



YATES PETROLEUM CORPORATION

188 IBLA 321

Decided September 22, 2016



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

703-235-3750

703-235-8349 (fax)

YATES PETROLEUM CORPORATION

IBLA 2014-149

Decided September 22, 2016

Appeal from a decision on State Director Review that upheld a notice of incidents of noncompliance for failing to seek and obtain BLM approval for the temporary abandonment of an oil and gas well. SDR 2014-01.

Set Aside.

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

For an oil and gas lease to be held beyond its primary term, it must have a well producing or capable of producing oil and/or gas in paying quantities, but it need not be in actual production and may be shut-in due to a lack of pipelines, roads, or markets for gas so long as it is in a condition to produce, both physically and mechanically, oil and/or gas of sufficient quantity and quality to cover the cost of operating the well and marketing its products. If a lease no longer has a well producing or capable of producing in paying quantities, the lease will terminate after notice and a reasonable opportunity to return the well to a producing status.

2. Oil and Gas Leases: Termination;
Oil and Gas Leases: Well Capable of Production

BLM reviews shut-in wells every 5 years to ensure that if they are no longer capable of producing oil or gas in paying quantities, the well will be properly plugged and abandoned. When BLM finds a shut-in well is no longer capable of producing oil or gas in paying quantities, it will issue a 60-day Demand Letter if it is the only well on a lease in its extended term or order the operator to demonstrate that the well is capable of producing oil or gas in paying quantities or has a future beneficial use if the well is on a lease still in its primary term.

3. Administrative Procedure: Burden of Proof;
Administrative Review: State Director Review

BLM's decision must have a rational basis that is stated in the decision and supported by facts of record demonstrating it is not arbitrary, capricious, or an abuse of discretion. An appellant challenging such a decision has the burden to demonstrate, by a preponderance of the evidence, that BLM committed a material error in its factual analysis or that its decision is not supported by a record showing it gave due consideration to all relevant factors and acted on the basis of a rational connection between the facts found and the choice made.

APPEARANCES: Mary Lynn Bogle, Esq., Hinkle, Hensley, Shanor & Martin, LLP, Artesia, New Mexico, for Yates Petroleum Corporation; Michael C. Williams, Esq., U.S. Department of the Interior, Office of the Solicitor, Santa Fe, New Mexico, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE JACKSON

Yates Petroleum Corporation (Yates) appeals from a February 20, 2014, decision on State Director Review (SDR) by the Deputy State Director (DSD), New Mexico State Office, Bureau of Land Management (BLM), which upheld a notice of incident of noncompliance (INC) issued by the Carlsbad Field Office (CFO).¹ The INC was issued because Yates had not obtained BLM approval to temporarily abandon the Tractor BPC Federal 1H (Tractor) well.

If a well is capable of producing oil and/or gas in paying quantities, it is not temporarily abandoned and can be shut-in-waiting-on-pipeline. The INC stated that the Tractor well was shut-in or temporarily abandoned and found a violation of 43 C.F.R. § 3162.3-4(c), which provides that “[n]o well may be temporarily abandoned for more than 30 days without the prior approval of the authorized officer.” The DSD upheld the INC, concluding that when Yates removed a submersible pump from the well, its status changed from shut-in to temporarily abandoned, which resulted in a violation of 43 C.F.R. § 3162.3-4(c). The DSD necessarily found the Tractor well was not physically or mechanically capable of producing in paying quantities without that pump, since a well capable of producing

¹ Yates also petitioned for a stay of the SDR decision, which the Board granted by Order dated June 30, 2014.

in paying quantities is not abandoned.² Because we conclude the record does not support that finding, however, we set aside the DSD's decision.³

Background

Yates completed the Tractor well on April 30, 2012,⁴ which CFO determined was “capable of producing in paying quantities” on November 1, 2012, noting that it was “shut in pending construction of a gas sales line, water disposal line, and electric line.”⁵ In an INC dated September 23, 2013, CFO stated that “the [Tractor] well is shut-in (SI) or temporarily abandoned (TA),” found a violation of 43 C.F.R. § 3162.3-4(c), and directed Yates to return the well to production or submit a notice of intent to plug and abandon by October 23, 2013.⁶ Mike Hill, Yates’ Area Engineer, responded by explaining that these actions were neither necessary nor appropriate because its data showed “this well is capable of economic production,” and that the Tractor well was still “shut in-waiting on pipeline.”⁷ Hill added:

We [are] currently waiting on a power line ROW filed in August of 2011 to be approved by the BLM. The equipment has been removed from this location to conserve resources as we currently do not have electricity available. When the ROW issues are resolved and we have infrastructure in place[,] the well will be put into production. We are paying shut in royalties on this well that is shut in waiting on a pipeline.^[8]

² See 43 C.F.R. § 3162.3-4(a).

³ BLM submitted a Bates-stamped administrative record (AR). Yates filed a Motion to Correct Administrative Record on June 5, 2014 (Motion to Correct), claiming the AR was “incomplete” because it was “missing significant documents filed by Yates.” Motion to Correct at 1. We grant its motion and cite its attached documents as “Yates Ex. X.”

⁴ The Tractor well is on Federal oil and gas lease NMNM 103849, which is in sec. 20, T. 25 S., R. 25 E., New Mexico Principal Meridian, Eddy County, New Mexico.

⁵ AR 115, CFO Memo, dated Nov. 1, 2012.

⁶ AR 131, INC 14-DW-005, dated Sept. 23, 2013 (September INC), at 1; *see id.* at 2 (“If you decide to return the well to production, submit a sundry notice . . . within 30 days of receipt of this letter, include the date you anticipated the well being placed back in service. . . . If you decided to plug and abandon the well, submit a sundry notice . . . within 30 days of receipt of this letter and describe the proposed plugging program.”).

⁷ AR 152, Yates Response to September INC, dated Oct. 17, 2013.

⁸ *Id.*

CFO called Hill on October 30, 2013, informing him that the Tractor well had been temporarily abandoned and that Yates “must submit a sundry to request the well be put in TA status because a well cannot be temporarily abandoned for more than 30 days without approval.”⁹ They discussed other options for the well, during which Hill again stated that Yates had removed production equipment, a downhole pump, from the well site.¹⁰

CFO issued a second INC the following day, which was nearly identical to the first but included an assessment of \$250 if Yates failed to return the Tractor well to production or give notice of intent to plug and abandon by November 20, 2013, and a remark stating “down hole electric pump removed from well bore.”¹¹ Shortly thereafter, CFO issued a 60-Day Demand Letter, which stated it had determined Yates’ “lease is not capable of production in paying quantities” but that its lease would not terminate “so long as approved operations are commenced” or Yates showed the Tractor well was still capable of producing in paying quantities.¹²

Yates requested SDR of the October INC and the 60-Day Demand Letter, stays pending review, and a hearing, which were granted, but its request to consolidate these reviews was denied.¹³ Yates reinstalled a pump in the Tractor well on December 22, 2013, and provided additional production/cost data to CFO before the hearing on SDR.¹⁴ The DSD heard both requests on January 6, 2014, after which

⁹ AR 146, BLM Conversation Record for Oct. 30, 2013 (Chris Wallace); *see* 43 C.F.R. § 3162.3-4(c).

¹⁰ AR 147, BLM Conversation Record for Oct. 30, 2013 (Wesley Ingram).

¹¹ AR 144, INC 14-DW-005A, Oct. 31, 2013 (October INC), at 2.

¹² AR 121, 60-Day Demand Letter, dated Nov. 19, 2013, at 1 (citing 43 C.F.R. § 3107.2-2); *see* 43 C.F.R. § 3107.2-2 (“A lease which is in its extended term because of production in paying quantities shall not terminate upon cessation of production if, within 60 days thereafter, reworking or drilling operations on the leasehold are commenced and are thereafter conducted with reasonable diligence during the period of nonproduction. The 60-day period commences upon receipt of notification from the authorized officer that the lease is not capable of production in paying quantities.”); *see also* 43 C.F.R. § 3107.2-3 (“No lease for 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 fails to place the lease in Production within a period of not less than 60 days as specified by the officer after receipt of notice by certified mail from the authorized officer to do so.”).

¹³ *See* AR 49-78; Yates Exs. 1, 2, 4, 5, 6.

¹⁴ *See* AR 124, Yates Corresp. dated Dec. 19, 2013; AR 47, Sundry Notice dated Jan. 8, 2014.

Yates filed post-hearing statements of reasons (SORs).¹⁵ The DSD issued separate decisions on SDR on February 20, 2014.

The DSD noted that CFO discussions with Hill on October 30, 2013, “brought into question the continued economic feasibility of the [Tractor] well,” which resulted in its issuing the 60-Day Demand Letter, but since Yates had shown its “well and lease are still capable of production in paying quantities,” he set aside the 60-Day Demand Letter.¹⁶ As to the October INC, the DSD found Yates’ removal of production equipment “resulted in a status change of the well, from gas shut in (GSI) to temporary abandoned (TA).”¹⁷ Since Yates did not have approval to temporarily abandon the well for more than 30 days, the DSD found “CFO was technically and procedurally correct in issuing [the October INC],” upheld its assessment because Yates’ challenge was an untimely review of the September INC, and modified the corrective action in the October INC so as to require that Yates request and obtain BLM approval for the temporary abandonment of the Tractor well.¹⁸

Yates timely filed an appeal from the Decision on SDR and an SOR challenging its upholding the October INC. BLM filed an Answer; Yates then filed a Reply. The appeal is now ripe for decision.

Discussion

[1] The Mineral Leasing Act provides that Federal oil and gas leases are extended beyond their primary term for so long as “oil or gas is produced in paying quantities” and that no such lease shall expire if production ceases and the lease has a well capable of producing oil or gas in paying quantities unless the lessee is “allowed a reasonable time, which shall not be less than sixty days after notice by

¹⁵ See Yates Ex. 3 (SOR on SDR) at 12, 13 (“The second [INC’s] directive that Yates plug the well is untenable and would be unjustifiably and ridiculously wasteful, based on no facts whatsoever and not supported by a rational basis.”); AR 49-79, SDR Hearing Transcript (SDR Tr.), Jan. 6, 2014; Yates Ex. 2, SOR on 60-Day Letter; Yates Ex. 3, SOR on SDR from October INC.

¹⁶ AR 22, 60-day Demand Letter Set Aside (Demand Letter Decision on SDR), dated Feb. 20, 2014, at 2, 3.

¹⁷ AR 4, Upheld (Decision on SDR), Feb. 20, 2014, at 2; *see id.* (“Yates stated [at the hearing on Jan. 6, 2014] that a submersible pump had been installed in the well on or about December 22, 2013, . . . Yates [informed CFO on Oct. 30, 2013] that the submersible pump had been removed from the well because the high concentration of H₂S would probably destroy the pump.”).

¹⁸ *Id.* (citing 43 C.F.R. § 3262.3-4(c)).

registered or certified mail, within which to place such well in producing status.”¹⁹ Thus, a lease in its extended term will terminate without notice when production ceases if it does not then have a well capable of producing in paying quantities, but if it has such a well, BLM must notify the lessee and allow a reasonable time within which to return the lease to production to avoid BLM declaring the lease expired by operation of law for lack of production.²⁰ As we recognized in *Coronado Oil*:

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). This is the notice provided in the regulations at 43 CFR [§] 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.^[21]

A well capable of producing in paying quantities does not require “actual production,” only evidence it is “actually in a condition to produce,” both physically and mechanically, oil or gas of sufficient quantity and quality to cover the cost of operating the well and marketing its products.²²

[2] The BLM Assistant Director, Minerals and Realty Management, has directed each BLM field office to review shut-in wells at least once every 5 years

¹⁹ 30 U.S.C. § 226(e), (i) (2012).

²⁰ *Coronado Oil Company*, 164 IBLA 309, 322-23 (2005), *aff’d* No. 05-CV-111J (D. Wyo. Aug. 23, 2006).

²¹ *Id.* at 323 (citing *Robert W. Willingham*, 164 IBLA 64, 68 (2004); *Merit Productions*, 144 IBLA 156, 161 n.5 (1998); *Steelco Drilling Corp.*, 64 I.D. 214, 219 n.3 (1957)).

²² *Amoco Production Co.*, 101 IBLA 215, 221 (1998) (quoting *United Manufacturing Co.*, 65 I.D. 106, 113 (1958)); *accord*, *Coronado Oil*, 164 IBLA at 323; *see* *Atchee CBM, LLC*, 183 IBLA 389, 397-98 (2013); *International Metals & Petroleum Corp.*, 158 IBLA 15, 22 (2002); *Abe M. Kalaf*, 134 IBLA 133, 138-39 (1995); *American Resources Management Corp.*, 40 IBLA at 200; *see also* 43 C.F.R. § 3160.0-5 (“*Paying well* means a well that is capable of producing oil or gas of sufficient value to exceed direct operating costs and the costs of lease rentals or minimum royalty.”).

and to “ensure that any shut-in well that is no longer capable of producing oil or gas in paying quantities . . . will be timely and properly plugged and abandoned.”²³ Authorized officers (AOs) are directed to “determine whether the shut-in well is capable of producing oil or gas in paying quantities,” which is defined as “production in quantity and quality to cover the costs to operate the well and market the products [but excluding the cost of a pipeline].”²⁴ If an AO finds a shut-in well is not “physically or mechanically capable of producing oil or gas in paying quantities” and it is the only well on a lease in its extended term, “the AO will send the operator a 60-day letter”; but if on a lease still in its primary term, “the AO will send the operator a written order requiring the operator to demonstrate that the well is capable of producing oil or gas in paying quantities or has a future beneficial use.”²⁵

Issues on Appeal

Yates argues on appeal that the October INC was arbitrary and capricious and that CFO and the DSD wrongly concluded that removing the downhole pump changed the status of the Tractor well from shut-in awaiting pipeline to temporary abandonment.²⁶ Yates further argues that the October INC is inconsistent with the DSD’s decision to set aside the 60-day letter: “Both the INC Decision and the 60-day letter Decision were based on precisely the same evidence,” and in the 60-day letter Decision, the DSD concluded that the Tractor well “was capable of producing in paying quantities”²⁷ Yates thus argues that because the well is capable of producing in paying quantities, BLM erred in the October INC in directing Yates to temporarily abandon the well.

After learning a submersible pump had been removed from the Tractor well, CFO issued the October INC and a 60-day Demand Letter. Yates responded by requesting SDR and reinstalling that pump. It is uncontroverted that a well shut-in awaiting pipeline must be physically and mechanically capable of producing in

²³ Instruction Memorandum (IM) No. 2012-181 (Idle Well Review), dated Sept. 5, 2012, at 1.

²⁴ Decision on SDR at 1.

²⁵ *Id.* at 1, 2; *see id.* at 1 (“The 60-day letter will give the operator a chance to re-work an existing well, drill another well, or demonstrate that any existing well is still capable of producing oil or gas in paying quantities.”) (“If the well is not physically or mechanically capable of producing oil or gas in paying quantities, but may have [a beneficial use], the well can be defined as temporarily abandoned (TA).”).

²⁶ SOR at 12, 17-19.

²⁷ *Id.* at 12; *see also id.* at 20-22.

paying quantities, that a well not capable of producing in paying quantities may be in need of being reworked or abandoned, and that the Tractor well is capable of producing in paying quantities with a pump. However, the parties disagree on whether a pump is required for it to produce in paying quantities. BLM contends it is; Yates asserts it is not required. Thus, if the record shows a pump is necessary for the Tractor well to produce in paying quantities, as claimed by BLM, the DSD properly upheld a violation of 43 C.F.R. § 3162.3-4(c) for the period when the pump was not in the well; but if it is not necessary, as asserted by Yates, the DSD erred in upholding that violation.

Analysis

[3] A BLM decision must have a rational basis that is stated in the decision and supported by facts of record demonstrating it is not arbitrary, capricious, or an abuse of discretion. An appellant challenging such a decision has the burden to demonstrate, by a preponderance of the evidence, that BLM committed a material error in its factual analysis or that its decision is not supported by a record showing it gave due consideration to all relevant factors and acted on the basis of a rational connection between the facts found and the choice made.²⁸

The only evidence provided on SDR to support the INC and its implicit finding that the well was not capable of producing in paying quantities without a pump are statements by Tom Zelenka, a petroleum engineer in BLM's State Office. In response to evidence showing gas was produced by the Tractor well when its submersible pump lost electricity and pressure at its wellhead was 2000 pounds, Zelenka stated:

You know, we were talking about this well having pressure on it, but it didn't have a downhole pump in it, and I don't - - - I would have to say that I would not think it could be producing rates of gas you had produced with the pump operating. Therefore, I probably would have said that it probably couldn't produce in paying quantities without that pump.^[29]

²⁸ See, e.g., *James R. Stacy*, 188 IBLA 134, 138 (2016); *Mark Patrick Heath*, 175 IBLA 167, 176 (2008); *Michael Lederhause*, 174 IBLA 188, 192 (2008); *Wyoming Outdoor Council*, 170 IBLA 130, 144 (2006) (“BLM must ensure that its decision is supported by a rational basis, which must be stated in the decision as well as being demonstrated in the administrative record accompanying the decision.”); *Stove Creek Oil, Inc.*, 162 IBLA 97, 106 (2004).

²⁹ AR at 70, SDR Tr. at 13; see *id.* at 15 (“Without the pump, I don't believe it would be able to produce in paying quantities.”); Answer at 10.

According to Yates, Zelenka simply pointed out the obvious: the well would not produce as much gas without the pump as it could with a pump. More substantively, it claims Zelenka's statements are insufficient to support a finding that the Tractor well was not capable of producing in paying quantities because Zelenka did not observe the well or state any basis for his speculation, which he rendered without the benefit of any test results or hard data that BLM could have ordered.³⁰ In short: "Zelenka's speculation is nothing more than a conclusory snippet and does not provide a factual basis or form a 'reasoned factual explanation' for the decision."³¹

Yates contends it met its burden to overcome BLM's reliance on Zelenka's uninformed views by showing "error in the methodology used, error in the data collected, or error in the factual conclusion drawn from the data,"³² claiming these snippets are unsupported in the record and appear to be informed speculation, not an expert opinion based on the facts or evidence presented. Based on our review of his statements, the arguments of the parties, and the record, we conclude the October INC finding a change in status of the well to be unsupported and the DSD implicitly finding the Tractor well not capable of producing in paying quantities are not supported by the facts of record. BLM is entitled to rely on the opinions of its technical experts, but their opinions must be supported by record evidence.³³ But in this case, Zelenka did not personally observe the well, review any data, consider any testing results, or provide a foundation for his views. We therefore conclude his statements and speculation provide insufficient support for the implicit finding of fact made by the DSD that the Tractor well is not capable of producing in paying quantities without a pump.

Yates asserts it affirmatively showed the Tractor well is capable of producing in paying quantities without a pump and that the Board should therefore reverse the DSD. It claims well data from when the pump was not operating in November of 2012 showed sufficient pressure at the wellhead "to maintain the well in producing status,"³⁴ but its only support is the following interchange between Hill and Jay Spielman, a geologist in the New Mexico State Office:

³⁰ SOR at 17.

³¹ *Id.* at 18; see Yates Ex. 3, SOR on SDR at 4.

³² Reply at 21 (citing *West Cow Creek Permittees*, 142 IBLA 224, 238-42 (1998)).

³³ See *West Cow Creek Permittees*, 142 IBLA at 238.

³⁴ SOR at 18 (citing Hill).

Mr. Hill: We could have overcome some pipeline pressure. Unless we had extremely high line pressure, we could have overcome line pressure. . . . I think that it would have been capable of production without the downhole equivalent in the well.

Mr. Spielman: So it would have overcome the water pressure within the reservoir?

Mr. Hill: Yeah. You know, if we had casing pressure capable of putting gas into the pipeline, obviously, [a submersible pump is] much more capable of pumping it, but we could produce gas.^[35]

Hill may have been referring to producing in paying quantities, but the record does not clearly show that to be the case. We are not persuaded that Yates has shown by a preponderance of the evidence that the Tractor well is, in fact, capable of producing in paying quantities without a submersible pump.

The Tractor well may or may not be capable of producing in paying quantities without a pump. BLM's reliance on Zelenka to show it was not capable is insufficient; Yates' reliance on Hill to show it was capable of producing in paying quantities is overstated. We find the facts in equipoise, insufficient to affirm or reverse the decision on SDR, and, therefore, we set aside its upholding of the October INC's finding that Yates was in violation of 43 C.F.R. § 3162.3-4(c) on October 31, 2013.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior,³⁶ this decision on State Director Review is set aside.

_____/s/_____
James K. Jackson
Administrative Judge

I concur:

_____/s/_____
Amy B. Sosin
Administrative Judge

³⁵ SDR Tr. at 11-12.

³⁶ 43 C.F.R. § 4.1.