



PETRO MEX, LLC

180 IBLA 94

Decided September 27, 2010



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

PETRO MEX, LLC

IBLA 2010-1, 2010-2

Decided September 27, 2010

Appeal from a decision by the Colorado State Office, Bureau of Land Management, terminating two oil and gas leases. COC 088586; COC 0124705.

Reversed and remanded.

1. Oil and Gas Leases: Termination--Oil and Gas Leases: Well Capable of Production

Where BLM orders the immediate shutting in of wells due to violations that could, if operations continued, result in immediate, substantial, and adverse impacts on public health, safety, or the environment under 43 C.F.R. § 3163.1(a), such order may remain in effect until the violations upon which it was based are corrected and resolved.

2. Oil and Gas Leases: Terminations--Oil and Gas Leases: Well Capable of Production

An oil and gas lease in its extended term by reason of production that embraces a well capable of producing oil or gas in paying quantities expires by operation of law when production ceases if the lessee fails to place that well in a producing status within a reasonable period of time after receiving notice that it must do so. Termination of the lease by operation of law is properly distinguished from cancellation of an oil or gas lease for noncompliance with lease terms, regulations, statutes, or any notice or order of the authorized officer. A lease has not terminated by operation of law when it embraces a producing well that is ordered shut-in by the authorized officer and the lessee corrects the violation giving rise to the shut-in order. Failure of the lessee to comply with the

lease terms, regulations, statutes, or a notice or order of the authorized officer may result in cancellation of a lease in accordance with the procedures specified in 43 C.F.R. §§ 3173.1 and 3108.3.

APPEARANCES: Douglas J. Reynolds, Esq., Durango, Colorado, for Petro Mex, LLC; Philip C. Lowe, Esq., Office of the Regional Solicitor, U.S. Department of the Interior, Lakewood, Colorado, for the Bureau of Land Management.

#### OPINION BY ADMINISTRATIVE JUDGE JACKSON

Petro Mex, LLC (Petro Mex), appeals from August 26, 2009, decisions by the Colorado State Office, Bureau of Land Management (BLM) terminating Federal oil and gas leases COC 088586 (IBLA 2010-1) and COC 0124705 (IBLA 2010-2). BLM terminated these leases based on determinations made by the Grand Junction Field Office (GJFO) that they were no longer capable of producing oil or gas in paying quantities. For the reasons discussed below, we reverse and remand those decisions.<sup>1</sup>

#### BACKGROUND

Federal oil and gas lease COC 0124705 is in Garfield County, Colorado, and has five wells, including Federal 15-9 and Federal 5 (sometimes also referred to as Government 5); its primary lease term was earlier extended by production. Statement of Reasons (SOR), Ex. J.<sup>2</sup> Following a routine inspection on April 25, 2008, GJFO issued a Notice of Incidents of Noncompliance (NOIC) for a “major” violation<sup>3</sup> at Federal 15-9 (EF8017, an unsealed sales valve), and other NOICs for three minor violations at that well, and a minor violation at Government 5. Ex. A.<sup>4</sup> A

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<sup>1</sup> IBLA 2010-1 and IBLA 2010-2 are hereby consolidated because they involve similar circumstances, nearly identical decisions, and the same issues.

<sup>2</sup> For ease, we refer to the exhibits included with the SOR as “Ex. X” whenever possible and to other, identified documents in the administrative record as necessary.

<sup>3</sup> BLM rules for onshore oil and gas operations (43 C.F.R. Part 3160) specify that: “*Major violation* means noncompliance that causes or threatens immediate, substantial, and adverse impacts on public health and safety, the environment, production accountability, or royalty income.” 43 C.F.R. § 3160.0-5 (Definitions). If such impacts could occur if operations continue, BLM may take immediate action to halt those operations under 43 C.F.R. § 3163.1(a)(3). *See* discussion *infra*.

<sup>4</sup> The minor violations at Federal 15-9 were for an “unnumbered” tank (EF8018), inadequate “freeboard” for storing produced water in a tank (EF8020), and a failure  
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follow-up inspection was conducted on May 27, but no action to correct the above-violations had yet been taken. Ex. E. In addition, the inspector identified a “major” violation at Federal (Government) 5, for which an NOIC issued (EF8025, “an underground leak . . . marked by a flag”). Exs. A, E. GJFO then ordered an immediate shut-in of all wells on the lease, “until all leaks are corrected and all compliance issues are resolved.” Ex. D. Federal oil and gas lease COC 088586 is in Mesa County and has two wells, including Federal 2. Following a routine inspection on May 27, 2008, GJFO issued an NOIC for a “major” violation at Federal 2 (EF8027, a “leaking” scrubber hose) and ordered Petro Mex to shut-in all wells on that lease “until all leaks are corrected and all compliance issues are resolved.” Exs. A,<sup>5</sup> D.

GJFO records show both of the major violations on COC 0124705 were corrected on or before June 3, 2008, the minor violations were corrected later that month, and the leaking scrubber hose at Federal 2 (COC 088586) may also have been corrected during June 2008.<sup>6</sup> Ex. E. After informing GJFO that all corrective actions had been effected, Petro Mex resumed production under both leases in August, mistakenly believing it was permitted to do so. Jesus Villalobos (Petro Mex President) Aff. ¶¶ 3-4. When informed by GJFO that its May 2008 shut-in orders would remain in place until lifted, Petro Mex again shut-in all wells on both leases in early October 2008. *Id.* Villalobos testifies that Petro Mex repeatedly inquired of GJFO as to what “to do to have that order lifted” but received only “vague, inconsistent and uncertain instructions or directions regarding what Petro Mex need[ed] to do to have it lifted” until he participated in a call with GJFO on May 5, 2009. Villalobos Aff. ¶¶ 5-6; *see* discussion, *infra*.

GJFO reinspected the leases on March 30, 2009, identified no unresolved or new compliance issues, and observed that a compressor that was earlier placed on the Federal 5 pad had been removed. *See* Ex. G.<sup>7</sup> By correspondence dated April 1,

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<sup>4</sup> (...continued)

to submit a “tank gauging report and strapping table” (EF8021); the minor violation at Government 5 was for “a leaking bull plug”(EF8016). Ex. A.

<sup>5</sup> A leaking scrubber hose at Federal 2 was identified as a “minor” violation on Nov. 14, 2007 (EF8008), but it is unclear whether that or another hose was leaking and identified as a “major” violation on May 27, 2008 (EF8027).

<sup>6</sup> Villalobos testifies that Petro Mex immediately repaired this leak and so informed GJFO, *see* Villalobos Aff. ¶ 3; no new or continuing scrubber leaks were identified during any subsequent inspections of Federal 2 by GJFO.

<sup>7</sup> The inspector also noted that ETC/Canyon Gas had “shut in the field at the off lease measure point,” but the relationship of ETC/Canyon Gas to Petro Mex, as well  
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2009, BLM informed Petro Mex that an inspector found a field compressor had been removed, “which eliminates the possibility of production from the wells,” and that GJFO had determined these leases were not “capable of production in paying quantities” under 43 C.F.R. § 3107.2-2 and would terminate unless Petro Mex commenced drilling/reworking operations, restored production, or submitted a “justification” that they are “capable of producing in paying quantities.” Exs. I, J.

Petro Mex responded to GJFO during a call on May 5, 2009, by assuring it that these leases and their wells are “capable of production,” questioning GJFO’s “conclusion that the wells were not capable of production,” and making clear it “intended to return the wells to production as soon as the shut-in order was lifted.” Villalobos Aff. ¶ 6. BLM then informed Petro Mex that the shut-in orders would not be lifted unless and until its reclamation bond was increased and certain issues with the Minerals Management Service (MMS), U.S. Department of the Interior, were resolved.<sup>8</sup> *Id.* Petro Mex followed up that conversation with a May 20 letter informing GJFO that its oil field service contractor was in bankruptcy, it had “lost” three compressors and other equipment from the leases,<sup>9</sup> and disagreed with the MMS penalty notice because it had paid the royalties then due. Ex. L, Encl. 1.

Petro Mex met with GJFO on May 27, 2009, and explained that production “did not depend on having compression onsite,” but that if such later proved necessary, “compressors would be reinstalled on the wells once the shut-in order was lifted and the wells were permitted to return to production.” Villalobos Aff. ¶ 7. It then offered to flow test the wells and either vent the gas to the atmosphere or set a compressor and sell the gas, but GJFO found neither to be acceptable. Petro Mex

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<sup>7</sup> (...continued)

as why and which (if any) leases or wells were then shut-in, is unexplained by the parties or the record. *See* Ex. G. We consider the shutting-in of “the field” by ETC/Canyon Gas no further.

<sup>8</sup> The record shows Petro Mex was directed to submit an increased, state-wide reclamation bond by late September (*i.e.*, within 30 days of its receiving GJFO correspondence dated Aug. 25, 2008), and received an MMS Notice of Civil Penalty dated Oct. 22, 2008, alleging that Petro Mex knowingly failed to pay royalties on its sale of gas from the leases between August 2007 and May 2008 and requiring it to either pay a penalty of \$149,131 or contest that penalty by late November (*i.e.*, within 30 days of its receiving that Notice of Civil Penalty). Ex. L, Encls. 2, 5.

<sup>9</sup> The cause of this “loss” is unexplained by the parties or the record, but it appears not to have been the result of theft. *See* Ex. L at 2 (recounting contacts with the Sheriff’s offices for Mesa and Garfield Counties).

letter dated July 2, 2009. Petro Mex again stated it intended “to return the wells to production as soon as the shut-in order was lifted.” Villalobos Aff. ¶ 7.

By letter dated June 16, 2009, GJFO disagreed with Petro Mex’s contention that these leases were capable of production because “without compression the wells are not able to produce.” Ex. L (June 2009 Order) at 2. It added that while minimum royalties may be current, MMS believed Petro Mex’s royalties “on production are not.” *Id.* at 2-3. GJFO then ordered Petro Mex to respond “to our August 25, 2008 letter concerning our requirement to have Petro Mex increase their operating bond,” to remain shut in until it satisfied GJFO’s request for an increased bond and paid all its outstanding fines to MMS, and “to explain the paying status for lease COC-0124705A and COC-088586 . . . as outlined in our April 1, 2009 letters.” *Id.* at 3. GJFO added that a failure “to provide adequate justification [for its current paying status] will result in the termination of the leases.” *Id.*

Petro Mex timely responded to the GJFO orders with a handwritten letter stating the wells “are still shut in” and that it was “working” on the bond and “investigating” royalty payments to ensure they had been (or would be) paid. Petro Mex letter dated July 2, 2009. Petro Mex also reminded GJFO that during their May 27 meeting, it had offered to “flow test the wells, and vent the gas[] or set a new compressor[] to go to sales,” but that neither was then acceptable to GJFO. *Id.*

GJFO recommended that both leases terminate due to a lack of production by memoranda to the State Director on July 21, 2009, representing that it had yet to receive any “verbal or written intent to reestablish production on the lease[s].” AR; see Ex. M. By decisions dated August 26, 2009, the State Office terminated the leases because GJFO determined they were “no longer capable of producing oil or gas in paying quantities after October 1, 2008,” and “no evidence of new production has been received.” Ex. N (BLM Decisions). These appeals followed.

#### DISCUSSION

An oil or gas lease issued pursuant to the Mineral Leasing Act of 1920 (MLA), 30 U.S.C. §§ 181-287 (2006), “shall continue so long after its primary term as oil or gas is producing in paying quantities,” 30 U.S.C. § 226(e) (2006). Although the general rule is that a lease in its extended term terminates automatically when production ceases, the MLA specifies three discrete, sometimes overlapping exceptions to lease termination: (1) where the lessee begins reworking or drilling a well within 60 days after production ceased; (2) where BLM has ordered a suspension of lease operations or production; and (3) where the lessee places a well capable of producing in paying quantities in producing status within a reasonable

time after receiving notice from BLM. 30 U.S.C. § 226(i) (2006);<sup>10</sup> *see, e.g., Two Bay Petroleum, Inc.*, 166 IBLA 329 (2005), *aff'd*, *Two Bay Petroleum v. U.S. Dept. of the Interior*, No 2:05-CV-2335, 2007 WL 2028192 (E.D. Calif. July 10, 2007).

The Board provided a comprehensive review of 30 U.S.C. § 226(i) and our precedent in *Coronado Oil Co.*, 164 IBLA 309 (2005), *aff'd*, No. 05-CO-11J (D. Wyo. Aug. 23, 2006), *appeal dismissed*, No. 06-8083 (10th Cir. Sept. 14, 2007):

Both [30 U.S.C. § 226(i)] and the case law differentiate between a lease without a well capable of production in paying quantities and one containing a well capable of production in paying quantities. When the term of an oil and gas lease has been extended by production and there is *no* well capable of production in paying quantities when production ceases, the lessee has 60 days to commence reworking or drilling operations and must continue the reworking or drilling operations with reasonable diligence to avoid lease termination; if such operations are not timely initiated and diligently pursued, the lease terminates automatically upon cessation of production. *Coronado Oil Co.*, 164 IBLA 107, 115 (2004) [*aff'd in part, rev's in part and remanded*, 415 F. Supp. 2d 1339 (D. Wyo. 2006)]. Notice is not required in this situation. *Id.*; *see Stove Creek Oil Inc.*, 162 IBLA 97, 104-105 (2004),

<sup>10</sup> As amended, 30 U.S.C. § 226(i), states:

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 lease premises without permission granted by the Secretary under the provisions of this chapter.

This subsection was given its current form by the Act of July 29, 1954, Pub. L. No. 555, 68 Stat. 583 (1954 Amendments), which amended MLA section 17(f) that had been earlier codified as the third paragraph of 43 U.S.C. § 226 (1952).

citing *Merit Productions*, 144 IBLA 156, 160-61 (1998) (Burski, A.J., concurring); *International Metals & Petroleum Corp.*, 158 IBLA 15, 20-21, n.6 (2002). When the term of an oil and gas lease has been extended by production and the lease *does* contain a well capable of production in paying quantities, however, BLM must notify the lessee and allow a reasonable time of at least 60 days from receipt of the notice to place the well into production to avoid having BLM declare the lease expired by operation of law for lack of production. *International Metals & Petroleum Corp.*, 158 IBLA at 21; *Merit Productions*, 144 IBLA at 161, 163-64; *Great Western Petroleum & Refining Co.*, 124 IBLA [16,] 24 [(1992)]. The different treatment afforded leases with wells capable of production in paying quantities reflects Congress' concern both that a lease in its secondary term not be automatically terminated for lack of production where a lessee has in good faith expended money to develop a well capable of production, but where production has been deferred because of lack of pipelines, roads, or markets for the gas, and that such lessees are afforded a reasonable period in which to place the well in producing status. See *American Resources Management Corp.*, 40 IBLA 195, 200-201 (1979), citing H.R. Rep. No. 2238, 83d Cong., 2nd Sess. (1954), *reprinted in* 1954 U.S.C.C.A.N. 2695, at 2700.<sup>[11]</sup> This is the notice provided in the regulations at 43 C.F.R. 3107.2-3. The Department has recognized that this notice provision is applicable to a well capable of production in paying quantities that was shut in for reasons such as lack of a pipeline or market for the oil or gas. *Robert W. Willingham*, 164 IBLA 64, 68 (2004); *Merit Productions*, 144 IBLA at 161 n.5; *Steelco Drilling Corp.*, 64 I.D. 214, 219 n.3 (1957).

In defining a well capable of production in paying quantities, the Department has required evidence of the present capability of the well to produce:

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<sup>11</sup> As quoted in *American Resources Management Corp.*, 40 IBLA at 201, the legislative history of the 1954 Amendments to the MLA states:

This amendment is needed because leases in their secondary term must be terminated if there is no production. This works inequitably in the case of lessees who in good faith have expended money to develop a well capable of production, when production must be suspended because of lack of pipelines, roads, or markets for the oil and gas. It seems only fair to give such lessees a reasonable period within which to place the well on a producing status.

The phrase “well capable of producing” means a “well which is actually in a condition to produce at the particular time in question.” *United Manufacturing Co.*, 65 I.D. 206 (1958). In the absence of perforation of the well casing, a well has been held to be physically incapable of production and, hence, not capable of production in paying quantities. *Arlyne Lansdale*, 16 IBLA 42 (1974); *United Manufacturing Co.*, *supra*. A well has been held not capable of production in paying quantities where substantial pumping of water from the well is required before oil could be produced in paying quantities. *The Polumbus Corp.*, 22 IBLA 270 (1975). Further, a well has been held not capable of production in paying quantities where sandfracing operations were unsuccessful and the record indicated further efforts were needed to restore production, including hot oil treatment and swabbing the well. *Steelco Drilling Corp.*, 64 I.D. 214 (1957).

*Amoco Production Co.*, 101 IBLA 215, 221 (1988) (footnotes omitted). In addition, in order to be considered capable of production in paying quantities, a well must be “physically capable of producing a sufficient quantity of oil and/or gas to yield a reasonable profit after the payment of all the day-to-day costs incurred after the initial drilling and equipping of the well, including the costs of operating the well, rendering the oil or gas marketable, and transporting and marketing that product.” *International Metals & Petroleum Corp.*, 158 IBLA at 22; *see Stove Creek Oil Inc.*, 162 IBLA at 105-106; *Amoco Production Co.*, 101 IBLA at 221-22. Actual production is not required to qualify a well as capable of production in paying quantities as long as production can clearly be obtained but has not been because of a lack of pipelines, roads, or markets for the gas. *John G. Swanson*, 66 IBLA 200, 202 (1982); *American Resources Management Corp.*, 40 IBLA at 201; *see also C & K Petroleum Inc.*, 70 IBLA 354, 356 (1983); *Burton/Hawks, Inc.*, 47 IBLA 125, 127 (1980).

164 IBLA at 322-24 (footnotes omitted). Applying that law to this case, we reverse BLM’s decisions terminating these leases.

Petro Mex challenges the decisions on appeal as violative of its rights under the MLA’s exceptions to lease termination. It claims GJFO erroneously determined that the wells on these leases were not capable of producing in paying quantities and compounded its error by failing to afford Petro Mex an opportunity to be heard

before an Administrative Law Judge on that issue. Petro Mex also contends it was precluded by GJFO's shut-in orders from restoring production under the MLA's third exception. Petro Mex raises additional claims under the MLA's other exceptions to automatic lease termination, but in light of our resolution of this case, we need not address them here.

Petro Mex contends GJFO erred in determining that these leases (and their wells) were incapable of producing gas in paying quantities. SOR at 6, 9. BLM responds by asserting that Petro Mex failed to provide "objective evidence that the wells could produce gas in paying quantities" and failed to request State Director Review of the June 2009 Order. Answer at 7. It is uncontroverted that wells on the leases at issue were producing natural gas in paying quantities when they were again shut-in to comply with the GJFO orders in early October. The only stated basis for GJFO determining these leases were not capable of producing gas in paying quantities under 43 C.F.R. § 3107.2-2 was that Petro Mex lacked field compressors necessary to deliver that gas to purchasers. See June 2009 Order at 2; Ex. L, Encls. 3, 4. Although the parties disagree on whether these wells can produce without compression, it is undisputed that if GJFO's shut-in orders were lifted, Petro Mex could install field compressors and return them to producing status shortly thereafter.

There is no record evidence that the wells at issue were not "capable of producing oil or gas in paying quantities" under the MLA's third exception,<sup>12</sup> only that their production could not be sold without compression. The legislative history makes clear that "actual production" is not necessary for this exception to apply and that it is sufficient if a well has an "established physical capability . . . to produce oil or gas in paying quantities." *American Resources Management Corp.*, 40 IBLA at 200; see discussion, *supra*. The adequacy of or necessity for surface facilities is largely (if not totally) irrelevant in determining whether a well is capable of producing oil or gas in paying quantities. See 40 IBLA at 201. Moreover, we are unable to discern a legal distinction between a compressor used to transmit gas by pipeline and a gas transmission pipeline itself, as recognized in that legislative history. See n.11, *supra*; see also *Robert W. Willingham*, 164 IBLA at 68 (lease termination set aside because a

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<sup>12</sup> BLM claims that Petro Mex's failure to test these wells constitutes a failure to prove they were capable of producing gas in paying quantities. Answer at 6-7. As discussed, Petro Mex offered to test the wells by either venting the gas to the atmosphere or placing a compressor and selling that gas, but GJFO found both were then unacceptable. See discussion, *supra*; see also *Robert W. Willingham*, 164 IBLA 64, 68-69 (2004) (refusing to allow the testing of a shut-in well precludes lease termination until its capability to produce is determined). We reject BLM's claim as a classic "Catch 22": the wells must be tested to show they are capable of producing gas, but GJFO will not allow Petro Mex to operate and test those wells.

well was shut-in due to the purchaser's refusal to purchase its gas). We therefore conclude that GJFO erred in determining that these leases (and their wells) were not capable of producing gas in paying quantities under 43 C.F.R. § 3107.2-2 because they currently lack field compressors and an ability to compress the gas produced for transport by pipeline. To the extent those determinations were affirmed by BLM's decision, they are reversed and that decision is modified. *See Coronado Oil Co.*, 164 IBLA at 326.

The MLA states that no lease "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." 43 U.S.C. § 226(i) (2006). Since both COC 088586 and COC 0124705 have wells capable of producing in paying quantities, Petro Mex could avoid lease termination under this exception if it could place those wells in producing status within a reasonable time after receiving notice from BLM under 43 C.F.R. § 3107.2-3. *See* discussion, *supra*. Petro Mex repeatedly informed GJFO that it would restore production from these leases if the May 2008 shut-in orders were lifted, but GJFO refused to lift those orders. Thus, the issue here presented is what effect, if any, those shut-in orders have on Petro Mex's rights and obligation, under and pursuant to the MLA's third exception to lease termination.

GJFO's shut-in orders were issued pursuant to 43 C.F.R. § 3163.1(a)(3), which directs that immediate action be taken "where continued operations could result in immediate, substantial, and adverse impacts on public health and safety, the environment, production accountability, or royalty income." Petro Mex did not challenge GJFO's May 2008 shut-in orders or contest the "major" violations upon which it was based. Instead, it corrected those and all other violations in the NOICs it received and so informed GJFO. With the possible exception of a leak on the scrubber at Federal 2 (COC 088586), *see* n.6, *supra*, the record shows that all these violations were resolved to GJFO's satisfaction when Petro Mex resumed production from these leases in early August 2008. Rather than allow production to continue, GJFO directed Petro Mex to shut-in the wells on these leases because its orders had not and would not be lifted until "all compliance issues are resolved." Exs. D, E; *see* Villalobos Aff. ¶¶ 2-6; Ex. L, Encl. 2.<sup>13</sup>

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<sup>13</sup> As made clear to Petro Mex some 7 month later, those compliance issues were its failure to submit an increased, state-wide reclamation bond by the end of September and either pay or contest the MMS civil penalty by the end of November 2008. June 2009 Order at 2-3; *see* n.8, *supra*. This noncompliance by Petro Mex may well be significant, but neither of these violations could justify the taking of immediate action  
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[1] Petro Mex repeatedly represented that it would and could restore production if the May 2008 shut-in orders were lifted; GJFO refused to lift its orders, which were still in place when BLM terminated these leases on August 26, 2009. Although they state that all wells would remain shut-in until “all compliance issues are resolved,” we interpret this language in the context of the facts presented as referring to the violations identified by GJFO in its NOICs to Petro Mex. Ex. D; see n.4, *supra*. Moreover, we do not believe an order to avoid “immediate, substantial, and adverse impacts on public health and safety [or] the environment” under 43 C.F.R. § 3163.1(a)(3) can be continued simply because a minor violation or other compliance concern subsequently arises or comes to light. Under these circumstances, we find GJFO erred by refusing to lift its shut-in orders and then ordering: “All production is to remain shut in on leases COC 124705A and COC 088586 until Petro Mex satisfies the increased bond request and all fines are paid to Mineral[s] Management Service.” June 2009 Order at 3.

GJFO erroneously refused to lift and required continuing compliance with its May 2008 shut-in orders. The record shows Petro Mex could restore its wells to producing status if those orders were lifted. Until GJFO lifts those orders and gives notice to Petro Mex under 43 C.F.R. § 3107.2-3, BLM cannot terminate these leases for nonproduction. If it intends to pursue lease termination under 30 U.S.C. § 226(i), BLM must allow Petro Mex a reasonable time in which to place its wells in a producing status after such notice is given. *Cf., Coronado Oil Co.*, 164 IBLA at 326. Simply stated, there can be no termination of these leases by operation of law under the circumstances of this case.

[2] In *Great Western Petroleum and Refining Co. (Great Western)*, 124 IBLA 16 (1992), the Board distinguished between cancelling an oil and gas lease for noncompliance and terminating a lease by operation of law under the MLA for nonproduction. The Board there stated:

Cancellation of a lease may indeed require resort to suit in the U.S. District Court where the leased lands are known to contain valuable deposits of oil or gas. 30 U.S.C. §§ 188(a), (b) (1988). Termination of a lease by operation of law, on the other hand, occurs automatically

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<sup>13</sup> (...continued)

under 43 C.F.R. § 3163.1(a)(3). Nor could it result in lease cancellation by the Department under the MLA, which requires judicial action before a lease with wells capable of producing in paying quantities can be cancelled for noncompliance because both leases have wells capable of producing gas in paying quantities. 30 U.S.C. § 188(a), (b) (2006); 43 C.F.R. § 3108.3 (Cancellation); see *Oil Resources, Inc.*, 28 IBLA 394, 405, 84 I.D. 91, 96 (1977).

under the terms of the relevant statute in certain circumstances where the lessee fails to take the required action. *See Oil Resources, Inc.*, [28 IBLA at 405, 84 I.D. at 96]. An oil and gas lease in its extended term by reason of production terminates by operation of law when paying production ceases on the lease subject only to three exceptions provided by statute. *John S. Pehar*, 41 IBLA 191 (1979); *Universal Resources Corporation*, 31 IBLA 61, 65 (1977).

*Great Western*, 124 IBLA at 23-24. Great Western asserted that its leases contained wells capable of producing oil or gas in paying quantities and that BLM actions had been consistent with such a finding. Accordingly, we there stated “the leases shall not expire because of the cessation of production unless the lessee fails to obtain production after being given 60 days notice to produce.” *Id.* at 24.

In the instant case, BLM has lost sight of the distinction between cancelling a lease with a well capable of producing oil and gas lease in paying quantities for noncompliance and terminating such a lease for nonproduction. The GJFO appears to have acted on the assumption that the failure to lift its shut-in orders due to new compliance concerns necessarily results in a cessation of production that renders these leases subject to termination under the MLA. As we have found, the subject leases embrace wells that were producing at the time BLM issued the shut-in orders in May, as well as when Petro Mex mistakenly resumed operations in August 2008, and GJFO refused to lift its shut-in orders because Petro Mex failed to comply with the authorized officer’s order to increase its bond (and pay a civil penalty to MMS). Not being allowed to resume production from these leases because of BLM’s shut-in orders is not synonymous with their not having wells capable of production. Petro Mex’s failure to comply with the authorized officer’s order renders the leases subject to cancellation through judicial proceedings, provided the procedures in 43 C.F.R. §§ 3108.3 and 3163.1 are followed.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the August 26, 2009, decisions by the Colorado State Office to terminate Federal oil and gas leases COC 088586 and COC 0124705 are reversed and remanded for further action consistent with this decision.

\_\_\_\_\_/s/  
James K. Jackson  
Administrative Judge

I concur:

\_\_\_\_\_/s/  
James F. Roberts  
Administrative Judge