



ROCKY MOUNTAIN MINERAL LAW FOUNDATION

# MINERAL LAW NEWSLETTER

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## FEDERAL — MINING

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PATRICIA J. WINMILL  
— REPORTER —

### ALCHEMY? COMMON USE OF AN UNCOMMON VARIETY CONVERTS THE MATERIAL INTO A COMMON VARIETY

In *Copar Pumice Co. v. Bosworth*, No. CV-06-97 WJ/WPL, 2007 WL 2126298 (D. N.M. July 5, 2007), the court sustained the U.S. Forest Service's position that an uncommon variety mineral cannot be sold for common variety uses. At issue in *Copar* was the Forest Service's Notice of Noncompliance, asserting that the mining claimant was not in compliance with federal regulations because it was selling some of the pumice extracted from its mining claims outside of the stonewash laundry industry.

The Common Varieties Act, 30 U.S.C. §§ 601-615, removed common variety materials from the application of the General Mining Law, and made those materials disposable only pursuant to sales. The Act identifies pumice as a common variety, but specifies that material having a "distinct and special value" is an uncommon variety and, accordingly, remains subject to the Mining Law. *Id.* § 611. The Act goes on to provide that uncommon varieties include "so-called 'block pumice' which occurs in nature in pieces having one dimension of two inches or more." *Id.*

The background of the dispute in *Copar* was a takings claim filed when the claims were included in a National Recreational Area, which closed the area to mining locations and directed the holders of valid existing claims to file claims for takings. 2007 WL 2126298, at \*3. The claimants filed a successful claim with the U.S. Court of Federal Claims, which concluded that certain of the deposits on the claims contained  $\frac{3}{4}$  inch or greater pumice blocks, which qualified the deposits as an uncommon variety, because their size made them uniquely valuable for use in the stonewash laundry industry. Under a later Settlement Agreement, *Copar* agreed only to mine the  $\frac{3}{4}$  inch or greater material and was compensated for the loss of the right to mine the smaller material, which it could have done had the claims been patented. *Id.* at \*4.

In accordance with the Settlement Agreement and its Plan of Operations, *Copar* extracted only the larger-sized pumice blocks from the claims; however, the Forest Service became concerned that some of the material had been sold for uses other than in the laundry industry and demanded that *Copar* provide an accounting showing that all of the pumice produced from the claims had been

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## FEDERAL — OIL & GAS

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GREGORY R. DANIELSON  
— REPORTER —

### IBLA REVERSES BLM DENIAL OF STANDING IN UNIT EXPANSION DECISION

The Deputy State Director (State Director) of the Colorado State Office of the Bureau of Land Management (BLM) dismissed the request of Three Forks Ranch for State Director Review of a decision approving the expansion of the Focus Ranch Unit. Three Forks, an owner of unleased mineral interest in the unit area, appealed this decision. In *Three Forks Ranch, Inc.*, 171 IBLA 323, GFS(O&G) 7(2007), the Interior Board of Land Appeals (IBLA) reversed, holding that Three Forks Ranch should have been served with a copy of the BLM's decision and therefore its appeal was timely filed within 20 days after receiving actual knowledge of the decision.

Clayton Williams Energy Inc. (CWE), the unit operator, served Three Forks Ranch with notice of the proposed expansion of the Focus Ranch Unit. Three Forks Ranch filed with BLM an objection to the unit expansion. BLM approved the unit expansion but did not serve Three Forks Ranch with the decision. Within 20 days of learning of the BLM decision, Three Forks Ranch filed a request for State Director Review under 43 C.F.R. § 3165.3(b) which provides that any party adversely affected by an instruction, order, or decision issued under the regulations in this part may request an administrative review before the State Director. The State Director dismissed Three Forks Ranch's appeal because it was not filed in a timely manner. The State Director further concluded that because Three Forks Ranch was not a party to the Focus Ranch Unit Agreement it cannot be adversely affected by a BLM decision relating to administration of the Focus Ranch Unit.

In reversing the State Director decision, IBLA held that "when a person entitled to notice under the Unit Agreement has received such notification and has filed objections to the expansion of the unit, that person becomes a 'party' to the proceeding leading to BLM's adjudication of the application for expansion of the unit." 171 IBLA at 328. Three Forks Ranch became a party to the proceeding by filing its objection to the expansion of the unit. As a party to the proceeding, Three Forks Ranch should have been served with a copy of BLM's decision approving unit expansion. IBLA further held that since BLM should have served a copy of its decision on Three Forks, the 20-day period for filing for State

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used in the laundry industry. When Copar failed to provide the accounting, the agency issued a Notice of Noncompliance.

In analyzing the question, the court acknowledged that the Forest Service regulations governing common variety materials, 36 C.F.R. pt. 228, do not expressly provide that uncommon varieties cannot be sold for common variety purposes, but the court concluded that the regulations did provide reasonable support for that position. 2007 WL 2126298, at \*8. 36 C.F.R. § 228.41(d) provides that mineral materials are uncommon if they are used in industries “for which no other mineral can be substituted due to unique properties giving the particular mineral a distinct and special value.” The regulations further provide that “a use which qualifies a mineral as an uncommon variety under paragraph (d) overrides . . .” the classification of particular materials as common varieties under other provisions of the regulation. *Id.* § 228.41(e)(2). The court concluded that these regulations can “plausibly be read” to mean that how a mineral is actually used is the true test of whether it is an uncommon variety, notwithstanding its potential for other uses. 2007 WL 2126298, at \*8.

The court also examined several Interior Board of Land Appeals (IBLA) cases, which it again conceded did not expressly support the Forest Service’s view that a common use of what would otherwise be considered an uncommon variety converts the material into a common variety. *Copar*, 2007 WL 2126298, at \*10-14. The IBLA cases emphasized that there must be a unique end use of material in order for it to be characterized as an uncommon variety or they focused on the need to show that the material is marketable for a use that gives the material special value. The court concluded that the emphasis in these cases on use of the material supported the Forest Service’s position that the actual use of a material is determinative of its common or uncommon nature.

The result in *Copar* suggests a new role for the Forest Service and the Bureau of Land Management (BLM) and an additional burden for mining claimants. As the *Copar* court sees it, the agencies’ role is not merely to ensure that a mining claimant is mining only uncommon varieties, but also to monitor all sales for the life of the mine to ensure that no material is sold for a common use. The corresponding burden on the mining claimant will be the need to ascertain how each purchaser will use the material, determine in each case whether the use qualifies as an uncommon use, reject unqualified end-users, and maintain accurate records reflecting that all of its end users are qualified.

#### TIME TO APPEAL UNDER BLM’S 3809 REGULATIONS

*Ferrell Anderson*, 171 IBLA 289, GFS(MIN) 11(2007), clears up an ambiguity in BLM’s 3809 appeal regulations. The regulations at 43 C.F.R. §§ 3809.800-.809 govern appeals from BLM decisions implementing the 3809 surface management regulations and provide a process by which the claim owner can request review of BLM’s initial decision by the State Director. The regulations specify that the State Director can choose not to accept the request for review, act on the merits of the request within 21 days

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 MINERAL LAW NEWSLETTER
 

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of its receipt, or not respond to the request during that time period, which is treated as a decision not to review the underlying decision. 43 C.F.R. §§ 3809.801(a)(2) & (4), .806(a). The regu-

lations specifically provide that an appeal to IBLA from a decision not to review the original decision or from a decision on the merits of the request must be made within 30 days of the State Director's action, but are silent as to when an appeal must be taken if the State Director does not act on the request within the specified time period. 43 C.F.R. § 3809.801(a)(2) & (4). In *Anderson*, the claimant requested review of the BLM decision, but the State Director did not act on the request. Eleven months later, the claimant appealed the decision to IBLA. In arguing that the appeal should be dismissed as untimely, BLM argued that because the regulations provide that the State Director's failure to act within the 21-day time period is a *de facto* decision not to review the original decision, the 30-day time limitation that applies to express decisions not to review should apply and run from the last day of the 21-day period. The IBLA simply noted that the regulations do not impose a time period in which appeals must be brought when the Director fails to act, and that, accordingly, the appeal was timely.

#### **SURFACE OWNER OF STOCK-RAISING HOMESTEAD LANDS MAY FILE A NOITL**

In *Margaret L. Berggren*, 171 IBLA 297, GFS(MIN) 12(2007), IBLA ruled that a surface owner may file a Notice of Intention to Locate mining claims (NOITL) on land patented under the Stock-Raising Homestead Act of 1916 (SRHA), 43 U.S.C. §§ 291-301. Under SRHA patents, the United States reserved minerals, which are thus subject to location. 43 U.S.C. § 299(a). Under an amendment to the SRHA, enacted in 1993, Congress extended additional protection to surface owners, requiring that before prospective mining claimants enter lands patented under the Act, they must file a notice of intention to locate a claim with BLM and give the notice to the surface owner. *Id.* § 299(b)(1)(A) & (3). The effect of a NOITL is to segregate the lands from any other mineral entry for a 90-day period following the date of its filing. *Id.* § 299(b)(2). BLM's regulations implementing these statutory provisions provide that a surface owner of SRHA land is free to locate a mining claim on the reserved minerals, and "do[es] not need to follow" the notice requirements of the Act. 43 C.F.R. § 3838.3(b). Berggren filed a NOITL with BLM on SRHA lands that she owned and on lands owned by a trust, for which she was the trustee. BLM rejected the filings, asserting that surface owners may not file NOITLs on their own lands. IBLA reversed that decision, ruling that nothing in the statute or regulations precludes a surface owner from filing a NOITL and obtaining the exclusive right to prospect and locate claims afforded by the segregative effect of a NOITL. BLM argued that allowing surface owners to file NOITLs would allow them to effectively segregate the land permanently by filing a series of NOITLs. IBLA dismissed this argument, noting there was no evidence that Berggren had filed successive NOITLs. In any event, IBLA noted that BLM's regulations effectively preclude that behavior by providing that anyone who has submitted a NOITL may not submit another NOITL for the same lands until 30 days after the expiration of the prior NOITL. 171 IBLA at 302-03; 43 C.F.R. § 3838.13(c).

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Director Review should have run from the date of Three Forks Ranch's receipt of that decision.

IBLA also addressed BLM's assertion that even if service was not properly made, Three Forks Ranch could not be adversely affected by the decision and therefore had no standing to request State Director Review. Previous IBLA decisions have held that receipt by the unit operator of notice of BLM actions regarding general unit operation constitutes constructive receipt by all parties signatory to the unit. Further, interest owners who have not joined the unit are not entitled to any notice from BLM regarding general unit operation actions and they cannot be considered adversely affected by them. *Global Natural Resources Corp.*, 121 IBLA 286, 289 (1991), GFS(O&G) 2(1992). IBLA held that the expansion of a unit does not fall within the term "general unit operations" and that BLM may have an obligation to serve parties in addition to the unit operator with a decision approving expansion of the unit. In this case, Three Forks Ranch asserted that the drilling of wells in the expanded unit area would affect its surface activities. IBLA stated that this was sufficient to support a finding that Three Forks Ranch may be adversely affected by BLM's decision, as required under 43 C.F.R. § 3185.1.

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## CONGRESS / FEDERAL AGENCIES GENERAL

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**ROBERT C. MATHES  
KATHLEEN S. CORR  
— REPORTERS —**

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#### **FOREST SERVICE PLANNING RULES STRUCK DOWN—FOREST SERVICE WILL PREPARE AN EIS**

On March 30, 2007, the U.S. District Court for the Northern District of California issued a decision enjoining the implementation of the Forest Service's 2005 Planning Regulations, 70 Fed. Reg. 1023 (Jan. 5, 2005). See *Citizens for Better Forestry v. U.S. Department of Agriculture*, 481 F. Supp. 2d 1059 (N.D. Cal. 2007). (For a history of the Forest Service Planning Regulations please see Vol. XXII, No. 1, and Vol. XXI, No. 4, of this *Newsletter*). In a lengthy opinion, Judge Phyllis J. Hamilton ruled that the Forest Service violated the National Environmental Policy Act of 1969 (NEPA) by not preparing environmental documentation before issuing the new planning regulations in January of 2005. The administration had argued that the new planning regulations did not require NEPA analysis because they prescribed a general planning strategy rather than on-the-ground changes. The Forest Service also

**EDITOR'S NOTE ON UNPUBLISHED OPINIONS:** This *Newsletter* sometimes contains reports on unpublished court opinions that we think may be of interest to our readers. Readers are cautioned that many jurisdictions prohibit the citation of unpublished opinions. Readers are advised to consult the rules of all pertinent jurisdictions regarding this matter.

argued that the issuance of the planning regulations was categorically excluded from NEPA documentation as a routine administrative function. The court rejected the agency's arguments and determined that NEPA analysis was required given the potential for significant environmental impacts stemming from the rule change. The court also determined that the Forest Service violated the Endangered Species Act (ESA) when it failed to conduct the requisite analysis and/or consultation with the U.S. Fish and Wildlife Service prior to concluding that the 2005 Planning Regulations had no effect on listed species. The court enjoined the implementation of the 2005 Planning Regulations nationwide until the Forest Service complied with both NEPA and the ESA. On July 3, 2007, the court denied a motion to amend the judgment filed by the Forest Service. *Citizens for Better Forestry v. U.S. Department of Agriculture*, No. C05-1144, 2007 WL 1970096 (N.D. Cal. July 3, 2007).

As a result of the March 2007 decision, the Forest Service issued a letter on April 27, 2007, instructing the Regional Foresters to comply with the order. The letter indicated that national forests that were completing revisions under the 1982 planning regulations (47 Fed. Reg. 43,026, 43,037 (Sept. 30, 1982)), as allowed by the transition provisions of the 2005 Planning Regulations, are unaffected, except that the authority for continuing under the 1982 regulations is not found in the transition provisions of the 2005 Planning Regulations (65 Fed. Reg. 67,514, 67,568 (Nov. 9, 2000), as amended). The Forest Service is thus required to comply with the 2005 Planning Regulations, 65 Fed. Reg. 67,514 (Nov. 9, 2000), as amended and interpreted by subsequent regulations and interpretive rules issued prior to January 5, 2005—the date on which the 2005 Planning Regulations were promulgated. *See* 66 Fed. Reg. 1864 (Jan. 10, 2001) (interpretive rule regarding appeal procedures); 66 Fed. Reg. 27,552 (May 17, 2001) (interim final rules extending compliance dates for 2000 Planning Regulations); 67 Fed. Reg. 35,431 (May 20, 2002) (extending compliance dates for 2000 Planning Regulations); 68 Fed. Reg. 53,294 (Sept. 10, 2003) (interim final rule extending the transition period for site-specific project decisions under the 2000 Planning Regulations); 69 Fed. Reg. 58,055 (Sept. 29, 2004) (interpretive rule regarding use of best available science for site-specific authorizations implementing forest plans). Pursuant to the interim final rule, site-specific project decisions made from November 9, 2000, until new Planning Regulations are issued implementing pre-November 9, 2000, forest plans, are to be made *only* using the “best available science standard.” *See Utah Environmental Congress v. Troyer*, 479 F.3d 1269, 1272-74 (10th Cir. 2007) (interpreting the 2000 Planning Regulations and the various transition rules); *Ecology Center, Inc. v. U.S. Forest Service*, 451 F.3d 1183, 1190-91 (10th Cir. 2006) (same). Neither the remainder of the 2000 planning regulations nor any of the 1982 planning regulations are binding on site-specific decisions under the interim transitional rules. *See Utah Environmental Congress v. Richmond*, 483 F.3d 1127, 1132 (10th Cir. 2007); *Ecology Center*, 451 F.3d at 1191.

On May 11, 2007, the Forest Service issued a Notice of Intent to prepare an Environmental Impact Statement (EIS) to disclose the potential environmental consequences associated with new planning rules. 72 Fed. Reg. 26,775 (May 11, 2007). The notice indicated that the Forest Service planned to issue a draft EIS by June 2007, but the draft EIS and prepublication of the proposed

rule were not released until August 16, 2007. The draft EIS includes five alternatives. These alternatives are the proposed action (essentially the 2005 rule), the 2000 planning rule, the 1982 planning rule, and two modifications of the 2005 planning rule. Comments on the draft EIS will be accepted for 60 days after the Notice of Availability is published by the Environmental Protection Agency in the *Federal Register*, which occurred August 23, 2007. *See* 72 Fed. Reg. 48,513 (Aug. 23, 2007) (to be codified at 36 C.F.R. pt. 219).

#### **BLM AND MMS ISSUE NEW GEOTHERMAL LEASING AND ROYALTY RULES**

On May 2, 2007, the Minerals Management Service (MMS) and Bureau of Land Management (BLM) issued sweeping new regulations altering geothermal resource leasing, unit agreements, and royalty payments. 72 Fed. Reg. 24,358 (May 2, 2007) (Geothermal Resource Leasing) (to be codified at 43 C.F.R. pts. 3000, 3200, and 3280); 72 Fed. Reg. 24,448 (May 2, 2007) (Geothermal Royalty Payments) (to be codified at 30 C.F.R. pts. 202, 206, 210, 217, and 218). Both the BLM and the MMS regulations were required by the Energy Policy Act of 2005, Pub. L. No. 109-58, §§ 221-236, 119 Stat. 594, 660-74 (2005). The new regulations substantially revised the BLM's geothermal leasing regulations. The rule restructures regulations concerning the geothermal leasing process and revises regulations on royalties and readjustment of lease terms, conditions, and rentals. The rule also substantially revises the regulations on lease duration and work commitment requirements, annual rental and credit of rental towards royalty, unit and communitization agreements, and acreage limitations. One of the more significant changes required by the Energy Policy Act is the general requirement, with few exceptions, for geothermal resources to be offered through a competitive leasing process substantially similar to that for oil and gas leases. The Energy Policy Act also requires a royalty based on the “gross proceeds” from the sale of electricity from federal geothermal leases issued after August 8, 2005, multiplied by a royalty rate established by the BLM, rather than on the “net back” system that was used under the Geothermal Steam Act of 1970, 30 U.S.C. §§ 1001-1028. Lessees who use geothermal resources directly will pay fees according to a fee schedule established by the MMS. Additionally, under the Energy Policy Act and the new implementing regulations, existing lessees have the opportunity to convert the royalty provisions in their leases to those of the Energy Policy Act. Under the new regulations, leases will be issued for a ten-year primary term with two five-year extensions of the primary term; a five-year drilling extension; a production extension of up to 35 years; and a renewal term for up to 55 years under specific circumstances. In addition to significant changes regarding lease unitization and communitization, the new regulations impose an acreage chargeability limit of 51,200 acres in any one state. Both the BLM and the MMS regulations went into effect on June 1, 2007.

#### **CLAIMS AGAINST BLM EMPLOYEES FOR ALLEGED RETALIATORY ACTIONS AGAINST LANDOWNER ARE DISMISSED**

In *Wilkie v. Robbins*, 127 S. Ct. 2588 (2007), the U.S. Supreme Court held that rancher Frank Robbins lacked a cause of action against BLM employees for alleged retaliation under either

the Fifth Amendment or the Racketeer Influenced and Corrupt Organizations Act (RICO). Robbins had sued employees of the BLM, alleging that their decisions and actions, which included revoking grazing permits held by Robbins, were made in retaliation for Robbins's refusal to grant the BLM a right-of-way across his property. In a 7-2 decision, the Supreme Court, with Justice Souter writing for the majority, refused to recognize a cause of action for the alleged retaliation against Robbins for exercising his Fifth Amendment right to exclude the government from his private property. In doing so, the Court found that the alleged coercive acts by the BLM employees could not constitute a Fifth Amendment taking of Robbins's property rights. Justice Ginsburg, joined by Justice Stevens, dissented. The Supreme Court then unanimously rejected Robbins's claims under RICO, finding that the statute did not apply to the alleged extortionate acts of the BLM defendants. The Court reasoned that RICO does not provide a cause of action when the federal government is the intended beneficiary of an extortionate act by government officials. The Supreme Court's decision ends a 19-year legal battle between the government and Robbins.

#### SENATE CONFIRMS JAMES CASWELL AS NEW BLM DIRECTOR AND BRENT WALQUIST AS THE NEW DIRECTOR OF THE OFFICE OF SURFACE MINING

On August 3, 2007, the U.S. Senate confirmed the nomination of James Caswell as the next director of the Bureau of Land Management (BLM) and Brent Wahlquist as Director of the Office of Surface Mining (OSM). Caswell most recently headed the State of Idaho's Office of Species Conservation, which was established in 2000 by the state legislature to bring a policy focus to endangered species issues and to coordinate state and federal efforts on endangered species management in Idaho. Before that Caswell spent 33 years in various positions with the BLM, Bonneville Power Administration, and the U.S. Forest Service, 16 of those years serving as forest supervisor on the Clearwater and Targhee National Forests. He was also deputy forest supervisor at Boise National Forest, and acting deputy regional forester in Missoula, Montana. Caswell is a 1967 graduate of Michigan State University, where he received a Bachelor of Science degree in forestry.

Senator Ken Salazar (D-Colo.) had placed a hold on the nomination of Caswell as the BLM director to protest a BLM decision to authorize oil and gas leasing on the Roan Plateau in northwest Colorado. Senator Salazar withdrew his protest in early August after Secretary of the Interior Dirk Kempthorne agreed to provide the State of Colorado additional time to study the BLM Plan. In related news, the U.S. House voted on August 4, 2007, to prohibit surface occupancy on the top of the Roan Plateau in HR 3221. The measure must still be approved by the Senate.

Brent Wahlquist is a career OSM employee with more than 22 years with the agency at the executive level. He is currently Acting Director of the OSM, but most recently served as the OSM regional director of the Appalachian region, where he oversaw the agency's programs in a seven-state area. Previously he served as regional director of the agency's Mid-Continent and Western regions and as assistant director in Washington D.C. Wahlquist, a native of Idaho, holds a PhD in biology from New Mexico State University, and both a masters and a bachelors degree in botany from Brigham Young University.

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## CONGRESS / FEDERAL AGENCIES MINING

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RANDALL E. HUBBARD  
— REPORTER —

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#### MINING LAW REFORM BILL INTRODUCED BY CONGRESSMAN RAHALL

On May 10, 2007, Representative Nick Joe Rahall (D-W.Va.) introduced comprehensive Mining Law reform legislation. That bill, H.R. 2262, was referred to the Energy and Minerals Subcommittee of the House Natural Resources Committee, which held hearings on the proposed legislation in July and August. The text of the bill is available at <http://www.govtrack.us/congress/bill.xpd?bill=h110-2262>. A summary of some of the bill's material provisions is set forth below.

#### H.R. 2262 SUMMARY

##### Section 2—Definitions and References

###### *New Definitions.*

- Broadly defines “affiliate” and “control.” (Applicants and their affiliates may be denied permits for mining operations.)
- Limits the size of a “millsite claim” to not more than 5 acres per 20 acres of mining claim with which the millsite is associated.
- Defines “valid existing rights” as a mining claim properly located and maintained and supported by a discovery of a valuable mineral deposit, or a millsite claim properly located and maintained that meets the limitations under existing law for millsite claims (does not define what those existing limitations are).

##### Section 3—Application Rules

- **Preexisting claims.** Applies to all preexisting mining claims or millsites for which a Plan of Operations (POO) had not been approved or a Notice filed prior to the date of enactment.
- Where POO has been approved, **existing operations** would have five years to meet the new environmental compliance requirements and reclamation standards. During that five years new financial assurance requirements, new inspection and monitoring requirements, and new enforcement requirements would apply on the basis of surface management requirements applicable to such POOs prior to the effective date of the Act.
- Only minor modifications to those existing POOs could be made under the old rules.
- Applies to ancillary activities on mining claims or millsites even if mineral production is from non-federal lands.

### Title I—Mineral Exploration and Development

- **Patent Moratorium.** Makes the patent moratorium permanent except for certain existing grandfathered claims. § 101.
- **Royalty.** Establishes an 8% gross royalty payable to the United States on all existing and new claims. § 102.
  - " Claimants must comply with extensive recordkeeping and reporting requirements: failure to comply can result in claim forfeiture.
  - " 25% penalty for underreporting royalties.
  - " Joint and several liability to pay production royalty on the part of claim holder, operator, or any person who controls claim holder or operator.

### Title II—Protection of Special Places

- **Lands Not Open to Location:**
  - " Lands recommended for wilderness designation or otherwise being managed as roadless areas under an applicable land use plan.
  - " Lands being managed as wilderness study areas or national monuments, unless mining claim is statutorily allowed therein.
  - " Designated Wild and Scenic Rivers areas and those under study for inclusion in the National Wild and Scenic River System.
  - " Lands withdrawn or segregated from mineral entry.
  - " Lands designated as Areas of Critical Environmental Concern.
  - " Land identified as "sacred sites" pursuant to Executive Order 13007.
  - " Lands identified in the Roadless Area Conservation Rule of January 2001. § 201(b).

### Title III—Environmental Protection Standards

- **Overarching Environmental Protection Standard.** "[M]ineral activities on mining claims, millsite claims, or tunnel site claims conducted by any person shall protect the environment, public health, and public safety from undue degradation; and . . . shall assure that mineral activities . . . are conducted in a manner that recognizes the value of such lands for other uses, including but not limited to recreation, wildlife habitat, and water supply." § 301(2).
- **Permitting.** Prohibits all activities that may cause surface disturbance (defined to include land, air, ground water, surface water, fish, and wildlife) unless mining claim was properly located and maintained and permit had been issued. Exception for casual use activities. § 302. Permit application must contain:
  - " *General information*, including name of applicant and affiliates; acknowledgment of any violations of SMCRA, Mineral Leasing Act, or federal or state environmental laws by applicant, operator, or any subsidiary, affiliate, or other person controlled by or under common control with applicant or operator during the previous five years; description of mining tech-

niques; detailed maps; mining timeframes; description of measures to protect fish and wildlife resources; description of the quantity and quality of surface and groundwater resources in or associated with the area based on predisturbance monitoring sufficient to establish seasonal variations; an analysis of the potential hydrologic consequences of the mineral activities both on and off the area subject to mineral activities; description of monitoring and reporting systems that would be in place to determine compliance with environmental protection requirements; accident contingency plans; information as deemed necessary by the Secretary to assess the cumulative impacts of mineral activities as required to comply with NEPA; environmental baseline data; evidence of financial assurance; site security provisions. § 303(b).

- " *Operation and Reclamation Plan:* Applications must include a description of the land and fish and wildlife resources and habitat contained thereon; a discussion of applicable land use plans and how reclamation will make post-mining condition of land consistent with land use plans; engineering techniques; timing of various phases of reclamation; post-reclamation description of land condition; description of maintenance measures; reclamation cost estimates. § 303(c).
- " *Permits may be denied* for failure to provide the information required in the permit application; failure to conform to the applicable land use plan upon completion of reclamation; failure to comply with all applicable federal and state permits; failure to comply with the financial assurance requirements; failure to demonstrate that cumulative impacts of all anticipated mining in the area will not cause undue degradation and that operation is designed to minimize disturbance to the prevailing hydrologic balance in the area; outstanding violations of environmental standards or regulations; failure to conclusively demonstrate that 10 years following mine closure, no treatment of surface water or ground water for carcinogens or toxins will be required to meet water quality standards at the point of discharge. § 303(d).
- " Permits may not exceed a *10-year term* but may be renewed for up to 10 additional years (and successively renewed after that) upon successful completion of new compliance reviews. Operations must be commenced within two years after permit is granted. § 303(e).
- " *Permit modification* can be at the request of the applicant or required by the Secretary of the Interior or the Secretary of Agriculture for unanticipated events such as: development of acid or toxic drainage; loss of springs or water supplies; unanticipated water quantity or quality impacts; need for long-term water treatment; significant reclamation difficulties or failure; discovery of new significant scientific, cultural, or biological resources; discovery of hazards to public safety. § 303(f).

- " Requires approval of *temporary cessation* of operations (anything over 90 days). § 303(g).
  - " *Public participation* provisions relating to issuance of permits include opportunity for comment and a hearing. § 303(k).
  - " *Permits can be denied or suspended* if the claimant, the applicant (or any affiliate or officer or director of the claimant or the applicant) is currently in violation of any provision of the Act or regulation under the Act; any applicable state or federal toxic substance, solid waste, air, water quality, fish and wildlife conservation law or regulation; or SMCRA. Permits may be reinstated upon correction or during an appeal. § 304.
  - " *Financial assurance* is required as a prerequisite to permit issuance. Assurance must cover all lands within the permit areas and all affected waters that may require restoration, treatment, or other management. Amount of assurance must be sufficient to cover the obligations as if the work were to be performed by the Secretary concerned. It must take into account the administrative costs associated with a government agency reclaiming the site. Adjustment of the financial assurance amount is allowed. For operations with discharges to water, no release of financial assurance is allowed until five years after discharge has ceased or until all applicable effluent limitations and water quality standards have been met for five years without treatment. No release of any financial assurance without notice and opportunity for public comment. § 305.
- **Operation and Reclamation Standards.** The general rule is that the operator must restore lands to a condition capable of supporting either prior uses or other beneficial uses that conform to applicable land use plans. Standards that apply to all operations include:
    - " *Soils* must be segregated from waste materials, preserved from wind and water erosion, protected from contamination by use of best technology currently available.
    - " *Stabilization* is required at all surface areas to prevent hazards and to control fugitive dust and erosion.
    - " *Hydrologic Balance.* Mineral activities must be conducted to minimize disturbances to prevailing hydrologic balance; to prevent to the fullest extent possible formation of acidic, toxic, or other contaminated water; to prevent any damage off-site from contamination of surface and ground water; to restore approximate hydrologic balance that existed prior to mining.
    - " *Surface Restoration* includes return to natural topography. Backfilling may be required (if determined by the Secretary to be the most appropriate means of controlling long-term adverse impact on public health or to the environment).
    - " *Vegetation* as necessary to establish a diverse, effective, and permanent vegetative cover of the same seasonal variety native to the permit area, capable of self-regeneration and plant succession.
- " *Excess Waste* must be transported to and placed in approved areas, graded and contoured to blend with surrounding topography, and revegetated.
  - " *Sealing.* All drill holes and openings must be back-filled, sealed, or otherwise controlled.
  - " *Structures.* All buildings, structures, roads, and equipment must be removed unless needed for environmental monitoring.
  - " *Cultural, Paleontological, and Cave Resources.* Must make reasonable efforts to identify and protect any scientifically important paleontological or other cultural resources.
  - " *Structures, Roads, and Equipment.* Must design and maintain all buildings, structures, roads, and equipment to minimize erosion, siltation and air pollution, and remove after mining.
  - " *Drill Holes.* Drilling fluid not allowed to flow off site; must be drilled, operated, and plugged to prevent mixing of water from aquifers.
  - " *Leaching Operations and Impoundments* must be designed, constructed, and operated to achieve and maintain the stability of the site and to withstand a local 24-hour, 100-year storm event.
  - " *Fire Prevention and Control* must comply with all applicable laws and take reasonable measures to prevent and suppress fire.
  - " *Temporary Cessation.* During cessation, must maintain and stabilize the site. § 306.
- Title IV—Mining Mitigation
- **Two new funds would be created:**
    - " *Abandoned Locatable Minerals Mine Reclamation Fund:* Funded by permit fees, transfer fees, donations, 2/3 of royalty payments, penalties, fees for issuance of patents. This fund would be used to reclaim and restore land and water resources adversely affected by past mineral activities. §§ 401, 402.
    - " *Locatable Minerals Community Imprint Assistance Fund:* Funded by 1/3 of royalty payments. (The bill says that this account will be funded by amounts collected under Section 111 of the Act, but probably meant Section 102(2)). This fund would be used to provide assistance for the planning, construction, and maintenance of public facilities and the provision of public services to states, political subdivisions, and Indian tribes that are socially or economically impacted by mineral activities conducted under the general mining laws. §§ 421-423.
- Title V—Administrative and Miscellaneous Provisions
- **Mining and Minerals Policy Act of 1970:** Revised to not only promote the development of an economically sound and stable domestic mining industry but also to "ensure that mineral extraction and processing not cause undue degra-

dation of the natural and cultural resources of the Federal lands.” § 501(a)(1).

- **User Fees:** Authorizes establishment and collection of fees as necessary to reimburse the United States for the expenses incurred in administering the requirements of the Act. § 502.
- **Inspections and Monitoring:**
  - “ *Inspections* must be conducted at least once per quarter for active operations.
  - “ Any person who has reason to believe he or she may be *adversely affected* due to a violation of the environmental protection requirements may request an inspection.
  - “ *A monitoring and evaluation system* must be implemented to identify compliance with all environmental protection requirements. § 503.
- **Citizen Suits.** Any person may commence a civil suit alleging a violation of the Act or regulations promulgated pursuant to the Act. Citizen suits must be filed in U.S. district court and must give written notice (unless imminent threat to environment or public health exists). Citizen suits are not allowed if the Secretary is diligently prosecuting a civil or criminal action (but not an administrative action) to require compliance. § 504.
- **Administrative and Judicial Review.** Any person issued a notice of violation or cessation or assessed a penalty under the Act may request Secretarial review within 30 days. A public hearing may be requested. The D.C. Circuit will hear all appeals, except for patent appeals, in which case the Secretary will choose the appropriate federal district court. § 505.
- **Enforcement.** Authorizes orders to immediately cease all mineral activities when claimant does not act within 30 days of receipt of notice of violation. No notice of violation is necessary and an immediate cessation order is required if there is an imminent danger to health or public safety or a significant, imminent environmental harm. § 506(a).
- **Compliance/Civil and Criminal Penalties.** Authorizes the Attorney General to institute a civil action for relief, including a permanent or temporary injunction or restraining order, or any other appropriate enforcement order, including the imposition of civil penalties. § 506(b).
  - “ *Authorizes penalty* of up to \$25,000/day for each violation of environmental protection requirements, and a penalty of a minimum of \$1,000/day for failure to correct a violation for which a cessation order has been issued. § 506(d).
  - “ *Knowing violations* of mining without a permit or an environmental protection requirement or permit provision are punishable by a fine of not less than \$5,000 nor more than \$50,000 per day of violation or by imprisonment of not more than three years, or both. § 506(g).

“ *Knowing and willful violations* of the Act for which civil penalties are assessed are, upon conviction, punishable by a fine of not more than \$50,000 or imprisonment of not more than two years, or both. § 506(h).

- **Regulations; Effective Dates.** Provisions of the Act are effective immediately unless otherwise noted, and regulations as necessary are authorized. § 507.
- **Oil Shale Claims.** Makes activities on oil shale claims subject to the same environmental protection standards as are set forth in the Act. § 511.
- **Miscellaneous Powers.** All fees, penalties, and other dollar amounts are adjusted for inflation every five years. Broad powers to investigate, inspect, or make inquiries; Secretary can require affidavits, administer oaths, subpoena, order testimony to be taken by deposition, and have right of access to properties. §§ 512, 515.

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## ALABAMA — OIL & GAS

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### MEASURE OF DAMAGES FOR TEMPORARY INJURY

In a matter of first impression, the Alabama Supreme Court set the measure of damages for temporary injury to property in Alabama when the cost of remediation exceeds the diminution in value of the property caused by the injury. In the case of *Poffenbarger v. Merit Energy Co.*, \_\_\_ So. 2d \_\_\_, No. 1041707, 2007 WL 1378333 (D. Ala. May 11, 2007), the Alabama Supreme Court held that when the remediation costs exceed the diminution in value to the property, the proper measure of damage is the diminution in value of the property. *Poffenbarger* involved a Citronelle Oil Field pipeline leak that contaminated the Poffenbarger 32-acre tract. The plaintiffs presented evidence in response to Merit Energy’s motion for partial summary judgment that the remediation costs would be \$2,608,740. Merit Energy presented evidence in support of its motion for partial summary judgment that the diminution in value of the Poffenbarger property was \$6,000. The Alabama Supreme Court upheld the trial court partial summary judgment that the plaintiffs’ damages could not exceed the diminution in value.

The Alabama Supreme Court expressly did not decide “whether and under what circumstances the separate remedy of injunctive relief may be available to require a trespasser to remove objects or substances tortiously placed on the affected land.” *Poffenbarger*, 2007 WL 1378333, at \*10. Thus, a pipeline rupture conceivably could lead to substantial cleanup costs required by injunctive relief.

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**CALIFORNIA — OIL & GAS**


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**CALIFORNIA COURT OF APPEAL AFFIRMS THAT, FOR TAX PURPOSES, FAIR MARKET VALUE OF UNPROVED RESERVES IS THE PURCHASE PRICE**

In *California Minerals, L.P. v. County of Kern*, 152 Cal. App. 4th 1016, 62 Cal. Rptr. 3d 1 (Cal. Ct. App. 2007), the appellant taxpayer, California Minerals, L.P., a Texas limited partnership, brought a suit claiming that the valuation method for assessing the value of its mineral interests was improperly applied for tax purposes. The taxpayer's mineral interests did not contain any "proved reserves," and apparently were not producing oil or gas. The Kern County tax assessor valued the mineral interests at an amount equal to the value allocated to those properties in the purchase and sale agreement pursuant to which the taxpayer purchased the properties. Since the taxpayer's mineral interest did not contain "proved" oil and gas reserves, as defined under the State Board of Equalization (SBE), the taxpayer argued that the enrolled base year value of its mineral interest should have been zero and sued for a refund of ad valorem taxes.

The Superior Court of Kern County (California) ruled against the taxpayer, reasoning that the value of unproved oil and gas reserves was not zero, but rather the fair market value. The court of appeals affirmed. According to SBE Rule § 468(b), the fair market value of an oil and gas mineral property is determined "by estimating the value of the volumes of proved reserves. Proved reserves are those reserves that 'geological and engineering information indicate with reasonable certainty to be recoverable in the future, taking into account reasonably projected physical and economic operating conditions.'" 152 Cal. App. 4th at 1024 (quoting Cal. Code Regs. tit. 18, § 468). The SBE rule does not address mineral interests containing unproved reserves.

The appellate court noted that the taxpayer and the former owner of the mineral interests, Chevron, had negotiated an allocation of the purchase price to various properties. This allocation was not based on a traditional reserve report, but on a Monte Carlo analysis of the likelihood of oil and gas reserves being located on the properties based on information from other fields in the area. Thus, even though no proved reserves were attributed to the properties at issue, the parties allocated a portion of the purchase price to them.

In its appeal, the taxpayer argued that according to the Assessors' Handbook (Jan. 2002), real property appraisals "must be based on the most productive or highest and best use of the property." The court also noted that Revenue and Tax Code § 110(b) contains a presumption that the fair market value of real property is the purchase price. Cal. Rev. & Tax Code § 110(b). In light of the Revenue and Tax Code § 110(b), and the inapplicability of SBE's Rule § 468, this court determined that the highest and best use value of oil reserves that have not yet been proved is the purchase price, and that amount should be the basis for property taxes.

**U.S. DISTRICT COURT GRANTS SUMMARY JUDGMENT IN FAVOR OF OIL-RELATED SUBSIDIARY IN DISPUTE OVER CERCLA LIABILITY**

In *California Department of Toxic Substances Control v. California-Fresno Investment Co.*, No. CV F06-0488 (LJO SMS), 2007 WL 1345580 (E.D. Cal. May 8, 2007), the Department of Toxic Substances Control (DTSC) brought a claim for hazardous substances clean up costs against a former oil-related subsidiary, California-Fresno Investment Company (Fresno Oil), under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). Fresno Oil's former parent company, California-Fresno Realty Company (Realty), had been in existence since 1901 for the purpose of the production, transport, and commercial exchange of petroleum, petroleum products, real estate dealings, and borrowing and lending of money. As of 1976, the parent company's activities were mainly comprised of (1) oil operations and (2) an investment division that conducted real estate dealings. In August of 1976, the shareholders of the parent company agreed to create the subsidiary, Fresno Oil, to take over the oil operations of the parent.

Between August and September of 1976, Realty sold all of the stock of Fresno Oil to a director who had been in charge of the day-to-day oil-related operations for Realty. The director also sold all of his shares in Realty. Thus, the (former) director of Realty became the sole shareholder of Fresno Oil.

Fresno Oil had received all the assets and liabilities of the former parent company, except for a tract of land called the Railroad property. Realty, which remained as owner of the Railroad property, granted a lease to Fresno Oil covering the bulk plant, service station, and a building at the Railroad property for up to five years, beginning in 1976. However, the parties terminated this lease as of January 1, 1978.

The DTSC brought its claim against Fresno Oil, alleging that Fresno Oil was a successor to the former parent and therefore owner and operator of the Railroad property when hazardous substances were released at the Railroad property. With respect to the issue of whether environmental liability under CERCLA had been transferred from the parent to the subsidiary, the court noted that the subsidiary was not deemed a "corporate successor" nor a "continuation" of the parent company and therefore could not be held liable. In its reasoning, the court made note of the fact that Realty had sold the stock of Fresno Oil and that Realty had specifically agreed to retain the Railroad property. Furthermore, the court determined that the agreement between Realty and Fresno Oil was not broad enough to conclude that Fresno Oil agreed to assume liability under CERCLA, which was not known at the time of the transfer of the stock and assets, and did not come into existence until 1980.

**ASSIGNMENT OF "UNITIZED INTERESTS" INCLUDES RIGHT TO RECEIVE ROYALTIES UNDER EXISTING LEASES; RESERVATION AND SUBSEQUENT CONVEYANCE OF MINERAL RIGHTS DOES NOT INCLUDE SUCH UNITIZED ROYALTY INTERESTS**

In *Cornerstone Oil Co. v. Stocker Resources*, No. B183950, 2006 WL 3491384 (Cal. Ct. App. Dec. 4, 2006), the appellate court considered whether an assignment of certain interests in oil

and gas properties included the royalty interests under existing oil and gas leases, or whether a reservation of the mineral interests in those properties was effective to reserve those royalty interests attributable to the mineral interests. The court found, construing and interpreting the specific language of the various conveyances, in addition to a party's subsequent admissions in correspondence, that the initial conveyance was effective to convey the royalty interests and that, in the subsequent sale of the underlying mineral interests, the purchaser did not receive the royalty interests under existing oil and gas leases.

Arco was the owner of the surface and mineral fee in three parcels totaling approximately one acre, located in the Cities of Beverly Hills and Los Angeles. Arco granted subsurface oil and gas leases on the tracts. The leases granted to the lessee the right to pool or unitize the tracts.

At some point, these leases were apparently contributed to the Crescent Heights Unit and the West Salt Lake Unit. At the time of the case, the working interests in these leases were held by Stocker Resources and Plains Exploration. Although Cornerstone sought to invalidate the leases for failure to pay royalties that it claimed, there did not appear to be any other dispute concerning the continuing existence of the leases or the validity of the steps taken to pool or unitize the leases, but rather simply a dispute as to which party was entitled to receive the royalty payments under those leases, as unitized.

In the period from 1992 to early 1995, Arco entered into transactions in which, eventually, assignments of certain interests were made to Columbine II Limited Partnership (Columbine). The assignments transferred all of Arco's interests in royalty interests in certain described lands (including these three tracts), and other interests "which [have] been unitized, communitized or pooled under unit, communitization, pooling or similar agreements, or under orders of state or federal regulatory agencies." 2006 WL 3491384, at \*1. In the assignment, Arco reserved "any executive right, or reversionary mineral fee interest or servitude of ARCO, its successors and assigns." *Id.*

Later, Arco gave a mineral deed to Cornerstone Oil Company that included a description of the three tracts. The conveyance to Cornerstone was made subject to the prior conveyance to Columbine and any prior agreements. Arco did not warrant title to Cornerstone.

A few months after Cornerstone's purchase of the mineral interest, it wrote a letter to Columbine offering to purchase Columbine's royalty interest previously transferred by Arco to Columbine. The appellate court characterized the letter as being an admission by Cornerstone that Columbine owned the royalty interest. Since the relevant assignment from Arco to Columbine was of record in Los Angeles County several months prior to the Cornerstone transaction, and the mineral deed was expressly subject to the prior assignment to Columbine, the court noted that Cornerstone had "actual and constructive notice" of the earlier conveyance.

The trial court found the language of the various conveyance instruments to be ambiguous and received parol evidence to help understand and interpret the documents. The court found that incorporating these tracts into the Crescent Heights Unit and the West Salt Lake Unit converted them from "lessor royalty inter-

ests" to "unitized interests." And thus, they were included in the first round of assignments to Columbine. The appellate court affirmed, holding that Cornerstone acquired the mineral interests, and presumably the executive rights to future leases, but not the amounts attributable to the unitized royalty interests under the existing leases.

#### **INSURER NOT OBLIGATED TO DEFEND LESSOR AGAINST LITIGATION RELATING TO OIL AND GAS OPERATIONS AT BEVERLY HILLS HIGH SCHOOL GROUNDS**

In *Beverly Hills Unified School District v. Gulf Underwriters Insurance Co.*, No. B188322, 2007 WL 495501 (Cal. Ct. App. Feb. 16, 2007) (not officially published), the appellate court affirmed the holding of the trial court that the insurance company was not obligated to defend its insured, the Beverly Hills Unified School District, in various "Erin Brockovich" pollution cases brought against the district relating to oil and gas operations from 1977 to 1996 near the athletic field of the high school campus. The district tendered defense of these claims to its insurer, which declined to defend based on a pollution exclusion in the policy.

In the first of the underlying cases to be decided, the plaintiffs' claims that the oil and gas operations caused injuries and death to former students at the high school were denied on summary judgment. *Moss v. Venoco, Inc.*, No. BC297083 (Cal. Super. Ct. filed Dec. 12, 2006). In analyzing the causation claims, the court found that the plaintiffs' experts did not have reliable evidence to establish that exposure to any of the chemicals was a substantial factor in causing any of the diseases.

#### **ALLOCATION OF LIABILITIES IN DAYWORK DRILLING CONTRACT UPHELD**

In *Caza Drilling (California), Inc. v. TEG Oil & Gas U.S.A., Inc.*, 142 Cal. App. 4th 453, 48 Cal. Rptr. 3d 271 (Cal. Ct. App. Aug. 29, 2006), the court upheld the provisions of a daywork drilling contract that allocated various liabilities to the operator, rather than the drilling contractor. A blowout involving death, personal injury, and property damage was the responsibility of the operator, notwithstanding alleged negligence on the part of the drilling contractor. The provision does not violate California public policy under Cal. Civil Code § 1668 (invalidating contracts that have as their object exempting one from responsibility for one's own fraud or willful injury to others, or violation of law).

#### **COURT UPHOLDS CONDEMNATION OF EASEMENT IN ABSENCE OF EVIDENCE SUPPORTING ALTERNATE ROUTE**

*Wild Goose Storage, Inc. v. Roseville Land Development Ass'n*, No. C045754, 2005 WL 3196714 (Cal. Ct. App. Nov. 30, 2005) (not certified for publication), was an eminent domain case involving the condemnation of an easement across private property for the construction of a natural gas pipeline. Wild Goose filed an application with the Public Utilities Commission for a certificate of public convenience and necessity to be used in developing an underground natural gas storage facility. The project proposed to build an underground pipeline that crossed six privately owned properties, including Roseville Land.

After the Commission granted the certificate, Wild Goose filed a complaint seeking condemnation of a permanent easement

over Roseville Land and also filed an ex parte application for prejudgment possession of the easement. The trial court granted prejudgment possession and Wild Goose built the pipeline shortly after. However, Roseville Land responded to the condemnation claim by raising several affirmative defenses: the purpose of the condemnation was private not public, public interest and necessity did not require the project, and the location of the project did not promote “the greatest public good and the least private injury.” Wild Goose filed a motion in limine to exclude evidence on the affirmative defenses, which the trial court granted. The court then vacated the trial on condemnation and conducted the trial on compensation for the easement.

Roseville Land appealed. Following remand, Roseville Land filed a motion for cross-complaint and amendment of its answer to include new affirmative defenses involving an alternate route theory. The trial court denied the motion and subsequently entered judgment of condemnation in favor of Wild Goose.

On second appeal, the appellate court found that Roseville Land had not established enough facts and evidence to show that Wild Goose could have pursued an alternate route and that the alternate route rendered the use of the Roseville Land obsolete. The court reasoned that Roseville Land’s attempt to show that Wild Goose could have built the pipeline elsewhere was an argument for an “alternate approach to Wild Goose’s business” and not for an alternate route pertaining to this particular project. Hence, the court affirmed the trial court’s judgment granting the permanent easement to Wild Goose and compensation of \$12,500 to Roseville Land.

#### **COURT UPHOLDS INSURER’S OBLIGATION TO INDEMNIFY REFINERY FOR COSTS INCURRED FROM GOVERNMENT CLEANUP ORDERS**

The issue in *Powerine Oil Co. v. Superior Court*, 37 Cal. 4th 377, 118 P.3d 589 (Cal. 2005), involved an insurer’s obligation to indemnify a defunct oil refinery for costs incurred from government cleanup orders. Powerine Oil Company was engaged in oil refinery operations in Southern California since the 1930s. Following bankruptcy in 1985, the refinery ceased operations. However, Powerine remained liable for the soil and groundwater pollution, and the California Regional Water Quality Control Boards for Los Angeles and San Diego initiated administrative proceedings against Powerine under the Porter-Cologne Act, which resulted in orders for environmental cleanup. After Powerine notified its insurer, the insurer filed declaratory relief action against it and Powerine cross-complained for indemnification.

Central National, the insurer, moved for summary judgment, alleging that its duty under the excess/umbrella policies was limited to money ordered by a court in a suit for damages against Powerine and, as such, the cleanup costs were outside the scope of its responsibility. The trial court granted the insurer’s motion, finding that the term “damages” in the insurance provision “does not encompass environmental response costs ordered by an administrative agency outside the context of a lawsuit.” 118 P.3d at 594. However, the appellate court found that the policies provided umbrella coverage and construed “expenses” broadly to include cleanup costs mandated by a government agency.

Upon review of the nature and language of the insurance policies, the California Supreme Court affirmed the judgment of the appellate court and held that the insurer was not entitled to summary judgment. The court found that in addition to court ordered damages, the policies required Central National to indemnify Powerine for governmentally imposed environmental liabilities.

#### **COURT UPHOLDS COUNTY ASSESSMENT APPEALS BOARD’S TAX ASSESSMENT OF OIL-PRODUCING PROPERTY**

*County of Los Angeles v. County of Los Angeles Assessment Appeals Board No. 4*, No. B173000, 2006 WL 459326 (Cal. Ct. App. Feb. 27, 2006), involved the property tax assessment of an oil-producing property owned by Atlantic Richfield Corporation (ARCO). In assessing the tax, the L.A. County Assessor alleged that the L.A. County Assessment Appeals Board No. 4 relied on the proper “income approach to value” method but applied it erroneously. Hence, the Assessor’s appeal raised several issues, including whether the Board correctly forecasted the economic life, annual oil production levels, and expenses for the property.

The “economic life” of an oil field is the duration in which the selling price of oil from the field exceeds its production cost. The owner of the property projected a 19.8-year economic life while the Assessor projected 38 years. The Assessor argued that the Board’s decision to use 21 years was arbitrary and inconsistent with cash flow information. However, the Board decided to reject the Assessor’s estimate because it was based on projected oil prices of over \$80 per bbl. in 2027 while testimony indicated that real oil prices excluding the impact of inflation have continuously declined since 1980. The court held that “determination of a property’s economic life is a matter for the Board’s judgment, and when the Board adopts and uses a reasonable method this court does not reject that method because this court might have preferred another method.” 2006 WL 459326, at \*9. Hence, absent evidence of fraud, mistake, or reliance on an improper valuation method, the Board’s assessment of economic life was proper.

The court also found that the Board did not improperly project annual oil production by retroactively relying on geological data and arbitrarily escalating and de-escalating the annual production rates. The Board properly based its production estimates for each assessment year on prior years’ production data. Also, in its decision to escalate and de-escalate production rates, the Board was allowed to rely on analysis indicating that oil production was a declining asset.

As for the Board’s calculation of expenses based on a fixed percentage of income, the Assessor argued that this method does not accurately reflect actual expenses and “frontloads” expenses, since expenses as a percentage of revenue are smaller in earlier years than later years. Frontloading was problematic because it caused property valuation to be lower than market value. However, the court found that the Assessor had not presented evidence to prove that the fixed percentage approach was erroneous.

The court affirmed the Board’s tax assessment since the Assessor failed to satisfy his burden of showing that the Board erred in estimating economic life, oil production, and expenses.

**COURT UPHOLDS DENIAL OF RECOVERY FOR ENVIRONMENTAL CLEANUP COSTS UNDER CERCLA BECAUSE OF FAILURE TO COMPLY WITH THE NATIONAL CONTINGENCY PLAN**

The issue in *Carson Harbor Village v. County of Los Angeles*, 433 F.3d 1260 (9th Cir. 2006), involved the recovery of environmental cleanup costs under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). Carson Harbor, a limited partnership, purchased property previously used by Unocal for oil production and storage and converted it into a mobile home park. Carson Harbor subsequently discovered tar-like and slag material on the property; the material contained lead concentrations above levels permitted by the state. Carson Harbor notified the Regional Water Quality Control Board (RWQCB), residents of the mobile home park, and Unocal of the pollution. Evidence showed that Unocal was responsible for at least one of the numerous oil spills that had occurred on the property.

Carson Harbor thereafter arranged for a remedial action plan in compliance with RWQCB's requirements and then successfully removed the pollution. In addition, Carson Harbor filed a claim against Unocal to recover cleanup costs under CERCLA. The district court granted summary judgment in favor of Unocal upon finding that Carson Harbor failed to comply with the National Contingency Plan.

CERCLA provides for a private cause of action for cleanup costs against parties responsible for the pollution pursuant to 42 U.S.C. § 9607(a). To establish a claim under this provision, claimants must show that, in addition to other elements, the pollution caused the claimant to incur remedial costs that were "necessary" and "consistent with the National Contingency Plan." The National Contingency Plan, promulgated by the Environmental Protection Agency under CERCLA, purports to make the party seeking response costs choose a cost-effective course of action to protect public health and the environment. Accordingly, the plan requires an opportunity for public participation, remedial site investigation, and a feasibility study.

On appeal, the circuit court found that Carson Harbor did not satisfy the public participation requirement, which generally included interviews of officials and residents, development of a formal community relations plan including an "information repository" for making information regarding remedial efforts publicly available, publication of a notice in the newspaper, opportunity for submission of comments on the plan, a public meeting, etc. Carson Harbor cited other cases in which participation by a public agency in the remedial action was enough to satisfy this requirement and argued that RWQCB's involvement should be sufficient. However, the court found that in order for agency involvement to be sufficient, it must be "extensive." RWQCB's involvement did not meet this standard because it had only approved the plan and inspected the property after cleanup had already taken place.

Furthermore, although Carson Harbor satisfied the remedial site investigation requirement, the court found that Carson Harbor had not conducted a sufficient feasibility study. According to 40 C.F.R. § 300.430(e), an adequate feasibility study must include detailed analysis on a number of alternative remedies. "One of the hallmarks of the feasibility study requirement is assessing a va-

riety of possible alternatives and providing analysis of the costs, implementability, and effectiveness of each, and choosing the best alternative for the site at issue." 433 F.3d at 1268. However, Carson Harbor's remedial action plan discussed only the removal option. Hence, due to lack of evidence indicating that Carson Harbor considered other alternatives, the court held that it had not satisfied the feasibility study requirement.

Because Carson Harbor failed to establish its compliance with all of the requirements of the National Contingency Plan, the court affirmed the district court's decision to deny recovery of cleanup costs from Unocal under CERCLA.

**COURT UPHOLDS DENIAL OF INSURANCE COVERAGE FOR INJURY CLAIMS CAUSED BY TOXIC SUBSTANCES FROM OIL PRODUCTION**

*Bechtel Petroleum Operations, Inc. v. Continental Insurance Co.*, Nos. B176561, B179969, 2006 WL 531277 (Cal. Ct. App. Mar. 6, 2006), involved indemnification for injury claims caused by exposure to toxic substances on a property used for production, storage, and distribution of oil and gas. Employees of the subcontractors working on the property filed claims for injuries caused by exposure to toxic substances and "unsanitary, hazardous or dangerous working conditions at the reserve." 2006 WL 531277, at \*2. Bechtel and Chevron, the respective operator and owner of the property, requested their insurers to defend and indemnify them in the lawsuits. The insurers refused, invoking the pollution exclusion clause in the policies.

Bechtel and Chevron filed suit against the insurers for coverage on the injury claims and the insurers moved for summary judgment. The trial court dismissed the actions. The appellate court affirmed the decision of the trial court upon applying the test articulated by the California Supreme Court in *MacKinnon v. Truck Insurance Exchange*, 31 Cal. 4th 635, 73 P.3d 1205 (Cal. 2003), which limited the applicability of a similar pollution exclusion clause to "traditional environmental pollution." Since toxic substances released from oil and gas fields was deemed a type of traditional environmental pollution, the court held that the pollution exclusion clause applied in this case to preclude insurance coverage.

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COLORADO — OIL & GAS

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SHERYL L. HOWE  
— REPORTER —

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**SURFACE OWNER'S ACT PASSED BY LEGISLATURE**

After several years when surface owner's acts were proposed but not passed in Colorado, this year a bill passed which addresses accommodation of surface owners during oil and gas operations. H.B. 07-1252 added a new section, Colo. Rev. Stat. § 34-60-127. Section 1 of this statute is succinct and each word is important, so we quote it in full:

Reasonable accommodation. (1)(a) An operator shall conduct oil and gas operations in a manner that accommodates the surface owner by minimizing intrusion upon and damage to the surface of the land.

(b) As used in this section, “minimizing intrusion upon and damage to the surface” means selecting alternative locations for wells, roads, pipelines, or production facilities, or employing alternative means of operation, that prevent, reduce, or mitigate the impacts of the oil and gas operations on the surface, where such alternatives are technologically sound, economically practicable, and reasonably available to the operator.

(c) The standard of conduct set forth in this section shall not be construed to prevent an operator from entering upon and using that amount of the surface as is reasonable and necessary to explore for, develop and produce oil and gas.

(d) The standard of conduct set forth in this section shall not be construed to abrogate or impair a contractual provision binding on the parties that expressly provides for the use of the surface for the conduct of oil and gas operations or that releases the operator from liability for the use of the surface.

Section 2 provides a cause of action to the surface owner if an operator fails to meet the requirements of Section 1. The surface owner may seek compensatory damages or equitable relief; the surface owner shall present evidence that the operator’s use of the surface materially interfered with the surface owner’s use of the land. If such a showing is made, the burden of proof shifts to the operator to show it met the standard set out in subsection 1 of the statute. The statute also provides that the operator may assert an affirmative defense that it has conducted operations in accordance with a regulatory requirement, contractual obligation, or land use plan provision that is specifically applicable to the alleged intrusion or damages.

The statute states that it does not prevent an operator and a surface owner from addressing the use of the surface for oil and gas operations in a lease, surface use agreement, or other written contract.

The effective date of this new statute was September 1, 2007.

In this reporter’s opinion, this new statute recognizes the rights of both surface owners and oil and gas operators. By providing that the alternative measures required of operators to minimize intrusion need not exceed what is technologically sound, economically practicable, and reasonably available, the act includes protections for operators. The meaning of all these provisions will likely be further developed as the act is applied in practice and in the courts.

#### **LEGISLATURE REVISES STATUTE REGARDING NOTICE TO MINERAL OWNERS OF SURFACE DEVELOPMENT AND ADOPTS SPECIFIC REQUIREMENTS FOR DRILLING OIL AND GAS WELLS IN THE GREATER WATTENBERG AREA**

New legislation in S.B. 07-237 amends the statute regarding notice to mineral owners of proposed surface development, to provide that notice is given to owners shown in the assessor’s tax records or to owners who have recorded a request for notification form. This statute is not limited to any particular area in Colorado. The new legislation also provides that in the greater Wattenberg area, prior to local government final approval of an application for surface development, the applicant must certify that notice has

been given to mineral owners and either no mineral owners objected to the application, or a surface owner agreement has been reached, or the application for development provides access to mineral operations and related facilities and the applicant has deposited into escrow an amount for incremental drilling costs for directional drilling. The greater Wattenberg area is north of Denver, where extensive oil and gas development and residential and commercial development are occurring. The details of these new statutes are described below.

The new statutes are amendments to the existing statute on notice to mineral estate owners of an application for surface development. Colo. Rev. Stat. § 24-65.5-103 is amended to provide that notice by certified mail, return receipt requested, or by a nationally recognized overnight courier is to be given to a mineral estate owner who is identified in the county tax assessor’s records, if the records are searchable by parcel number or by legal description, or the owner has filed a request for notification in the form described in (3) of this statute. Colo. Rev. Stat. § 24-65.5-104 regarding enforcement is repealed and reenacted. The repeal removes the prior provision that a surface owner could rely on a listing of mineral owners prepared by a licensed attorney, title insurance company, or certified professional landman. The provision in the new statute that notice is based on the tax records and recorded requests for notification makes it more important for mineral estate owners to file the requests for notification under the statute. Colo. Rev. Stat. § 24-65.5-103(6) provides that transfer of an interest by a mineral estate owner following filing of the request for notification shall not modify the address to which the applicant may deliver notice. Thus, after a transfer the transferee should file a new request for notification or an amendment to the prior owner’s request for notification.

Colo. Rev. Stat. § 24-65.5-104 provides that if the applicant certifies it has complied with the notice requirements and no mineral estate owner has entered an appearance or filed an objection, after final approval of the application for development, no development or activities contemplated by the application shall be rescinded or curtailed for purported noncompliance with the notice requirements. If the applicant complies with the publication and posting notice requirements of the local government reviewing the application, and the applicant certifies it provided the required notice in a timely manner, mineral estate owners shall be deemed to have constructively received notice of the application for development. The applicant then has no liability to a mineral estate owner for its development activities or any impediment to drilling operations or other development of the mineral estate, except in certain limited circumstances involving knowing and willful false certification of notice (or existence of a surface use agreement or escrow account for the greater Wattenberg area, see below), or negligence in identifying the owners entitled to notice. If there is a knowing and willful false certification, approval of the application is void. If there is negligence in identifying the owners entitled to notice, a mineral estate owner entitled to notice who was not sent notice may (1) object prior to final approval of the application or (2) thereafter within one year of posting of the property with a sign indicating that the application for development has received final approval, the mineral estate owner may file suit for compensatory damages. If suit is filed, the prevailing party is entitled to an award of reasonable attorney fees, and the

mineral estate owner may not recover special, punitive, or other extraordinary damages and is not entitled to equitable relief.

The greater Wattenberg area is defined as the lands in Townships 2 South to 7 North and Ranges 61 West to 69 West of the 6th P.M. In this area, "qualifying surface developments," which are defined as an application for development covering at least 160 acres, plus or minus 5%, are subject to specific requirements. The applicant must further certify to the local government that (1) no mineral estate owner has entered an appearance or filed an objection to the proposed application for development within 30 days after the initial public hearing on the application, (2) the applicant and any mineral estate owner who filed an objection have entered into a surface use agreement, the provisions of which are incorporated into the application for development or evidenced by a memorandum or otherwise recorded in the county records so as to provide notice to transferees of the applicant, or (3) the application for development provides access to mineral operations, an oil and gas operations area, and existing wellsite locations, and the deposit for incremental drilling costs has been made.

Colo. Rev. Stat. § 24-65.5-103.5 defines the oil and gas operations area that is required if there is no surface use agreement. The area depends on the number of existing wells in the governmental quarter section, and provides for a 250-foot or 200-foot radius around existing wells or a 600-foot by 600-foot area, depending on the number of wells; a 200-foot radius around tanks; and easements for flowlines, pipelines, and roads. The oil and gas operations area shall be the exclusive area for location of wells and associated surface production facilities. A surface owner may not encroach on the oil and gas operations area, except the plat may allow the outer 50 feet of any setback to be used for underground utilities, sidewalks, trails, and parking and to be landscaped at the surface owner's cost and risk.

The deposit for incremental drilling costs is addressed in Colo. Rev. Stat. § 24-65.5-103.7 and provides for \$87,500 per well for each well in an approved oil and gas operations area that is required to be drilled directionally in order to access a bottom-hole location in one of the five drilling windows permitted by the Colorado Oil and Gas Conservation Commission (Commission) under its greater Wattenberg rule 318A, as in effect on August 3, 2007, except certain directional wells the operator was required to drill under rule 318A(e). The \$87,500 amount is subject to yearly adjustment based on the consumer price index. There are provisions to post a letter of credit instead of establishing the escrow account. The statute creates a procedure for certifying to the Commission that incremental drilling costs have been expended, in order to obtain monies from the escrow account. At the end of three years after recording the plat, subject to a one-year extension for pending filed drilling permits, any funds in escrow shall be released or returned to the applicant (i.e. surface developer) or its designated successor.

These statutes were effective August 3, 2007, and Colo. Rev. Stat. § 24-65.5-103 applies to applications for development where the initial public hearing had not been held prior to that date.

## CHANGES TO COLORADO OIL AND GAS CONSERVATION COMMISSION

The legislature made several significant changes to the statute regarding the Colorado Oil and Gas Conservation Commission (the Commission). H.B. 07-1341 revises the make-up of the Commission and H.B. 07-1298 adopts provisions for the Commission to protect and conserve wildlife in some of its functions.

Colo. Rev. Stat. § 34-60-104(2)(a)(I) regarding members of the Commission is amended to provide for nine commissioners (formerly the number was seven). The revised statute provides that the executive director of the department of natural resources and the executive director of the department of public health and environment shall be ex officio voting members of the Commission. The number of commissioners who shall have substantial experience in the oil and gas industry is now three (formerly it was five). One member of the commission shall be a local government official, one member shall have formal training or substantial experience in environmental or wildlife protection, one member shall have formal training or substantial experience in soil conservation or reclamation, and one member shall be actively engaged in agricultural production and also be a royalty owner. The requirement that no more than four member be from the same political party is retained, but the executive directors on the Commission are excluded from this provision.

The Commission is directed to promulgate rules to establish a timely and efficient procedure for reviewing applications for a permit to drill and applications for an order establishing or amending a drilling and spacing unit. The Commission is to submit a semiannual report to the legislature that tracks the number of applications for permits to drill, the average time to review and issue permits to drill, and a description of the number and character of applications for permits to drill for which approval has been withheld, including the ultimate disposition of such applications.

The Commission is required to promulgate rules, in consultation with the department of public health and environment, to protect the health, welfare, and safety of the public in the conduct of oil and gas operations. The rules shall provide a procedure for the department to have an opportunity to provide comments during the Commission's decision-making process.

These provisions became effective May 29, 2007.

H.B. 07-1298 amends the legislative declaration in the Oil and Gas Conservation Act to include that it is in the public interest to plan and manage oil and gas operations in a manner that balances development with wildlife conservation in recognition of the state's obligation to protect wildlife resources and the hunting, fishing, and recreation traditions they support, which are an important part of Colorado's economy and culture. The definitions in the Oil and Gas Conservation Act are amended to define "minimize adverse impact" to mean, wherever reasonably practicable, to avoid adverse impacts from oil and gas operations on wildlife resources, minimize the extent and severity of those impacts that cannot be avoided, mitigate the effects of unavoidable remaining impacts, and take into consideration cost effectiveness and technical feasibility with regard to actions and decisions taken to minimize adverse impacts to wildlife resources.

Colo. Rev. Stat. § 34-60-128, the Colorado Habitat Stewardship Act of 2007, is adopted in the Oil and Gas Conservation Act and provides that the Commission shall act so as to minimize adverse impacts to wildlife resources affected by oil and gas operations; consult with the wildlife commission and division of wildlife on decisions that impact wildlife resources; provide for Commission consultation and consent of the affected surface owner or tenant on permit-specific conditions for wildlife habitat protection; implement, whenever reasonably practicable, best management practices and other reasonable measures to conserve wildlife resources; and promulgate rules in consultation with the wildlife commission, to establish standards for minimizing the adverse impacts to wildlife resources affected by oil and gas operations. These rules shall address developing a consultation process with the wildlife commission, encouraging operators to utilize comprehensive drilling plans and geographic area analysis strategies to provide for orderly development, and minimizing surface disturbance and fragmentation in important wildlife habitat by incorporating appropriate best management practices in orders or rules establishing drilling units or allowing the drilling of additional wells in drilling units, in orders approving secondary recovery unit agreements, and, on a site-specific basis, as conditions of approval to a permit to drill.

This act took effect July 1, 2007.

#### LEGISLATURE ADDRESSES PRODUCTION REPORTING

H.B. 07-1180 amends Colo. Rev. Stat. § 34-60-106 to require the Colorado Oil and Gas Conservation Commission to adopt rules to ensure accuracy of oil and gas production reporting by establishing standards for wellhead oil and gas measuring and reporting. Colo. Rev. Stat. § 34-60-118.5, regarding payment of proceeds of production, is amended to provide that the payee may request meter calibration testing and production reporting records.

#### LEGISLATURE AMENDS ACCESS TO ASSESSMENT INFORMATION

H.B. 07-1142 amends Colo. Rev. Stat. § 39-7-102.7 to provide that notices of valuation for lands and leaseholds shall be public records and available for inspection under the applicable statute.

#### PETITIONER MAY NOT CONDEMN AN EASEMENT FOR A PRIVATE WAY OF NECESSITY FOR A NATURAL GAS PIPELINE

In *Akin v. Four Corners Encampment*, \_\_\_ P.3d \_\_\_, No. 05CA1228, 2007 WL 1150450 (Colo. Ct. App. 2007), the Colorado Court of Appeals upheld the trial court's decision that an easement for a private way of necessity could not be condemned for a natural gas pipeline. The district court and court of appeals found that Article II, § 14 of the Colorado Constitution, and Colo. Rev. Stat. § 38-1-102(3) do not authorize condemnation of an easement for a private way of necessity for the purpose of constructing and maintaining a natural gas pipeline and related equipment and facilities. The court found that private way of necessity refers to roadways and passageways connecting landlocked property to a public road.

#### CERTIORARI DENIED IN GUNNISON COUNTY DECISION

In Vol. XXIV, No. 1 (2007) of this *Newsletter*, we reported the decision in *Board of County Commissioners v. BDS International, LLC*, 159 P.3d 773 (Colo. Ct. App. 2006). On June 11, 2007, the Colorado Supreme Court denied the petitions for certiorari in this case. *Colorado Oil & Gas Conservation Commission v. Board of County Commissioners*, No. 07SC75, 2007 WL 1666562 (Colo. June 11, 2007).

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## OKLAHOMA — OIL & GAS

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JAMES C. T. HARDWICK  
— REPORTER —

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#### SCOPE OF MARKET SHARING ACT LIMITED

In *McCall v. Chesapeake Energy Corp.*, 2007 OK CIV APP 59, 164 P.3d 1120 (Okla. Civ. App. 2007), McCall was a working interest owner in four wells operated by Chesapeake Operating, three of which were subject to a joint operating agreement (JOA) on the 1956 Model Form (the JOA Wells), and the fourth of which was not subject to a JOA but governed by a Corporation Commission pooling order (the Force Pooled Well). McCall was not bound by a gas balancing agreement as to any of these wells.

Oklahoma's Natural Gas Market Sharing Act (NGMSA), Okla. Stat. tit. 52, §§ 581.1 *et seq.*, enacted in 1992, provides a mechanism by which certain working interest owners in a well can require the operator to share its market for gas or, alternatively, to secure an independent non-affiliated purchaser for the owner's gas. The NGMSA was enacted as a replacement for the so-called Sweetheart Gas Act, Okla. Stat. tit. 52, §§ 540-547 (repealed in part, amended in part).

McCall requested Chesapeake to market her share of gas from the four wells. Chesapeake offered to do so, provided McCall would sign its marketing letter entitling Chesapeake to charge marketing fees on gas of 2% of gross sales and 20¢ per barrel on oil. These fees were subsequently increased to 3% of the net resale price on gas and 30¢ per barrel on oil. McCall declined to sign Chesapeake's marketing letter and filed suit seeking a declaration that she was entitled to have Chesapeake market her share of gas under the NGMSA. Section 581.4 of the NGMSA provides (among other things) that owners are not entitled to the benefit of the Act if they are "subject to a balancing agreement or other written agreement which expressly provides for the taking, sharing, marketing or balancing of gas in a manner other than as provided for" in the Act. Even though McCall had not signed a gas balancing agreement, Chesapeake asserted that section 13 of the JOA, the right-to-take-in-kind provisions, came within this exclusion. The trial court ruled for Chesapeake on this issue.

On appeal, the Oklahoma Court of Civil Appeals noted that, under the right-to-take-in-kind provisions of section 13 of the JOA, each working interest owner was obligated to "take in-kind or separately dispose of its proportionate share of the oil and gas produced from the Unit Area." The court then examined the further provisions of section 13 stipulating that if a party fails to make arrangements to take in-kind or separately dispose of its

share of production, the operator has the right, but not the obligation, to purchase the production or sell it to others at not less than the prevailing market price, subject to revocation at will by the party owning the production, and the right of the owner at any time to take in-kind or separately dispose of its share of production. After quoting these provisions verbatim and without any rationale, the court declared that these were provisions governing the taking, sharing, and marketing of gas and, therefore, McCall was not entitled to avail herself of the NGMSA for the JOA Wells.

The parties agreed that the NGMSA applied to the Force Pooled Well. The dispute here, however, was McCall's claim that the 3% marketing fee paid by Chesapeake to its marketing affiliate and to be assessed against McCall was unreasonable. Pursuant to § 581.10 of the NGMSA, the Corporation Commission established a schedule of reasonable administrative fees to cover the actual costs incurred by an operator in performing its duties under the Act. The court noted, however, that these administrative fees were in addition to and separate from "any and all post-production costs and expenses, including but not limited to reasonable marketing costs," which were authorized to be deducted from the proceeds received. After quoting this provision of the statute and again without further rationale, the court found no error in the trial court's determination that McCall was obligated to bear her proportionate share of the 3% marketing fee paid Chesapeake's marketing affiliate.

McCall had also sought relief against Chesapeake Operating's parent, alleging that the Chesapeake entities had created through accounting management a structure whereby funds for the marketing and operations flow to the same entity and were managed so as to realize or eliminate profit from any particular subsidiary. The court rejected any claim against the parent on the basis that there were no allegations against the parent other than that Chesapeake Operating was its subsidiary. The court stated that the separate existence of the two entities would not be disregarded in the absence of proof that the parent and subsidiary were so closely linked and extricably intertwined as to be effectively one entity. McCall had failed to tender evidentiary material showing a disputed issue of fact as to whether the subsidiary was the mere agent or instrumentality of the parent. According to the court, the record did not establish more than a usual parent-sub-sidiary relationship.

On April 9, 2007, the Oklahoma Supreme Court denied certiorari and ordered that the opinion of the Court of Civil Appeals be released for publication and be accorded precedential value.

*Comment:* The court's decision that the right-to-take-in-kind provisions of the JOA place an owner beyond access to the NGMSA on the basis that it is an agreement expressly providing for the taking, sharing, marketing, or balancing of gas will come as a surprise to many. The Oklahoma Corporation Commission, in promulgating rules under the Sweetheart Gas Act, predecessor to the NGMSA, expressly ruled that parties signing a joint operating agreement "identical in content to AAPL Form 610-Model Form Operating Agreement, with no gas balancing agreement attached" would not be excluded from the Sweetheart Gas Act and the rules thereunder because those provisions do not "expressly provide for the taking, sharing or gas balancing of gas produced . . . in a manner other than as set forth in these Rules." Order No.

256161 in General Cause No. 28356, March 26, 1984. This ruling of the commission was widely known in the industry and, to this reporter's knowledge, not challenged further. There was nothing surrounding the enactment of the NGMSA as a replacement for the Sweetheart Gas Act indicating a legislative intent to change the effect of the prior Act. Without commenting on the policy wisdom of the Sweetheart Gas Act or its successor, the NGMSA, it would seem that this decision substantially restricts access to the NGMSA. A great majority of well owners in Oklahoma will be parties to a JOA on either the 1956, 1977, 1982, or 1989 Model Form, all of which contain right-to-take-in-kind provisions with respect to oil and gas production which are the same in all material respects to the language relied upon by the court in this case. Thus, it may be that only owners participating in wells under Corporation Commission forced pooling orders are entitled to benefits of the NGMSA.

#### **WITHHOLDING OF PAYMENTS TO NON-RESIDENT ROYALTY OWNERS UPHeld**

Okla. Stat. tit. 68, § 2385.26, enacted in 2000, directs payors of oil and gas royalties to withhold 5% of the royalty payments to non-Oklahoma residents and remit the same to the Oklahoma Tax Commission. The statute grants non-residents credit for amounts withheld toward income taxes owed and provides refunds if amounts withheld exceed income taxes owed. In *Panhandle Producers & Royalty Owners Ass'n v. Oklahoma Tax Commission*, 2007 OK CIV APP 68, 162 P.3d 960 (Okla. Civ. App. 2007), the Royalty Association challenged the constitutionality of this statute, claiming it violated the privileges and immunities provisions, the equal protection provisions, and the interstate commerce clause of the U.S. Constitution.

After reviewing various U.S. Supreme Court decisions dealing with the constitutionality of statutes providing for tax treatment of non-residents different than for residents, the Oklahoma Court of Civil Appeals upheld the constitutionality of the statute. The court noted the Tax Commission's rationale for different treatment of non-residents was to secure payment of taxes on royalties by withholding the taxes before the income left the state. Although the Tax Commission had jurisdiction over non-resident royalty owners and could secure payment by imposing liens against non-residents' property, litigation would be necessary to enforce payment. The court found avoidance of that burden to be a substantial reason for different treatment of non-residents, and the method chosen bore a substantial relationship to the state's objection. Therefore, the statute did not violate the privileges and immunities clause of the U.S. Constitution.

The court next stated that the Tax Commission's rationale to ensure taxes are collected before the income leaves the state provided a rational basis for classification based on residence and, therefore, the statute did not violate the equal protection clause. Finally, the court found no violation of the commerce clause as discriminatory against non-residents because, although it directed withholding only against non-residents, it also granted non-residents the right to credit or refund, and the burden on interstate commerce was only incidental. Further, the court noted that it was not the tax itself which the non-residents challenged, but only the method of collection. The court said that statutes requiring withholding of taxes from non-residents have been upheld if the tax

itself is not more onerous than that applicable to residents. The court held that the temporary loss of use of the withheld amounts was not a constitutionally protected interest.

On July 2, 2007, the Oklahoma Supreme Court denied certiorari and ordered that the opinion of the Court of Civil Appeals be published and accorded precedential value.

#### **CLASS MEMBER'S APPEAL OF ROYALTY CLASS ACTION SETTLEMENT FAILS**

*Velma-Alma Independent School District No. 15 v. Texaco, Inc.*, 2007 OK CIV APP 42,162 P.3d 238 (Okla. Civ. App. 2007), involved a class member's attempt to appeal the settlement of a royalty class action approved by the trial court. The class action suit seeking recovery of unpaid or underpaid oil and gas royalties was settled for \$27 million, including a 40% fee to class counsel. Class member Browne challenged the agreement on attorney's fees. Notice of the proposed settlement gave the 6,000 class members three options: (1) they could do nothing and participate in the settlement, (2) they could opt out and not be bound by the settlement, or (3) they could remain in the class but object to the settlement agreement. However, if they objected to the settlement, they were required to file with the court on or before a date certain a written statement containing certain information including a statement of whether they wished to appear at the settlement fairness hearing and a detailed statement of the specific legal and factual basis for every objection. Browne did not attend the fairness hearing, but sent a letter to the court identifying the letter as an objection to the settlement, stating a belief that the 40% award of attorney's fees is "much too high compared to other similar cases of which I am aware." 162 P.3d at 240. At the fairness hearing, the trial court treated Browne's letter as an invalid objection. It then approved the class settlement, finding no valid objection was filed. When Browne attempted to appeal, class representatives sought to dismiss her appeal on the basis that she was not a proper party to appeal because she failed to object to the settlement by following the court's instructions, and further failed to appear at the fairness hearing.

After reviewing several federal appellate and U.S. Supreme Court decisions, the Court of Civil Appeals held that, in order to be considered a party with the right to appeal, the class member must appear and present objections to the trial court at the fairness hearing. If, as in this case, the settlement notice allows for written objections to be filed, those objections will be considered by the trial court in exercising its discretion to approve the settlement but, to be considered a party for the purpose of appeal, that party must appear at the fairness hearing and present those objections.

However, since the court's rule had not previously been adopted in Oklahoma, the court declined to dismiss Browne's appeal on that basis alone. The court then examined Browne's letter and found that it was insufficient under the notice because it failed to present a detailed statement of the specific legal and factual bases for each and every objection.

#### **STATUTE OF LIMITATIONS FOR REFORMATION; AMBIGUOUS WELLBORE RESERVATION**

In *Cox v. Kaiser-Francis Oil Co.*, 2007 OK CIV APP 10, 152 P.3d 274 (Okla. Civ. App. 2007), landowner Cox executed in

September 1986 a non-participating royalty deed in favor of Kaiser covering a 320-acre tract on which were two producing wells: the Stevens #1-12 and the S.P. Helm #1-12. This deed conveyed all grantor's oil royalty and gas royalty, but reserved "Grantor's interest in the wellbore rights and production from the S.P. Helm #1 well located in the center of the Southwest quarter of Section 12-T14-R10W, Canadian County, Oklahoma." 152 P.3d at 276. In 2001, the operator, pursuant to Corporation Commission approval, drilled the S.P. Helm #2 well as a replacement for the S.P. Helm #1 well. When a dispute arose over whether the S.P. Helm #2 well was covered by the deed reservation, Cox sued. Kaiser moved for summary judgment asserting the deed unambiguously reserved only the S.B. Helm #1 wellbore, there was no mutual mistake, and the statute of limitations began to run in September 1986. The trial court granted summary judgment for Kaiser.

On appeal, the appellate court said the applicable statute of limitations was five years after the cause of action accrued and that a cause of action for reformation accrues when plaintiff discovered or should have discovered the mistake. The court concluded that plaintiff's claim for reformation here did not accrue until Kaiser disputed Cox's rights to royalties from the Helm #2 well. In doing so, the court distinguished decisions that held that the statute begins to run upon delivery of the deed, reasoning that those cases did not involve a mistake as the legal effect of the deed. The court reasoned here that Cox could not have known of any adverse claim to her royalty rights so long as the Helm #1 continued to produce and she received royalty checks, and it was only when the new well was drilled and Kaiser claimed the royalty interest that the cause of action accrued.

The court next considered plaintiff's claim that the deed was ambiguous, entitling her to put on extrinsic evidence of the parties' intent. The court first stated that the deed was not subject to construction unless it was ambiguous. In examining the reservation, the court found ambiguity in the words "wellbore rights." The court reasoned that rights to a "well bore and its associated mechanisms" belong to the lessee while the lease is in force, that grantor did not own any such rights, and that these were extrinsic facts resulting in a latent ambiguity. The court further reasoned that even if the reservation of "wellbore rights" were ignored, an ambiguity still existed because the Helm #1 well was a unit well, by statute grantor's interest in production from that well was based on her percentage ownership of royalty in a unit tract multiplied by the proportion that the acreage in that tract bore to the entire unit acreage, with the result that the deed was subject to the interpretation that grantor's reservation was of some percentage of royalty in acreage in the unit, and that she would therefore have the same interest in a replacement well that she had in the earlier unit well.

*Comment:* Under the court's reasoning, it would seem that almost any change in facts subsequent to execution of a deed or making of a contract could form the basis for postponing of the running of the statute of limitations on a reformation claim no matter how clear the instrument may have appeared on its face. Further, many practitioners will find the court's conclusion as to ambiguity surprising. Inclusion of the term "wellbore rights" is, at worst, an example of redundancy commonly encountered in legal drafting. If unnecessary words are tantamount to ambiguity, it

could be argued that all practitioners are guilty of aiding and abetting. Further, the rationale supporting the court's alternate basis for finding ambiguity could easily be extended to finding that the grantor intended to retain an interest in any additional well drilled, even if not a replacement well.

#### **MULTIPLE APPRAISER REPORTS UPHELD IN SURFACE DAMAGE ACTION**

In *Chesapeake Operating, Inc. v. Loomis*, 2007 OK CIV APP 55, 164 P.3d 254 (Okla. Civ. App. 2007), when Chesapeake and the landowners could not agree on surface damages, Chesapeake initiated an action under the Oklahoma Surfaces Damages Act, Okla. Stat. tit. 52, §§ 318.2 *et seq.*, by the filing of a petition to appoint appraisers, which resulted in the appointment of three appraisers. Two appraisers returned a report that 1.83 acres of land had been used as a well site and that landowner suffered surface damages of \$12,350. The third appraiser filed a separate report assessing total damages of \$5,490. Chesapeake filed exceptions to the majority report asserting, among other things, that the Surface Damages Act did not authorize the filing of more than one appraiser report, that the majority had used an improper methodology in determining surface damages, and that it had allocated damages to items not allowed by the Act. At the hearing on exceptions, it was revealed that the majority's damage report was comprised of \$6,405 for the 1.83 acres taken, \$1,750 for damage to property near the well site used for off-site parking, \$1,000 for damages for erosion to off-site property caused by a water spill, and \$3,200 for the "stigma" of having oil and gas operations located on the 240-acre tract of which the 1.83 acre well site was a part. The trial court accepted the majority appraisal.

On appeal, the court acknowledged that the wording in the statute suggests only a single report. However, the court concluded that the parties were not harmed by the filing of multiple reports because the court's role on hearing exceptions in surface damage proceedings confers upon the court the authority to confirm, reject, modify, or order a new appraisal. It also felt that a minority report could be of assistance to the court. The court upheld the trial court's acceptance of the majority appraisal, finding that the award of "stigma" damages was proper, based upon the detrimental effect that "perceived limitations" on potential use of the land caused by oil and gas operations may have on the fair market value of the adjoining property.

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## TEXAS — OIL & GAS

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WILLIAM B. BURFORD  
— REPORTER —

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#### **"DON'T WORRY, I'LL TAKE CARE OF YOU": GEOLOGIST WITHOUT A CONTRACT CAN GET COMPENSATION FOR HIS TIME BUT NOT FOR A MILLION-DOLLAR OVERRIDE**

When Quigley decided to sell his interest in the Samano oil and gas leases in 1997, Bennett, a geologist, agreed to assist him in analyzing the leases and making a sale presentation as a favor to a sick colleague who had been working for Quigley. When Quigley asked Bennett to do some work on the project beyond

what Bennett had anticipated, he told him, "Don't worry Bennett, I'll take care of you." *Quigley v. Bennett*, 227 S.W.3d 51, 52 (Tex. 2007). Quigley later sold the leases to Coastal Oil & Gas, reserving an overriding royalty interest, and Coastal drilled two producing wells. When Bennett and Quigley could not agree on Bennett's compensation, Bennett sued Quigley, asserting causes of action for quantum meruit, conversion, and fraud. In *Quigley v. Bennett*, the Texas Supreme Court reversed a \$1 million award to Bennett, based on a jury verdict, on his fraud claim.

Bennett presented evidence at trial that he was a generating geologist and that generating geologists are usually compensated with overriding royalty interests in the prospects they generate. He testified that he personally only accepted prospect work for royalty interests. Evidence was also presented that the value of a 1% royalty interest in the Samano leases was approximately \$4 million and that geologists who worked for cash compensation rather than overriding royalty interests earned between \$500 a day and \$20,000 per job. The jury found, on Bennett's quantum meruit claim, that the reasonable value of his work was \$2,500, but it found that \$1 million would fairly and reasonably compensate him for Quigley's fraud. Bennett elected to recover on the larger fraud claim, and Quigley appealed.

There was no agreement, Quigley argued, for Bennett to receive an overriding royalty interest as compensation, and Bennett did not disagree. The supreme court agreed with Quigley that to allow Bennett to recover damages based on the value of an overriding royalty interest would violate the statute of frauds.

An overriding royalty interest in an oil and gas lease is an interest in real estate that falls within the statute of frauds. Absent a writing, an agreement to convey such an interest is unenforceable. Allowing recovery of the value of the royalty interest when the interest itself could not be recovered because of the statute of frauds would circumvent the statute's protections. Thus, evidence of the value of a royalty interest, which was what Bennett contended for as compensation, could not be considered as evidence supporting the jury's finding. The only remaining evidence of damages was testimony as to cash-based compensation for a geologist. Although that testimony provided some evidence of the value of Bennett's work, it would not support a \$1 million award.

#### **DIVORCING GEOLOGISTS' AGREEMENT DIVIDING OIL AND GAS INTERESTS HELD AMBIGUOUS**

Two geologists, Rebecca L. Broesche and John Daniel Jacobson, divorced in 1993. Protracted litigation involving the interpretation of their agreed divorce decree began in 1996 and was still not resolved after the court of appeals' decision in *Broesche v. Jacobson*, 218 S.W.3d 267 (Tex. App.—Houston [14th Dist.] 2007, pet. denied).

The disputed portion of the divorcing parties' divorce decree involved their division of oil and gas properties to which Jacobson had become entitled in his employment with Texas Independent Exploration, Inc. Regarding these interests the decree awarded each party one-half of the interests of the parties as described in an Exhibit "A" to the decree. Exhibit "A" consisted of a chart with fifty rows and five columns. The five columns were headed "County," "Well," "WI%," "NRI%," and "Status" (the "Status" column containing symbols for active, inactive, and "after pay-

out”). All oil and gas interests not specifically listed, the decree continued, were awarded to the party whose personal efforts or signature created them. Broesche contended that the decree unambiguously awarded her one-half of the interests in the oil and gas leases on which the listed wells were located (i.e., undrilled locations). Jacobson maintained that Broesche was unambiguously entitled only to one-half interest in the wells on the list and no leasehold interest outside those specific wells.

Broesche cited Williams & Meyers to the effect that a “working interest” is generally understood to mean a mineral interest created by a leasehold. Terms such as “working interest” are often used loosely and inaccurately, however, the court noted. The two geologists may well have used the term in its technical sense, the court optimistically remarked, as dividing their leasehold interests. Exhibit “A” to the decree made no reference to any oil and gas leases, however, and the portion of the decree disposing of interests not included in Exhibit “A” seemed to contemplate that such interests existed. Both parties’ interpretations were reasonable, the court concluded, and the decree was ambiguous. It remanded the case for further proceedings to determine the decree’s intent.

The court’s decision in this case seems correct, but the suggestion that the term “WI%” has some technical meaning that might help determine whether it refers merely to a single well or the leasehold on which it is situated gives too much credit to the divorcing geologists and their divorce lawyers. A reading of the opinion makes clear that the appellate panel is, unfortunately, unfamiliar with basic oil and gas law. The lesson of this case is simply that the resolution of legal rights in oil and gas properties should be entrusted to experts in oil and gas law, not geologists and family law practitioners.

#### **NONCONSENTING WORKING INTEREST OWNER HELD NOT OBLIGATED TO ACCOUNT TO OVERRIDING ROYALTY ASSIGNEE BEFORE PAYOUT OF NONCONSENT PENALTY**

Oil and gas operating agreements typically provide that, after an initial well has been drilled, each working interest owner may either consent or not to the drilling of any subsequent well that may be proposed in the contract area. If a party does not consent, the typical agreement provides that the proposed well may be drilled at the cost of the other working interest owners and that the nonconsenting owner must, to compensate for the risk undertaken by the parties drilling the well, relinquish its interest in the well until the consenting parties have recovered a specified multiple of the drilling and completing costs. If a working interest owner, after entering into such an operating agreement, creates an overriding royalty interest as a burden against its working interest and then “goes nonconsent” in the drilling of a well so that its overriding royalty assignee’s interest is eliminated during the recoupment period along with its own, must the nonconsenting owner account to the overriding royalty owner for the lost overriding royalty proceeds? The court in *Boldrick v. BTA Oil Producers*, 222 S.W.3d 672 (Tex. App.—Eastland 2007, no pet. h.), held that it need not.

The operating agreement at issue appears to have been the 1956 A.A.P.L. Model Form with provisions consistent with those mentioned as typical. It included an additional provision that, if a party should create an overriding royalty interest after the date

of the agreement, the “subsequently created interest” would be subject to the operating agreement. BTA assigned an overriding royalty interest to the predecessor to Boldrick’s interest. BTA thereafter elected not to consent to the drilling of the Stallings Gas Unit 2H Well proposed by the operator, Chevron U.S.A. Inc. After initially paying Boldrick for production from the well attributable to his overriding royalty interest, Chevron concluded it has been mistaken in doing so and asked for reimbursement. Boldrick sued BTA and Chevron alleging breach of contract, unjust enrichment, and conversion. Chevron and BTA counterclaimed for declaratory judgments that, respectively, Chevron had no obligation to pay Boldrick for his overriding royalty interest and that BTA had no obligation to account to Boldrick while it was not itself entitled to oil and gas proceeds. Boldrick appealed the trial court’s summary judgment for BTA, which the court of appeals affirmed.

Boldrick acknowledged that he was aware of the operating agreement before he acquired his overriding royalty interest but contended that it did not apply to his interest. By the clear terms of the operating agreement, the court pointed out, Boldrick’s interest was chargeable with a pro rata portion of all costs and expenses as if it were a working interest. That Texaco, Chevron’s predecessor, had consented to BTA’s assignment of the overriding royalty did not mean that it should not be treated as a subsequently created interest.

More compelling was Boldrick’s insistence that even if BTA’s relinquishment of its pre-payout interest in the well included his overriding royalty interest, BTA should not be excused from its specific grant to him. The court rejected that contention as well. Inasmuch as the operating agreement to which Boldrick’s interest was clearly subject mandated that proceeds of his production be used to meet the consenting parties’ drilling costs, such a use could not constitute a breach of contract between Boldrick and BTA and could not constitute unjust enrichment or conversion. The court emphasized that it left undecided whether BTA might be compelled to reimburse Boldrick for his lost overriding royalty proceeds if and when BTA itself became entitled to proceeds from the well’s production.

The court of appeals convincingly addressed numerous flaws in Boldrick’s arguments, but it disappointingly failed adequately to explain why BTA’s assignment should not be interpreted to contractually obligate BTA for the interest it purported to assign, particularly given that BTA’s assignment was not specifically made subject to the possibility of BTA’s electing not to consent to drilling operations. It must be that the character of the interest assigned by BTA, and BTA’s obligations with respect to it, were considered by the court to be inherently limited by the operating agreement. Why this should be so deserves more careful consideration than the court seems to have given it.

#### **CONTRACTUAL CHOICE OF FORUM IN AMI DISPUTE HELD BINDING ON OIL COMPANY’S SUCCESSORS IN INTEREST BUT NOT NON-RATIFYING AFFILIATES**

Independent Indonesian American Petroleum Company (IIAPCO), an affiliate of Diamond Shamrock, in 1968 entered into an operating agreement with Warrior International Company and Carver-Dodge International Company for the exploration and development of potential petroleum resources in offshore Indo-

nesia. The operating agreement included an “area of mutual interest” (AMI) provision that any party acquiring a petroleum exploration interest in another part of Indonesia must offer the others the option to participate. Settling a dispute over whether the AMI provision applied to an acquisition by Diamond Shamrock, it and Warrior entered into a 1986 settlement agreement in which they agreed that venue and exclusive jurisdiction of claims arising under the AMI provision would lie in Texas, that the AMI provisions would apply to Diamond Shamrock, Warrior, and the affiliates of each of them, and that the settlement agreement would remain in effect as long as Warrior and Diamond Shamrock were parties to the 1968 operating agreement, as defined in its section 17. In the ensuing years the Diamond Shamrock interest under the operating agreement passed to CNOOC SES Ltd. (SES), a subsidiary of CNOOC Southeast Asia Ltd. (SAL), an affiliate of China National Offshore Oil Corporation, the Chinese state oil company. Paladin Resources acquired Warrior’s interest. In 2004 Paladin sued SAL, SES, CNOOC International Limited (International), CNOOC Muturi Limited (Muturi), and CNOOC Ltd. (LTD) in Dallas County, Texas, alleging that International and Muturi, as affiliates of SES, violated the AMI provision by acquiring Indonesian exploration rights without offering Paladin the option to participate. *CNOOC Southeast Asia Ltd. v. Paladin Resources (Sunda) Ltd.*, 222 S.W.3d 889 (Tex. App.—Dallas 2007, pet. filed), decided the appeal of special appearances filed by the defendants to challenge the jurisdiction of the Texas courts.

After preliminarily noting that a contractual forum selection clause does not offend due process, the court first dealt with the defendants’ argument that the 1986 settlement agreement containing the clause had expired because Diamond Shamrock and Warrior had ceased to be parties to the underlying operating agreement. It rejected the argument, observing that the settlement agreement was, by its terms, to remain in effect so long as Warrior and Diamond Shamrock were parties *as defined in section 17 of the operating agreement*. Section 17 defined a “party” to include “each successor to any or all of the working interest of a Party” in the original production-sharing agreement with the Indonesian government. Since Paladin and SES had succeeded to the working interests of Warrior and Diamond Shamrock, respectively, the forum-selection clause was enforceable against SES. Furthermore, SAL and LTD were properly found to be subject to the forum-selection clause by ratification. The 2002 purchase agreement under which they had acquired the corporation that became SES and other affiliated entities recited that the 1986 settlement agreement was among the documents under which the entities’ assets were operated, and this was enough to support the trial court’s finding that SAL and LTD had agreed to be bound.

The court’s conclusion was different with respect to the remaining two defendants, International and Muturi. Paladin argued that they were bound by the forum-selection clause simply because they were affiliates of SES and had become bound when their parent corporations, LTD, and SEL, respectively, became subject to the 1986 settlement agreement. The court disagreed. International and Muturi were nonsignatories to the settlement agreement, and in legal proceedings the separateness of parent and subsidiary corporations will generally be observed by courts even where one company may dominate or control the other. Moreover, Paladin offered no evidence that International or Muturi

authorized SAL, LTD, or SES to bind them to the forum-selection clause. The forum-selection clause was therefore not shown to be enforceable against them.

#### **EXECUTIVE RIGHTS OWNER HELD NOT TO HAVE BREACHED DUTY OF UTMOST GOOD FAITH TO NONEXECUTIVE**

*Marrs & Smith Partnership v. D. K. Boyd Oil & Gas Co.*, 223 S.W.3d 1 (Tex. App.—El Paso 2005, pet. denied), decided the appeal by Marrs & Smith, the owner of a nonexecutive mineral interest, of an adverse judgment in favor of Boyd, the owner of the executive rights appurtenant to Marrs & Smith’s interest.

To finance its purchase of the 136,000-acre Frying Pan Ranch, Boyd sought funding in exchange for mineral interests in the land to be acquired. Marrs & Smith provided \$1.3 million, for which Boyd agreed to assign it 20% of the mineral estate in the ranch. After closing on the ranch on December 10, 1996, using Marrs & Smith’s money and funds provided by other investors, Boyd retained approximately 1/3 of the mineral estate, as well as the executive rights to Marrs & Smith’s minerals, subject to the obligation to convey to Marrs & Smith the executive rights to its interest upon request. Boyd and its principal, D. K. Boyd, then embarked on efforts to have the ranch’s minerals developed for oil and gas production. Boyd hired a geologist, a geophysicist, and landmen to generate prospects and made an agreement with Rutter and Wilbanks Corporation to market them. To further its plans, Boyd executed leases on its own minerals and on Marrs & Smith’s, apparently to Boyd itself. Marrs & Smith ratified the lease on its minerals shortly after Boyd executed it.

Amid disputes between Boyd and Marrs & Smith on a variety of matters, Boyd and Rutter negotiated a farmout of the Boyd lease and many others to Titan Resources. The Titan farmout included a surface agreement under which Boyd, as the surface owner, would be paid somewhat less than its usual rate for surface damages. It did not include the Marrs & Smith lease because, as the court’s opinion puts it, Marrs & Smith had refused to “grant” an assignment to Rutter, suggesting there was a proviso in Marrs & Smith’s lease requiring its consent to assignments. Nevertheless, Titan, at Boyd’s request, requested that Marrs & Smith approve the farmout. Marrs & Smith responded by purporting to rescind its lease, forcing Titan and Boyd, with a rig on the way, to agree to Marrs & Smith’s demands for additional bonus money for itself.

Marrs & Smith sued Boyd for breach of its fiduciary duty relating to its exercise of the Marrs & Smith executive rights, claiming that Boyd had obtained terms more favorable to Boyd than to Marrs & Smith in several transactions, including the Boyd lease, the Titan farmout agreement, and the Rutter marketing agreement. After a February 2001 bench trial on which a final judgment was not entered until more than three years later, Marrs & Smith appealed the trial court’s judgment that Marrs & Smith take nothing on its claims. In an opinion seemingly replete with extraneous facts but lacking in the clear exposition of salient ones, the court of appeals affirmed.

The court began by noting that the duty of utmost good faith owed by the owner of executive rights to a nonexecutive mineral owner, sometimes equated with a fiduciary obligation, requires the executive rights owner to execute the same type of lease on the

same terms as it would have done in the absence of any third-party nonparticipating interest and, in the exercise of the executive rights, to acquire for the nonexecutive every benefit exacted for itself. Here the terms of the Boyd lease of its own minerals and that of Marris & Smith's minerals were identical insofar as they related to mineral interests. Marris & Smith pointed to several additional paragraphs of the Boyd lease not found in the Marris & Smith lease that it alleged gave Boyd advantages not enjoyed by Marris & Smith. All of these related solely to the lessee's surface activities, and the court of appeals agreed with the trial court that the material lease terms were identical.

Boyd had likewise not breached its duty to Marris & Smith by entering into the Rutter agreement under which Boyd became entitled to compensation in various forms. The evidence, the court held, established that these benefits were based on D. K. Boyd's personal efforts and expense and not through the exercise of Boyd's executive rights. Further, because Marris & Smith had rejected the Titan farmout that it contended contained terms more favorable to Boyd than to Marris & Smith, it was never executed. Marris & Smith had instead forced a farmout agreement on terms more favorable, conversely, to Marris & Smith and suffered no damages. And although Boyd's executive duty prohibited it from negotiating surface damage payments as a substitute for larger bonus, royalty, or other benefits that would have to be shared with its mineral owner, there was no evidence that Boyd's surface damages agreement with Titan did anything other than compensate for surface damage.

#### **CLAIMS FOR FAULTY PIPELINE ENGINEERING HELD BARRED BY ALBERTA STATUTE OF REPOSE**

*Nexen Inc. v. Gulf Interstate Engineering Co.*, 224 S.W.3d 412 (Tex. App.—Houston [1st Dist.] 2006, no pet.), involved the engineering work performed by Gulf Interstate Engineering (GIE), headquartered in Texas, in the design and construction of an oil processing facility in Yemen for CanadianOxy Offshore International Ltd., a corporate predecessor of Nexen. GIE's duties included the design and engineering of a pipeline and a number of other facilities. The pipeline was substantially completed by August 1993, and all of GIE's engineering work concluded in July 1994. In April 2002, flooding at the project site caused the pipeline to move and become damaged. Nexen sued GIE in April 2004, alleging breach of contract, breach of warranty, negligence, and strict liability for design defect. GIE's defense was based on the ten-year statutes of repose under both Texas and Alberta law. Nexen appealed from the trial court's summary judgment in favor of GIE, and the court of appeals affirmed.

The parties' contract called for the application of the law of Alberta, Canada, and the court of appeals was called upon to determine whether to enforce the parties' choice of law or to apply Texas law. Although both jurisdictions had ten-year statutes of repose, barring claims based on breaches involving professional services such as those at issue here, the Alberta statute provided that a claim or any number of claims based on any number of breaches of duty, resulting from a continuing course of conduct or a series of related acts or omissions, arises when the conduct terminates or the last act or omission occurs, whereas the Texas statute required that a suit be filed within ten years after the substantial completion of the improvement or the beginning of

operation of the equipment involved. Because the pipeline was completed more than ten years before the suit was filed, but the date when the project was ready for operation was less than ten years before the filing, what law governed the claim was material to its resolution.

Texas has adopted section 187 of the *Restatement (Second) of the Law of Conflicts*, under which the law chosen by the contracting parties will be applied unless the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or application of the chosen state's law would be contrary to a fundamental policy of a state with a materially greater interest than the chosen state in the determination of the issue. Here, the representatives of Nexen's predecessor involved in the negotiation of the contract and in the project execution were located in Calgary, Alberta, so that there was no question that the contract bore a reasonable relationship to the chosen jurisdiction. Alberta law would therefore govern unless its application would offend fundamental Texas public policy and Texas had the most significant relationship to the transaction and the parties. Although there were some differences between the two jurisdictions' statutes of repose, both were ten-year statutes and shared similar underlying policies and purposes. That the application of Alberta's repose law might lead to a different result than Texas's did not make the Alberta law contrary to Texas's fundamental public policy, and the court held that it was not.

Applying the Alberta statute, the court noted that its period focuses on the time the breach of duty on which the claim is based occurs. Nexen's claims were based entirely on GIE's engineering and design work on the pipeline rather than on other aspects of the project that were completed later. GIE's last relevant act or omission in engineering and design work on the pipeline must have occurred when the pipeline was finished, regardless of whether its work or other aspects of the project continued.

#### **DEED CONSTRUED TO CONVEY 1/4 MINERAL INTEREST, NOT 1/32 MINERAL INTEREST OR 1/32 NONPARTICIPATING ROYALTY INTEREST**

The court in *Hamilton v. Morris Resources, Ltd.*, 225 S.W.3d 336 (Tex. App.—San Antonio 2007, pet. filed), construed a 1926 mineral deed and a subsequent correction deed. The original mineral deed, from John and Matilda Richardson to George H. Coates, executed while there were outstanding oil and gas leases providing for 1/8 royalty, conveyed a "1/4th interest in and to all the oil, gas and other minerals" in the land at issue, specifically including 1/4 of the royalty due under the terms of the existing leases and 1/32 of delay rentals paid under it. Should the lease terminate, the deed continued, the "lease interests and all future rentals on said land, for oil, gas, and mineral privileges shall be owned jointly by the undersigned [grantors] owning 31/32 and [the grantee] owning 1/32 interest . . . in all oil, gas and other minerals in and upon said land, together with their interest in all future rentals." 225 S.W.3d at 341. The correction deed, executed in 1932 while there were no effective leases, recited "the intention of the parties to convey an undivided one-fourth (1/4th) interest in the minerals, being a one-thirty-second (1/32nd) of the gross production for a perpetual term," and then, after reciting that the earlier deed was ambiguous, amended it to convey precisely that, "which interest, however, shall not be participating as to delay rentals payable under the out-

standing lease nor as to delay rentals or cash bonuses payable under the future leases,” and to provide that the grantee’s joinder in future leases would be unnecessary but that the grantors “shall execute no oil, gas and mineral leases . . . providing for a royalty of less than one-eighth (1/8th) of the oil, gas and other minerals in and under the above described land.” *Id.* at 342. In 1999 the successor to the grantors’ interest executed a lease providing for a 1/4 royalty on oil and gas. After production was established, the successors to the grantee’s interest sued the successor to the grantors’ interest. The trial court found after a bench trial that the deed, as corrected, conveyed a 1/4 mineral interest and entitled the grantee to 1/4 of the 1/4 royalty, and the defendant owners of the grantors’ interest appealed its judgment.

The deed, the defendants asserted, should be construed as conveying a 1/4 mineral interest during the life of the existing leases but only a 1/32 possibility of reverter. This would, they maintained, entitle the grantee to only a 1/32 of the 1/4 royalty production. The court of appeals disagreed. No language of the original deed divested the grantee of the 1/4 mineral interest conveyed in the granting clause, it pointed out, and the correction deed began with the recital of the parties’ intention to have conveyed a 1/4 mineral interest. The final provision of the correction deed prohibiting leases at less than 1/8 royalty ensured that the grantee’s interest would not fall below 1/32 of gross production. If a subsequent lease calls for more than 1/8, the grantee’s interest would be 1/4 of that royalty. In summary, the court held, from the four corners of the deed and correction deed, the grantors did not intend to convey mineral estates differing in magnitude and duration but instead simply conveyed a 1/4 mineral interest.

The court went on to reject the defendants’ alternative argument that the correction deed amended the interest conveyed to a 1/32 nonparticipating royalty interest. The correction deed’s stripping of the grantee’s mineral interest of the right to lease and of the right to receive bonuses and delay rentals, they maintained, resulted in its conversion to a nonparticipating royalty interest. A mineral interest shorn of certain attributes remains a mineral interest, however, under *Altman v. Blake*, 712 S.W.2d 117, 118-19 (Tex. 1986). If the grantors had intended to convey only a royalty interest, they need not have reserved the rights to lease and to receive bonuses and delay rentals, since the grant of a royalty interest, without more, does not convey those.

The result in this case seems correct. The court would have done a service to better explain how the contradictory provisions of the deeds, such as the original deed’s recital of a division of ownership of 1/32 to the grantee and 31/32 to the grantors, might be harmonized with the other provisions.

#### **OPERATING AGREEMENT’S PROVISIONS FOR REMOVAL AND REPLACEMENT OF OPERATOR RESULT IN STALEMATE**

*Fasken Land & Minerals, Ltd. v. Occidental Permian Ltd.*, 225 S.W.3d 577 (Tex. App.—El Paso 2005, pet. denied), illustrates the need to carefully consider how workable provisions of an operating agreement such as those for removal and replacement of the operator will prove to be when the parties must attempt to follow them.

Altura Energy Ltd., a partnership formed to hold and operate the Permian Basin oil and gas assets of Amoco Production Com-

pany and Shell Oil Company’s domestic exploration and production subsidiary, was the operator of the Midland Farms Unit, an oil and gas unit on the C Ranch in Andrews County, Texas. Fasken was a nonoperating working interest owner. The operating agreement for the unit, as amended in 1995, included a preferential right to purchase provision requiring any party desiring to sell its interest to offer it to the other parties under the same terms being offered by the intended third-party purchaser. The operating agreement also included the following provisions for removal of the unit operator and the selection of a successor:

6.2 *Resignation or Removal.* Unit Operator may resign at any time. Working Interest Owners may remove Unit Operator by the affirmative vote of at least eighty-five percent (85%) of the voting interest remaining after excluding the voting interest of Unit Operator. A Unit Operator who resigns or is removed shall not be released from its obligations hereunder for a period of three (3) months after its resignation or discharge unless a successor Unit Operator shall have taken over the operations hereunder prior to the expiration of said period.

6.3 *Selection of Successor.* In the event of the resignation or removal of a Unit Operator, a successor Unit Operator shall be selected by the affirmative vote of three (3) or more Working Interest Owners having at least eighty-five percent (85%) of the combined voting interest of all Working Interest Owners, provided no Unit Operator who is removed may vote to succeed itself.

225 S.W.3d at 592.

When Altura was acquired by Occidental Petroleum Corp. in 2000, Altura sent Fasken a letter advising it that the nonoperating working interest owners in the Midland Farms Unit might have a preferential right to purchase pursuant to the operating agreement and furnishing a copy of the purchase and sale agreement, under which Altura’s 74.67% working interest in the Midland Farms Unit was allocated a value of \$63 million. Fasken was interested in acquiring Altura’s interest but placed its true value at least \$20 million below the purchase and sale agreement’s allocation. Instead of exercising the preferential right or declining to do so within the 15-day option period specified in the operating agreement, Fasken responded by asserting that it had the right to sufficient information to enable it to make an informed decision and requesting all documents and information necessary to verify the basis of the \$63 million allocation and to verify that, as Altura’s notice had stated, that amount was payable in cash at closing. In subsequent meetings Altura (which had become Occidental Permian Ltd. after the closing of the acquisition) declined to provide much further explanation of the basis of the Midland Farms Unit valuation, and Fasken took the position that its 15-day purchase option would not begin to run until it received sufficient information and that Occidental Permian’s failure to provide it was a material breach of the operating agreement.

Several weeks after Altura’s notice to Fasken of the pending sale to Occidental, as the dispute over the preferential right proceeded to a lawsuit filed by Fasken, a meeting of the Midland Farms Unit working interest owners was held in Fasken’s offices to consider Fasken’s call for the removal of Occidental as operator and the appointment of a successor. At the meeting Occi-

dental voted its 74.67% unit interest against its removal; Fasken and two other working interest owners, Lowe Partners LP and Valence Operating Co., voted their collective 25.32% for removal. Following that vote Fasken's representative nominated a Fasken affiliate, D. H. Acquisition, Ltd., as successor operator. Occidental voted its interest against the nomination, and its representative, chairing the meeting, stated that the item had failed. After the vote Fasken took the position that the operator has been properly removed and D. H. Acquisition properly elected by vote of the working interest owners other than Occidental. Occidental's representative responded that Occidental would continue to operate the unit in good faith until a successor operator had been properly elected. Fasken thereupon amended its petition in the existing suit to request a declaratory judgment that Occidental had been removed as unit operator and that D. H. Acquisition had been duly elected as successor operator. Fasken appealed from a summary judgment concluding that Occidental had been removed as unit operator but denying any other relief.

The court first addressed Fasken's argument that its 15-day option period under the operating agreement's preferential purchase right provision did not begin to run upon receipt of Altura's notice of the sale because Fasken had not been provided the "full information" concerning the proposed sale as the operating agreement required. Such "full information," Fasken maintained, must disclose how the Altura sellers arrived at their allocation of the purchase price. The court of appeals disagreed. The preferential right to purchase provision, it pointed out, required a selling party to give notice of an intended sale "with full information . . . , which notice shall include" four specific items: (1) the name and address of the purchaser, (2) the price or, in the case of a business entity or group of properties, the allocation of that portion of the price attributable to the interest covered by the operating agreement, (3) a legal description of the property, and (4) all other terms of the proposed sale. By specifying those items the parties had prescribed what would constitute full information. Thus, the operating agreement did not require that Fasken be furnished any information concerning the basis for its allocation of the purchase price.

Turning to the voting on removal and replacement of the unit operator, the court first observed that it was undisputed that the initial vote validly removed Occidental as operator. The selection of a successor was a different matter. Although the agreement prohibited a removed operator from voting to succeed itself, it in no way prohibited it from voting against its nominated successor. Occidental's "no" vote and its refusal to participate in the election of a successor operator were not, as Fasken contended, tantamount to a vote to succeed itself, nor did they bind Occidental to accede to the election of the other owners' choice of a successor under the doctrine of quasi-estoppel. Underlying the court's holding, at least in part, undoubtedly was the recognition that Occidental, although it did not hold or control the interest required to elect its own choice of a successor, was entitled to due consideration as the owner of, by far, the largest unit interest. The result seems to be a stalemate in which Occidental has formally been removed but cannot be effectively replaced.

#### MINERAL RESERVATION RENDERED AMBIGUOUS BY WORDING OF DEED'S SEPARATE RESERVATION TO DIFFERENT GRANTOR

*Morrison v. Robinson*, 226 S.W.3d 472 (Tex. App.—Waco 2006, pet. denied), is an extraordinary decision whose basis seems wholly elusive.

Charlsie Northcutt Morrison and her sister-in-law Barbara Morrison Evans together owned an 87.36-acre tract in Robertson County, Texas, each apparently owning an undivided one-half interest in both surface and minerals. They sold the land to the Robinsons in 1998, joining in a single deed with separate mineral reservations to each of the two grantors:

SAVE AND EXCEPT and there is hereby reserved for Grantor, Charlsie Northcutt Morrison, and her heirs, administrators, successors or assigns, an undivided one-half (1/2) interest of the oil, gas and other minerals produced with the oil and gas *now owned* by Charlsie Northcutt Morrison that are in and under the property and that may be produced from it.

SAVE AND EXCEPT and there is hereby reserved for Grantor, Barbara Morrison Evans and her heirs, administrators, successors or assigns, for a period until June 11, 2000, an undivided one-half (1/2) interest of the oil and gas and other minerals produced with the oil and gas *now owned* by Barbara Morrison Evans, that are in and under the property and that may be produced from it.

. . . .

On June 11, 2000, an undivided one-fourth (1/4) interest of the total mineral estate shall pass to and be owned by Grantees, their heirs and assigns. It is the intent of the Grantor Barbara Morrison Evans and the Grantee [*sic*] James E. Robinson and Charles Owen Robinson, that as of June 11, 2000 that Barbara Morrison Evans, her heirs and assigns shall own an undivided one-fourth (1/4) of the oil, gas and other minerals and James E. Robinson and Charles Owen Robinson and their heirs and assigns shall own an undivided one-fourth (1/4) of the total oil, gas and mineral estate.

226 S.W.3d at 474-75.

Although the plain meaning of the reservation to Morrison seems to be that she reserved one-half of the one-half mineral interest owned by her as of the date of the deed, she argued, on appeal of the trial court's summary judgment for her grantees, that the true meaning was revealed only by reference to the reservation to Evans. Because the Evans reservation, according to Morrison, made clear that the parties intended for Evans to retain her undivided one-half mineral interest until June 11, 2000, the Morrison reservation, with virtually identical language, must be construed likewise to reserve to Morrison her own one-half interest, not merely one-half of the one-half she then owned.

Ambiguity exists, the court noted, when parties advance conflicting interpretations of an instrument, but only when both interpretations are reasonable. It was reasonable, the court found, to read the reservation according to the grantees' interpretation, that Morrison intended to reserve one-half of the minerals "now owned" by her, or one-half of her one-half (one-quarter of the

total mineral estate). But the court must, it went on, examine and consider the entire writing in an effort to harmonize and give effect to all provisions so that none will be rendered meaningless. Because the wording of the Morrison reservation was substantially identical to that of the Evans reservation, and considering the additional language in the Evans reservation, the court found Morrison's interpretation reasonable as well and held the reservation to her ambiguous.

The dissent by an incredulous Justice Gray seems on target. Remarking on the majority's finding that it was reasonable to conclude that Morrison's intention was to reserve one-half of the interest then owned by her, he observed that this is not merely a *reasonable* interpretation but the *only* interpretation for the language used. For Morrison's interpretation to be considered reasonable, it was necessary for the majority to completely disregard the words "now owned" or to give it a completely different meaning from its ordinary one. What Evans intended in her own reservation has no bearing on determining what Morrison intended, he maintained. Comparing the Morrison and Evans reservations, the majority might at most conclude that Morrison might have intended to say something other than what was expressed in the deed. The majority should interpret the deed by looking solely to what the grantor, Morrison, expressed in the deed, he summed up, not what some other grantor expressed, and give effect to the clear wording of the Morrison granting clause and reservation. One might also wonder about the majority's apparent acceptance of Morrison's assertion that the Evans reservation made clear the parties' intent for Evans to retain her own entire interest until a future date. Leaving aside whether the Evans reservation has any bearing on the interpretation of Morrison's, the two portions of the Evans reservation seem at best to create ambiguity, not to provide clarity, concerning the parties' intention for the period until June 11, 2000.

This decision represents another in what is to some a disturbing trend in the Texas courts away from interpreting deeds and conveyances according to their plain meaning. The court of appeals' attempt to divine the grantor's meaning from something other than her own words, and the supreme court's denial of the grantees' petition for review, seem a departure from the firm rule, invoked by Justice Gray in dissent, that the parties' intention must be ascertained from what the grantor actually said, not what he may have meant to say.

#### **DOWNSTREAM GAS PURCHASER HELD NOT LIABLE FOR CONVERSION OF PRODUCER'S STATUTORY SECURITY INTEREST**

*Edge Petroleum Operating Co. v. GPR Holdings, L.L.C. (In re TXNB Internal Case)*, 483 F.3d 292 (5th Cir. 2007), decided the appeal of Edge, a gas producer, of an adverse summary judgment on its claim for conversion against Duke Energy Trading and Marketing, L.L.C. In May and June 2001, Edge Petroleum sold gas to GPR Holdings and affiliates, which filed bankruptcy in August 2001, without having paid for the gas. GPR resold the gas to Duke, which did not pay cash but instead offset its obligation against overpayments by Duke to GPR in earlier months. Instead of filing claims in the GPR bankruptcy, Edge sued Duke on the lien provided by the Texas Mineral Lien Act, Tex. Bus. &

Com. Code § 9.343, which grants a security interest to oil and gas producers in oil and gas production and the identifiable proceeds of it to secure the payment obligations of the first purchaser.

The security interest under the Mineral Lien Act ceases to apply to gas once it is sold in the ordinary course of business. A person who acquires goods in satisfaction of a prior debt, however, is not a buyer in the ordinary course of business. Thus, the court acknowledged, since Duke had offset a prior overpayment to GPR—a debt—instead of paying for the gas, Edge could assert the statutory lien against the proceeds of Duke's resale of the gas. Edge could not, however, pursue its claim through an action for conversion.

To establish conversion, Edge was required to prove that (1) it owned or had a right to possession of the property; (2) the defendant assumed and exercised dominion and control over the property inconsistent with the plaintiff's rights; and (3) the defendant refused the plaintiff's demand for return of the property. At the time Duke exercised dominion over the gas, the court pointed out, payment had not yet come due, and Edge had no right to enforce its interest in the gas. The court disagreed with Edge, moreover, that Duke's reselling the gas in the ordinary course of business, free of the security interest any further downstream, was so blatant and egregious a repudiation of Edge's rights as to foreclose any need for Edge to demand a return of its property. Edge's sale to the bankruptcy debtors, consistent with prevailing practices in the gas industry, the bankruptcy court had found, constituted Edge's implied consent to resale of the gas to downstream purchasers, before the due date of payment, in the ordinary course of business. It had thus consented to its security interest's being cut off. Only extraordinary circumstances excuse the need for a demand. Duke, which never even had notice of Edge's rights, could hardly be said to have used the property so inconsistently with the manner in which it was received as to assert a property right inconsistent with that of the owner.

Edge likewise could not maintain an action for conversion of the proceeds of the gas it resold. Actions for conversion of money are available in Texas only where money is (1) delivered for safekeeping, (2) intended to be kept segregated, (3) substantially in the form it is received or an intact fund, and (4) not the subject of a title claim by the keeper. Edge's argument that Duke, upon its resale of the gas, was in the position of a trustee for Edge was somewhat feeble, the court remarked. A party that benefits from proceeds subject to a statutory lien may be liable for conversion of them if it has notice of the lien and then accepts and benefits from the proceeds. Duke is presumed to have been aware of the law granting Edge its lien, but it did not know that Edge was owed the money. Without more, the court held, Edge could not overcome Texas courts' traditional hostility to claims for conversion of money.

The court's interpretation would not, it emphasized, foreclose creditors such as Edge from pursuing actions for collection. Creditors are cut off by this decision only from actions for conversion with the attendant possibility of punitive damages against downstream purchasers without notice of the producer's claims or the first purchaser's nonpayment.

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## WYOMING — OIL & GAS

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WILLIAM N. HEISS  
— REPORTER —

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### WYOMING SUPREME COURT FINDS THAT SEVERANCE AND AD VALOREM TAXES ARE NOT ASSESSED ON HELIUM PRODUCED UNDER A FEDERAL OIL AND GAS LEASE

In *Wyoming Department of Revenue v. ExxonMobil Corp.*, 2007 WY 112, 162 P.3d 515 (Wyo. 2007), the Wyoming Supreme Court found that severance and ad valorem taxes are not owed on helium produced under federal oil and gas leases. Under the Mineral Leasing Act of 1920, the ownership and right to extract all helium produced under federal oil and gas leases is reserved to the United States. In compliance with the Mineral Leasing Act of 1920, the leases at issue reserved to the United States the helium, along with the right to extract helium from the gas stream. At the time of construction of Exxon's Shute Creek plant in 1985, which plant would process the gas at issue, Exxon negotiated with the United States to purchase the helium. Thus Exxon and the federal government entered into a Helium Sale and Disposition Agreement (Agreement) in 1985. This agreement gave Exxon the right to take possession of the gas stream containing helium and to process, extract, and purchase helium. Exxon was granted title to the helium at the point where helium was extracted from the gas stream.

The Wyoming Department of Revenue notified Exxon that production taxes (severance and ad valorem) were owed on all products, including helium produced under Exxon's federal leases. In response, ExxonMobil filed a declaratory judgment in district court asking the court to find that production taxes are not owed on helium produced under federal oil and gas leases. On cross

motions for summary judgment the district court found that neither the state nor the county could collect taxes on helium produced under federal leases and extracted under the Agreement. The separate appeals of both the county and the Department of Revenue were consolidated on appeal to the Wyoming Supreme Court.

In 1988 Exxon was a party to a suit over the applicability of severance and ad valorem taxes to non-hydrocarbon taxes. *Amoco Production Co. v. State*, 751 P.2d 379 (Wyo. 1988). That case determined that helium and carbon dioxide were considered "natural gas" under the tax statute, but did not address the issue of whether helium was subject to ad valorem or severance tax. The Wyoming Supreme Court held that ExxonMobil was not barred by doctrines of res judicata or collateral estoppel based on the findings in the 1988 case since that case did not consider the issue of whether helium produced under a federal lease was taxable.

As to the county's contention that ad valorem taxes were owed on the helium produced, the court held that ExxonMobil did not meet the statutory definition of a taxpayer of the ad valorem tax since it was neither "the lessor, lessee or lessee's assignee," as set forth in Wyo. Stat. § 39-14-203(c)(i).

With regard to the applicability of the severance tax, the court looked to the statute imposing the tax: "There is levied a severance tax on the value of the gross product extracted for the privilege of severing or extracting crude oil, lease condensate or natural gas in the state." Wyo. Stat. § 39-14-203(a)(i).

Because 30 U.S.C. § 181 specifically reserves to the United States "ownership of and the right to extract helium from all gas produced from lands leased . . .," with such reservation being specifically set forth in the federal lease form, ExxonMobil did not possess the privilege of removing, extracting, severing, or producing helium on federal leases. Accordingly, ExxonMobil was not liable for severance taxes on helium produced from the federal leases.



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