

United States Department of the Interior

BUREAU OF LAND MANAGEMENT

Montana State Office

5001 Southgate Drive, P.O. Box 36800

Billings, Montana 59107-6800

<http://www.mt.blm.gov/>

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June 6, 2001

Instruction Memorandum No. MT-2001-051

Expires: 9/30/2003

To: Field Managers, Miles City and North Dakota Field Offices
Supervisor, Great Falls Oil and Gas Field Station

From: Deputy State Director, Division of Resources

Subject: Revised Procedures Under the New Drainage Regulations

The final rule that revises the drainage regulations was published in the Federal Register, Volume 66, No. 7, Wednesday, on January 10, 2001, under pages 1883-1894. These regulations were to be effective on February 9, 2001; however, in accordance with the memorandum of January 20, 2001, from the Assistant to the President and Chief of Staff, entitled "Regulatory Review Plan," 66 FR 7701 (January 24, 2001), the rule was temporarily delayed for 60 days. The Secretary of the Interior has reviewed the final rulemaking and is rescinding from the final rule, the "Joint and Several Liability" provision (43 CFR 3162.2-7). This regulation was to clarify the situations wherein more than one person holds undivided record title/operating rights interest in the portion of the lease that is subject to drainage. However, a Federal Register Notice re-opened the "Joint and Several Liability" provision (43 CFR 3162.2-7) for comment until June 11, 2001, with a proposed effective date of August 10, 2001. The rest of the final rule went into effect April 10, 2001.

The final rule clarifies the responsibilities of the oil and gas lessee/operating rights owner for protecting Federal and Indian oil and gas resources from drainage. It specifies when the obligations of the lessee/operating rights owner to protect against drainage begin and end; clarifies what steps to take to determine if drainage is occurring; and specifies the responsibilities of assignors and assignees for reclamation and other lease obligations.

With the implementation of this final rule, some of the current drainage procedures need to be revised. This IM clarifies those changes and establishes new procedures regarding how we will implement these changes. Through the years, we issued various instruction memoranda regarding the drainage program. This IM will supersede some of those instructions; however, the majority will continue to remain in effect.

1. Who is responsible for protecting lands from drainage?

The regulations have been revised to identify that both the lessee/operating rights owner as being responsible for protection from drainage of their Federal or Indian lease. Therefore, all correspondence should be sent to both parties.

2. Does the final rule change how drainage cases are established?

The final rule does not change any of the procedures currently in place for establishing a drainage case. Drainage cases will continue to be established through the use of public sources when the completion of a well occurs adjacent to either leased or unleased Federal or Indian lands.

3. Will we still be required to send an initial notification letter after a drainage case is established?

You will no longer have to notify a lessee/operating rights owner when a producing well is completed on land adjacent to a Federal or Indian lease. In accordance with 43 CFR 3162.2-9(b), it will be the lessee/operating rights owner obligation to notify the BLM. If the lessee/operating rights owner has an interest in the draining well, he must notify the BLM within 60 days after completion of a drill stem, production, pressure analysis, or flow tests of the well. However, if the lessee/operating rights owner has no interest in the well, he must notify the BLM within 60 days after well completion or first production reports for the draining well are filed with either BLM, State Oil and Gas Commissions, or regulatory agencies and are publicly available.

4. What information is required in the notification letter from the lessee/operating rights owners?

The lessee/operating rights owner must inform BLM of his plan to either protect the lease from drainage, or demonstrate that a protective well would not be economic. If the lessee/operating rights owner does not have sufficient information to submit a plan, he must explain in the notification letter to the BLM when he will be able to provide such a plan.

5. Who is responsible to analyze and evaluate if the Federal/Indian lease is being drained by an offending well?

This is a major change from the old drainage procedures. In accordance with 43 CFR 3162.2-9(a), the lessee/operating rights owner is responsible to analyze and evaluate information and make the necessary calculations to determine: (1) the amount of drainage from production of the draining well; (2) the amount of mineral resources which will be drained from the Federal or Indian lease during the life of the draining well; and (3) whether a protective well would be economic to drill. Our responsibility is to review the analysis provided by the lessee/operating rights owner and determine if it is reasonable or not.

6. How should BLM monitor drainage cases?

Since the BLM may not always be notified by the lessee/operating rights owner, each Field Office should establish a tickler or monitoring system that enables it to track, if the information needed from the lessee/operating rights owner required by the regulations is received. If the information is not received

as required under 43 CFR 3162.2-9(b), you must request the lessee/operating rights owner to submit an analysis demonstrating whether drainage is or is not occurring from his federal or Indian lease as required under 43 CFR 3162.2-9(d). Attachment 1 is a sample letter that should be used in such requests, if the draining well is completed on an adjacent spacing unit. This letter may also be modified by the Field Offices to request specific information needed in the analysis. Also, if you do not receive a response to this letter, the lessee/operating rights owner must again be notified and permitted 30 days to provide a response. This second request letter should also identify that failure to comply may result in our taking action in accordance with 43 CFR 3163.1(a)(2).

7. What letter should I send to the lessee/operating rights owner if the draining well is completed within a spacing unit?

You should send a communitization agreement demand letter, if the draining well is completed within a spacing unit.

8. Are there any changes to the current procedures regarding approval of lease assignments/transfers if a drainage case has been established on the lease?

The Field Offices will no longer be required to follow the procedures established under Montana IM MT-96-043, dated May 8, 1996. These procedures were established in order to ensure that if drainage was identified prior to lease acquisition, the new assignee would be offered an opportunity to either agree or decline to assume the drainage liability. The final rule (43 CFR 3162.2-13) clarifies that the lessee/operating rights owner is liable for all drainage obligations accruing during the period that he owned the lease.

9. Who has the liability in cases where an assignment occurs?

The transferor remains liable for obligations that accrued prior to lease transfer, including compensatory royalties. However, the new lessee/operating rights owner will be liable for all drainage obligations; e.g., payment of compensatory royalty, or drilling a protective well, from the effective date of the transfer and during his tenure of the lease.

10. Will the Field Offices still be required to enter the 221 (drainage identified) action code from LR2000?

The Field Offices will still be required to enter the 221 action code into LR2000. Since the public can access LR2000 from the Internet, this action code will indicate to the public that the lease is undergoing drainage review. The Field Office should enter the 221 code when: (1) notice of the drainage is received from the lessee/operating rights owner, (2) when BLM notifies the lessee/operating rights owner that he must comply with 43 CFR 3162.2-9(b), or when the case is established, whichever is earliest. In addition, the 221 action code does have a corresponding Action Remarks column that can also be used to identify additional information such as the well status; i.e., shut-in, waiting on pipeline. However, the 221 action code needs to be removed from LR2000 when a drainage cases affecting a lease is closed. If compensatory royalty is assessed, you need to remove the 221 action code from LR2000 and enter the 062 action code (compensatory royalty assessment).

11. Have there been any changes to appeals on drainage decisions?

Under the old drainage rule, any adversely affected party had the right to

file a State Director Review (SDR) request. However, the final rule allows the lessee/operating rights owner to appeal a drainage decision to either the State Director or the Interior Board of Land Appeals (IBLA). If the lessee/operating rights owner intends to file an appeal, you should encourage filing of an appeal with the State Director. The advantage of filing an appeal with the State Director is that the lessee/operator rights owner can receive a final ruling on the drainage case within 10 days upon filing of an appeal. In addition, if the lessee/operating rights owner does not agree with the State Director's decision, he may still appeal to the IBLA. Following this process, the lessee/operating rights owner would have two appeal rights. Attachment 2 provides the language that should be included in any final drainage decision.

If you have any questions, please contact Pascual Laborda, at (406) 896-5102.

Signed By: Thomas P. Lonnie

Authenticated By: Rosetta Deines

2 Attachments

1-Sample Letter (1 p)

2-Revised Appeals Language (1 pp)

Distribution w/attms.

WO-310, LS, Rm. 501

BLM State Offices

SMT

SAMPLE LETTER

(Date)€

Certified Mail - Return Receipt Requested

Gentlemen:

As lessee/operating rights owner of record under (Federal) (Indian) oil and gas lease _____, you are required to protect the lands on your lease from drainage.

A well has been completed for production in the _____(name)_____ Formation on _____(date)_____. with an initial potential of _____. The well is known as the _____, located in the __ 1/4__1/4 Section _____, T., _____, R._____, _____County, _____. The well lies approximately _____feet _____(direction)_____ of your lease.

The regulations at 43 CFR 3162.2-9 (b) require that, within 60 days from the date of actual or constructive notice, you notify this office what action you will take to protect your lease from drainage. As of the date of this letter, you have not notified us of your plans.

As a prudent lessee/operating rights owner, it is your responsibility to monitor the drilling of wells in adjacent spacing units and gather sufficient information to determine whether or not drainage is occurring. It is your responsibility as required under 43 CFR 3162.2-9(a) to analyze and evaluate this information and make the necessary calculations to determine (1) the amount of drainage from production of the draining well; (2) the volume of mineral resources which will be drained from your Federal or Indian lease during the life of the draining well; and (3) whether or not a protective well would be economic to drill.

Pursuant to 43 CFR 3162.2-9 (d), you must provide this office with your analysis as specified under 43 CFR 3162.2-9 (a) within 60 days receipt of this letter. If you do not have sufficient information to conduct your analysis at the end of the 60th day, an extension of time for submitting the analysis must be requested.

If you have any questions, please feel free to contact _____.

Sincerely,

cc:
Tickler

