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FEDERAL -- MINING
Daniel A. Jensen, Reporter

Appeals Court Overturns Mountaintop Mining Permit Decisions

Previous editions of this *Newsletter*, Vol. XVIV, Nos. 2 & 3 (2002), discussed the issuance of an injunction by a federal district court in West Virginia prohibiting valley fill permits to accommodate the controversial practice of mountaintop removal coal mining. *See Kentuckians for the Commonwealth, Inc. v. Rivenburgh*, 204 F. Supp. 2d 927 (S.D. W. Va. 2002); *Kentuckians for the Commonwealth, Inc. v. Rivenburgh*, 206 F. Supp. 2d 782 (S.D. W. Va. 2002). The district court found that the Army Corps of Engineers' longstanding practice of issuing fill permits under § 404 of the Clean Water Act, 33 U.S.C. § 1344, is illegal because the fill material serves no useful purpose and is deposited solely for purposes of waste disposal, contrary to the text and legislative history of the Clean Water Act. The court further held that agency regulations allowing such permits are invalid because they exceed the scope of regulatory authority delegated under the Clean Water Act. The court therefore enjoined the Corps "from issuing any further § 404 permits that have no primary purpose or use but the disposal of waste." 204 F. Supp. 2d at 946. More specifically, the "issuance of mountaintop removal overburden valley fill permits solely for waste disposal under § 404 is enjoined." *Id.* at 946-47. The injunction affected five key states and stopped all such permitting on 97% of the lands containing valley fills.

The Fourth Circuit Court of Appeals has vacated the injunction and reversed the judgment of the district court on the merits. *Kentuckians for the Commonwealth, Inc. v. Rivenburgh*, 317 F.3d 425 (4th Cir. 2003). The injunction was held to be fatally overbroad because it applied to an area containing nearly all of the valley fills in the nation rather than to the single permit at issue. The injunction was far broader in scope than that necessary to provide complete relief to those challenging the permit, and it did not carefully address only the circumstances of the case. 317 F.3d at 436. The court vacated the injunction in its entirety. A concurring opinion takes the district court to task for ever issuing the injunction, citing the court's "roving interpretations" and "utterly bewildering treatment of this relatively straightforward case." *Id*. at 449 (Luttig, J. concurring in part and dissenting in part).

On the merits of the dispute, the court held that the Corps' treatment of valley fills under § 404 was consistent with the Clean Water Act and that the Corps' regulations were a rational interpretation of the Act and were therefore valid. The valley fill permit for the mine at issue was sustained. The district court's opposite conclusions were reversed. *Id*. at 448.

IBLA Restricts the Use of Mineral Materials by Federal Lessees

Mississippi Potash, Inc. (MPI) operates a potash mine on federal land in New Mexico under a lease issued pursuant to the Mineral Leasing Act of 1920. 30 U.S.C. §§ 181, 181-263. MPI excavated caliche from a site on the leased land and used it to repair a breached tailings pond dam also located on the leased land. The Bureau of Land Management issued MPI a trespass notice for removing mineral materials (caliche) from public lands without a valid material sales contract, based on 43 C.F.R. § 9239.0-7. MPI argued that the tailings pond dam was absolutely necessary for the extraction and processing of potash, and that MPI's use of caliche from the lease, on that same lease, in connection with lease operations, was permitted under the leasing regulations (namely 43 C.F.R. § 3610.2-3, since replaced by 43 C.F.R. § 3602.33).

In *Mississippi Potash, Inc.*, 158 IBLA 9 (2002), GFS(MIN) 3(2003), the Interior Board of Land Appeals upheld the trespass notice, finding that the lessee was free to use only those mineral materials necessarily moved in the process of extracting the miner-al under lease, and then only if the materials remain within the boundaries of the lease. Any other use of mineral materials from the leased property requires a material sales contract. *Id*. at 11-12. The caliche in question, although used on the lease for processing purposes, was not necessarily removed in the course of potash mining, and thus was a compensable trespass.

Denial of Plan of Operations for Unpatented Mining Claims in Wilderness Study Area not a Taking

In *Reeves v. United States*, 54 Fed. Cl. 652 (Fed. Cl. 2002), the owner of 40 unpatented mining claims located within and after the creation of a wilderness study area (WSA) alleged that the Bureau of Land Management's (BLM) refusal to approve a plan of operations that would result in surface disturbance amounted to an unconstitutional taking of private property. The claims were staked in 1996 inside the Carcass Canyon WSA in Garfield County, Utah. At that time, the Carcass Canyon WSA had been analyzed by the BLM and by the President and recommended to Congress as not suitable for wilderness preservation. Congress, however, has never acted on that recommendation and the area was later included as part of the Grand Staircase-Escalante National Monument.

Section 603 of the Federal Land Policy and Management Act (FLPMA), 43 U.S.C. § 1782(c), requires the BLM to manage WSA lands in a manner that will not impair the suitability of such lands for preservation as wilderness. Commonly known as the "non-impairment standard," this provision prohibits surface disturbances within a WSA unless the disturbance is a continuation of existing mining activities that were ongoing at the time of FLPMA in 1976. Thus, activities on a mining claim located in a WSA after 1976 are severely limited.

The claims at issue had no such grandfathered disturbance rights. The BLM denied the claimant's plan of operations because it would result in surface disturbances in violation of the non-impairment standard. The claimant argued that the non-impairment standard no longer applied once the BLM and the President recommended the Carcass Canyon WSA not be preserved as wilderness. Instead, claimant argued that the land should be subject to the less stringent "unnecessary or undue degradation" standard applicable to ordinary mining claims under section 302 of FLPMA, 43 U.S.C. § 1732(b); 43 C.F.R. § 3809.1(a). 54 Fed. Cl. at 654. The court rejected that argument, holding instead that the non-impairment standard continues to apply to WSAs until Congress formally acts on the recommendation. *Id*. at 673.

The claimant also argued that application of the non-impairment standard constituted a regulatory taking by prohibiting the owner from developing his claims and denying all viable economic use of the property. The court readily dismissed this argument because the claims were located well after the land was designated a WSA, and the owner's rights were thus subject to all WSA restrictions. *Id.* at 674.

United States Owns Sand and Gravel Under Pittman Act Patents

In *Bedroc Limited, L.L.C. v. United States*, 314 F.3d 1080 (9th Cir. 2002), the Ninth Circuit Court of Appeals held that sand and gravel are within the scope of "valuable minerals" reserved by the United States in land patents issued under the now-repealed Pittman Act. The Pittman Underground Water Act of 1919, 43 U.S.C. §§ 351-359, applied only to lands in Nevada. The law was designed to encourage settlement of Nevada's arid lands by authorizing a patent to those who found and properly developed underground sources of water. Lands appropriated under the Pittman Act were to be non-mineral in character. Pittman Act patents reserved to the United States "all the coal and other valuable minerals." 314 F.3d at 1082.

Bedroc owns land patented in 1940 under the Pittman Act. The land was subsequently mined for sand and gravel, which led to a dispute over whether the sand and gravel belong to the patentee's successor (Bedroc) or to the United States. On summary judgment, the trial court held that sand and gravel were reserved to the United States in the patenting process. *Id.*

The Ninth Circuit agreed, basing its decision on the purpose of the Act, its legislative history, and on the principle that mineral reservations in public lands are to be broadly construed in favor of the government. *Id.* at 1090. The court noted that this result was consistent with decisions regarding ownership of sand and gravel on lands patented under the Stock-Raising Homestead Act (SRHA), enacted three years prior to the Pittman Act. *Id.* at 1085-86. The court was not persuaded by Bedroc's arguments that the SRHA more broadly reserved all "minerals," while the Pittman Act reserved only "valuable minerals," or by its claim that the term "valuable minerals" should be interpreted the same as locatable minerals under the General Mining Law. *Id.* at 1090.

FEDERAL -- OIL & GAS

Gregory R. Danielson, Reporter

IBLA Reverses Approval of Coalbed Methane Project and Remands for Further NEPA Analysis

The Wyoming State Director of the Bureau of Land Manage-ment (BLM), affirmed a decision record/finding of no significant impact (DR/FONSI) for the Lower Prairie Dog Creek Coal Bed Methane Project (Project) in the Powder River Basin of Wyoming and a DR/FONSI for a plan of development that would partially implement the Project. The Interior Board of Land Appeals (IBLA) in *Wyoming Outdoor Council*, 158 IBLA 155, GFS(O&G) 2(2003), voted 6-3 to reverse the BLM's approval of the Project and remanded the case for further analysis under the National Environmental Policy Act (NEPA). The IBLA found that the BLM failed to take the required "hard look" at water quality issues presented by the proposed Project and also failed to properly assess the cumulative impacts of reasonably foreseeable coalbed methane (CBM) activity in the Project area.

The proposed Project involved the drilling and development of approximately 190 CBM wells on 34,560 acres of private, state, and federal land in Sheridan County, Wyoming. Less than half of the proposed wells would be located on federal leases, which constituted only 12% of the total project acreage. In August of 1999, the BLM issued the Lower Prairie Dog Creek Coal Bed Methane Project Environmental Assessment (Project EA), analyzing the environmental consequences of the Project and alter-natives thereto. Based on the analysis in the Project EA, the BLM field manager issued the DR/FONSI which concluded that the proposed alternative, with additional mitigation measures, posed no significant impact that would require preparation of an Environmental Impact Statement (EIS). BLM also prepared an environmental assessment for a 13-well drilling plan within the Project which was tiered to the Project EA. The BLM field manager issued a second DR/FONSI approving the drilling plan. The Wyoming Outdoor Council and others appealed these decisions, claiming violations of NEPA and the Federal Land Policy and Management Act of 1976.

The IBLA held that the BLM's environmental assessments did not take a "hard look" at the proposals because they failed to consider a substantial environmental problem in their analysis of discharged water from the proposed Project. According to the IBLA, the BLM's water quality analysis was based upon only one water sample from a CBM well in the Project area and "[n]o mention is made in either EA of any deleterious impact of CBM discharge water due to its chemical composition, yet the record contains multiple documents supplied by appellants demonstrating the serious water quality issues presented by CBM-discharged waters." 158 IBLA at 163. These "serious water quality issues" were based on allegations that the high sodium content in the discharged waters would create conditions unfavorable for aquatic life and irrigation. The BLM's analysis of these issues in the environmental assessments contained no substantive reference to the sodium absorption ratio of the discharged water, which the IBLA called one of the two most important characteristics of determining the suitability of water for irrigation. The IBLA remanded the case for an expanded examination of the water quality impacts of the Project.

The IBLA distinguished between the BLM's approval of the Project and the leasing decisions challenged in *Wyoming Outdoor Council,* 156 IBLA 347, 358, GFS(O&G) 6(2002), noting that the actions being challenged in the present case are post-leasing events. Nevertheless, the IBLA noted that the Environmental Impact Statement supporting the Buffalo Resource Management Plan/Record of Decision at issue in *Wyoming Outdoor Council* did not address the impacts of CBM extraction and development. Accordingly, the IBLA held that the BLM may not look to that EIS to support its claim that it took a hard look at the water quality issues presented by the Project.
The IBLA also held that the BLM failed to consider some of the cumulative impacts of the Project as required by the regulations implementing NEPA. For a cumulative impact to be relevant, there must be a likelihood of interaction due to geographic proximity or other factors between the proposed project and other projects that may result in enhanced or modified impacts. *See Wyoming Outdoor Council*, 147 IBLA 105, 109, GFS(O&G) 6(1998). The IBLA found that the appellants failed to demonstrate any interaction between the Project and the proposed or existing wells in Sheridan, Johnson, or Campbell counties because most of the wells were from 6 to 18 miles from the Project area, with many as far away as 72 miles. However, the IBLA ruled that a project in Montana involving the drilling of some 300 wells did meet the geological-proximity test because produced waters from those wells flow into the same watershed as that of the Project. Although no environmental analysis had been finalized for the Montana project at the time the BLM issued the DR/FONSI, the IBLA said "it is clear that much information regarding potential surface water impacts from that project existed." *Id*. at 174. Accordingly, the IBLA held that the BLM should have considered the Montana project in its cumulative impacts analysis and instructed the BLM to consider the project on remand.

In response, the dissent argued that the discharged water would be suitable for irrigation when mixed with other perennial waters, as admitted by the appellants' expert, and nothing in the record indicated any intent to use the discharged waters for irrigation prior to such mixing. In terms of cumulative impacts, the dissent noted that only 12% of the total Project area consisted of federal lands. The unknown portion of CBM and resulting water that will now be drained through wells on state and private tracts is not subject to the mitigation measures imposed by the BLM in the environmental assessment and DR/FONSI. In contrast, had the IBLA affirmed the BLM, developers intending to drill wells on federally owned Project lands would have been required to implement the mitigating measures in the environmental assessment for all of their operations in the entire Project area, including operations on the 88% of the Project lands that are not federally owned. According to the dissent, "[d]evelopment on the non-Federal lands without the mitigating measures could well result in greater adverse impact than the mitigated impact resulting from development of the entire project area." *Id*. at 181.

MINING -- OIL & GAS, ENVIRONMENTAL ISSUES
Steven E. Marlin, Guest Reporter

EPA Extends Revised SPCC Rule Compliance Deadlines Following Petroleum Industry Lawsuits

On January 9, 2003, EPA issued an interim final rule that extended compliance deadlines prescribed by the revised Spill Prevention, Control, and Countermeasure (SPCC) rule that became effective on August 16, 2002. 68 Fed. Reg. 1348 (Jan. 9, 2003). EPA published the revised SPCC rule on July 17, 2002. 67 Fed. Reg. 47,042, 47,140 (July 17, 2002). Under § 112.3(a) of the revised SPCC rule, owners or operators of affected facilities in operation on or before August 16, 2002, were required to amend their SPCC plans on or before February 17, 2003, and implement the amended SPCC plans as soon as possible but no later than August 18, 2003. Owners or operators of facilities subject to the rule that became operational after August 16, 2002, but before August 18, 2003 were required to prepare SPCC plans on or before August 18, 2003 and fully implement the plans as soon as possible, but no later than August 18, 2003. Section 112.3(b) provides that facilities subject to the SPCC rule that become operational after August 18, 2003, must have SPCC plans fully implemented prior to commencement of operations.

The interim final rule, effective January 9, 2003, extends for a period of 60 days the dates for a facility to amend its SPCC plan and implement the amended plan, or in the case of a facility becoming operational after August 16, 2002, to prepare and implement an SPCC plan that complies with the newly amended requirements. In addition, EPA concurrently issued a proposed rule in which the agency is proposing to further extend these compliance deadlines for one year. 68 Fed. Reg. 1352 (Jan. 9, 2003). The comment period for this proposed rule ended January 29, 2003. According to EPA, the 60-day extension was issued to avoid the anticipated flood of extension requests from affected facilities, and to ensure adequate consideration of comments received for the proposed one-year extension of the deadlines.

EPA's suspension of the compliance deadlines comes on the heels of three lawsuits filed by the petroleum industry that challenge the revised SPCC rule. *American Petroleum Institute v. Whitman*, No. 1:02CV02247 (D.D.C., filed Nov. 14, 2002); *Petroleum Marketers Ass'n of America v. Whitman*, No. 1:02CV02249 (D.D.C., filed Nov. 14, 2002); and *Marathon Oil Co. v. Whitman*, No. 1:02CV02254 (D.D.C., filed Nov. 14, 2002). American Petroleum Institute and Marathon Oil Company assert similar points of dispute over provisions in the revised SPCC rule, including EPA's exclusion of produced water from the wastewater treatment exemption to the rule; EPA's broad application of "loading rack" secondary containment requirements to all tank truck loading and unloading facilities; EPA's expansion of the definition of "navigable waters" under the rule to encompass areas that are not traditional navigable waters, wetlands adjacent to such waters, or adjoining shorelines; and EPA's conclusion that facilities are not permitted to consider costs and economics in making a determination that satisfaction of secondary containment requirements is not practicable.

The suit filed by Petroleum Marketers Association (PMA) added a key point of significant interest to the oil and gas industry which was emphasized in many comments. PMA claims that EPA improperly interpreted "impracticability" as excluding cost and economic considerations, and asserts that EPA failed to adequately assess whether the revised SPCC rule will have a significant economic impact on small facilities. The lawsuits request the court to vacate the SPCC rule or the relevant portions under challenge, or to issue an injunction deferring enforcement of the rule pending compliance with the Administrative Procedure Act and Regulatory Flexibility Act. On January 17, 2003, the court stayed the litigation and ordered the parties to show cause why these three cases should not be consolidated. Future developments will be tracked in subsequent columns. In the meantime, those affected by the SPCC rule should closely consider how best to balance these timing uncertainties against the need to start implementing pending SPCC program changes.

CONGRESS / FEDERAL AGENCIES -- GENERAL
Laura Lindley, Reporter

Revised Procedures to Obtain Disclaimer of Interest from United States

The Bureau of Land Management (BLM) amended its regulations implementing section 315 of the Federal Land Policy and Management Act (FLPMA), 43 U.S.C. § 1745, effective February 5, 2003. 68 Fed. Reg. 494 (Jan. 6, 2003). Section 315 of FLPMA authorizes the Secretary of the Interior to issue a recordable disclaimer of interest to help remove a cloud on the title to such lands where a record interest of the United States has terminated by operation of law or is otherwise invalid or in cases of avulsion, reliction, or accretion. The implementing regulations adopted in 1984 added a requirement that the applicant for a disclaimer be a "present owner of record." 43 C.F.R. § 1864.1-1(a). The new rules eliminate that requirement. In addition, under the former rule an application for a disclaimer would be denied if more than 12 years had elapsed since the owner knew or should have known of the alleged claim attributed to the United States. 43 C.F.R. § 1864.1-3(a)(1). The amended rule removes this time limit insofar as it applied to applications by "states," which are defined to include any of its creations such as cities, counties, or other local governmental entities. The preamble to the regulations states that this change was necessary to conform to the 1986 revisions to the Quiet Title Act, 28 U.S.C. § 2409a(g), which also carves out an exception to the 12-year statute of limitation for actions brought by a state.

The BLM received over 18,000 comments on the draft rule, most of them opposed, based on concerns that the amended rule would allow states and counties to obtain disclaimers of asserted R.S. 2477 rights-of-way without having established their entitlement to that right-of-way. *See generally* Thomas E. Meacham, "Public Roads Over Public Lands: The Unresolved Legacy of R.S. 2477," 40 *Rocky Mt. Min. L. Inst.* 2-1 (1994). However, the BLM's response to that claim is that BLM could issue disclaimers for valid R.S. 2477 rights-of-way prior to the amendment of the rule, and this rule change does not expand or modify BLM's ability to issue such disclaimers.

The opponents of the rule also charged that it violated the prohibition contained in the Omnibus Interior Appropriations Act for Fiscal Year 1997 on placing into effect any final rule pertaining to the recognition, management, or validity of an R.S. 2477 right-of-way. BLM responded that this rule is not affected by the moratorium because it simply amends the existing rule to more closely conform to FLPMA and the Quiet Title Act, and does not relate to the "recognition, management or validity" of an R.S. 2477 right-of-way.

Environmentalists claim that the new rule will allow a land rush by states and counties to obtain disclaimers of interests in trails or tracks across sensitive public lands, including wilderness, without any environmental analysis. The BLM's position is that a disclaimer does not convey an interest in land, but is merely an administrative determination that the United States owns no interest in the lands; therefore, no environmental analysis is necessary. The preamble to the rule points out that the existing rules require publication in the Federal Register and in local newspapers at least 90 days before a decision is made on a disclaimer application. The amended rule does not affect that provision for public comment.

Congress Names New Committee Chairs

With the commencement of the 108th Congress and the installation of a Republican majority in the Senate comes announcement of the new chairs of committees of interest to mineral developers. In the Senate, Pete Domenici (R-NM) chairs the Committee on Energy and Natural Resources and his colleague, Jeff Bingaman (D-NM) is the ranking minority member. Lamar Alexander (R-TN) chairs the Subcommittee on Energy, while Larry Craig (R-ID) chairs the Subcommittee on Public Lands and Forests and Lisa Murkowski (R-AK), appointed by her father, Frank Murkowski (the newly-elected governor of Alaska) to fill out his term, chairs the Subcommittee on Water and Power. Craig Thomas (R-WY) chairs the Subcommittee on National Parks.

On the House side, Richard Pombo (R-CA) was elected to chair the Resources Committee, succeeding retiring Jim Hansen (R-UT). Barbara Cubin (R-WY) heads the Subcommittee on Energy and Mineral Resources and Scott McInnis (R-CO) chairs the Subcommittee on Forests and Forest Health.

CONGRESS / FEDERAL AGENCIES -- OIL & GAS

Laura Lindley, Reporter

BLM Releases EPCA Study

On January 16, 2003, the Bureau of Land Management (BLM) released its study of impediments to the development of federal oil and gas reserves in five basins in the western United States. The report is available on the BLM website, www.blm.gov.

Section 604 of the Energy Policy and Conservation Act Amendments of 2000, Pub. L. No. 106-469 (Nov. 9, 2000) directed the Secretary of the Interior to inventory all onshore federal lands for the purpose of identifying oil and gas reserve estimates and the "extent and nature of any restrictions or impediments to the development of such resources." The resulting report, often referred to as the "EPCA Report," focused on five principal geographic areas: Paradox/San Juan Basins in Colorado, Utah, and New Mexico; the Uintah/Piceance Basins in Utah and Colorado; the Powder River Basin in Wyoming and Montana; the Greater Green River Basin in Wyoming, Colorado, and Utah; and the Montana Thrust Belt in Montana. The EPCA Report concluded that roughly 39% of the federal land in these five basins is available for oil and gas leasing with standard stipulations; approximately 25% is available with more restrictive stipulations; and approximately 36% is not available for oil and gas leasing. Environmental groups pointed to the study as evidence that most federal lands are open to oil and gas development while industry groups objected that the study downplays the extent and cost of restrictive stipulations and ignores delays in obtaining drilling permits and the restrictive conditions that are imposed on those permits.

ALABAMA — OIL & GAS
John Land McDavid, Reporter

Alabama Reverses $3.5 Billion Judgment Against Exxon

The Alabama Supreme Court reversed and remanded a trial court judgment in favor of the State of Alabama against Exxon for $87,692,695 in compensatory damages and $3,420,000,000 in punitive damages because an opinion letter of an Exxon staff attorney was a confidential communication and should not have been admitted. *Exxon Corp. v. Dep't of Conservation Natural Resources*, No. 1001053, 2002 WL 31845900 (Ala., Dec. 20, 2002) (not released for publication).

The action involved royalty payments and deductions for costs on production from Exxon's wells in Mobile Bay. In the 1980s Exxon paid $585 million in bonuses for its Mobile Bay leases, which were taken on an oil and gas lease form prepared by a staff attorney of the Alabama Department of Conservation especially for the offshore sales. As production was obtained, the various facilities for treatment and transportation completed, and the time for payment of royalties approached, Exxon's manager of its Mobile Bay project requested from an Exxon staff attorney an opinion as to payment of royalties and allocation of costs in connection with the Alabama offshore leases. The opinion gave three possible interpretations of the lease provisions concerning royalty and costs, assessed the likelihood of success of each in the event of litigation, and indicated the interpretation most favorable to Exxon was the least likely to be upheld in the event of litigation. The letter was admitted by the trial court and was used by Alabama in all stages of the litigation. On appeal, Alabama argued: (1) the writing was not a "confidential communication," (2) if it was a confidential communication, Exxon had waived the privilege by the distribution of the letter to representatives of Exxon who were outside the "control group" and whose duties were not closely related to the payment of royalties, (3) the confidentiality privilege was waived through the crime-fraud exception to the attorney-client privilege, and (4) even if the privilege was not waived, the admission was harmless.

The Alabama Supreme Court held the attorney was an in-house attorney for Exxon and Exxon was his client; corporations are entitled to the benefit of the attorney-client privilege; the attorney had been requested to render a legal opinion as to the interpretation of the lease; and the letter clearly represents a communication of legal advice pertaining to the interpretation of a contract.

Alabama argued that Exxon had waived the privilege by distribution to persons who were not qualified representatives of Exxon on the basis of two items of evidence. One was the "Courday documents," which were admittedly not confidential, and were prepared for presentation to a senior vice president. This document contained some of the information also contained in the attorney's letter. The court found that the Courday documents and the staff attorney's opinion letter were sufficiently dissimilar so that the Courday documents did not represent a waiver of the privilege.

Another item of evidence was a rubber stamp that contained a date and ten sets of initials beside which were boxes to be initialed by the recipients. The stamp was placed on the upper right hand corner of the opinion letter. None of the boxes were initialed. Testimony revealed that several people received copies of the letter. The court found that all of them were qualified representatives of Exxon and that Exxon had made a prima facie showing of confidentiality so that the burden shifted to the state, which the state did not meet.

Concerning the crime-fraud exception, the court pointed out that the trial court had rejected this argument and also rejected it on the basis that there was no evidence Exxon was engaging in fraud at the time it requested the letter or that the letter was requested to further the scheme of the alleged fraud, and thus did not qualify for the crime-fraud exception.

The court stated the admission of the letter, instead of being harmless, was prejudicial, pointing out that Alabama's attorney had made use of the letter throughout the trial and said statements of Alabama's attorney at the trial essentially admitted that the admission of the letter prejudiced Exxon.

Six justices joined in the per curiam opinion. One justice concurred as to punitive damages and dissented as to compensatory damages. Two justices dissented.

ALASKA -- OIL & GAS
John K. Norman, Reporter

IBLA Dismisses Air Quality Appeal for Lack of Standing

In *Alaska Center for the Environment*, IBLA 2000-231 (Order Dec. 20, 2002), several environmental advocacy groups argued that the Bureau of Land Management's grant of "exclusion zones" around oil drilling platforms could result in unacceptable pollution and environmental harm to these areas. They contended that, by excluding the public from these areas, the permittees might not be required to meet national ambient air quality standards established by the U.S. Environmental Protection Agency pursuant to the federal Clean Air Act, 42 U.S.C. §§ 7408-7409, and would thus be free to emit more air pollutants. Appellants argued that BLM's approval of the air quality exclusion zones violated provisions of the National Environmental Policy Act of 1969, 42 U.S.C. § 4332(2)(C), the Federal Land Policy and Management Act of 1976, 43 U.S.C. § 1732(b), and the Alaska National Interest Lands Conservation Act (ANILCA), 16 U.S.C. § 3120. The Interior Board of Land Appeals (IBLA), by Order dated December 20, 2002, dismissed the air quality appeal due to the appellants' lack of standing.

On January 28, 2000, the Northern Field Office (NFO) of the Bureau of Land Management (BLM) in Alaska originally issued a finding of no significant impact and record of decision (FONSI/ROD), approving, without modifications and additional stipulations, applications submitted by ARCO Alaska, Inc. -- now Conoco Phillips Alaska, Inc. (ARCO), for permits to drill and a right-of-way to conduct winter exploration operations on certain of its oil and gas leases in the National Petroleum Reserve-Alaska (NPR-A).

The NFO authorized ARCO to drill up to eight winter exploratory wells during not more than three winter seasons, and, *inter alia*, to establish air quality exclusion zones of 130 meters by 130 meters immediately around each drill pad to protect the public from exposure to ambient air that, under worst case conditions, might temporarily exceed national air quality standards. The NFO based its decision on the analysis in environmental assessment (EA) AK-02-00-0011, which was tiered to and incorporated a 1998 environmental impact statement (EIS) prepared by the Northeast National Petroleum Reserve-Alaska Integrated Activity Plan (IAP/EIS).

The Director of the Alaska State Office, BLM, upheld the NFO's original decision. The Director's decision was then appealed by the Alaska Center for the Environment; Alaska Wilderness League; Defenders of Wildlife; Greenpeace, Inc.; Northern Alaska Environmental Center; Sierra Club; and the Wilderness Society (Appellants).

In its Order dated December 20, 2002, the IBLA dismissed the appeal for lack of standing. In dismissing the appeal, the IBLA held that there are two requirements which must be met to establish standing: (1) the appellant must have been a party to the case being appealed, and (2) the appellant must have a legally cognizable interest that is adversely affected by the decision of the BLM officer. In this case, the IBLA found that Appellants satisfied the first requirement, as they "clearly participated both in the process leading up to issuance of the FONSI/ROD and in the administrative appeal to the State Director"; however, Appellants had not satisfied the second requirement, as they had not demonstrated they had a legally cognizable interest adversely affected by the state director's decision.

The IBLA reasoned that to have a "legally cognizable interest," Appellants "must identify how the particular BLM action in question actually adversely affects [their] interest." Appellants could not rely alone on their organizational interest or "deep concern for a problem." The IBLA held that the interest need not be an economic or property interest (although it might include use of the land involved or ownership of adjacent land), but the interest must be colorable, identifying specific facts giving rise to a conclusion, rather than merely stating a conclusion. The threat of injury and its affect on an appellant must be more than hypothetical. The threat of injury must be real and immediate.

In an attempt to demonstrate standing, Appellants submitted a declaration from an individual who was a member of most of the Appellant organizations. The declaration asserted that the individual was an owner of an environmental and consulting and guiding business that focuses on the Arctic wilderness, that she visited the Arctic several times, and that she personally has enjoyed and will continue to enjoy the beauty, wildness, quiet, and rich wildlife of the Arctic.

The IBLA found the declaration insufficient to establish a legally cognizable interest that was adversely affected by the challenged decision. The IBLA noted that the declarant "has not shown that she has used or will use lands actually included in or adjacent to the exclusion zones." Furthermore, the IBLA did not find an explanation for how the exclusion zones (within which national ambient air quality standards might temporarily be exceeded under worst case meteorological conditions during the winter drilling season) would adversely affect declarant's interests during her planned annual summer visits to the NPR-A. The speculative nature of the harm declarant alleged was not enough to present the type of real and immediate injury necessary to support standing. Therefore, the IBLA dismissed the appeal.

This Order provides guidance as to what is required to establish standing in an administrative appeal to the IBLA involving environmental and land use matters. In a related proceeding currently pending before the Commissioner of the Alaska Department of Natural Resources (DNR), Trustees for Alaska (Trustees) have appealed a decision of the Director of the Division of Oil and Gas, allowing the creation of the same air quality exclusion zones that were involved in this IBLA appeal. The parties (ARCO and Trustees) have briefed the standing issue and a decision by the Commissioner of DNR is expected soon.

ARIZONA -- MINING
Michael R. Urman, Reporter

New Law Authorizes Counties to Establish Aggregate Mining Operations Zoning Districts

The Arizona legislature recently amended Ariz. Rev. Stat. § 11-830 relating to the regulation of aggregate mining operations in Arizona. The legislature also added Ariz. Rev. Stat. §§ 27-441 to 27-448 to provide definitions and procedural guidance consistent with the modifications to Ariz. Rev. Stat. § 11-830.

The recent amendments allow counties to prevent, restrict, or otherwise regulate aggregate mining operations. The term "aggregate mining" refers to clearing, covering, or moving land using mechanized earth-moving equipment for aggregate development and production purposes. "Aggregate" is defined as cinders, crushed rock or stone, decomposed granite, pumice, pumicite, and sand. An "aggregate mining operation" is real property that is owned, operated, or managed by the same person for mining aggregate and is located in an "aggregate mining operations zoning district" established under Ariz. Rev. Stat. § 11-830.

Under the new law, if a county with a population of two million or more receives a request by at least 100 residents who live within one-half mile of an existing aggregate mining operation, the board of supervisors of that county *must* establish an aggregate mining operations zoning district. Additionally, the board of supervisors of any county, irrespective of its population, may in its discretion establish one or more aggregate mining operations zoning districts. Such zoning districts, however, may only be located in areas that are inventoried and mapped as areas of known reserves or in areas with existing aggregate mining operations.

Upon establishing an aggregate mining operations zoning district, the county board of supervisors must appoint an Aggregate Mining Operations Recommendation Committee for that district. The Committee may include up to seven aggregate mining operators. The Committee must also have an equal number of property owners who are not operators and who are not employed by or represent operators.

The purpose of the Committee is to make recommendations to the county board of supervisors for standards regulating zoning districts. A county may then adopt regulations recommended by its Committee with respect to permitted uses, procedures for approval of property development, standards for dust control, days/hours of operation, setbacks, off-street parking, signs, property reclamation not regulated by other laws, and noise and air pollution control. Any administrative regulations adopted by the board of supervisors must also be approved by the Arizona State Mine Inspector. The State Mine Inspector may only disapprove such regulations if they duplicate, conflict with, or are more stringent than applicable federal, state, or local laws.

The new law also requires that new and existing aggregate mining operations obtain a "community notice approval" from the Arizona State Mine Inspector before beginning new operations or making "major modifications" to existing operations. Obtaining a community notice approval requires that the operator file an application and filing fee with the State Mine Inspector. The application must contain detailed information about the operation. A copy of the community notice is then sent to each residential property owner within a one-half mile radius of the aggregate mining operation, the Aggregate Mining Operations Recommendation Committee for that district, if one exists, and the appropriate Arizona Water Conservation District. If there is public interest in the community notice, the State Mine Inspector must schedule and hold a public meeting regarding the operation.

The State Mine Inspector must approve or disapprove a community notice application within 60 days. After an operation has been approved, property owners may file complaints with the applicable Aggregate Mining Operations Recommendation Committee if they believe that an operation is not in compliance with its approved community notice. The Committee must give a written recommendation to the State Mine Inspector within 30 days of considering any complaint, and the State Mine Inspector must render a decision on the complaint within 30 days of receiving the Committee's recommendation.

Existing aggregate mining operations desiring to make only "minor modifications" have different requirements than those that apply to new operations or existing operations making major modifications. Existing operations making minor changes must file an application for a minor modification to an approved community notice with the State Mine Inspector. These minor modifications will be considered approved upon submission to the State Mine

Inspector. Minor modifications of existing operations are not subject to the application fee or the public notice requirements for new operations or major modifications to existing operations.

ARKANSAS -- OIL & GAS
Thomas A. Daily, Reporter

Arkansas Court of Appeals Affirms Injunction Against Use of Well Road Under "Accommodation Doctrine"

In *McFarland v. Taylor*, 76 Ark. App. 343, 65 S.W.3d 468 (2002), the Arkansas Court of Appeals affirmed an injunction granted by the trial court against appellants' continued use of a road across the appellees' land for access to appellants' oil well. The road had been used for access to the well for approximately 20 years. However, the appellees' son, daughter-in-law, and small granddaughter recently moved into a mobile home on the road and complained about the annoying traffic on the road and potential danger to the small child. They presented evidence that an alternate road could be utilized at a cost of no more than $1,500 to the appellants.

The court of appeals held that, while an oil and gas lessee has a reasonable right of ingress and egress, he must use it in the manner "least injurious" to the surface owner. Moreover, the court stated that "what is reasonable is a question of fact." 65 S.W.3d at 471. Thus, the standard of review was whether the lower court's determination of reasonableness was clearly erroneous. The appellate court held that the lower court's injunction requiring the use of the alternate road, even at an additional cost, was not clearly erroneous and thus should be affirmed.

This case, as well as *Diamond Shamrock Corp. v. Phillips*, 511 S.W.2d 160 (Ark. 1974), suggests that Arkansas takes a more liberal approach to the accommodation doctrine than some other states.

CALIFORNIA -- MINING
M. William Tilden & Penelope Alexander-Kelley, Reporters

Easement of Necessity Arises Where the United States was the Common Owner Before Conveyance

In *Kellogg v. Garcia*, 102 Cal. App. 4th 796 (2002), the Kelloggs claimed an easement of necessity across adjacent land in order to access its landlocked parcel, which included portions of land known as the Chino Quartz Mine and Wild Rose Mine. The evidence showed that the federal government issued a patent to the Chino Quartz Mine in 1878 and that all of the property surrounding the Chino Quartz Mine was federal land. Thus, any roads that would have existed in the area would have been on land owned by the federal government. No evidence was produced showing that a road existed in 1878, but evidence did show that a road, called the "north road," was in use in 1944 providing access to the Chino Quartz Mine. In the early 1990s, the Kelloggs sued to quiet title, claiming an easement along the north road. The trial court found the Kelloggs did not have an easement by way of necessity, but the court of appeal reversed.

Under California law an easement by way of necessity arises by operation of law when it is established that: (1) there is a strict necessity for the right-of-way (e.g., landlocked) and (2) the dominant and servient estates were under the same ownership at the time of the conveyance giving rise to the necessity. The trial court determined that the element of common ownership was not satisfied because the original owner of the properties in this case was the federal government. The court of appeal found that the current trend in the law and more recent California case law support the conclusion that an easement by necessity can exist where the federal government conveyed a property landlocked by other federal property. In this case, the parties conceded on appeal that in 1878, substantial evidence showed that the federal government was the common owner of the land, including land between the Chino Quartz Mine and the north road. Additionally, since the Chino Quartz Mine was landlocked by federal land after it was conveyed, substantial evidence supported the finding of strict necessity for the right-of-way. Finally, evidence showed that the necessity had never ceased to exist at any time, but if it did cease to exist, the owner of the servient estate would be entitled to seek relief from the easement.

Update on New Legislative Limits on Surface Mining Operations Near Native American Sites

The last *Newsletter*, Vol. XIX, No. 4 (2002), reported that S.B. 483 was enacted into law on September 30, 2002. This law prohibited approval of a mining reclamation plan and financial assurances for certain mining operations located near any Native American sacred site and/or area of special concern. S.B. 483 specifically provided that it would not take effect unless another law, A.B. 1878, also became effective. On September 30, 2002, Governor Davis vetoed A.B. 1878, and S.B. 483 failed to become effective law by its own terms.

Subsequently, the governor's office directed the State Mining and Geology Board to pass emergency regulations to require the backfilling of open pits. An emergency rule was adopted on December 12, 2002, requiring that any

open pits for certain metallic mines be backfilled to original contours. On January 16, 2003, the State Mining and Geology Board voted unanimously to initiate the public comment process for adopting final pit backfill regulations. The Board made some changes to the regulation, e.g., adding copper and lead to the list of metals, but the substantive requirement remains. That regulation is undergoing public comment prior to becoming effective.
In addition, there is current legislation pending in the state legislature that would impose similar, and more onerous requirements. S.B. 22 would impose new requirements on approvals of reclamation plans or financial assurances for a surface mining operation for gold, silver, copper, or other metallic minerals, for operations located on, or within one mile of, any Native American sacred site and located in an area of special concern. This new legislation proposes that the reclamation plan require that all excavations be backfilled and graded to achieve original contours including by placing excess materials into excavated areas, and that there be sufficient financial assurances to provide this level of appropriate reclamation. Any surface mining operation in existence on January 1, 2003, with an approved reclamation plan and with financial assurances approved prior to September 1, 2002, is exempted, as are any amended reclamation plans or financial assurances for the continued operation or expansion of such surface mining operations. These changes were designed to block the Glamis Imperial mining project in Imperial County. S.B. 22 was passed by a 2/3 majority in the state senate and has moved on to the assembly.

IDAHO -- MINING
Christopher H. Meyer, Guest Reporter

Idaho Passive Road Creation Statute and R.S. 2477

In a unanimous decision, the Idaho Supreme Court upheld the public road status of Indian Creek Road near the main Salmon River in Idaho. *Farrell v. Board of County Comm'rs of Lemhi County*, No. 27,546, 2002 WL 31875415 (Idaho Dec. 27, 2002), *petition for rehearing pending.* The road traverses a narrow canyon and provides access to 32,000 acres of public lands and various inholdings. The court first addressed whether the road was properly created. Because the road was created by early settlers on public lands, it qualifies as an "R.S. 2477" road. (Revised Statute 2477, adopted by Congress in 1866, declared "the right of way [for such roads] is hereby granted.") The issue in *Farrell* was what is required, under Idaho law, to "accept" the federal government's grant. Idaho courts have long held that acceptance requires either compliance with the state's passive road creation statute (prescriptive use and maintenance for five years) or some "positive act" by local government manifesting an intent to accept.

In *Farrell*, the court made clear that the "positive act" does not require full compliance with statutory rules for formal road creation. Instead, the court said, it meant something "more lax." Just how lax is not clear. In this case, the county action accepting the road was quite formal and, although the court did not say so, presumably sufficient to satisfy the statutory procedure for formal road dedication.

The court went on to affirm a second, and more dramatic, theory offered by the Road Users (Appellants). In 1916-1917 (fifteen years after the county accepted the road into its system), the federal government patented lands along the road to various homesteaders. In executing this conveyance, the government filed and recorded plats depicting Indian Creek Road crossing the properties. Although there were no words of dedication, the mere identification of the road on the recorded plat in conjunction with sale of the property was sufficient to constitute a proper common law dedication of the road under Idaho law. The court specifically rejected two arguments: (1) that the doctrine is limited to urban settings, and (2) that it requires a metes-and-bounds description of the road.

The court then turned to the issue of abandonment. The court restated the operative principles of the "passive abandonment" statute. The party urging abandonment has the burden of demonstrating both non-use and non-maintenance for a five-year period. Non-use is a separate issue, and will not be presumed on the basis of non-maintenance. The court repeatedly refers to the passive abandonment statute as having applicability only until 1963. The reader should understand that 1963 was the pivotal date in this case, because in that year the legislature made it inapplicable to roads that serve public lands. However, the passive abandonment statute continued to operate in other contexts until its complete repeal in 1993.

Because the evidence regarding non-use in this case was sketchy, at best, Ranch Owners (Appellees) placed considerable emphasis on the fact that parts of the road had been relocated within the narrow river canyon. However, the court rejected the argument that such relocation, without modification of the termini, constituted abandonment. The new standard set by the court is that the realignment must "change the identity of the road" to constitute an abandonment.

Another significant ruling of the court is that the passive abandonment statute does not apply at all to roads created by common law dedication. In other words, a road created by common law dedication may only be vacated through formal action of the controlling local government. This point of law is a central issue in the pending petition for rehearing. The court noted that state statutes have provided over the years mechanisms for a county to formally abandon a road. The court, however, rejected Ranch Owners' arguments that (1) failure to include the road on a county road map, and (2) the existence of a prosecutor's opinion concluding that the road had been abandoned do not satisfy the requirement for a finding that the road is no longer necessary and/or not in the public interest.

The opinion also dealt with the validity of a county stipulation during the course of the litigation, finding that the county government may not make decisions to abandon litigation on the basis of "consensus," particularly in light of open meeting laws. This point is also subject to the petition for rehearing.

Finally, the court addressed the Road Users' argument that the entire case was improperly postured as a quiet title action, and should instead have been initiated by a petition to the county under Idaho Code § 40-203. The court's resolution of this claim is somewhat difficult to decipher. The court concluded that "the procedures outlined in § 40-203 apply to any claims of abandon-ment between 1963 and 1998." 2002 WL 31875415, at *10.

KANSAS -- OIL & GAS
David E. Pierce, Reporter

Lessee Entitled to Inject Off-Lease Produced Water for Secondary Recovery Operations

In 1962 the landowner entered into an oil and gas lease giving the lessee the right to use the leased land "for the sole and only purpose of mining and operating for oil and gas...." Prior to 1988 a salt water disposal agreement with the lessor allowed the lessee, for a fee, to dispose of produced water from adjacent leases into an injection well on the leased land. The salt water disposal well was plugged and abandoned in 1988. In 1996 the lessee obtained a permit from the Kansas Corporation Commission (KCC) to inject water into a well on the leased land as part of a secondary recovery operation. The lessee did not attempt to unitize the leased land. The parties stipulated that the lessee's secondary recovery operations resulted in increased oil production from the leased land. The lessor conceded the lessee had the authority to conduct secondary recovery operations. However, the lessor asserted the lessee could not bring off-lease produced water onto the leased premises without lessor's consent. The lessee contended the use of off-lease produced water to conduct secondary recovery operations was encompassed by its right of "operating for oil and gas."

In *Crawford v. Hrabe*, 44 P.3d 442 (Kan. 2002), the court held that the lessee, under the facts, had the right to use off-lease produced water to support legitimate secondary recovery operations on the leased land. Although the lessee would not be able to use the injection well to merely "dispose" of the produced water, in this case the lessee was injecting the water as a necessary component of its secondary recovery operations.

"Commence to Drill" Clause Can be Satisfied with Small Rig Used to Set Conductor Pipe

The primary term of an oil and gas lease would terminate on July 14, 2000, unless the lessee "shall commence to drill a well." The lessee took the following action prior to midnight on the 14th: July 11, filed notice of intent to drill; July 12, contracted with Big A to drill to the targeted 6,500 foot depth and dirt contractor began preparing drill site; July 14, filed amended notice of intent to drill and Weeder Well Services drilled a 51-foot hole and set 20-inch conductor pipe. Following a brief rain delay, Big A moved on site to begin completing drilling operations on July 16. The lessor asserted the lessee failed to commence to drill a well because it did not have a rig on site, capable of drilling to the targeted 6,500-foot depth, on July 14.

The court in *Bunnell Farms Co. v. Samuel Gary, Jr. & Assoc.*, 47 P.3d 804 (Kan. Ct. App. 2002), held the lessee complied with the literal terms of the lease clause by using the small rig to "drill" on the critical date. However, the court expressly noted that it was consistent with "standard drilling practices" to use a small rig to set conductor pipe. 47 P.3d at 807.

The court's opinion in *Bunnell* appears to take a more accommodating tone than *Hall v. JFW, Inc*., 893 P.2d 837 (Kan. 1995), which held that anything short of actual drilling on the critical date would not satisfy a "commence to drill" clause -- although the result might be different under a "commence *operations* to drill" clause. The Kansas Supreme Court has not addressed these issues.

Surface Lease Could Not Be Renewed after Expiration

In *Duffy v. Casady*, 28 P.3d 1040 (Kan. Ct. App. 2001), Casady entered into a lease with Duffy to use the surface of his land for a centralized collection of tanks to support Casady's oil operations on six area leases. The lease term was from July 1, 1975, through June 30, 1980, "provided, however, that Lessee shall have the option to extend this lease for successive one-year terms upon payment to Lessors, in advance of each July 1 anniversary, the annual rental hereunder." 28 P.3d at 1041. The annual rent was $250; the lease did not provide for any increase of rent upon renewal. Casady exercised his renewal option from July 1, 1980, through July 1, 1997. Duffy sought to renegotiate the rent in 1985 and 1992 but Casady "elected to stand on the terms of the written lease and his unconditional right to a 1 year extension upon timely payment of $250." *Id*. Casady inadvertently failed to make the July 1, 1998, extension payment and on July 20, 1998, Duffy gave him notice his lease had terminated. On July 22, 1998, Casady attempted to make the July 1 payment which Duffy refused. When Duffy sued to have Casady vacate the leased land, Casady sought to avoid the "forfeiture" that would cost him in excess of $90,000 to remove his tanks and relocate his operations. The trial court concluded equitable relief was appropriate and Duffy appealed.

The appellate court reversed, finding equitable principles should not apply because this is not any sort of forfeiture. As Judge Knudson noted: "Under the facts of this case, equity could not be invoked to extend or renew a commercial lease that has already expired by its express terms." *Id*. at 1042.

Courts Can Now Consider the Separate Value of Gas Well When Determining Fair Market Value of Condemned Land

In *Creason v. Unified Government of Wyandotte County*, 33 P.3d 850 (Kan. 2001), the Kansas Supreme Court construed amendments to Kan. Stat. Ann. § 26-513. The county had condemned 31 acres with a home and other improvements, including an operating natural gas well owned by the landowner. The trial court refused to admit evidence concerning the commercial value of the gas well. Under the "unit rule," used with the comparable sales method of valuation, improvements on land cannot be separately valued but are merely considered in determining the total value of the real estate.

However, in 1999, Kan. Stat. Ann. § 26-513 was amended to provide: "The fair market value shall be determined by use of the comparable sales, cost or capitalization of income appraisal methods or any combination of such methods." The Kansas Supreme Court found this statute placed the three valuation methods on equal footing with the "unit rule" being a limit only on the comparable sales method. Creason had argued: "that to arrive at the fair market value of his property, the capitalization of income method of valuation must be utilized, and McCune's testimony regarding the potential income represented by the gas reserves was necessary to value the property using the capitalization of income method of valuation." 33 P.3d at 854. The court agreed and reversed the trial court holding:

> [T]o demonstrate how the value of the property as a whole is enhanced by a natural asset, evidence can be introduced of its separate value.... Properly instructed, the jury could have found that the commercial value of the gas well on Creason's property would have an effect on the amount of money that a well-informed buyer would be justified in paying for Creason's property. The trial judge erred by failing to allow the jury to consider the testimony relative to the value of the gas well.

33 P.3d at 855.

Appeal Concerning Refunds for Overpayment of Royalty Not Ripe for Review

From 1983 through 1988 gas producers were able to provisionally recover ad valorem taxes as part of the price charged pipeline purchasers for natural gas. At the time it was believed the Kansas ad valorem tax qualified as a production-related tax under § 110 of the Natural Gas Policy Act. This meant the tax could be added to the maximum lawful price paid by the purchaser of the gas. The total proceeds paid for the gas were thereby increased with a portion of the increase paid to the lessor, reflecting a reimbursement of the lessor's share of the ad valorem tax. In 1997 it was finally determined that the Kansas ad valorem tax did not qualify under § 110 and the producers were ordered to refund all ad valorem taxes recovered in excess of maximum lawful prices since 1983. In *Plains Petroleum Co. v. First National Bank of Lamar*, 49 P.3d 432 (Kan. 2002), the Kansas Supreme Court considered the first ruling in the producers' attempt to recoup the royalty owner's share of the refunded ad valorem taxes. The trial court had before it producer unjust enrichment claims which the court held were time-barred and also ruled that a statute purporting to address the statute of limitations after-the-fact violated due process. The court did not address the producers' theory that even if their claims were barred by the statute of limitations, they could nevertheless engage in a setoff of the amount due against future royalties. The court elected not to decide that issue.

The holding in *Plains* is pretty simple: the decision of the trial court was not a "final order" and therefore not appealable. The parties did not seek, or obtain, a finding under Kan. Stat. Ann. § 60-2102(b); nor did they obtain permission from the court of appeals to accept an interlocutory appeal. The court sent the case back to the trial court for further proceedings.

Trial Court Properly Exercised Discretion to Deny Prejudgment Interest on Operator's Reimbursement Claim

Conoco had been held liable for all price overcharges associated with wells that were erroneously classified as "stripper" wells. Although there were several working interest owners who actually received the overcharges, the government held Conoco liable for the full amount under an "operator liability" theory. Conoco paid all amounts due, including interest, and then sought to recover the principal and interest from its working interest owners, including J.M. Huber Corp. The interest ran from 1982 to 1998 and for J.M. Huber Corp. the principal was $60,000 and the interest was $255,000. The trial court awarded Conoco $60,000 plus $10,000 in interest. The remaining $245,000 in interest was denied because Conoco had not demanded reimbursement until July 30, 1998.

In *Conoco Inc. v. J.M. Huber Corp.*, 289 F.3d 819 (Fed. Cir. 2002), the court affirmed Judge Belot's use of the court's equitable powers to fashion an appropriate remedy, recognizing recovery was being sought using the equitable remedy of restitution.

Deed Created a Joint Tenancy with Right of Survivorship

In re Estate of Lasater, 54 P.3d 511 (Kan. Ct. App. 2002), a mother conveyed her home to herself and her son, providing in the deed that it would be owned 99% by the mother and 1% by the son. The son actually paid the mother the equivalent of 1% of the value at the time of the conveyance. However, the intention clause of the deed indicated they would hold the property in "joint tenancy" and that their disproportionate rights while both parties were living would not "defeat the survivorship rights of the surviving joint tenant to succeed to a predeceased joint tenant's ownership interest in said property." 54 P.3d at 513. During the mother's last sickness she received Medicaid benefits and upon her death the Kansas Department of Social and Rehabilitation Services (SRS) initiated a creditor's administration of her estate. The SRS claimed her home was part of her estate; the son claimed it was non-probate property that passed to him through his right of survivorship. The appellate court held the conveyance created a joint tenancy with the right of survivorship and not a tenancy in common. Therefore, the home passed outside of the mother's estate.

The major issue was whether it was possible to create a joint tenancy, with the requisite "unity of interest," when the property was not owned in equal, undivided interests. The court distinguished "unity of interest" from "unity of *equality* of interest" and held the latter was not required to create a joint tenancy. The court stated: "The 'unity of interests refers to the necessity that all tenants have interests of the same duration, and accordingly one cannot be a joint tenant for life and another joint tenant for years.' " 54 P.3d at 514, quoting 2 *Tiffany Real Prop.* § 418 (3d ed. 2001).

The Rural Kansas Self-Help Gas Act

The Rural Kansas Self-Help Gas Act, 2002 Kan. Sess. Laws ch. 77, allows a "rural gas user," or the rural gas user's "gas provider," to arrange for gas service without becoming a public utility and without being hindered or limited by any certificated area held by a public utility. "Rural gas user" is defined as "any person currently using natural gas from a wellhead or gathering facility for agricultural purposes on property they own, lease or operate that is located outside city limits and not presently receiving gas service from an existing gas service utility." Ch. 77, § 1(k). If the utility holding the certificate is not already providing "firm gas service" as defined in the act, "then the existence of such public utility and its certificate will not in any way limit the rural gas user or the rural gas user's provider in establishing and maintaining the rural gas service provided for by this act." *Id*. § 2.

This statute was designed to address the rights of persons who are currently obtaining gas from a wellhead or off of a gathering system who, due to declining gas production and field pressures, seek out alternative gas supplies and transportation options. In many instances certain gas utilities had obtained exclusive "certificated areas" that allowed them to require the consumer to pay in excess of 50¢ per Mcf of gas to access a transportation system. The utility had the exclusive right to "serve" the area, but no *obligation* to serve. Essentially the consumer was required to build all connecting pipelines and the 50¢ per Mcf fee was collected to let the gas flow through a meter -- with the consumer also paying for the gas and whatever it cost to move the gas to the metering point on the pipeline. The economics were apparently such that the utilities holding the certificates were not interested in extending service and instead served a passive role as gatekeeper to the third-party pipeline. The regulatory system created exclusive rights that, absent any obligation or incentive to provide services, actually retarded the availability of gas service to the area farmers -- all of whom were sitting in the world's largest gas field. The act was designed to provide the rural gas user with maximum flexibility to meet their own gas supply needs; thus the title "Rural Kansas *Self-Help* Gas Act." The act also recognizes the importance of the "nonprofit public utility" (NPU) in providing service in areas neglected by existing certificate holders. Section 4 of the act provides:

> When two or more rural gas users combine...to operate as a nonprofit public utility (NPU), if the rural gas service is provided within an area where a public utility holds a certificate, the existence of such public utility and its certificate will not in any way limit the rural gas users, the NPU, or their gas provider, in establishing and maintaining the rural gas service provided for by this act.

Flaring/Venting Statute Broadened to Include Gas from Gas Wells

The original version of Kan. Stat. Ann. § 55-102 contained authority to flare gas only "in connection with the production of oil...." The amended version of § 55-102 expands the Kansas Corporation Commission's authority to permit flaring or venting of gas "*from natural gas wells or* in connection with the production of oil, *or coalbed natural gas produced from coal seams or associated shale*...." 2002 Kan. Sess. Laws ch. 206.

MISSISSIPPI -- OIL & GAS

John Land McDavid, Reporter

Mississippi Tort Reform Legislation

In a special session that ran for 83 days in 2002, the Mississippi legislature first adopted a Medical Malpractice Tort Reform Act, 2002 Miss. Laws 3d Ex. Sess. ch. 2 (H.B. 2), and then a Civil Justice Reform Act, 2002 Miss. Laws 3d Ex. Sess. ch. 4 (H.B. 19). Both bills were signed by Governor Musgrove and became effective January 1, 2003.

The U.S. Oil and Gas Association, Alabama/Mississippi Division, joined with other business trade associations to lobby for tort reform. In addition to the usual tort claims, the Mississippi oil and gas industry has had to defend numerous lawsuits involving naturally occurring radioactive material (NORM).

The Civil Justice Reform Act provides in major part:

(1) civil actions shall be commenced in the county where the defendant resides, or where the act occurred, or where the event that caused the injury occurred; civil actions against a nonresident may be commenced in the county where the plaintiff resides or is domiciled; civil actions alleging a defective product may also be brought in the county where the plaintiff obtained the product; and several statutes providing for venue in actions against non-residents, nonresident motorists, railroads, and insurance companies are repealed;

(2) liability for noneconomic damages shall be several only and economic damages shall be several if the defendant is determined to be less than 30% liable and joint and several for liability above 30% but not more than 50%;

(3) a defendant whose liability is based solely on his status in the stream of commerce may be dismissed from a product liability claim provided another defendant, including the manufacturer, is properly before the court and from whom recovery may be had for the plaintiff's claim, however, no such dismissal shall operate to divest a court of venue or jurisdiction otherwise proper at the time the action is filed; and a defendant so dismissed shall be considered to remain a party only "for such purposes," which order of dismissal shall be interlocutory;

(4) places a cap on punitive damages based on the net worth of the defendant, beginning at $20 million for a defendant with a net worth of one billion dollars and descending in five increments to 4% of the net worth of a defendant with a net worth of $50 million or less, which limitation shall not be disclosed to a jury; these limitations shall not apply to actions brought for damages resulting from an act because of which a defendant is convicted of a felony, or if the act was done while under the influence of alcohol or drugs, which exception shall not apply (that is, the caps will apply) to an employer of such a person if such person was acting outside the scope of his authority; and the caps do not apply in any instance to contracts, libel, or slander and actions involving asbestos;

(5) no owner or person controlling or managing property shall be civilly liable for criminal acts of a third party unless such owner knew or reasonably should have known of the risk of criminal conduct;

(6) the authority to bring an action against firearms or ammunition manufacturers or dealers is exclusively reserved to the state;

(7) there shall be no recovery for loss of enjoyment of life as a separate element of damages apart from pain and suffering damages and in a wrongful death action there shall be no recovery for loss of enjoyment of life caused by death;

(8) an attorney who is not a member of the Mississippi bar may not advertise legal services to solicit clients unless such out-of-state attorney associates a Mississippi attorney who actually works on substantial aspects of the action;

(9) a court may impose $1000 assessment on a party and an attorney who files a frivolous suit; and

(10) statutes that placed up to a 15% penalty for an unsuccessful appeal were repealed.

Full text of the act may be obtained from the Mississippi legislature at www.ls.state.ms.us.

MONTANA -- MINING

Steven P. Ruffatto & Colby Branch, Reporters

Limitation on Local Control of Mining: No Constitutional Right to Ignore Statutes

In recent years, the Montana Supreme Court has undertaken to interpret and develop the environmental provisions of Montana's 1971 Constitution, Article II, section 3 and Article IX, section 1. The court held in *Montana Environmental Information Center v. Dep't of Environmental Quality*, 296 Mont. 207, 988 P.2d 1236 (1999), that Montana's Constitution guarantees a fundamental right to a clean and healthful environment, and that any statute or rule implicating this right is subject to strict scrutiny. *See* "An Inalienable Right to a Clean Environment," Vol. XVI, No. 4, at 14 (1999) of this *Newsletter*. Then, in *Cape-France Enterprises v. Estate of Peed*, 305 Mont. 513, 29 P.3d 1011 (2001), the court held that a contract is unlawful and may be rescinded whenever its anticipated performance *may* result in significant or substantial environmental degradation. *See* "Court Finds Constitutional Right to Rescind a Contract," Vol. XVIV, No. 1, at 7 (2002) of this *Newsletter*.

Such decisions raise significant questions for the mining industry. For example, can a citizen skirt the legislature and the regulatory agencies by going directly to court to enjoin the issuance of a mining permit—or even the continued operation of an existing mine? Does Montana's Constitution provide a cause of action—a right to sue—for interference with one's fundamental right to a clean environment? Because of these concerns, this *Newsletter* will continue to track new developments in this area of law.

In *Dorwart v. Caraway*, 2002 MT 240, 58 P.3d 128 (2002), the court held that a cause of action for money damages is avail-able under Montana's Constitution for violation of personal rights guaranteed by Article II, sections 10 (right to privacy), 11 (right to be free from unreasonable searches and seizures), and 17 (right to due process). *Dorwart* involved an improper search and seizure *by law enforcement personnel*, and not private parties, which the court found significant. Therefore, the potential application of *Dorwart* to a violation of one's right to a clean and healthful environment by a private party is uncertain. Still, the right to a clean and healthful environment has been determined to be a fundamental individual right, and so the possibility exists that violation of that right, at least by governmental actors, will eventually be found to be a constitutional tort.

A recent case that more directly involves the constitutional right to a clean and healthful environment is *Merlin Myers Revocable Trust v. Yellowstone County*, 2002 MT 201, 53 P.3d 1268 (2002). In this case, Myers wanted to mine and process gravel on his property, and filed an application for special review with the Yellowstone County Commissioners, a necessary first step. The county planning department recommended approval of the application with various operating conditions. The planning depart-ment advised the county that under Montana law, it could not prohibit gravel mining on the property. The Yellowstone Deputy County Attorney concurred with this opinion. Nonetheless, the county commissioners denied Myer's application on the grounds that permitting it would "violate the Montana Constitutional rights of students at [a neighboring school] to a clean, healthful and safe environment." 58 P.3d at 1270.

Myer sought judicial review in district court, which found the county's denial of Myer's application to be in direct violation of Montana zoning statutes prohibiting any ordinance, resolution, or rule from preventing the "complete use, development, or recovery of a mineral, forest, or agricultural resources by the owner thereof." Mont. Code Ann. §§ 76-1-113 & 76-2-209. The district court found that the commissioners failed to faithfully execute the laws of Montana, and instead usurped the power of the judiciary by attempting to pass on the constitutionality of laws they were required to uphold. The district court declined the county's request to rule on the constitutionality of the statutes. Instead, it reversed and remanded the matter to the county commissioners with instructions to grant the special review and determine what, if any, reasonable conditions should be placed on the gravel mine.

On appeal, the Montana Supreme Court affirmed the district court's decision in its entirety. It made no attempt to analyze the constitutionality of the subject statutes under Montana's constitutional environmental provisions, instead stating that "the [d]istrict [c]ourt correctly and appropriately resolved the dispute between the parties in this case on a statutory basis, and without addressing constitutional issues." 53 P.3d at 1272. The court further stated that it is "not the County Commissioners' function to ignore the plain provisions of a duly enacted statute." *Id*.

The Montana Supreme Court's decision in *Myers* is some-what surprising given the court's recent predilection to interject Montana's constitutional right to a clean and healthful environ-ment at every opportunity. It is unclear whether *Myers* represents a shift in the court's thinking on the scope of the constitutional right to a clean environment, or whether *Myers* will ultimately be limited to its facts.

Three Strikes for District court

For the third time, the Montana First Judicial District Court has struck down that portion of Montana's Mineral Mines Reclamation Act pertaining to the reclamation of open pits and rock faces. *See National Wildlife Federation v. Montana Dep't of Environmental Quality*, No. CDV-92-486 (Mont. 1st Jud. Dist., Mar. 21, 2002) (holding Mont. Code Ann. § 82-4-336(9) unconstitutional). The same court struck down two earlier versions of the statute, once in 1994, and again in 2000. *See* "Economic Feasibility Not a Factor in Mine Reclamation," Vol. XVII, No. 2, at 15 (2000), and "Legislature Liberalizes Reclamation Statute," Vol. XVII, No. 4, at 17 (2000) of this *Newsletter*.
As amended May 18, 2000, in a special session of the Montana legislature, the Mineral Mines Reclamation Act requires reclamation of open pits and rock faces only to a condition "of stability structurally competent to withstand geologic and climatic conditions without significant failure...; that affords some utility to humans or the environment; and that mitigates post-reclamation visual contrasts between reclamation lands and adjacent lands." Mont. Code Ann. § 82-4-336(9)(b). Further, a new subsection was added to the statute stating that the "reclamation of open pits and rock faces does not *require* backfilling...." *Id*. § 82-4-336(9)(c) (emphasis added). The district court held that the new subsection violates Article IX, section 2 of the Montana Constitution, which requires all lands disturbed by the extraction of natural resources to be reclaimed, because it "eliminates an effective reclamation tool." The Montana Department of Environmental Quality has appealed the decision to the Montana Supreme Court.

Montana -- Oil & Gas
Steven P. Ruffatto & Colby Branch, Reporters

Doctrine of Temporary Cessation Adopted

The Montana Supreme Court in *Somont Oil Co. v. A & G Drilling, Inc.*, 49 P.3d 598 (Mont. 2002), adopted the doctrine of temporary cessation of production as it applies to oil and gas leases. Pursuant to this doctrine, a temporary cessation of production will not effect termination of the lease, so long as the lessee works with reasonable diligence to restore production within a reasonable time. The court, however, took a strict view of the doctrine, holding that a cessation of production may only be deemed temporary if caused by a sudden stoppage of the well or a mechanical breakdown.

In the facts of the case, Somont had offered to buy a number of very old oil and gas leases from A & G (and related entities), most of which had been held by production since the 1920s. When A & G declined the offer, Somont acquired new leases from A & G's lessors, and then sued to compel release of the old leases. Following a show cause hearing in which the district court determined that Somont lacked standing to maintain the action, Somont obtained assignments from A & G's lessors of "any and all rights that [the lessors] may have to any and all claims and demands that any previous oil and gas lease on the subject property has expired...." 49 P.3d at 601. Somont then filed an amended complaint.

At trial, Somont presented evidence of a lack of production from several of A & G's oil and gas leases. A & G argued the lack of production was justified as a temporary cessation, and presented evidence of reduced oil prices, a deflated economy, and the company's financial pressures as justification for the cessation. The district court instructed the jury to consider "all surrounding circumstances" in determining whether A & G's leases had terminated for lack of production. In a special verdict in favor of A & G, the jury found that none of the subject leases had terminated due to a lack of production, and also found that Somont had wrongfully interfered with A & G's contractual and business relationships.

On appeal, the state supreme court was charged with deter-mining whether the district court erred in allowing the jury to consider oil prices, economic considerations, and A & G's financial condition in determining whether A & G's oil and gas leases had terminated due to lack of production. The court first made clear that the temporary cessation of production doctrine applies in Montana to limit the harshness of the rule of automatic lease termination. It then noted a jurisdictional dichotomy with regard to what constitutes a temporary cessation. In some states, the court stated, an oil and gas lease will not be terminated for lack of production in paying quantities "unless the period of cessation, *viewed in the light of all the circumstances*, is for an un-reasonable time." 49 P.3d at 231. Other states limit application of the doctrine of temporary cessation primarily to mechanical or production breakdowns.

The Montana Supreme Court chose to adopt the later rule, thereby limiting application of the doctrine of temporary cessation to those circumstances in which the cessation is caused by "a sudden stoppage of the well or a mechanical breakdown of the equipment used in connection with the well, or the like." 49 P.3d at 606. Therefore, in

Montana, the analysis as to whether an oil and gas lease has terminated due to lack of production in paying quantities must now proceed under two separate inquiries. *Id*.

First, the court must determine whether in fact the lease is producing in paying quantities. This is where economic considerations enter. If there is a lack of market, but the lease is capable of producing in paying quantities and the lessee is using reason-able diligence to market the production, Montana law will deem the lease to be "producing in paying quantities." If, and only if, it is determined that the lease is *not* producing in paying quantities, will the inquiry shift to whether the cessation is temporary or permanent. Under this prong, neither economic nor equitable principles factor into the equation. The cessation must be caused by a sudden stoppage or mechanical breakdown, and the lessee must exercise reasonable diligence to restore production within a reasonable time.

OKLAHOMA -- OIL & GAS
James C.T. Hardwick, Reporter

Joint Operating Agreement Precludes Multiple Operators

In *Pitco Production Co. v. Chaparral Energy, Inc*., 74 Okla. B.J. 430, No. 94,748, 2003 WL 140052 (Okla., Jan. 21, 2003), the Scott No. 1-23 well was drilled in 1980 by working interest owners who had entered into a joint operating agreement utilizing the AAPL Form 610-Model Form Operating Agreement-1956 designating Cheyenne Petroleum as operator of the unit area, which was a one-section drilling and spacing unit established by the Oklahoma Corporation Commission. In 1981, a second well, the Kirkwood No. 1-23, was drilled and also operated by Cheyenne. In 1982, Samson, which also owned an interest in the unit, sold its interest in the wellbore of the Scott well resulting in different ownership interests in the Scott well than in the Kirkwood well and the remainder of the unit area. In 1998, Cheyenne sold its interest to Chaparral and resigned as operator. In voting for a successor operator, Chaparral received 69.547840% of the vote of the working interest owners in the Scott well, but only 46.129760% of the owners in the Kirkwood well. Pitco then sought to become operator and received a vote of 51.07738% of the owners in the Kirkwood well and in the balance of the unit area, excluding the Scott well. Samson supported Pitco. When Chaparral refused Pitco's request that Chaparral relinquish operation of the Kirkwood well, it sought a declaratory decree that it was properly the operator of the Kirkwood well. The trial court concluded that the operating agreement did not preclude multiple operators and directed that Chaparral remain as operator of the Scott well and Pitco serve as operator of the Kirkwood well.

Chaparral appealed contending the operating agreement permits the election of only one operator for the unit area. At trial, Pitco had presented the testimony of a landman that it was not an uncommon industry practice for there to be more than one operator in a unit area. However, the supreme court held that this testimony of industry custom could only be permitted if the operating agreement were ambiguous so as to permit extrinsic evidence. Upon review of the operating agreement, the court noted that the term "operator" was commonly used in the oil and gas industry but was of no technical significance; and similarly, the term "unit area" was not technical in nature. The court concluded that the operating agreement's terms were plain and unambiguous, and, thus, refused to consider Pitco's proof of custom.

In analyzing the operating agreement, the court reasoned that initially it had designated one party (Cheyenne) as operator. Further, Section 5 of the operating agreement empowered the operator "to conduct and direct and have full control of all operations on the unit area." 2003 WL 140052, at *4. The agreement provided for the selection of "a successor operator" upon the removal or resignation of an acting operator. Noting that all references in the operating agreement and its exhibits to "operator" were in the singular accompanied by singular grammatical articles, the Oklahoma Supreme Court concluded that only one construction was reasonable—that one operator is to conduct and exercise complete control of all operations on the unit area, regardless of the number of wells.

This decision may also have implications on the enforce-ability of the operating agreement's maintenance of unit owner-ship clause, Section 20 of the 1956 Form JOA and comparable provisions of later form operating agreements. In commenting upon the imbalance in ownership between the Scott and Kirkwood wells, the supreme court referred to Samson's conveyance of its interest in the Scott well as a "breach" of these provisions and at another point as a "violation" of these provisions, provisions which the court stated were made to maintain the same ratio of owner-ship throughout the unit area. Although the court of civil appeals had concluded the operating agreement permitted only one operator, it had affirmed the trial court's decree on the basis that the parties had permitted the existence of a condition which led to the problem of multiple operators. The Oklahoma Supreme Court rejected this reason stating that allowing the breach of one con-tract provision (violation of the maintenance of the uniform interest provision) to excuse enforcement of another (the election of only one entity as operator) would not be permitted.

Operating Agreement Did Not Prevent Forced Pooling by Owner Not Subject to Operating Agreement

In *Chesapeake Operating, Inc. v. Burlington Resources Oil & Gas Co.*, 60 P.3d 1052 (Okla. Civ. App. 2002) (*cert. denied*), El Paso, Exxon, Universal Resources, and others entered into an operating agreement in 1980 covering a four-section area, including Section 36, designating Universal as operator. The parties calculated their respective interests in the contract area by dividing the number of acres each owned by the total number of acres in the four sections without regard to their ownership in any particular section. Universal was credited with all acreage that was to be acquired by forced pooling. In 1980, Universal pooled various owners for the drilling of the Marriott No. 1-36 well in Section 36, including Fuller, who was not subject to the operating agree-ment. El Paso and Exxon were not named in the pooling. In 2001, Lortz, successor to Fuller, filed with the Corporation Commission to clarify the original pooling order and add provisions for the drilling of a subsequent well, designation of operator for sub-sequent wells, compensation for participation, election periods, and designating the prior order as unit pooling. Lortz named all owners, including Burlington and Exxon, even though they were not subject to the original pooling orders. The Commission entered an order clarifying and amending the original pooling order by adding the requested provisions, including a provision that par-ties not electing to participate in the drilling of a subsequent well would forfeit their rights for further unit participation. Burlington did not appeal this order.

Lortz next sent a well proposal and an authorization for expenditure to Burlington for the drilling of an additional well in Section 36. Because Burlington considered itself not subject to the 1980 pooling order, Burlington never responded and, under the Commission's 2001 clarifying order, was deemed to have forfeited its rights in the well and unit for cash consideration in lieu of participation. Also in early 2001, Chesapeake succeeded to the interests of Questar, successor to Universal, in Sections 30 and 31. Later in 2001, Chesapeake succeeded to the interest of Lortz in Section 36 and Lortz's well proposal. When Chesapeake sent Burlington a check for compensation in lieu of participation, Burlington refused the check, claiming that it was not bound by the Commission's clarifying order and, furthermore, that it was entitled to elect to participate under the operating agreement by which, according to Burlington, Chesapeake was bound.

Although admitting it was a party to the operating agreement as to Sections 30 and 31, Chesapeake disputed that it was a party as to Section 36 because its interest in Section 36 came from Lortz, who was not subject to the operating agreement. Chesapeake filed with the Corporation Commission for further clarification and, in the alternative, pooling as to Burlington. In December 2001, the Corporation Commission ruled that procedural due process rights prevented Burlington from being subject to the 1980 pooling order through the clarification order because of lack of proper notice of the impact that the clarification proceedings would have upon Burlington's interest, that the dispute between Burlington and Chesapeake as to whether the operating agreement covered the interests of Chesapeake in the entire four-section area was a private rights dispute over which the Commission had no jurisdiction, but that that dispute did not deprive the Commission of its jurisdiction to pool Burlington's interest in the present well. The Commission's order further required Burlington to elect to participate in the well within a five-day period and to put up its estimated share of well costs or forfeit its interest.

On Burlington's appeal of the Commission's latest order, the Oklahoma Court of Civil Appeals noted that under Okla. Stat. tit. 52, § 87.1(e), the Commission could require owners who "have not agreed to pool their interests" to pool their interests and develop their lands as a unit. Since it was, according to the court, undisputed that Burlington had not agreed to pool its interests with Chesapeake, the Commission had authority to pool Burlington and require it to elect to participate or not in the drilling of the well. Burlington's argument that the Commission had no jurisdiction to pool Burlington because, as to Burlington, the operating agreement controlled was rejected. The court held that the dispute over the effect of the operating agreement was a private dispute concerning the application and interpretation of a con-tract over which the Commission had no jurisdiction, but a matter properly resolved only in the district courts.

TEXAS -- MINING

William B. Burford, Reporter

Mine Operator Not Liable on Obligations under Conveyance Refused by Landowner

TCA Building Co. v. Entech, Inc., 86 S.W.3d 667 (Tex. App.—Austin 2002, no pet.), decided a long-standing dispute between TCA, the owner of a lignite-bearing 107-acre tract, and Northwestern Resources Co., the operator of a mining operation completely surrounding TCA's tract.

Northwestern held coal leases covering the TCA tract when TCA purchased the land in 1991. After its purchase TCA asserted that Northwestern's leases were void and ordered North-western off the land. Northwestern continued to prepare the tract for mining by removing the soil and 60 feet of overburden but did not take the lignite. Instead, faced with TCA's threat of a lawsuit claiming large damages, Northwestern decided to bypass the 107-acre tract. After TCA sued Northwestern for a declaratory judgment that the leases were invalid and for other relief, Northwestern executed and recorded a "Release of Exclusivity and License" in which it released "the exclusivity of its rights and estate" under its leases so that TCA "shall have a right . . . to mine, market and sell coal from the Property," together with an irrevocable license to cross through Northwestern's mine for ingress and egress, reserving to Northwestern the right to conduct reclamation operations. 86 S.W. 3d at 669. Northwestern subsequently executed and recorded another document, a "Supplement to Release of Exclusivity and License," clarifying its intent to have conveyed and released to TCA the coal and lignite under the tract, reserving only the right to reclaim the land as required by the leases and by law. TCA lost its suit over the validity of the leases. During the pendency of TCA's appeal of that result, North-western replaced the overburden, over TCA's objection, citing the need to comply with Texas Railroad Commission requirements.

TCA then sued Northwestern again for damages based on Northwestern's alleged breach of contract, fraud, trespass, and tortious interference with contract. TCA's claims were based on Northwestern's Release of Exclusivity and License and Supple-ment to Release of Exclusivity and License executed during the earlier litigation. Northwestern had breached an implied obligation under those agreements, TCA alleged, to give TCA a reason-able amount of time to mine and sell the lignite before replacing the overburden. TCA had thus been deprived of a $36 million profit on sale of the lignite.

The court of appeals affirmed a summary judgment for North-western, holding that there was no contract on which TCA could sue. Northwestern had executed and recorded the documents without consideration. Although TCA argued that Northwestern received consideration in the form of tactical advantages in the earlier suit, these were not given by anyone in exchange for any obligations on Northwestern's part. On the contrary, TCA had, by its conduct in continuing to assail the leases' validity, rejected the conveyance embodied by the Release and Supplement. The court disposed of TCA's fraud, trespass, and tortious interference claims in similar fashion. An essential element of common law fraud, the court pointed out, is reliance on the defendant's alleged misrepresentation. TCA's rejection of Northwestern's agreement was inherently inconsistent with such reliance. Northwestern had not committed the unauthorized entry necessary for a finding of trespass, because it possessed the necessary authority under its coal leases and did not lose it under the rejected Release and Supplement. Finally, no conduct of Northwestern in preventing TCA's mining and sale of the lignite was actionable, since TCA had never acquired the right to mine superior to Northwestern's.

TEXAS -- OIL & GAS
William B. Burford, Reporter

Partnership's Royalty Underpayment Claim Held Not Transferable to Probate Court

In re SWEPI, L.P., 85 S.W.3d 800 (Tex. 2002), was a mandamus action addressing the propriety of a probate court's assumption of jurisdiction over a suit brought by Bridwell Oil Company, a partnership, and others for alleged underpayment of overriding royalty obligations on carbon dioxide production from the McElmo Dome Unit in Colorado.

Among the partners of Bridwell Oil were the trustees of various trusts established under the will of Margaret Bridwell Bowdle, who died in 1976. After the suit at issue had been pending in Harris County for over two years, two of the trust beneficiaries filed an application in the probate court of Wichita County, where Bowdle had resided and where her will had been probated in 1977, for the appointment of an administrator of her estate. An administrator was appointed and obtained an order transferring venue of the administration to the statutory probate court of Denton County, where a class action for underpayment of other McElmo Dome Unit overriding royalty interests, including interests held by Margaret Bowdle's testamentary trustees, was pending and a class had been certified. The administrator, one of the trust beneficiaries, and Bridwell Oil then filed a motion in the Denton County probate court to transfer the Harris County suit to the Denton County probate court. The Denton County court granted the motion on the basis of Tex. Probate Code § 5B, which authorizes the judge of a statutory probate court to transfer to that court causes of action "appertaining to or incident to" an estate pending there.

The cause of action clearly was not among the kinds specifically listed in Tex. Probate Code § 5A(b) as appertaining to or incident to an estate, so that the issue was whether it came within the section's general definition of "all matters relating to the settlement, partition and distribution of the estates of deceased persons." The suit would be transferable only if the con-trolling issue in the suit were the settlement, partition, and distribution of Bowdle's estate. The court held that it was not.

No party in the Harris County suit sought to directly affect Margaret Bowdle's estate, the court observed. Rather, the parties sought relief concerning royalty payments to a partnership in which Mrs. Bowdle and her estate had once been, but were no longer, partners. A partner is not a co-owner of partnership property, said the court, so the estate had no ownership in the property at issue in the suit. Moreover, whatever interests the estate may have had by virtue of its partnership status had passed to the testamentary trusts. Although the Harris County suit might have some collateral estoppel operation on the Denton County class action, as alleged by the proponents of the transfer but which the court did not decide, it did not involve calculation of any royalty claims held or controlled by Margaret Bowdle's estate. The controlling issue in the Harris County suit could not be said to be the settle-ment, partition, or distribution of the estate. Accordingly, held the court, the probate court was without authority to transfer the suit to itself and would be directed to vacate its order.

Method of Determining Shoreline of Laguna Madre Reaffirmed

Finally deciding a boundary case pending in the Texas Supreme Court for more than three years, the court in *John G. & Marie Stella Kenedy Memorial Foundation v. Dewhurst*, 90 S.W.3d 268 (Tex. 2002), ruled against the State of Texas in its dispute with private landowners, the Kenedy Foundation, affecting some 35,000 acres along the shoreline of the Laguna Madre in South Texas. Not an oil and gas case in the strict sense, the case nevertheless involved land that derived its value from the area's oil and gas production and had been closely watched by oil and gas title practitioners as an indicator of the court's devotion to settled precedent in boundary matters.

The case involved two land grants, one from Spain and the other from Mexico, each bounded on the east by "the waters of the Laguna Madre." The Laguna Madre is the submerged area between Padre Island, the barrier island extending 130 miles along the southern Texas Gulf Coast, and the mainland. The area in question was an algae-covered mud flat lying west of the Intra-coastal Waterway dredged for shipping through the length of the Laguna Madre in 1949 and east of a low "bluff" marked by change in vegetation and raised terrain. The area was dry most of the time but was inundated by a few inches of water at regular but infrequent intervals a few days, weeks, or months a year, depending on the area. The state contended that the shoreline, marking the western boundary of its land and the eastern boundary of the Foundation's based on the land grants, was the bluff line, representing the highest level reached by water during the year. In support it presented historical evidence in the form of early surveys appearing to depict the boundary of the grants approximately at the bluff line. The Foundation maintained that the correct boundary was the west line of the Intracoastal Waterway, about six miles to the east of the bluff line.

The court first noted that Spanish civil law, in effect at the time of the grants, must govern the location of the boundary. Following *Luttes v. Texas*, 159 Tex. 500, 324 S.W.2d 167 (Tex. 1958), and quoting extensively from it, the court held that the applicable civil law rule located the shoreline at the level of the average of highest daily water computed over or corrected to the regular tidal cycle of 18.6 years, not the highest level the water ever reaches. This cannot be determined without water level measurements, the court went on, which should be calculated on a daily basis even if the variation is very small. Historic misunderstanding of the boundary, as represented by the surveys on which the state relied, could neither diminish nor enlarge the grant. The Foundation's expert testimony showed that the mean daily high water level, under any method of calculation, placed the boundary at the west bank of the Intracoastal Waterway. 90 S.W.3d at 291.

The *Luttes* court's interpretation of the civil law, that shore-line boundaries must be determined with reference to measured mean daily high water levels, is reasonable and workable, the court said, and has provided a rule for determining boundaries for more than 40 years. While the subject is not beyond reconsideration, it observed, "*stare decisis* is never stronger than in protecting land titles, as to which there is great virtue in certainty." 90 S.W.3d at 281.

The state's strongest argument, which had proven convincing to the trial court, to the court of appeals, and to the supreme court before rehearing, was that conditions in the Laguna Madre made location of the boundary based on tidal measurements impossible or meaningless. Tidal forces have little effect on water levels there, and the mean high tide cannot be found, it contended. The west shore should therefore be found using a different method, such as locating the bluff or vegetation line by historical surveys. The six-justice majority disagreed, pointing out that the average daily water level could be found even if largely unaffected by astronomical forces. The Spanish law concept of the shore is the area in which land is regularly covered and uncovered by the sea over a long period, it said, and the area involved in the suit was not regularly covered and uncovered by the Laguna Madre and had not been for a very long time. 90 S.W.3d at 286.

Mineral Owners' Agreement to Lease Was Unenforceable "Agreement to Agree"

The court in *Oakrock Exploration Co. v. Killam*, 87 S.W.3d 685 (Tex. App.—San Antonio 2002, pet. filed), considered the enforceability of a letter agreement between Oakrock and three owners of mineral interests that Oakrock sought to lease. The letters offered "a bonus of $300 per acre for a one-year Oil, Gas & Mineral Lease with a twenty [five] percent [25%] royalty" on the tract. 87 S.W.3d at 687. It went on to agree to pay for an attorney to represent the mineral owners in drafting a lease and in resolving certain other matters. Finally, it requested the mineral owners' signature if the basic terms of the offer were acceptable, "subject to your final review and acceptance of the terms and conditions of an acceptable Oil, Gas & Mineral Lease." *Id*. The mineral owners signed the letter and were paid a nonrefundable $50 per acre advance on the bonus as provided in the letter. The mineral owners never executed a lease, however, instead leasing to Killam Exploration Partners for a higher bonus.

On Oakrock's appeal from the trial court's judgment in favor of the mineral owners and their lessee, the court of appeals held the letter unenforceable. For an agreement to be enforceable, the parties must have agreed on the essential terms. Although the parties may leave some contractual terms to be agreed upon later, when an essential term is left open for future negotiation, there is nothing more than an unenforceable agreement to agree, void as a contract. Because the letter lacked essential terms defining the character, extent, and duration of the rights to the oil and gas in the tract, it did not sufficiently identify the lease to be granted and could not be enforced.

Deed Conveyed Fixed 1/16 Royalty Interest, Not 1/2 of Royalty

The court in *Neel v. Killam Oil Co.*, 88 S.W.3d 334 (Tex. App.—San Antonio 2002, pet. denied), was called upon to construe a 1945 royalty deed from Joe A. Ortiz to George E. Neel, predecessor to the plaintiffs' interest. In its granting clause the deed conveyed "an undivided one-half (1/2) interest in and to" all of the royalty in oil, gas, and other minerals produced and mined from the described land. It then provided that it covered and included one-half of all the royalty to be paid under any then existing lease and that, if such lease should terminate, the grantee would be entitled to

> (1) An undivided one-sixteenth (1/16th) of all the oil produced and saved from the premises, delivered to Grantee's credit free of cost in the pipe line, (2) An undivided one-sixteenth (1/16th) interest and portion of the value or proceeds of the sales of natural gas, (3) An undivided one-sixteenth (1/16th) portion of the net amount of gasoline or other products manufactured from gas or casing head gas produced from wells situated on the premises, (4) An undivided (1/16th) of all minerals produced from the said premises forever, from the above described property.

88 S.W.3d at 338. In its next paragraph the deed provided that should a future lease be executed, the grantee "shall receive the mineral interest described in the preceding paragraph out of the royalty provided for in such leases." *Id*.

An oil and gas lease in effect at the time of the deed provided for payment of 1/8 royalty, so that 1/2 of the royalty and 1/16 of all production were the same. Under the 1980 lease in effect at the time of the suit, however, the royalty rate was 1/4. The plaintiffs claimed the right to 1/2 of the 1/4 royalty, or 1/8 of total production. The producing lessees disagreed, crediting the plain-tiffs with a royalty of only 1/16 of production, and withheld all royalty payments to the plaintiffs when they refused to sign a division order consistent with the lessees' interpretation.

The plaintiffs argued that the deed's granting clause should prevail over the contradictory future lease provision on the basis that the grant of one-half of the royalty was followed by the sentence, "This grant shall run forever." *Id*. at 340. The court disagreed, noting that under the fundamental "four corners" rule, the parties' intent must be determined from the entire deed, not a single sentence. The deed specifically provided that the grantee would be entitled to a fixed 1/16 of total production if the existing lease terminated. Under the lease in effect at the time of the deed, the court pointed out, the 1/2 of the royalty described in the granting clause was equivalent to 1/16 of total production, so that all parts of the deed were harmonized.

The plaintiffs were, nevertheless, entitled to prejudgment interest on their unpaid 1/16 royalty. Their entitlement to at least 1/16 of production was never in dispute, and it had been wrong-fully withheld. The statute of limitations barred their collection of unpaid royalty due more than four years prior to the suit, how-ever. A 1995 letter from one of the lessees agreeing to pay all un-paid royalties was not an unequivocal acknowledgment of the debt, which would have taken it out of the operation of the statute, because it was conditioned on the royalty owners' signing a division order.

Non-use of Part of Pipeline Did Not Terminate Easement

Stephenson v. Vastar Resources, Inc., 89 S.W.3d 790 (Tex. App.—Corpus Christi 2002, pet. filed), decided the appeal from a summary judgment in favor of Vastar, the owner of a pipeline across Stephenson's 90-acre tract. Vastar operated the pipeline under a 1924 easement that provided in part that it would terminate "when at any time said pipeline or lines on said lands are not used for a period of two (2) years." 89 S.W.3d at 793. Vastar and its predecessor had not transported gas through the portion of the line crossing the Stephenson tract between December 1995, and January 1999, although they apparently continued to use the line for gas transportation across other land included in the same easement and, the court observed, "used" the pipeline across the Stephenson tract by maintaining it, protecting it with cathodic equipment, mowing, cutting, and keeping up the easement route, and eventually replacing the line. Vastar's partial non-use did not terminate the easement, held the court, nor was it invalidated by the alleged uncertainty brought about by the failure of the instrument granting the easement to define non-use.

Jury Finding Upheld That Most of Payment for Gas Was Commitment Fee, Not Price of Gas, for Purpose of Tax Valuation

Zapata County Appraisal District v. Coastal Oil & Gas Corp., 90 S.W.3d 847 (Tex. App.—San Antonio 2002, pet. filed), involved Coastal's appeal of the appraisal district's valuation, for ad valorem taxation, of its working interest in two gas units. Be-cause the units were income producing property, the district based its appraisal on the income method prescribed by Tex. Tax Code Ann. § 23.175(a) (Vernon 2001), which requires that "the method must use the average price of the oil or gas from the interest for the preceding year as the price at which the oil or gas produced from the interest is projected to be sold in the current year of the appraisal."

Half of Coastal's gas from the property was sold on the spot market for an average price of about $2 per Mcf during the valuation years. The other half was committed to a long-term gas contract with Tennessee Gas Pipeline Company, under which the contract price had escalated to approximately $8 per Mcf. The appraisal district averaged these two extremes to arrive at an average or "blended" price for all gas sold in order to make its valuation.

Coastal protested the valuation before the local appraisal re-view board, as required by the Tax Code, and then appealed to the district court. At trial Coastal maintained that although Tennessee paid $8 per Mcf, only $2 represented the price of the gas. The rest, it argued with the support of expert testimony, was a commitment fee—consideration for Coastal's commitment of its gas to the contract—and thus nontaxable intangible personal property. The appraisal district countered with its own expert who testified that the entire $8 per Mcf was the price of the gas sold, as nothing in the contract allocated any part of it to a "commitment fee." The jury agreed with Coastal and determined the value of Coastal's interest based on a price of $2 per Mcf for all gas sold.

The court of appeals first dealt with the appraisal district's argument that the trial court had no jurisdiction. Because Coastal had not raised its "commitment fee" argument before the Zapata County Review Board, according to the appraisal district, it had failed to exhaust its administrative remedies. The appraisal district cited no authority, however, and the court found none, for the proposition that a party fails to exhaust its administrative remedies if it fails to raise a particular argument before the review board. Coastal's protest had been sufficient in that it was timely filed and informed the review board of the substance of the com-plaint, that the appraisal of Coastal's property was higher than its market value.

Turning to the substantive issues, the court addressed the appraisal district's contention that the plain language of Tex. Tax Code § 23.175 requires that all prices paid for gas must be used in calculating the preceding year's average price. The court agreed but pointed out that the dispositive issue was instead whether all of the $8 per Mcf contract price was in fact paid for gas. This was a hotly debated factual issue, the court said, resolved by the jury in Coastal's favor. 90 S.W.3d at 851. The admission of ex-pert testimony did not violate the parol evidence rule, which precludes consideration of evidence that contradicts, varies, or adds to an unambiguous contract, because the rule is inapplicable to situations where one of the litigants is a stranger to the agreement. Moreover, the court said, the expert testimony was offered to assist the jury in construing the contract so that it could determine the price paid for the gas, not to vary, add to, or contradict the con-tract's terms. An interesting question left unremarked upon is why the jury should have been assisted in "construing the con-tract," ordinarily the exclusive province of the court.

Disclosures and Confidentiality Agreement Imposed No Duty with Respect to Later Unrelated Purchase

Richter v. Wagner Oil Co., 90 S.W.3d 890 (Tex. App.—San Antonio 2002, no pet. h.), decided the appeal of a summary judgment denying various claims asserted by Karl P. Richter and RMS Monte Christo, L.L.C. after they were shut out of an acquisition by Wagner Oil and others. In early 1998 Richter had approached Wagner (then known as Duer Wagner & Co.) with his ideas for a gas project that would involve reserves held by Wagner in the

Jourdanton Field. Richter and Wagner executed a confidentiality agreement, after which Richter presumably shared his ideas with Wagner. The parties disagreed on whether Richter's proposed project included joint acquisitions; if so, there evidently never was a written agreement for Richter to participate in acquisitions

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The court analyzed in turn the various theories asserted by Richter and RMS, first addressing their quantum meruit claim. In order to recover under quantum meruit, it noted, the plaintiff may recover only if there is no express contract and "must establish the following elements: (1) valuable service was rendered or materials furnished, (2) to the party sought to be charged, (3) which were accepted by the party sought to be charged, and (4) under such circumstances as reasonably notified the recipient that the plaintiff, in performing, expected to be paid." 90 S.W.3d at 894. Richter's project ideas were the subject of an express agreement, so summary judgment was proper insofar as it denied a quantum meruit award for his having provided those. The court acknowledged that Richter may have provided Wagner valuable information when he notified it that RMS was the likely successful Exxon bidder and that there was a material fact issue whether Wagner had accepted and used that information. Richter had presented no evidence, however, that he had notified Wagner he expected to be paid for the information. He had provided it instead to determine whether Wagner wanted to jointly pursue the acquisition. An expectation of a future business advantage or opportunity, said the court, cannot form the basis of a quantum meruit claim. *Id*. at 895.

Richter and RMS also contended that summary judgment against them was improper because a confidential relationship existed between the parties. "Courts do not recognize confidential relationships lightly," the court observed. *Id*. at 896. The relationship must exist prior to, and apart from, the agreement that is the basis of the suit. Here no relationship existed prior to and apart from the Richter-Wagner confidentiality agreement. Statements in summary judgment affidavits presented by Richter and RMS that the nature of the oil and gas industry requires the customary imposition of confidential relationships were, held the court, contrary to established law.

Richter and RMS asserted fraud and negligent misrepresentation claims based on Wagner's alleged misrepresentation at the time of the confidentiality agreement that it was then actively engaged in reserve acquisition and interested in pursuing additional opportunities. In fact, Richter and RMS alleged, Wagner at the time was attempting to sell its assets, though its posture had changed by the time of the Exxon acquisition. Richter would not have disclosed RMS's bidding status absent the confidentiality agreement, he claimed, and his disclosure enabled Wagner to acquire the Exxon properties to Richter's and RMS's exclusion. However, Richter became aware that Wagner was engaged in selling reserves, not acquiring them, before he began discussing with RMS the possibility of acquiring the Exxon reserves. Having discovered that Wagner's alleged representation was false, he could not have relied on it when he disclosed RMS's bidding status to Wagner.

The court went on to hold that there was no evidence the confidentiality agreement had been breached. *Id*. at 899. In it Wagner agreed not to use any of Richter's proprietary information, data, and ideas for any purpose other than to consider and evaluate the proposed gas project. The only information Richter and RMS claimed that Wagner had used in acquiring the Exxon reserves was the information provided by Richter regarding RMS's likely successful bid status. Richter had not been in possession of that information at the time of the confidentiality agreement, and the agreement therefore did not prohibit its disclosure. Richter did not allege any promise of nondisclosure on Wagner's part, independent of the agreement, on which a promissory estoppel argument could be based.

Against Richter's and RMS's claims that Wagner's conduct constituted tortious interference with a prospective contract, the court held that Wagner's purchase from Exxon was a bona fide exercise of its own rights. When two parties are lawfully competing for interests to which neither is entitled, both are justified or privileged in their pursuit despite any claim of mere unfairness. Both Wagner and RMS, with Richter, were competing for the purchase of the Exxon reserves, and neither was entitled to be declared the successful bidder.

Duty of Good Faith Breached by Gasoline Seller's Setting of Price

Although not an oil and gas case, *Mathis v. Exxon Corp.*, 302 F.3d 448 (5th Cir. 2002), may have implications whenever goods are sold at a seller's or buyer's "posted" price, as produced oil often is.

Exxon was sued by 54 of its gasoline station franchisees, who alleged Exxon had overcharged them for gasoline they were required to purchase under their franchise agreements. Under the franchise agreements, the franchisees rented their stations from Exxon and entered into a sale contract for the purchase of Exxon gasoline. The franchisees agreed to buy all of their gasoline from Exxon and to pay Exxon's "price in effect at the time of the loading of the delivery vehicle," also known as the "dealer tank wagon" or "DTW" price. 302 F.3d at 452. The franchisees alleged that Exxon improperly set its DTW price at a level too high for the franchisees to compete with other retailers in order to drive them out of business so that Exxon could convert their stations to company-operated retail stores. Exxon appealed a judgment based on a jury award of more than $5.7 million plus the trial court's assessment of almost $2.3 million in attorney fees.

The parties agreed that the pricing provision of the franchise agreement was an "open price" term, thus governed by Tex. Bus. & Com. Code Ann. § 2.305 (Vernon 2002). According to this section of the Uniform Commercial Code (UCC), as enacted in Texas, a price to be fixed by the seller or by the buyer means "a price for him to fix in good faith." Tex. Bus. & Com. Code Ann. § 2.305(b) (Vernon 2002). The key disagreement here, the court noted, was over what constitutes a breach of the duty of good faith.

The UCC defines "good faith" generally as "honesty in fact in the conduct or transaction concerned." Tex. Bus. & Com. Code Ann. § 1.201(19) (Vernon 2002). Regarding merchants, including Exxon in this case, good faith means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." Tex. Bus. & Com. Code Ann. § 2.103(a)(2) (Vernon 2002). "But in the normal case a 'posted price,' 'price in effect,' 'market price,' or the like satisfies the good faith requirement Tex. Bus. & Com. Code Ann. § 2.305 cmt. 3 (Vernon 2002)." 302 F.3d at 454.

Exxon contended it had satisfied its duty of good faith because it had charged its franchisees a commercially reasonable DTW price within the range of its competitors' DTW prices, reflecting the company's investment in land, the store, transportation, and managers. The franchisees responded that even if Exxon's price was objectively commercially reasonable, a subjective intent to drive its franchisees out of business would abridge the "honesty in fact" good faith duty.

The difficult question, according to the court of appeals, was whether comment 3 to Tex. Bus. & Com. Code § 2.305 (UCC § 2-305), specifically recognizing that in the normal case a "posted price" or "price in effect" satisfies the good faith requirement, creates an exception to the normal principles of good faith governing the sale of goods. It resolved the difficulty by focusing on comment 3's use of the words "in the normal case." A challenge to the "price in effect" set by one party is not intended to be precluded, the court held, if the case is outside the normal type of case. Moreover, it went on, "any lack of subjective, honesty-in-fact good faith is abnormal." 302 F.3d at 457. Although it would be ill-advised to consider a case outside the norm based only on an allegation of improper motive by the party setting the price, the court said, the plaintiffs had produced enough evidence to escape comment 3's "normal case" limitation: an Exxon plan to replace franchises with company-operated stores, that the DTW price was higher than Exxon's rack price plus transportation, that Exxon had begun prohibiting franchisees from purchasing gasoline from others, and that a number of franchisees were non-competitive. Exxon's intention to drive its franchisees out of business, as found by the jury, was a breach of the "honesty in fact" definition of good faith and was not without foundation in law or fact.

The reasoning in this case suggests an opening for royalty owners and producers who may have agreed to sales at a purchaser's posted price or some price otherwise fixed by the buyer. If there is some evidence of an improper motive in setting a posted price, a plaintiff may be able to get the question of underpayment to the jury even if the price is commercially reasonable.

UTAH — OIL & GAS

Frederick M. McDonald, Reporter

Rule of Capture Reaffirmed; No Unilateral Duty Upon Operator to Space; Strict Statutory Compliance Required for Imposition of Non-Consent Penalty

In *Hegarty v. Board of Oil, Gas, and Mining*, 57 P.3d 1042 (Utah 2002), the Utah Supreme Court reaffirmed that an owner's failure to take action to establish and protect his or her interest in production prior to entry of a spacing order constitutes a waiver of that interest until a drilling and spacing unit is established. Additionally, so long as the operator does not obstruct the landowner from seeking a spacing order or otherwise commit fraud or other inequitable conduct, there is no unilateral duty upon the operator to seek such an order, and no requirement to pool any earlier than entry of such an order. However, the imposition of a statutory non-consent penalty upon a non-consenting owner requires strict compliance with the statutory requirements and in particular, providing actual, detailed, specific *written* notice of the *well* in which the landowner's participation is sought.

River Gas Corporation (RGC) formed the Drunkards Wash Federal Exploratory Unit (the Unit) in 1990. Seven members of one family (the Family) owned undivided interests in a 125± acre tract within the Unit area. As required by federal regulation, RGC initially offered the Family, through its designated spokesperson, the opportunity to ratify and join the Unit. In addition, on several occasions between 1990 and 1995, RGC also offered the Family the opportunity to lease. However, they never accepted these offers. During this same period of time, development of other portions of the Unit occurred. There were some verbal and written communications between RGC and the Family about drilling generally in the vicinity of the Family's lands. In anticipation of drilling a well within a quarter section inclusive of, but not on, a portion of the Family's lands, RGC sent to each Family member in July 1995 a final written offer to lease or participate as a working interest owner in the Unit. However, no specific proposed well was identified and no authorization for expenditure (AFE) was attached. The Family failed to respond. RGC drilled the well in September 1995. RGC drilled a second well within a quarter section inclusive of, but not on, the Family's remaining lands in November 1998. Again, no written notice of the well or an AFE was sent to the Family.

Both wells were drilled in accordance with an approved plan of Unit development on a quarter section density pattern. The second well was drilled closer to the Family's land than allowed under state regulation but the location was retroactively approved by order of the Utah Board of Oil, Gas, and Mining (BOGM). However, no spacing order covering the two quarter sections had ever been sought or entered by BOGM. Since the Family's lands were not committed to the Unit, RGC did not allocate production from either well to the Family.

In June 1999, the Family leased its interest to Hegarty. He then sought an order establishing the two quarter sections as drilling and spacing units, and the two wells as the allowed well for each respective unit, which BOGM granted on January 26, 2000. At the hearing, Hegarty requested that the order be made retroactive to the respective dates of first production of the wells but BOGM denied that request. He subsequently sought an order force pooling his interest retroactive to the dates of first production, claiming RGC's actions were wrongful and justified retroactive pooling. BOGM did enter an order force pooling Hegarty's interest but only effective as of January 26, 2000 (the date of entry of the spacing order). In addition, BOGM found that the Family (and as a consequence Hegarty) knew or should have known the oil and gas characteristics of their property, their oil and gas ownership, and that two Unit wells were planned on or near their property which could potentially drain their lands. BOGM found RGC's offers were sufficient to provide the Family an opportunity to have participated in the two wells, and therefore deemed the Family as non-consenting owners and imposed a 225% statutory non-consent penalty upon them. Hegarty appealed to the Utah Supreme Court.

After *dicta* addressing the interactions of state conservation laws with the statutes and regulations pertaining to federal units, the court first addressed the imposition of the non-consent penalty. "Imposition of a statutory penalty demands strict adherence to statutory notice requirements." 57 P.3d at 1048. Utah Code Ann. § 40-6-2(11) defines a non-consenting owner "as an owner who after *written notice* does not consent in advance to the drilling and operation of *a well*, or agree to bear his proportionate share of the costs." 57 P.3d at 1048 (emphasis added). "[T]he threshold requirement for nonconsent is the establishment of written notice sufficient to trigger the necessity for consent and sharing of costs in a specific well impacting a landowner's tract, or deliberate refusal. Any communication that does not rise to this level falls short of fulfilling the statutory requirement for written notice." *Id.* at 1049. The court found BOGM had ignored the non-equivalence of statutory written notice and "knew or should have known." Since the record before the court was devoid of any specific written notice of the drilling of the two wells in question and an offer for the Family to participate in their drilling by paying their proportionate share of costs, the court held the statutory notice requirement had not been satisfied, and therefore the nonconsent penalty does not apply.

The *Hegarty* court then addressed retroactive pooling. In *Cowling v. Board of Oil, Gas and Mining*, 830 P.2d 220 (Utah 1991), the court previously established that the rule of capture is still alive and well in Utah. Correlative rights are not defined until entry of a spacing order and an "owner's failure to take action to establish and protect his or her interest in production prior to the entry of a spacing order constitutes a waiver of that interest until a drilling unit is established." *Cowling*, 830 P.2d at 228. The *Hegarty* court found that, although they had not received specific written notice of the two wells, the Family knew the location of their lands, that wells were proposed in the general area, and their correlative rights, or at least the Family had notice to inquire of them. Furthermore, at the time of the drilling of the first well, the Family had access to enough information and standing to initiate a request for a drilling and spacing order. The Family "had, since 1995, substantially the same opportunity to seek state spacing and pooling that they exercised in 1999. By neglecting to protect their rights in the interim, [the Family] made a passive choice to allow their land to be drained until they took action." *Hegarty,* 57 P.3d at 1052.

The court did indicate that retroactive pooling could be appropriate if a party is "obstructed in his request for agency action [seeking spacing] or had been the victim of fraud or inequitable conduct." *Id.* at 1051 (citing *Adkins v. Board of Oil, Gas and Mining,* 926 P.2d 880, 884 (Utah 1996)). However, the record was completely devoid of evidence of any such conduct by RGC. "[RGC] did not prevent [the Family] from investigating the status of their own rights and taking action." *Hegarty,* 57 P.3d at 1051. Of particular note, the court stated that RGC had no duty to affirmatively seek spacing. RGC "fostered the formation and approval of the [Drunkards Wash Federal] Unit and was operating according to the unit agreements. It had no duty to act contrary to its own interests by seeking another layer of regulation. [RGC's] failure to initiate a request for agency action [seeking spacing] did not destroy [the Family's] ability to do so." *Id.* Thus, the court upheld BOGM's order denying retroactive pooling.

WYOMING ─ OIL & GAS
William N. Heiss, Reporter

Ambiguous, "Non Binding" Letter of Intent Found Binding

In *ACT I, LLC v. Davis*, 60 P.3d 145 (Wyo. 2002), the Wyoming Supreme Court reviewed a "non-binding" letter of intent. Act I and the Appellees (defendants) entered into a letter of intent (LOI) in March of 2000, pursuant to which Act I was to procure non-recourse financing for a coalbed methane project in exchange for a certain ownership of the leases. The LOI provided that the parties would

> work together on a best efforts basis to arrange for...the completion of the financing upon receipt of an acceptable financing commitment. In exchange for Act I's arranging financing for the Project, Act I will purchase and DNR and Tindall [Appellees] will sell, a 35% proportionately reduced working interest participation in the [project].... [T]he parties understand and agree that the transactions contemplated by this letter are non-binding and subject to... [c]ompletion of definitive agreements incorporating the terms of this letter on or before April 20, 2000, which deadline shall automatically extend for successive 10 day increments until any party gives notice of its intent to terminate....

60 P.3d at 147.

On May 4, 2000, the parties entered into an agreement extending the duration of the LOI by providing that Act I had until May 20 "in order to obtain financing arrangements for the Project and the parties." *Id*. at 148. The parties agreed to "continue to work together on a best efforts basis to arrange for the completion of the financing upon receipt of an acceptable financing commitment . . . . Upon receipt of an acceptable financing commitment [the parties] shall enter into definitive agreements to reflect the terms outlined in the Letter of Intent." *Id*.

Act I successfully negotiated a financing commitment from a lending institution. Although disputed, there was evidence in the record indicating that the Appellees orally accepted the terms of the proposed financing commitment; however, the Appellees ultimately decided they did not want to complete the deal and, consequently, never signed any loan documents. Act I believed it had successfully completed its obligations under the LOI by procuring a financing commitment that the Appellees accepted. Appellees countered that they did not owe any duty under the LOI unless and until they accepted a financing commitment in writing. Act I brought suit against Appellees, alleging breach of contract, breach of covenant of good faith and fair dealing, and demanding specific performance. The Appellees answered that because of operation of the Statute of Frauds they needed to fully execute a written financing agreement before any of the terms of the LOI could be enforceable against them.

The district court granted Appellees' motion for summary judgment, finding that enforcement of the LOI was barred by operation of the Statute of Frauds. The district court applied Colorado law, but specifically held that the outcome would be the same even under a Wyoming law. On appeal, the Wyoming Supreme Court found that there was no conflict of law question since the district court determined that both Colorado and Wyoming Statute of Frauds would render the LOI unenforceable.

The supreme court held that the district court erred in finding that the Statute of Frauds applies to prevent the enforcement of the LOI except upon completion of a written financing agreement between the Appellees and a lending institution. The court noted that Act I was not attempting to enforce any aspect of the financing agreement, but was simply enforcing the LOI and its extension, both of which are in writing and signed by the Appellees. For this reason, the supreme court found summary judgment should not have been granted on the ground of operation of the Statute of Frauds. The supreme court found that the LOI was ambiguous. Consequently, the district court was incorrect in finding the agreement unambiguous and thus could not determine the intent of the parties at the time the LOI was made.

This case points out the often-encountered problem when parties desire to commit their agreement to writing. The seeds of future disagreements are sown by parties signing a less than complete letter of intent, even though stated to be non-binding and subject to a definitive agreement to be drafted in the future. When problems subsequently arise before execution of a definitive agreement, courts are called upon to find the intent of the parties from the letter of intent.

CANADA — OIL & GAS
Nigel D. Bankes, Reporter

Lease Termination During Secondary Term

Two recent cases address the termination of a petroleum and natural gas lease during the secondary term. The first is that of Justice Romaine of the Alberta Court of Queen's Bench in *Freyberg v. Fletcher Challenge Oil and Gas Inc.*, [2002] ABQB 1173, and the second is that of the Saskatchewan Court of Appeal in *Montreal Trust Co. v. Williston Wildcatters Co.*, [2002] SKCA 91, affirming the trial judgment of Gerein CJ, [2001] SKQB 360.

Freyberg:

Reduced to the bare essentials, the facts of *Freyberg* were as follows: Freyberg was the successor in title to a two-thirds undivided interest in a gas lease granted November 13, 1975, for a five-year primary term and continuing for so long as the leased substances are produced from the lands, "subject to the continuation, further extension or sooner termination of the said term as hereinafter provided." The fourth proviso to the habendum stipulated that:

> PROVIDED that...subject only to Clause 3 hereof, if any well on the said lands...is shut-in...as the result of a lack of or an intermittent or uneconomical or unprofitable market, or any cause whatsoever beyond the Lessee's reasonable control, the time of such interruption or suspension or non-production shall not be deemed a discontinuance of...production...anything herein elsewhere contained or implied to the contrary notwithstanding.

The shut-in clause of the lease (Clause 3) provided that, at the expiration of any year during the secondary term, where there is a designated gas well on the lands from which no leased substances are being produced as the result of the lack of an economic or profitable market, such a well shall be deemed to be a producing well and

> the Lessee shall, on or before such anniversary date, pay to the Lessor in the same manner provided for the payment of delay rental hereunder, as royalty, an amount equivalent to the delay rental. Like payments shall be made in a like manner on each successive anniversary date during the period such well is deemed by virtue of this Clause to be a producing well....

The manner of payment clause had a deemed-timely-receipt clause that would be triggered if a cheque was mailed at least 48 hours before the anniversary date of the lease. The default clause of the lease purported to apply to any "breach or non-observance or non-performance" by the lessee of "any covenant, proviso, condition, restriction or stipulation" contained in the lease. It stipulated that the lessor could only exercise its right of re-entry in the event that it had given the lessee notice and the opportunity to remedy a default. Exercise of the right of re-entry was also subject to the proviso that the lease could not be terminated for so long as there was on the lands "a well capable of producing the leased substances."

Fletcher's predecessor in title drilled the 6-3 well in October 1978; a drill stem test in the Glauconitic formation gave a steady flow in excess of 6 million cubic feet per day. No further operations to complete or put the 6-3 well on production were undertaken for nearly 20 years. Over this period production did occur from wells on adjacent properties which produced for relatively short periods of time before being shut-in for excessive water production and subsequently abandoned. The evidence showed that the 6-3 well was up-structure of these wells and not subject to excessive drainage. Efforts to get the 6-3 well on production were frustrated by a number of factors including: (1) the intransigence of the operators of the local gas plant and gathering facilities, (2) the economics of constructing additional facilities, and (3) lack of access to regional gas sales agreements. While the lessee threatened the operators with an application to the Conservation Board for common-carrier and common-processor relief, no action was taken.

Fletcher completed and tested the 6-3 well in November 1998. The operation was very successful and the well was put on production in December 1999 resulting in significant royalty payments to Freyberg. Because of improved gas prices, royalty payments were significantly higher than they would have been had production occurred during some or all of the shut-in period.

Freyberg sought a declaration that the lease had terminated, either on the basis that two of the 19 shut-in royalty payments were not made in a timely manner, or on the basis that there was an economic or profitable market for production from the well before production commenced in 1999. Freyberg's claim was dismissed. The case stands for a number of important propositions. I shall summarize those propositions and then comment on two issues: (1) the interpretation of the habendum and the shut-in clause, and (2) the claim that termination during the secondary term is somehow different than termination during the primary term and the associated issue of the court's interpretation of the proviso to the default clause of the lease.

Here are the propositions: (1) Oil and gas lease litigation is subject to the general rules on onus of proof. There is no rule of law that invariably requires the lessee to bear the onus of showing that its lease is still valid. (2) A lessee wishing to rely on a deemed receipt of a shut-in payment will have the onus of proof even when it is a defendant. (3) Where the lessor alleges that a lessee cannot rely upon a shut-in clause on the grounds that the lessee has failed to meet a condition precedent for doing so relating to the absence of a market, the lessor will have the onus of proving absence of a market, at least where the lessor is the plaintiff. (4) Where the manner of payment clause allows for deemed receipt, evidence of late actual receipt of payments will not be relevant. (5) Termination during the secondary term should be treated differently than termination during the primary term. (6) Each oil and gas lease should be interpreted on the basis of its actual provisions. The court should be wary of general propositions of law in relation to oil and gas leases. (7) A post-dated cheque is a cheque for the purposes of the oil and gas lease, even if it is not for the purposes of the Bills of Exchange Act. (8) Inferentially, one tenant in common of the lessor's interest in a lease can sue for termination of the lease even though the other tenant in common of the lessor's interest wishes to uphold the lease. (9) The proviso to the default clause protects the lease from automatic termination. (10) Where the court must determine whether there was a market for lease production, the court will ask whether it was reasonable, at the relevant time, for the lessee to have formed the view that there was no viable market for the gas. The relevant time will be each anniversary date of the lease. The court will have regard to a variety of factors including price, the potential for sustained production in light of the experience of adjacent wells and the availability of, and premises for (e.g., proof of drainage), Board orders to compel sharing of pipeline and processing plant space.

What continued this lease? The interpretation of the shut-in clause. The shut-in clause of this lease posed an interesting interpretive issue that does not seem to have been taken by Justice Romaine. As drafted, this shut-in clause does two quite separate things. First, it provides that a well is deemed to be a producing well provided that there is a lack of or an unprofitable market. It is the deeming effect of the factual conditions that should extend the lease in accordance with the terms of the habendum. Second, and quite severable from the first as a matter of drafting, the clause provides an obligation to make a payment. There is nothing in the text that makes deeming conditional upon actual payment or deemed payment. On this line of reasoning, the failure to make a timely payment would not have been fatal on any construction of the terms of the lease or the proviso to the default clause; it would merely have triggered the main body of the default clause for there would have been a breach of an obligation. Given the space that the court accords to the plaintiff's late shut-in payment argument, the court must have rejected this line of reasoning (the premise of the plaintiff's argument must have been that late payment was fatal) but does not offer reasons for doing so. This seems odd in light of Justice Romaine's preference (which I share, see my comment on the first *Durish* case at (1988), 63 Alta. L. R. (2d) 269) for an approach that favours interpretation of each lease on its own terms rather than an application of presumptive rules of law.

Termination of the lease during the secondary term. Justice Romaine takes the view that there is something different about the secondary term of an oil and gas lease. Just what is the difference? According to Romaine, the difference lies in the fact that, by that time, the lessee will have made investment-backed expectations and that, therefore, commercial reality demands that we treat the lessee with greater solicitude. The reasoning is unpersuasive. Conversion from the primary term to the secondary term is not the magic moment at which investment-backed expectations arise, and, in any event, investment-backed expectations alone will not suffice; the lessee must bring itself within the four corners of a relevant estoppel doctrine. There are many cases in which such expectations have arisen during the primary term and yet the courts have still found the lease to have terminated. *Sohio Petroleum Co. v. Weyburn Security Co. Ltd.*, [1971] SCR 81, *aff'g* 69 WWR 680, is simply one case with a particularly dramatic set of facts. No; if we are going to find a difference, it must be a legal difference rather than a policy difference. And here we must at least think about just what the secondary term is; and to do that I believe that we need to think in terms of general legal categories, at least at the outset.

The lease in its secondary term is for an estate of an uncertain duration, most likely some form of determinable fee. The question that Romaine should have asked herself was: how do determinable fees come to an end? And the doctrinal answer is that they come to an end automatically without the need for the exercise of a right of re-entry: *Anger & Honsberger, Law of Real Property* ¶ 505.3 (2d ed.). Justice Romaine might then have asked whether the proviso to the default clause was really intended to change that result and whether it could do so as a matter of law. Putting the question this way makes the issue clearer. The case that the lessee must establish, framed this way, is that the proviso to the default clause was actually intended to serve as an additional (fifth) proviso to the habendum *thereby* preventing automatic termination. For it is, after all, the habendum that governs duration and it is the habendum that tells us what estate we have. Justice Romaine never addressed this point and instead seems (at para. 135), to accept the defendant's argument that somehow the lessee is entitled to the benefit of the proviso because it had *a duty* to produce if it could not avail itself of the terms of the shut-in clause. This too is unpersuasive and, with respect, Justice Romaine's reasoning on this point is confused.

Williston Wildcatters:

On February 26, 1952, Payne, et. al, the predecessor in title to the current plaintiff, granted a petroleum and natural gas lease to the predecessor in title of the current defendants. The lease had a 10-year primary term continued "so long thereafter as the leased substances or any of them are produced from the said lands . . . ." The third proviso to the habendum provided that:

> if at any time after the expiration of the said Ten (10) year term the leased substances are not being produced on the said lands and the Lessee is then engaged in drilling or working operations thereon, this lease shall remain in force so long as such operations are prosecuted and, if they result in the production of the leased substances or any of them, so long thereafter as the leased substances or any of them are produced from the said lands; provided that if drilling, working or production operations are interrupted or suspended as the result of any cause whatsoever beyond the Lessee's control, the time of such interruption or suspension shall not be counted against the Lessee, anything hereinbefore contained or implied to the contrary notwithstanding.

The lease also contained a standard default clause. The lessee had the 12-8 well drilled and producing by November 1955. Production continued thereafter but on a declining basis until, by December 1988, the then lessee was reporting to Saskatchewan Mineral Resources (SMR) monthly production of 0.6 cubic meters of oil and 1.6 cubic meters water. For each of the succeeding months of January, February, and March the lessee reported identical production data. In January 1989 the flow line froze. Further freezing problems were encountered in December 1989 and January 1990 notwithstanding efforts in the fall of 1989 to install an underground storage tank that SMR subsequently forbade the use of. There was no production from February to July 1990. There was a road ban during March and April. Following a workover in July, production re-commenced August 1990 before ceasing for good in May 1991. In the meantime, Wildcatters, a farmee from the lessee, drilled a second well, the 11-8 well which was commenced May 20, 1991, and completed May 28, 1991, with production commencing in June. A royalty cheque for this production was received by the plaintiff in August.

Under the terms of a royalty trust agreement of June 1955, Montreal Trust became the registered owner of the mines and minerals as a bare trustee for the beneficiaries under that trust. Royalties were payable to the plaintiff as trustee and all communication by the lessee was with the trustee. Under the terms of the trust deed the plaintiff exercised its powers and authorities under the lease upon direction from the unit holders. In February 1993 the plaintiff commenced this action seeking a declaration to the effect that the lease had terminated. Questions of accounting and quantification of losses and damage were reserved. There was also a cross claim by the farmees against the farmors alleging that if the lease were found to have terminated then the lessee/farmor would be in breach of its covenant to the effect that "it has complied with the terms of the lease . . . to the extent necessary to keep them (*sic*) in force."

Chief Justice Gerein at trial held that the lease had terminated and was not saved by estoppel. In Gerein's analysis there were two periods to consider during the secondary term: (1) January to March 1989 and (2) January to July 1990. For the first period, the identical production records, while suspicious, did provide some evidence of production and could not be rejected. Accordingly, the lease remained in force during this period. For the second period there was no production whatsoever and the lease could only be maintained in force by virtue of being engaged "in drilling or working operations" or if such operations were suspended by a cause beyond the lessee's control, all within the meaning of the third proviso.

While there was no standard definition of working operations, earlier decisions including *Cull* ([1971] 3 WWR 28 (SCC)) and *Crozet* ((1982), 18 Alta. L. R.(2d) 145 (QB)) supported the conclusion that working operations must be activities which are directed to bringing about the production of oil. With two exceptions, none of the lessee's activities could be so characterized including: removal of snow from the site, the hauling away of salt water, the acquisition and refurbishment of a service rig, the payment of taxes, the maintenance of the surface lease, and correspondence and records relating to the lease. These activities could be categorized, respectively, as efforts to clean up the site rather than to restore production, efforts undertaken as part of an overall business operation, and, simply as administrative matters of a clerical nature that had nothing to do with production. The two exceptions were both attempts to thaw the flow line but these were isolated acts, widely spaced in time, pursued only briefly, and best described as minimal and futile and not a meaningful attempt to secure production.

Neither (following the Alberta Court of Appeal's decision in *Kinninmonth* (1963), 44 WWR 393, *aff'd on other grounds*, (1964), 47 WWR 437 (SCC)) were there any matters that were beyond the lessee's control including the weather (nothing out of the ordinary for a Saskatchewan winter), road bans (either expected or avoidable by means of a permit), and the government's refusal to allow the lessee to use an underground storage tank (the lessee should have been familiar with the regulations and in any event the tank could have been readily replaced).

The lessee was unable to establish the requirements of estoppel by representation, estoppel by acquiescence, or proprietary estoppel. The argument of estoppel by representation failed because the actions of the plaintiffs in accepting royalty payments and in consenting to the drilling of a horizontal well (not in fact drilled) did not amount to a representation of fact relating to the validity of the lease. Neither was there an intention manifested that the lessee should rely upon such a representation and neither was there reliance. As to estoppel by acquiescence, while some of the five criteria from *Wilmott v. Barber*, (1880), 15 Ch. D. 96, could be met, the lessee could not establish that the plaintiff must have been aware of its legal rights. This was the case even though one of the beneficiaries of the trust was sophisticated in the ways of the industry and the rules pertaining to oil and gas leases. That beneficiary was on notice that the 12-8 well was shut in but that information was not itself conclusive without on-the-ground knowledge of just what (if any) working operations were being conducted and that was knowledge that only the lessee had. The plaintiffs had no obligation to seek out and acquire such information. Finally, there was no encouragement given to the drilling of the 11-8 well.

The authorities on proprietary estoppel were all distinguishable on the grounds that there was no underlying legal relationship between the parties or some form of understanding in relation to the work undertaken. Similarly, the common knowledge shared in proprietary estoppel cases was not present here. The default clause was not triggered on these facts and the lessee was not entitled to notice before the lease could terminate. As to the cross claim, there was a breach of the farmor's covenant and the farmees were entitled to recover.

The court of appeal affirmed. The trial judge had correctly stated the relevant law and tests for estoppel. Insofar as estoppel arguments raised mixed questions of fact and law an appellate court must not interfere with conclusions depending upon findings of fact unless there is a palpable or overriding error. In considering the meaning of "working operations" the trial court correctly dismissed those activities unrelated to production of oil as well as other activities that did not demonstrate due diligence.

Several points perhaps deserve further comment. First, the plaintiff trustee does not seem to have argued that the minimal production during or even before the first period was inadequate to maintain the lease on the grounds that it was uneconomic, as to which see Bartlett, "The Effect of Low Oil and Gas Prices on Freehold Oil and Gas Leases: A Problem of Interpretation" (1991), 29 *Alta. L. Rev.* 1. Second, the case does raise an interesting question as to whose knowledge is relevant in the context of an estoppel by acquiescence argument: is it the knowledge of the bare trustee or the knowledge of the beneficiaries? The court does not discuss the question explicitly but the court spends considerable space exploring the state of knowledge of one of the unit holders who is at least two steps removed from the actual lessor. Third, and as to the cross claim, Gerein quickly found that the farmees were entitled to succeed. While this finding seems correct, surely Gerein goes too far when he says that the farmor "covenanted that it held a valid lease." The farmor did not so covenant and in fact stated, as the farmor typically does, that it did not warrant title. The point might have deserved a little more consideration. After all, what does "compliance with the terms of a lease" (the language of the covenant) mean when production and working operations constitute options and not obligations?

Still outstanding are some interesting accounting problems. In that context one can expect Justice Gerein to regret his somewhat flippant comment in the context of the estoppel arguments (and apparently accepted by the court of appeal at para. 33) to the effect that: "Even if there was no valid lease the plaintiff was entitled to be paid royalties based on the oil produced." If the lease has terminated then the production is unlawful and the lessor is surely entitled to an accounting of all production, subject only to the availability of equitable arguments such as those found to be persuasive in *Sohio v. Weyburn*.