

## Can a Terminated Lease Be Reinstated?

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Federal leases can be terminated for a number of different reasons. The question answered here is whether or not they can be reinstated. The simple answer to that question is the same as all other legal questions: it depends. It depends on the reason the lease was terminated, how long the lease has been terminated, and what steps the lessee has taken to rectify the termination.

Three common ways that a federal lease will terminate are: (1) the expiration of the primary term, (2) the cessation of production in the extended term, or (3) the lessee's failure to make proper rental payments. All federal leases issued under the Mineral Leasing Act are granted for a specified period of time referred to as the primary term. If there is no discovery of oil or gas in paying quantities, the lease will terminate automatically upon the expiration of the primary term.<sup>[1]</sup> On the other hand, if there is a discovery, the lease will be extended past its primary term so long thereafter as there is a well capable of producing in paying quantities. If production ceases and no reworking or drilling operations are commenced within 60 days of cessation of production, the lease will terminate automatically. In both cases, the terminated leases may not be reinstated.

Generally, federal leases require the payment of an annual rental during the primary term and before discovery of oil and gas in paying quantities. If the lessee fails to make proper and timely rental payments, the lease will automatically terminate. However, a federal lease terminated for failure to make proper rental payments can be reinstated under certain circumstances. The purpose of such reinstatements is to give lessees a second chance to pay the annual rental, but there are certain limitations.

Where a rental is timely paid, but the rental amount is insufficient by a nominal amount or by reliance on an incorrect bill, the lease will not automatically terminate.<sup>[2]</sup> However, the nominal amount must be under \$100 or 5% of the total rental amount, whichever is less, and must be paid within the period stated in a Notice of Deficiency issued by the supervising agency (usually 15 days).<sup>[3]</sup> In all other cases, a lease terminated for failure to make proper and timely rental payments may only be reinstated under a Class I or Class II reinstatement.<sup>[4]</sup>

**Class I Reinstatement:** A lease may be reinstated as a Class I reinstatement if the following conditions are met:<sup>[5]</sup>

(1) The full rental amount must be paid within 20 days after the due date;

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(2) The lessee must show that the failure to timely pay the rental amount was either justified or was not due to a lack of the lessee's reasonable diligence;

(3) Within 60 days after receipt of a notice of termination, the lessee files a petition for reinstatement, together with a non-refundable filing fee (currently \$80)<sup>[6]</sup> and the required rental, including any back rental or royalty accrued on the lease if the lease becomes productive prior to reinstatement; and

(4) The terminated lands cannot be subject to a newly-issued oil and gas lease or otherwise have been disposed of or become unavailable for leasing.

By regulation, "reasonable diligence" includes a rental payment postmarked by the U.S. Postal Service, common carrier, or their equivalent (but not by private postal meters) on or before the due date (or the next day if the agency is closed for a holiday).<sup>[7]</sup> In most instances, where a Class I reinstatement is granted under reasonable diligence, the lessee is able to establish that the rental payment was lost in the mail or the lessee erroneously received notice from the BLM that the lease was in producing status.

Circumstances have been held "justifiable" where there are factors outside of the lessee's control, such a death or illness of the lessee or member of his or her close family or a natural disaster occurring immediately prior to the due date cause a failure to exercise reasonable diligence.<sup>[8]</sup> Generally, it is very difficult to demonstrate a "justifiable" cause. For example, Class I reinstatement petitions have been denied where the lessee suffered from a chronic illness and where the lessee was in the middle of relocating offices.

If a Class I reinstatement is granted, the lease is restored as the lease existed prior to termination. There is no change to the rental or royalty rates going forward or the primary term of the lease.

**Class II Reinstatement:** For leases that terminate after August 8, 2005, a lease may be reinstated as a Class II reinstatement if the following conditions are met:<sup>[9]</sup>

(1) The full rental amount is not paid within 20 days after the due date where the failure was either justified or not due to a lack of the lessee's reasonable diligence or any time if the failure was inadvertent;

(2) On or before the earlier of 60 days after receipt of a notice of termination or 24 months after the termination of the lease, the lessee files a petition for reinstatement, together with a non-refundable filing fee of \$500 and the required rental, including any back rental or royalty (at the increased rates, if applicable, see below) accrued on the lease if the lease becomes productive prior to reinstatement;

(3) Notice must be published in the Federal Register at least 30 days prior to the date of reinstatement, the cost of which shall be reimbursed by the lessee, and the authorized officer shall provide notice of the reinstatement to the Chairpersons of the Committee on Interior and Insular Affairs of the House of Representatives and of the Committee on Energy and Natural Resources of the Senate; and

(4) The terminated lands cannot be subject to a newly-issued oil and gas lease or otherwise have been disposed of or become unavailable for leasing.

Where the failure to timely pay is inadvertent generally means all circumstances where the lessee did not intentionally fail to make the rental payment. It does not include, circumstances where the lessee

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was not financially able to pay or simply chose not to pay.<sup>[10]</sup>

If a Class II reinstatement is granted, the reinstatement is effective as of the date of termination. However, for payments accruing after the termination date, the rental rate shall be increased by \$5 per acre for non-competitive leases and \$10 per acre for competitive leases and the royalty rate shall be increased to 16% for non-competitive leases and by an additional 4% from the then-current rate for competitive leases.<sup>[11]</sup> The increased rates are set forth in an agreement, which must be signed by all lessees.

There is no change to the primary term of the lease. However, if the reinstatement of a lease either: (1) occurs after the expiration of the primary term or any extension thereof, or (2) will not afford the lessee a reasonable opportunity to continue operations under the lease, the authorized officer may extend the term of the reinstated lease for such period as determined reasonable, but in no event for more than 2 years from the date of the reinstatement and so long thereafter as oil or gas is produced in paying quantities.<sup>[12]</sup>

The benefit of Class II reinstatements is that, unlike Class I reinstatements, they do not require the lessee to justify when it failed to make proper rental payments. Instead, the lessee only needs to show that the lessee did not deliberately fail to make the payment. However, they are subject to increased rental and royalty rates.

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[1] See Trent Maxwell, *The Habendum Clause – 'Til Production Ceases Do Us Part*, The Oil & Gas Report, available at:

<http://www.theoilandgasreport.com/2015/02/05/the-habendum-clause-til-production-ceases-do-us-part-2> (explaining what it means to have a well

producing in paying quantities).

[2] See PRM Exploration Co., 91 IBLA 165, GFS (O&G) 33 (1986).

[3] 43 C.F.R. § 3108.2-1(b).

[4] There is also a Class III reinstatement that deals with terminated leases stemming from a specific set of facts involving an unpatented oil placer mining claim. Although this will not be discussed at length, it is worth noting that a terminated oil placer mining claim can be converted/reinstated if it

meets the necessary requirements set forth in 43 C.F.R. § 3108.2-4.

[5] 43 C.F.R. § 3108.2-2.

[6] See 43 C.F.R. § 3000.12 for up-to-date filing fees.

[7] 43 C.F.R. § 3108.2-2.

[8] See Torao Neishi, 102 IBLA 49, GFS (O&G) 41 (1988), citing Louis Samuel, 8 IBLA 268, GFS (O&G) 72 (1972), but see also William H. Siegfried, 135 IBLA 155, GFS (O&G) 11 (1996) (finding that a chronic illness is not justifiable).

[9] 43 C.F.R. § 3108.2-3. The term for leases that terminate on or after August 8, 2005 is 15 months after the termination of the lease instead of 24 months.

[10] See Torao Neishi, 102 IBLA 49, GFS (O&G) 41 (1988).

[11] 43 C.F.R. §§ 3103.2-2(d) and (e) and 43 C.F.R. § 3103.3-1(a).

[12] 43 C.F.R. § 3108.2-3(e).

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