United States Department of the Interior
OFFICE OF HEARINGS AND APPEALS
Interior Board of Land Appeals
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December 10, 2012

IBLA 2012-73	)	WYW-132398
	)	
ENERGY EQUITY COMPANY	)	Oil and Gas Lease Termination
	)	
	)	Decision Reversed

ORDER

Energy Equity Company (EEC), has appealed from a December 22, 2011, decision of the Wyoming State Office, Bureau of Land Management (BLM), holding competitive oil and gas lease WYW-132398 (Lease) to have terminated, effective March 8, 2011, upon the cessation of production during its extended term. For the following reasons, we reverse BLM's decision.

FACTUAL BACKGROUND

BLM's case file shows that BLM issued the Lease for a 10-year period, effective June 1, 1994, through June 1, 2004, unless extended by production. The Lease, which covers approximately 2,560 acres in all of secs. 10 through 13, T. 26 N., R. 107 W., Sixth Principal Meridian, Sweetwater County, Wyoming, was committed to the Sublette Flats Unit Agreement, WYW 132751X, in 1994. *See* Memorandum from Wyoming Reservoir Management Team, BLM Casper District Office, to BLM State Director, dated Nov. 29, 1994.

BLM approved the Sublette Flats 4-10 Well (4-10 Well) as an exploratory obligation well for the Sublette Flats Unit. The 4-10 Well was drilled in 1994 by EEC's predecessor in interest, Snyder Oil Corporation (Snyder). *Id.; see* Memorandum from BLM Supervisory Petroleum Engineer to the Minerals Management Service (MMS), dated Apr. 13, 1995. The initial well completion report for the 4-10 Well shows that 230 thousand cubic feet of gas per day (MCFGPD) and 4 barrels of oil per day (BOPD) were produced from the well. Memorandum from BLM Supervisory Petroleum Engineer to MMS, dated Apr. 13, 1995 (Initial Production Memo). BLM noted that the 4-10 Well was capable of

production in paying quantities on a lease basis. *Id.* The Well was classified as "GSI"—gas shut-in. *Id.*[1]

Two months after the well was shut-in, BLM granted to Mountain Gas Resources LLC a 22.8-mile right of way for a pipeline, a portion of which would run close to the 4-10 Well. *See* (LIVE) Serial Register Page for WYW-134639 (through Dec. 2008). EEC states that "[i]n order to produce this oil and gas, a 22.8 mile pipeline would have to be installed." Statement of Reasons (SOR) at 3. There is nothing in the record to suggest that construction of this pipeline ever began.

The Serial Register Page for the Sublette Flats Unit Agreement indicates that the 4-10 Well was determined as a "non-pay" unit well and that the Sublette Flatts Unit terminated by its own terms in October 1995. In a decision dated March 4, 1996, BLM stated that the Lease remained in effect for its original term only: "Because the expiration dates of the [] leases are later than October 2, 1997 [2 years after termination of the unit, *see supra* note 1], the leases are not extended, but remain in effect for the remainder of their terms as long as rentals are timely paid[.]" *See* BLM decision dated Mar. 4, 1996. The Decision further indicated that the expiration date of the Lease was May 31, 2004. For the remainder of its original term, the only activity documented in the case file is the Lease's multiple assignments, transfers, and subleasing to various entities.

The Lease was transferred to EnCana Oil and Gas (EnCana) in 2007. The documentation in the record as to the 4-10 Well's status is conflicting. On May 30, 2007, 3 years after expiration of Lease's original term, BLM sent to EnCana a letter indicating that the Lease "is currently in its extended term by reason of production." However, BLM then reported in that same letter that the 4-10 Well "has never produced," and that it had "determined that the [L]ease is not capable of production

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[1] Under the "Remarks" section, BLM's petroleum engineer noted that the well qualified as a "Yates Determination" well. In *Yates Petroleum Corp.*, 67 IBLA 246 (1982), the Board held that, for lease extension purposes, a unitized well capable of production, but not in sufficient quantities to cover drilling and completion costs, is a well capable of production in paying quantities so that all committed Federal leases are extended beyond their primary terms. If no other wells are drilled that qualify as a unit paying well, the unit terminates for lack of production from a unit well and the leases are entitled to a 2-year extension upon elimination from the unit. 67 IBLA at 258; *see also* 43 C.F.R. § 3186.1 (Model Unit Agreement at § 9).

in paying quantities." BLM provides no explanation for its determination. However, BLM

> allowed [EnCana] 60 days from receipt of this letter within which to commence reworking or drilling operations on the leasehold. The [L]ease will not terminate so long as approved operations are commenced within the 60-day period and are continued with reasonable diligence until paying production is restored.

May 3, 2009, Letter from BLM to Encana.

Again, the record submitted to the Board does not include the relevant documentation, but documents submitted by EEC make clear that EnCana responded to BLM's May 2007 letter by requesting an extension of time to flow test the 4-10 Well and to review those flow test results. SOR at 3;[2] Answer, Ex. A (Declaration of Trisha Carmell, BLM Petroleum Engineer) at ¶¶ 14, 15; *see* Decision at 1. There appears to be no dispute that during the flow test, the gas rates were initially 1185 MCFGPD and dropping to 243 MCFGPD over the 7-day period, and a total of 122 barrels of oil were produced over that period. *See* SOR at 5; *id.*, Ex. 3 at 1 (Letter from BLM to EEC dated June 7, 2011).

EEC obtained an interest in the Lease and the 4-10 Well from EnCana in 2007. Effective February 1, 2008, BLM approved transfer of EnCana's operating rights in the Lease to EEC. Three years passed. Then, by letter dated February 28, 2011, BLM notified EEC that it had "determined the lease is not capable of production in paying quantities" and allowed EEC 60 days to "commence reworking or drilling operations" and to continue approved operations "with reasonable diligence until paying production is restored." BLM stated that if EEC "believe[d] the lease is capable of production in paying quantities which would pay the day-to-day operating costs, including rental and/or minimum royalty on a sustained basis, you must submit justification within 60 days from receipt of this letter." EEC received the letter on March 8, 2011.

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[2] EEC "includes, as Exhibits, numerous other documents that BLM should have included in [the] administrative record. The . . . administrative record provided by BLM to the Board is incomplete and missing many of the pertinent documents necessary for the Board's review of BLM's Decision." SOR at 3 n.3. BLM does not dispute the authenticity of EEC's Exhibits or otherwise respond to EEC's assertion regarding the state of the record.

BLM is required to file the complete case file surrounding any appeal made to the Board, including all official correspondence received by or sent to BLM. *See, e.g., Mobil Oil Exploration & Producing Southeast, Inc.*, 90 IBLA 173, 177 (1986).

According to attachments to EEC's SOR, EEC responded to BLM's letter with an April 1, 2011, Sundry Notice, in which EEC stated its intent to put the well into production but needed BLM's permission "to vent gas by building a flare pit and flaring the gas." SOR, Ex. 5. EEC explained that it "is beginning [to] build[] a tank battery [to] begin production of the well." *Id.*

BLM denied EEC's request by letter dated June 7, 2011. *See* SOR, Ex. 3. The well "is a gas well," stated BLM, and therefore, "[i]n accordance with NTL 4A, gas well gas cannot be vented unless the produced oil energy equivalent is greater than the gas energy equivalent. If EEC submits justification the oil energy equivalent exceeds the gas energy equivalent, [BLM] will consider the request."[3] *Id.* BLM recognized that gas had not been produced because the operators had been awaiting construction of the 22.8-mile pipeline. *Id.* BLM did not prescribe a due date for the requested information.

In a letter dated June 28, 2011, EEC notified BLM that it had "hired an engineer to provide justification of the oil energy equivalent exceeding the gas energy equivalent," and that it "should have the documentation within 60 days." SOR, Ex. 6 (letter from EEC to BLM, dated June 28, 2011). On July 8, 2011, EEC requested that BLM provide it with EnCana's testing records from 2007. SOR, Ex. 7 (e-mail from EEC to BLM). The engineer hired by EEC sought "the production history from EnCana's testing in May 2007, along with the gas compositional analysis." *Id.* BLM's petroleum engineer replied that she checked BLM's well file and found no submissions indicating that EnCana had performed a gas analysis in 2007. However, the daily reports in BLM's file showed that EnCana had produced over 100 barrels of oil during its flow test in 2007. *See* SOR, Ex. 7 (e-mail from BLM to EEC, dated July 11, 2011). On July 11, 2011, EEC again requested from BLM the well reports submitted by EnCana for the 4-10 Well. BLM agreed to fax the daily reports to EEC and recommended that EEC contact EnCana directly for any other desired information. *See id.*

In August 2011, EEC contracted with Open Range Access, Inc. (Open Range), to perform an oil and gas analysis of the 4-10 Well. A month later, Open Range was able to run an analysis of the Well. Open Range summarized that analysis in a September 13, 2011, report, which included specific details and analyses of the gas components of the Well. EEC submitted this report to BLM. *See* SOR, Ex. 8.

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[3] Under NTL-4A, titled "Royalty or Compensation for Oil and Gas Lost," gas from a gas well "may not be flared or vented. For the purposes of this Notice, a gas well will be construed as a well from which the energy equivalent of the gas produced, including its entrained liquid hydrocarbons, exceeds the energy equivalent of the oil produced." 44 Fed. Reg. 76600 (Dec. 27, 1979).

Based upon Open Range's analysis, EEC filed with BLM a follow-up Sundry Notice dated November 2, 2011, requesting approval to begin production. SOR, Ex. 8. EEC provided an economic analysis of the value of the natural gas and oil produced from the 4-10 Well based on the 3-day flow test performed by EnCana in 2007. Also, considering the current price of natural gas and oil, EEC indicated that the well would produce approximately $6,800 in oil and gas for those 3 days. According to EnCana's test figures from 2007, the Well

> produced a total of 820 MCFG and 50 [barrels of oil] during the last three days of EnCana's testing from July 15-17, 2007. The value of the gas at current (10/12/11) prices is . . . $ 3,187.[4] The value of the oil produced is 50 [barrels] x $ 73.81 / [Barrels] = $3,690. Therefore, the value of the produced gas (even before processing and transportation fees) is less than the value of the produced oil.

Id. Appended to the Sundry Notice was an oil and gas analysis report documenting the measurement figures (*i.e.*, BTU content) cited by EEC in its Sundry Notice. *Id.*; *see* SOR at 5. Exhibit 9 to EEC's SOR is a Declaration by Susan Murrah (Murrah Declaration), Administrative Assistant for EEC, in which she states that the November 2, 2011, Sundry Notice shows that the 4-10 Well is capable of production in paying quantities. She states that the operational costs to produce the Well are approximately $100,000 for the first year to install production facilities and to produce the Well; the Well would produce 17 barrels of oil a day; at a modest price of $75 a barrel, the Well would generate approximately $465,375 gross revenue for the year; and that the net revenue to EEC would be over $350,000 for the first year. She concludes that the production from the Well would result in a net profit to EEC, after the payment of all taxes and royalties. *See* SOR, Ex. 9 at ¶ 14.

BLM denied the Sundry Notice on November 7, 2011. SOR, Ex. 8. Words handwritten under the "Denied" ink stamp states: "Does not meet NTL4A Requirements as stated in June 7, 2011 letter." *Id.* Shortly thereafter, BLM sent a memorandum dated November 16, 2011, to the Office of Natural Resources Revenue of the Bureau of Ocean Energy Management, Regulation, and Enforcement, stating

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[4] Gas is generally sold per unit of energy that can be produced by burning the gas, and price is based on, among other things, British Thermal Units (BTUs), here $3.54 per MMBTU. According to EEC, it takes 1098 BTU to heat 1 standard cubic foot of the well's gas. If the well produced 820,000 cubic feet of gas, it would take 900.26 MMBTUs to generate energy from that gas (820 MCF x 1098 BTU). This figure, when multiplied by $3.54, leaves EEO with $3,186.92 for 3 days' worth of extracted gas.

that the date of last production on the Lease was October 1998,[5] that the well was shut-in, and that a 60-day letter had been issued and subsequently received on March 8, 2011.

On November 30, 2011, EEC hired Jon Potratz[6] "to determine what needs to be done in order to flow the well back to obtain a sample of the oil to compare the energy content of the oil with the energy content of the gas, as requested by the BLM." SOR at 6, Ex. 9 (Murrah Declaration) at ¶ 15.

On December 22, 2011, BLM issued the decision to terminate the lease. Quoting the text of 43 C.F.R. 3107.2-2,[7] BLM stated that EEC had received notice on March 8, 2011, that the last producing well on the Lease is no longer capable of producing hydrocarbons in paying quantities, and that EEC was allowed 60 days from receipt of that notice to commence reworking or drilling operations. According to BLM, "no reworking or drilling operations commenced within the specified time frame. **Therefore, the term of [the Lease] is exhausted and the Lease is held to have terminated by cessation of production effective March 8, 2011.**" EEC appealed.

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[5] The October 1998 date is not explained in the record. However, the online well database of the Oil and Gas Conservation Commission of the State of Wyoming indicates that the well produced 87 barrels of oil in 1998. It then states that the well has since been shut in and is classified as "idle." http://wogcc.state.wy.us (last visited on Aug. 27, 2012). To be clear, there is no order or any other correspondence in the case file to indicate that the lessee/operator requested and BLM approved the shut-in status of the 4-10 Well.

[6] Potratz' relationship with EEC is not explained in the record. However, on Jan. 20, 2012, Potratz took an oil sample from the 4-10 Well. Wyoming Analytical Laboratories, Inc., analyzed that sample and reported that the oil heating content exceeds the heating content of the gas from the Well. SOR at 6; SOR at 6, Ex. 9 (Murrah Declaration) at ¶¶ 15, 16.

[7] That regulation reads:

> 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.

LEGAL STANDARDS

The Lease was issued for a primary term of 10 years pursuant to section 17 of the Mineral Leasing Act (MLA), 30 U.S.C. § 226(e) (2006). For such a lease, if actual drilling has started before the end of the primary term, and is being "diligently prosecuted," the lease term "shall be extended for two years and so long thereafter as oil or gas is produced in paying quantities." 30 U.S.C. § 226(e); *see* 43 C.F.R. §§ 3107.1, 3707.2-1. After that time, a lessee's obligation to produce the well is indefinite–leases continue in an extended term only when a well actually produces oil or gas or is capable of production in paying quantities. The MLA mandates that a lease held in its extended term by production ends when that production ceases unless

> reworking or drilling operations 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[;] . . . [or] there is a well capable of producing oil or gas in paying quantities . . . [and] the lessee is allowed a reasonable time, which shall be not less than sixty days after notice by registered or certified mail, within which to place such well in producing status . . . .

30 U.S.C. § 226(i) (2006); *see* 43 C.F.R. §§ 3107.2-2, 3107.2-3.[8]

A lease in its extended term is subject to termination when there is a cessation of production of oil and gas in paying quantities in accordance with the standards discussed 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 the statute 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

[8] The statute also excuses nonproduction when operations or production has been suspended "under any order, or with the consent, of the Secretary." 30 U.S.C. § 226(i) (2006). BLM states that the Lease was never suspended. *See* Answer at 10-11. We discuss this exception no further.

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)[; *rev'd on other grounds, Coronado Oil Co. v. U.S. Dep't of the Interior*, 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), 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. 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. *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:

> 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).
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> *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 (text headnote and footnotes omitted).[9]

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[9] Other important and relevant cases by the Board construing 30 U.S.C. § 226(i), particularly the distinction to be made between a lease without a well capable of production in paying quantities and one that does contain a well capable of production in paying quantities, include: *Doud Land Co., LLC,* 182 IBLA 234, 236-37 (2012); *Ridgeway Arizona Oil Corp.*, 181 IBLA 232, 244 (2011); *Petro Mex, LLC,* 180 IBLA 94, 99-101 (2010); *Two Bay Petroleum, Inc.*, 166 IBLA 329, 345 (2005), *aff'd*, 2007 WL 2028192 (E.D. Cal. 2007); *Merit Productions*, 144 IBLA at 165 (Burski, A.J., concurring).

DISCUSSION

EEC disputes BLM's determination that the Well is not capable of production in paying quantities. When BLM determines that a well is not capable of production in paying quantities, the party challenging that determination bears the burden of showing, by a preponderance of the evidence, that it is capable of production in paying quantities. *Stove Creek Oil Inc.* 162 IBLA at 105-06. Because the burden of proof is on an appellant to show error in the decision appealed, the recipient of a decision is entitled to a reasoned and factual explanation of the rationale for the decision, and must be provided an adequate basis for understanding and accepting it or, alternatively, for disputing and appealing it. *Mark Patrick Heath,* 181 IBLA 114, 129 (2011), and cases cited; *Exxon Co., U.S.A.*, 113 IBLA 199, 205 (1990). An administrative decision that is not supported by a case record providing the information necessary for an objective, independent review of the basis for the decision will be overturned. *Shell Offshore, Inc.*, 113 IBLA 226, 233 (1990).

By citing 43 C.F.R. § 3107.2-2 and observing that no reworking or drilling operations commenced within the specified time frame, BLM presumably was of the belief that the Well was not physically capable of production and the Lease had therefore terminated by operation of law. *See* Decision at 1; Answer at 6-9. However, as EEC points out, neither the decision nor the record explains the basis upon which BLM made its determination. BLM's Answer also fails to state any meaningful rationale for its decision. On the other hand, EEC has shown that the 4-10 Well is in functioning condition and only needs equipment to begin production. While BLM stated that no reworking or drilling operations commenced within a specified time frame, it is unclear why such operations were required in the first instance. *See* Decision at 1; Answer at 7. Nothing in the record indicates that the 4-10 Well was not in a condition to produce at the time the Well was last shut-in or at the time BLM issued its Decision.[10]

We assume, without being able to confirm, that the 4-10 Well was shut in because no pipeline existed to transport the gas to market rather than because of any inability to produce. We have noted in past decisions that, by definition, wells that are shut in for authorized reasons such as lack of a pipeline or market for the oil or gas are wells capable of production in paying quantities. *Ridgeway Arizona Oil Corp.*, 181 IBLA 232, 245 (2011); *Coronado Oil Co.*, 164 IBLA at 324; *Robert W. Willingham,* 164 IBLA at 68; *American Resources Management Corp.,* 40 IBLA at 201; *Robert D. Snyder,* 13 IBLA 327, 330 (1973); *Steelco Drilling Corp.*, 64 I.D. at

[10] No inspection reports or any other data are included in the administrative record.

219 n.3.[11] Again, we cannot ascertain from the record whether or not the well was shut-in for reasons authorized by BLM.

The flow test conducted by Encana in 2007 demonstrates that the 4-10 Well is capable of production of both oil and gas. EEC claims that if it were allowed to install the production facilities, such as tank batteries for storing the oil, it could produce economic quantities of oil. *See* SOR at 12. We see merit in EEC's argument that "BLM is denying EEC the right to test the Well and produce oil to establish it is a paying well, while at the same time penalizing EEC for not producing oil and gas," and that "[i]n doing so, BLM terminated the Lease." *Id.* at 12-13. On balance, we conclude that the evidence provided by EEC tends to establish that the 4-10 Well is capable of production in paying quantities. The Murrah Declaration supports this conclusion. EEC's two 2011 Sundry Notices requested approval to begin actual oil production but BLM denied both requests, citing NTL-4A.

In *Petro Mex, LLC*, cited by EEC, BLM rejected the appellant's request to test the wells by venting the gas or installing compression, stating that the requests were "unacceptable." 180 IBLA at 102 n.2. The Board rejected "BLM's claim as a classic 'Catch 22': the wells must be tested to show they are capable of producing gas, but [BLM] will not allow Petro Mex to operate and test those wells." *Id.* EEC draws the following analogy, which is convincing: "Here, EEC is in nearly an identical situation. EEC attempted to flare the gas to produce the oil to establish that the Well is capable of producing oil in paying quantities, and to produce the Well. But BLM refused to allow EEC to test and produce the oil." SOR at 14.[12]

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[11] BLM defines "shut-in well" as a well that is "physically and mechanically capable of producing oil and/or gas in paying quantities, but is not in production because of the lack of a market due to well's remoteness or as a result of problems that require remedial action." H-3107-1 (glossary). BLM defines a "shut-in lease"

> as a lease with a nonproducing well that has been accepted by [BLM] as physically and mechanically capable of production in paying quantities, and is the only well or remaining well on the lease. Such a well may be shut in following its original completion . . . such as when the well is located in an area remote from a marketing outlet. . . . No lease shall be extended beyond its primary or fixed term by a shut-in well unless [BLM] is satisfied that the well remains capable of producing oil or gas in paying quantities based on a recent test of the well.

H-3107-1; *see Doud Land Co., LLC*, 182 IBLA at 238 n.8.

[12] *Petro Mex* also involved a well that was shut-in by BLM orders, which BLM refused to lift when requested by Petro Mex. The Board stated that "[n]ot being allowed to

(continued...)

Moreover, EEC stated in its April 1, 2011, Sundry Notice that it was "putting the Sublette Flats 4-10 into production" and was in the midst of constructing a "tank battery" to contain production. Placing such facilities on the Lease tends to substantiate EEC's argument that the well has present capability to produce. In sum, we are unable to confirm the need to rework or conduct drilling operations on the 4-10 Well, or that it was not presently capable of production. *See, e.g., Petro Mex, LLC*, 180 IBLA at 105-06.[13]

By stating that it had determined that the last producing well on the Lease is no longer capable of producing hydrocarbons in paying quantities, BLM presumably found that EEC's well could not yield a reasonable profit over and above the cost of operating the well and marketing the gas. Decision at 1. In response, EEC contends that its well can produce oil in paying quantities, that it has submitted to BLM corroborating evidence on this point, and that BLM has failed to rebut EEC's documentation. Based on the record, or lack thereof, we concur.

A shut-in well determination is not static—markets, technology, and other circumstances evolve so that a well's production capability in paying quantities may change over time. *See, e.g., Coronado Oil Co.*, 164 IBLA at 324. Consequently, BLM may require a lessee/operator to place a shut-in well into production in paying quantities at any time the agency finds that the well is not producing in those quantities. *See Robert W. Willingham*, 164 IBLA at 68-69. Here, EEC submitted to BLM a Sundry Notice with its economic conclusions, showing, based on EnCana's flow tests, that it could produce at least $3,600 of oil in a 3-day period, yielding about $438,000 per year. Moreover, EEC states on appeal, through the Murrah Declaration, that its operating costs are around $100,000 for the first year to install production facilities and produce the well. These numbers show the Well's profitability, explains EEC, and BLM has not provided any explanation of why it believes the Well cannot produce hydrocarbons in paying quantities.

BLM does not challenge EEC's operation costs, production rates, or whether that production could reliably be extrapolated to a daily rate of production. Nor is there anything in the record that refutes the figures offered by EEC to show that the wells are capable of producing sustained and sufficient hydrocarbons to yield the requisite profit. We acknowledge that EEC's figures are not conclusive. However, we

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[12] (...continued)
resume production from these leases because of BLM's shut-in orders is not synonymous with their not having a well capable of production." 180 IBLA at 105.

[13] We also note that failure to resume production from the Well because of BLM's concerns regarding waste does not create a well incapable of production.

must evaluate those figures in the context of a record that does not support BLM's position. What we do have is the Initial Production Memorandum from 1995 stating that the Well was capable of production in paying quantities, as well as the flow tests conducted by EnCana in 2007 showing that the 4-10 Well produced both oil and gas. We conclude that EEC has shown by a preponderance of the evidence that BLM's determination is in error. Accordingly, we reverse BLM's determination that EEC's well is not capable of producing hydrocarbons in paying quantities.[14]

There is no question that the well has had a prolonged cessation of production. EEC admits that the well still sits dormant, but blames BLM for its failure to place the well back into producing status. But for BLM's denial of its requests to put the well back online for oil production, argues EEC, the well would be up, running, and producing hydrocarbons in paying quantities. *See* SOR at 13. In its Answer, BLM states that it "gave EEC over nine months to bring the well into production, much longer than the minimum sixty-days provided by statute and regulation," and that "EEC still did not produce the well as a gas well, or, . . . take the steps necessary to obtain approval to produce the well as an oil well." Answer at 12. The record does not support BLM's assertion.

Upon receipt of BLM's initial 60-day letter in February 2011, EEC's actions demonstrate reasonable diligence in its attempts to test and equip the 4-10 Well so that it could produce oil from the Lease. The record includes documentation showing that EEC submitted a Sundry Notice on April 1, 2011, requesting to build a flare pit, install a tank battery and other facilities that would allow it to produce the Well, and BLM denied that Sundry Notice in June 2011; that on June 28, 2011, EEC notified BLM that it had contracted with an engineering firm to complete the BLM-requested tests to establish that the Well was capable of production; that on July 8 and 11, 2011, EEC communicated with BLM regarding the EnCana flow test results; that EEC contracted with Open Range to perform an analysis of the hydrocarbons in the Well resulting in the September 13, 2011, report; that EEC submitted a second Sundry Notice on November 2, 2011, demonstrating that the Well was capable of production in paying quantities and requesting BLM to authorize its testing of the hydrocarbons

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[14] We note that the Board has consistently held that when BLM determines that production on an oil and gas lease in its extended term by reason of production has ceased because the well on the lease is no longer capable of production in paying quantities, the lessee of record and lease operator are entitled to notice and an opportunity to request a hearing on the issue of the productive capacity of the well if they have presented evidence raising an issue of fact regarding the status of the well. *Coronado Oil Company*, 164 IBLA at 328, and cases cited. No hearing is needed here, however, because the record before us does not sustain BLM's conclusion that the well is not capable of production in paying quantities.

and to produce oil from the Well; and that in November 2011, EEC contracted with John Potratz and Wyoming Analytical Laboratories, Inc., to conduct an additional analysis of the heating content of the oil so that EEC could produce the oil to meet BLM's requests. EEC has shown that it was in the process of complying with BLM's November 7, 2011, denial of its second Sundry Notice in order to provide the information requested by BLM when it declared the Lease terminated. EEC provides the following summary of the documentation in the record:

> Here, EEC submitted a request to flare gas to test and produce the oil. BLM denied EEC's request to produce the oil and instead requested EEC to provide justification that the oil content exceeds the gas content. Immediately upon notification of this request, EEC began this process. In the interim, BLM terminated the Lease. In essence, EEC submitted a request to test and produce the oil from the Lease. BLM denied this request. BLM then terminated the Lease because EEC failed to produce the Well. BLM's circular justification for terminating the Lease cannot stand. BLM may not terminate the Lease for failure to produce when its actions prohibit EEC from producing the Well.

SOR at 18.

BLM denied EEC's attempt to return the 4-10 Well to production because the agency concluded that the well was a gas well. Consequently, according to BLM's reasoning, BLM could not authorize the flaring or venting of any gas, since NTL-4A explicitly disallows an operator to waste gas that is economically valuable and upon which royalties should be paid, and "[a]uthorizing the proposed venting/flaring without [oil/gas equivalency data] could result in waste of the Nation's mineral resources and violate NTL 4A." Answer at 8. However, NTL-4A should not be applied to deny EEC the opportunity to flare or vent the gas for purposes of determining whether the 4-10 Well is properly classified as an oil or gas well. NTL-4A is a royalty rule, in place to dissuade lessees/operators from wasting the more valuable natural resource, not to prevent production outright.[15] If BLM finds that vented or flared gas is economic, and that the lessee/operator wasted the gas without permission to do so, the lessee/operator would be required to pay royalties on that wasted resource. The question posed by NTL-4A in the present case is one of economics and marketability. In *Rife Oil Properties, Inc.*, 131 IBLA 357, 373 (1995), we explained that

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[15] The rule provides guidance regarding the volume of production upon which royalty is due under the lease and is typically administered by BLM. *See* 30 C.F.R. §§ 202.100, 202.150, and 202.151. Central to the determination of the volume upon which royalty is due is the exemption of volumes used for lease beneficial purposes.

> an operator must place into marketable condition "if economically feasible" all oil, gas, and other hydrocarbon substances produced from the lease. *See* 43 C.F.R. § 3162.7-1(a). The operator must also conduct operations in such a manner as to prevent "avoidable loss of oil and gas." 43 C.F.R. § 3162.7-1(d). The classification of a well as an oil well or a gas well [therefore] is not necessarily useful in making the determination whether recovery of the gas was economic. To the extent that BLM read NTL-4A as barring the venting of gas from a producing [] well without regard to whether it was avoidably lost, *i.e.*, whether it was economic to market the gas, we find that BLM misread NTL-4A.

Here, EEC has shown not only that gas produced from the 4-10 Well has no connecting pipeline, but has also submitted evidence showing it would be economic to produce and market oil from the well. EEC stated in its November 2011 Sundry Notice how the production of oil, based on geologic test data, exceeded the cost benefit of producing the gas from the well: For every barrel of oil sold at $73.81, natural gas was only $22.55. Thus, EEC appropriately answered BLM's NTL-4A question for production purposes. In doing so, EEC attempted to place the 4-10 Well into production. *Cf. Doud Land Co., LLC*, 182 IBLA at 243 (observing that appellant made no effort whatsoever to produce oil and gas).

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the decision appealed from is reversed.

James F. Roberts
Administrative Judge

I concur:

James K. Jackson
Administrative Judge

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