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Key Issues Confronting Industry in Federal Oil and Gas Leasing and Permitting – A Series

Topic 5: Leases in Extended Term With and Without a Well Capable of Production

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This fifth installment in our series on key issues in federal oil and gas leasing and development addresses termination of federal oil and gas leases that are in their extended term.

The primary term of a federal oil and gas lease is 10 years. Leases continue as long "as oil and gas is produced in paying quantities." 30 U.S.C. § 226(e). There are exceptions to this rule found in the Mineral Lease Act (MLA), 30 U.S.C. § 226(i), that allow for an extension of the lease if it contains a well capable of production.

One of the key determining factors in extension of a federal lease is whether the lease contains a well capable of production. The IBLA defines a well capable of producing as a well which is actually in a condition to produce at the particular time in question. The IBLA has further clarified that 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 lack of pipelines, roads, or markets for the gas.

Lease without a Well Capable of Production. If a federal lease is in its extended term—beyond 10 years and has been extended by production, but no longer contains a well capable of production in paying quantities, the lessee has 60 days to commence reworking or drilling operations with reasonable diligence or the lease will terminate upon the cessation of production. 43 C.F.R. § 3107.2-2. In other words, if a lease is in its extended term and the last well on the leases is plugged and abandoned, the lessee has 60 days to begin drilling a new well or the lease terminates by operation of law after 60 days. In this situation, BLM is not required to provide notice to the lessee because the lease automatically terminates.

However, the IBLA has held that if BLM refuses to allow the operator to restore production, BLM would be prohibited from terminating the lease for nonproduction.

Lease with Well Capable of Production. In contrast, if a federal lease contains a well capable of production in paying quantities but that well is not actually producing, BLM must provide notice to the lessee of potential lease termination and provide the lessee a reasonable time—at least 60

days from receipt of the notice—to bring the well back into production status or drill a new well. If the lessee begins diligent operations on the lease to restore production, the lease does not terminate. However, if during those 60 days, the lessee fails to take any action to restore production, the lease automatically terminates at the expiration of those 60 days without any further action by BLM.

Operators must also make any necessary minimum royalty payments which are due at the expiration of each year beginning after the discovery of oil and gas in paying quantities. Thus, if a lease contains a well capable of production, but is not actually being produced, operators must still pay minimum royalties to keep a lease from terminating.

For more information regarding federal oil and gas leasing issues, please contact Bill Sparks.

Previous and upcoming articles in this series include:

- Topic 1: BLM Discretion to Lease [view]
- Topic 2: Navigating Lease Protests and Oppositions to Leasing Decisions [view]
- Topic 3: Modifying Lease Terms And Cancelling Existing Leases [view]
- Topic 4: Suspension of Operations and/or Production [view]
- Topic 5: Leases in Extended Term With and Without a Well Capable of Production [current]
- Class I and Class II Reinstatements
- Drilling-over Extensions & Diligent Development
- Federal Exploratory Units and Communitization Agreements – A Brief Overview

References and citations: 30 U.S.C. §§ 226(e) & 226(i); 43 C.F.R. §§ 3103.3-2, 3107.2-2; *Amoco Production Co*., 101 IBLA 215, 222 (1988).*Ridgeway Ariz. Oil Corp*., 181 IBLA 232 (2011); *Petro Mex, LLC*, 180 IBLA 94 (2010); *Coronado Oil Co*., 164 IBLA 309 (2005).