 2001; Apr. 27, 2001.

fact that cannot be resolved on the record before us. See International Metals & Petroleum Corp., 158 IBLA at 24; Great Plains Petroleum, Inc., 117 IBLA at 132; C & K Petroleum, Inc., 70 IBLA at 356.

[3] What remains is the matter of when the lease terminated. BLM held that the lease terminated effective October 11, 2002, which was calculated on the basis of 60 days from receipt of the July 2002 notice. However, the MLA specifies that a lease continues after its primary term only so long as oil and gas is produced in paying quantities. 30 U.S.C. § 226(e) (2000). Here, there is no evidence that reworking or drilling operations were initiated within 60 days of ceasing production sometime in December 2000, and thus the further requirement of reasonable diligence in conducting any such activity in this case does not arise. As the Deputy Solicitor stated in Steelco, by discontinuing servicing operations and not conducting any other operations after production ceased,

appellant lost the opportunity, under the first provision of subsection (1) of the act of July 29, to continue for the period of nonproduction attempts to restore production, and so to prevent termination of the lease. Accordingly, the lease was not extended by reason of the first provision * * * and the Department cannot grant the appellant's request that the lease be reinstated now, long after the expiration of the period allowed by the first provision * * * and allow another 60-day period of time for reworking and drilling operations * * *.

64 I.D. at 219 (emphasis added).

It is equally clear that Two Bay failed to restore production within 60 days of cessation and thereafter maintain it, because there is no record of oil production in 2001 or 2002. Accordingly, Two Bay cannot invoke the first exception provided in § 226(i).

No suspension was requested or granted in the 60-day period following cessation of production in December 2000.

Assuming the availability of the third exception by reason of some oil or gas production in the latter part of 2002, notwithstanding the lack of records demonstrating the facts and circumstances of such production, for the reasons discussed above, BLM properly determined that the lease did not contain a well capable of producing oil or gas in paying quantities. Moreover, the third exception to lease termination upon cessation of production “covers only a situation where, at the

time when production ceases, there is on the lease a well capable of production.” Steelco, 64 I.D. at 220 (emphasis added). ^{15/}

When none of the circumstances that could save a lease from termination materialized in the 60 days following the cessation of production, the lease terminated by operation of law as of the date production ceased, not 60 days after Two Bay received the notice BLM has chosen to give lessees in these circumstances pursuant to 43 CFR 3107.2-2. See 30 U.S.C. § 226(i) (2000); see also Samuel Gary, Jr. & Associates, Inc., 125 IBLA 223, 228 (1993). BLM’s notice to a lessee directing it to demonstrate the producing status of a well is to be distinguished from the statutorily prescribed point when a lease terminates after it has been determined that production failed because there was no well on the leasehold capable of producing oil or gas in paying quantities. The lease therefore terminated in December 2000. The decision is modified accordingly.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the May 5, 2003, decision by the California State Office is modified to reflect that lease CACA 25325 terminated by operation of law in December 2000. The decision is affirmed as modified.

T. Britt Price
Administrative Judge

^{15/} As was noted in Steelco, the third provision of § 226(i) “was intended to cover situations where a well capable of producing oil or gas is shut off for various reasons, such as lack of pipelines, roads, or markets for oil or gas, in which event the provision would continue the lease for at least 60 days after notice to a lessee that he must place the well on a producing status (S. Rept. 1609, 83d Cong., 2d sess. (1954), pp. 3, 6). In the instant case, the well was shut down because production failed.” 64 I.D. at 219 n.3 (emphasis added). See also the Report of the Senate Committee on Interior and Insular Affairs, S. Rep. No. 2380 at 2-3, and the House Committee Report, H.R. Rep. 2238 at 2, both of which quoted the analysis prepared by BLM at the request of the Senate Committee. Given the kinds of reasons the third provision of § 226(i) was expressly intended to address, the Deputy Solicitor observed that there is no provision for allowing a lessee “60 days in which to ascertain whether he has a well capable of production.” 64 I.D. at 220 (emphasis added). For purposes of the third provision, it is presumed that the well is, but for the existence of the circumstances described, presently ready to produce.

I concur:

Will A. Irwin
Administrative Judge