



Recent IBLA Decision Holds that BLM Cannot Automatically Terminate a Lease Once Held by Production or for Reasons of Noncompliance

By: [Heidi Hande](#)

In *Petro Mex, LLC*, 180 IBLA 94 (2010), the Interior Board of Land Appeals (IBLA) reversed and remanded the August 26, 2009 decision of the Colorado State Office, Bureau of Land Management (the State Office) automatically terminating two federal oil and gas leases for lands in Garfield and Mesa Counties, Colorado. Lease COC 0124705 (Lease No. 1) contains five wells and was extended beyond its primary term by production. The Grand Junction Field Office (GJFO) issued a Notice of Incidents of Noncompliance (INC) for one well and a major violation for an underground leak, among some minor violations and other items. The second lease, COC 088586, has similar facts.

The GJFO ordered all five of the wells shut-in until Petro Mex was back in compliance. Petro Mex remedied all issues and began producing the wells. However, the GJFO informed Petro Mex the shut-in orders would remain in effect and Petro Mex shut the wells in again. Petro Mex inquired of the GJFO what needed to be done to lift the order. On March 30, 2009, the GJFO re-inspected the leases to find the compressor had been removed.

The BLM corresponded to Petro Mex stating the removed compressor "eliminates the possibility of production from the wells" further determining that Lease No. 1 was not "capable of production in paying quantities." *Id.* at *2 (citing 43 C.F.R. § 3107.2-2). For these reasons, the BLM stated it would terminate the lease unless Petro Mex "commenced drilling/reworking operations, restored production, or submitted a 'justification' that they are 'capable of producing in paying quantities.'" Further, BLM requested a higher reclamation bond and that Petro Mex remedy certain payment issues with the Minerals Management Service.

Petro Mex responded that it intended to return the wells to production and that its now bankrupt oil field service contractor had lost the compressors along with other equipment, but through other communication argued that compression was not necessary to operate the wells. Petro Mex voluntarily

corrected all major violations to GJFO's satisfaction. Further, Petro Mex offered to flow test wells, vent gas or set a new compressor. The GJFO was unwavering and ordered the wells to remain shut until all compliance issues were resolved. Petro Mex responded with a handwritten letter stating it was working on all matters. The GJFO recommended that both leases terminate, and the State Office automatically terminated the leases.

Under the Mineral Leasing Act (MLA), 30 U.S.C. §§ 181-287, the general rule is that a lease "shall continue so long after its primary term as oil or gas is producing in paying quantities" and automatically terminate when production ceases. There are three exceptions to this general rule. They are:

- (1) where the lessee begins reworking or drilling a well within 60 days after production ceased;
- (2) where BLM as 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.

Id. at *3. Additionally, pursuant to 43 C.F.R. § 3163.1(a), the BLM can order the immediate shutting in of a well for a violation that could result in immediate, substantial, and adverse impacts on public health, safety or the environment.

The IBLA began by highlighting that both Section 226(i) of the MLA and the case law differentiate between a lease with a well capable of producing in paying quantities and a lease without a well capable of producing in paying quantities. *Id.* at *4. For those leases without a well:

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 [without notice] upon cessation of production.

Id. at *4 (citing *Coronado Oil Co.*, 164 IBLA 107, 115 (2004)). On the other hand, when the lease contains a well capable of production in paying quantities, the "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." *Id.* (citing *International Metals & Petroleum Corp.*, 158 IBLA at 21; *Merrit Productions*, 144 IBLA at 161, 163-64; *Great Western Petroleum & Refining Co.*, 124 IBLA 16, 24 (1992)). The IBLA cited the legislative history discussing Congress' intent to treat the two differently because in the second

instance the lessee acted in good faith and expended money to develop a well capable of producing in paying quantities but must be shut in for lack of pipelines, roads or markets. *Id.* at *4. (citations omitted).

A well capable of production in paying quantities means “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.” *Id.* (citations omitted). The IBLA then detailed what has been found adequate evidence of a well capable of producing in paying quantities, meaning a “well which is actually in a condition to produce at the particular time in question.” *Id.* at *5 (citations omitted). Those conditions that are inadequate include the absence of perforation of the well casing, substantial pumping of water being required before oil can be produced in paying quantities and where sandfracing operations have been unsuccessful and further efforts are needed. *Id.* (citation omitted).

The IBLA applied the MLA’s third exception, and reversed the State Office’s holding to find that there was no record evidence that Petro Mex’s wells were not capable of producing in paying quantities. Noting that actual production was not a prerequisite, the IBLA further stated that the adequacy of surface facilities was irrelevant and found no legal distinction between the lack of a compressor used to transmit gas and the lack of a gas transmission pipeline.

The IBLA then briefly explained the distinction between cancellation of a lease for noncompliance and terminating a lease for non-production. While the State Office refused to lift the shut-in order for Petro Mex’s outstanding minor violations of an increased bond and civil penalties, the IBLA held that the proper venue for lease cancellation for non-compliance was through the courts.

For more information, please contact [Heidi Hande](#).