Environmental Management of Routine Oil & Gas Transactions

by

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I. Introduction

Many oil and gas industry participants are operating under a dangerous misconception concerning potential environmental risks associated with their "routine" oil and gas activities. Merely granting, or receiving, a mineral deed, oil and gas lease, pooling agreement, farmout, operating agreement, or unit agreement can give rise to significant environmental risks. This article examines the risks and offers techniques for managing the environmental risks associated with these routine transactions.

II. Liability-Driven Environmental Statutes

The newest breed of environmental laws seek to achieve their goals by imposing liability on persons that have a certain relationship with property where a hazardous substance is found. See generally David E. Pierce, The Emerging Role of "Liability-Forcing" in Environmental Protection, 30 Washburn L. J. 381 (1991). Typically this relationship is "ownership" or "operation" of the property. However, it also includes those having a relationship with the hazardous substance that is found on the property: those who created ("generated") the substance and those who had a role in moving the substance to the property ("arrangers" and "transporters"). The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C.A. §§ 9601 to 9675 (West 1983 & Supp. 1994), is the primary law that gives rise to this sort of "status" liability. However, the Resource Conservation and Recovery Act (RCRA), 42 U.S.C.A. §§ 6901 to 6992k (West 1983 & Supp. 1994), the Clean Water Act (CWA), 33 U.S.C.A. § 1321(f)(2) (West Supp. 1994), and the Oil Pollution Act (OPA), 33 U.S.C.A. § 2702 (West Supp. 1994), each impose their own brand of status liability that may pick up situations that are not otherwise covered by CERCLA liability. Each of these laws can apply to the ownership, development, and operation of oil and gas interests.
III. Misperceptions Caused by Exclusions and Exemptions

Many in the oil and gas industry believe that the "petroleum exclusion" under CERCLA and the exploration and production "associated waste exemption" under RCRA effectively remove oil and gas properties and operations from the hazardous waste arena. Although each law contains special exceptions from its application to the oil and gas industry, the courts have generally held that each statute, and its associated exemption, do not apply to other statutes that could otherwise be used to address the situation. For example, the petroleum exclusion under CERCLA does not limit the Environmental Protection Agency (EPA) or third parties from addressing petroleum under the OPA, CWA, and RCRA. Similarly, wastes excluded from hazardous waste regulation under RCRA may nevertheless create liability under CERCLA or the CWA or OPA. See generally, Zands v. Nelson, 779 F. Supp. 1254, 1257 (S.D. Cal. 1991) (RCRA applied to CERCLA-excluded petroleum); Jastram v. Phillips Petroleum Co., 844 F. Supp. 1139, 1142 (E.D. La. 1994) (CERCLA can apply to RCRA-excluded wastes); United States v. Hardage, Case No. CIV-86-1401-W, Slip Op. at 4-5, 7 (W.D. Okla. April 15, 1991) (CERCLA liability based in part on disposal of thread dope buckets containing thread dope residue which consisted of a lithium grease base and lead).

IV. Liability Under CERCLA

CERCLA liability is triggered whenever there is a release, or threat of a release, of a hazardous substance. The presence of the hazardous substance generally defines the "facility" that necessitates a cleanup to protect public health or the environment. The potentially responsible parties include persons having any one of the following relationships with the "facility":

1. Present "owners" or "operators" of the facility;
2. Owners or operators at any time hazardous substances were disposed of at the facility;
3. Persons who generated hazardous substances found at the facility;
4. Persons who arranged for disposal of hazardous substances at the facility;
5. Persons who transported hazardous substances to the facility and selected the facility;
6. Interim owners of the property who did not own it at the time of disposal, but discovered that disposal had taken place on the property and then failed to disclose this fact to their purchaser.

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This section addresses the extent to which owners of oil and gas interests could come within one or more of the CERCLA responsible party categories. CERCLA § 107(a)(1)-(4), 42 U.S.C.A. § 9607(1)-(4) (West Supp. 1994); § 101(35)(C), 42 U.S.C.A. § 9601(35)(C) (West Supp. 1994).

A. Relationship with a "Facility"

The first step in identifying responsible parties is to identify the "facility" at which hazardous substances have been placed. In the oil and gas context the facility could be an abandoned or active drilling, reserve, evaporation, or other type of pit where a hazardous substance has been placed. It could include areas at or near the well site where chemicals have been used in reworking, testing, fracing, acidizing, or otherwise treating the well. It could be a compressor, dehydrator, separator, storage tank, or processing plant site where chemicals have been used or wastes disposed through the years. It could be a site where oil and gas drilling or operation wastes have been taken for disposal. Liability for these substances does not require any sort of unlawful or improper disposal activity. In most instances, the disposal practices of the industry giving rise to liability will be the result of lawful conduct that complied with the appropriate industry standards, and all applicable environmental laws, at the time of disposal. This further demonstrates the "status" aspect of the liability: you may not have caused the pollution, you didn't do anything morally or legally "wrong"--you just happen to have the requisite statutory status with the property.

If the requisite status is found, the person will be liable for the cost of whatever cleanup is deemed necessary to protect public health and the environment. Although the statute provides a mechanism for recouping cleanup costs from other responsible parties for their contribution to the problem, if such parties are unable to pay their share of the costs, the responsible parties who can pay will often be required to pick up the total cleanup tab.

The concept of "owner" under CERCLA can include persons who merely own an interest in a facility. To date, courts have generally looked to a person's ownership interest to evaluate the degree of control that interest permits them to exercise over the property. For example, even though the owner of a severed surface interest may have no ownership interest in the mineral estate, activities on the surface to develop the mineral estate can impose CERCLA liability on the surface owner--as well as the mineral interest owner. If there is an abandoned pit on the property, or other contamination associated with oilfield development, the surface owner will have a substantial amount of control over the site and, for CERCLA purposes, is an "owner" of the facility. See generally Quaker State Corp. v. U.S. Coast Guard, 681 F. Supp. 280 (W.D. Pa. 1988) (surface owner held to be "owner" under Clean Water Act, 33 U.S.C.A. § 2701 et seq. (1994)).
Act and therefore responsible for cleanup of oil containment pit).

B. CERCLA "Owners" in an Oil and Gas Context

The "owners" in the oil and gas context can include: surface owners, mineral owners, oil and gas lessees, assignees, farmees, interest owners in a "contract area" under an operating agreement, and interest owners in a pooled or unitized area. Indeed, a plausible argument can be made that every party that comes into contact with the development process can become some sort of CERCLA owner, operator, generator, arranger, or transporter. The only party that escapes liability will be the end user who merely purchases or acquires the product--regardless of how contaminated the "facility" is from which the production was obtained.

An owner of a nonparticipating royalty (conveyed by the mineral interest owner), or an overriding royalty (conveyed by the working interest owner), may be able to escape liability by arguing they do not own an interest in the contaminated "facility." Instead, they own only a right to a share of production, or money measured by production. However, to the extent local law gives them the right to compel development of the property to generate the production or money, the party granting the interest may be viewed as their contractor for development. This could impute the mineral interest or working interest owner's CERCLA liability to the otherwise "passive" royalty or overriding royalty interest owner.

C. CERCLA "Operators" in an Oil and Gas Context

Liability as an "operator" would include the oil and gas lessee--arguably even if they are merely a nonoperating working interest owner in a designated "contract area." For CERCLA purposes, the operator designated in the operating agreement will most likely be viewed as the other working interest owners' contractor to develop the property for their benefit. The acts of the operator, and the contractors it hires (such as drilling contractors and service companies), will be imputed to all parties to the operating agreement. See generally Branch v. Mobil Oil Corp., 788 F. Supp. 531, 533 (W.D. Okla. 1991) (nuisance law).

However, the actions of the oil and gas lessee, and its contractors, might not be imputed to its lessor. Most oil and gas leases give the lessee the option to develop the leased land. The oil and gas lease is more in the nature of a distinct property interest that, once granted by the lessor, is not under the lessor's control. Although the lease may terminate if the lessee fails to develop, the lessee is under no obligation to develop. As long as this element in the relationship exists, courts will have a difficult time in characterizing the lessee as the lessor's contractor. However, this will not impact the lessor's potential liability as an "owner" of the surface estate and mineral estate.

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It will merely relieve the lessor of liability as an operator, generator, arranger, or transporter. If the lessee is viewed as the lessor's contractor, the lessor's liability would be expanded to include off-lease sites where the lessee takes hazardous substances for disposal.

The concept of "operator" under CERCLA has proven to be very broad and generally includes anyone that exercises control, or has the right to control, the facility. See Nurad, Inc. v. William E. Hooper & Sons Co., 966 F.2d 837 (4th Cir. 1992). As noted previously, this could include a nonoperating working interest owner authorizing development through a designated operator. It would certainly include the designated operator. It could also include the bulldozer contractor hired to prepare a drill site—since they have, for a brief moment, limited control over the work site. The drilling contractor, and other service contractors, could also be considered operators if they exercise control, or have the authority to control, when the disposal activity takes place. See Kaiser Aluminum & Chemical Corp. v. Catellus Development Corp., 976 F.2d 1338 (9th Cir. 1992).

V. Managing Status Liability

The technique for managing status liability prospectively is simple to state, but difficult to follow: Avoid the "status" by not becoming an owner or operator of property where hazardous substances exist or will be generated. To practice this technique, it requires information about the environmental condition of the property you plan to acquire. This information can be obtained through contractual representations by the current owner and independent investigation by the prospective owner. If the property presents a problem, avoid purchasing, leasing, drilling, or otherwise having any sort of interest in the property; consider whether the problem area can be excised from the balance of the property interests. For example, suppose you want to lease Section 30 but there is an old oil and gas development site in the Northwest Quarter that may be an environmental problem. In the lease you could provide for the exclusive right to extract oil and gas from Section 30 but disclaim any right to enter or use the surface and subsurface area where the suspected contamination is located. The lessee in such a case would arguably have no ownership interest in the problem "facility" nor would they have any "right to control" the facility.

A second management technique, which could apply to existing as well as prospective relationships, requires: Vigilant policing of activities conducted on the property by anyone having a concurrent right in the property. Since any activity on property in which you have an interest could give rise to your status liability, you want to try and control what others do on the property. When creating new interests in the property, such as conveying or leasing a mineral interest, the grantee's rights
should be tailored to limit or control their ability to increase your environmental liability. This can be done by limiting the scope of the rights granted and through restrictive covenants. For existing interests, the focus will be on what is "reasonable use" of the granted interest in conducting development.

A third management technique, when acquiring new property interests or permitting others to use your property interests, requires: Precise allocation of known and unknown environmental liabilities among the parties supplemented with agreements to reimburse (indemnify) one another for defined situations. The mineral deed, oil and gas lease, assignment, farmout, operating agreement, drilling contract, unitization agreement, and other conveyances or contracts affecting the property should address which party will be responsible for existing and future environmental conditions on the property. Although these agreements will not in any way relieve a party from liability to the government or third parties, they will be effective to define the rights of the parties to the transaction. Once the liabilities are allocated, the parties can define to what extent they will reimburse one another in the event a problem arises. Contractual indemnities are often used to leverage known and unknown environmental risks associated with a transaction. As with any contract, however, the indemnity is only as good as the party making the promise to indemnify.

VI. Environmental Restructuring of Routine Transactions

For a detailed treatment of this subject, see: David E. Pierce, Structuring Routine Oil and Gas Transactions to Minimize Environmental Liability, 33 Washburn L. J. 76 (1993).

A. Mineral Conveyances and Oil and Gas Leases

When a mineral interest is conveyed separate from the surface interest (whether by deed or lease), the party owning or controlling the mineral rights will generally receive expressly, or by implication, the right to use the surface to develop the granted minerals. Since oil and gas operations on the surface will include the use and disposal of hazardous substances, the surface owner needs to protect itself from CERCLA and similar status liability. The mineral owner/lessee should also be concerned about how the surface owner's retained rights in the surface could impact their status liability. When transferring any rights in the property, each party should consider how its ownership risks can be magnified by the rights being granted to the other party. The terms of the mineral deed, or oil and gas lease, should carefully define the surface easement rights of the mineral interest grantee. Matters that should be addressed in the mineral deed or oil and gas lease are set out in the "Conveyance of Oil & Gas Interests Environmental Check List" at APPENDIX A pages I-27 to I-28 of this article. APPENDIX B, pages I-29 to I-36, contains an illustrative
Mineral Deed form demonstrating how this routine transaction can be approached to address the associated environmental liabilities.

B. Special Concerns of Oil and Gas Lessees

The oil and gas lessee will most likely be deemed a CERCLA "owner". Although there are no reported decisions addressing the oil and gas lessee's CERCLA status, several cases dealing with other commercial relationships suggest that a "lessee" can be an "owner" under CERCLA. For example, in United States v. A & N Cleaners and Launderers, Inc., 788 F. Supp. 1317 (S.D.N.Y. 1992), the court was presented with the following issue:

Although it is undisputed that Marine [a lessee of a building] has never held title to the Property or any part thereof, the Government asks the court to rule that a lessee of property that maintains control over and responsibility for the property from which the release took place is an 'owner' for purposes of CERCLA.

The court stated the issue as "what constitutes 'ownership' in the absence of title?" The court held Marine liable as a CERCLA owner noting Marine "exercised a degree of site control over the Property, that . . . confers ownership status upon it for purposes of CERCLA § 107(a)."

The court in A & N Cleaners adopted the "site control" test articulated by the court in United States v. South Carolina Recycling and Disposal, Inc., 653 F. Supp. 984, 1003 (D.S.C. 1985), aff'd sub nom., United States v. Monsanto, 858 F.2d 160 (4th Cir. 1988) which provided that "the lessee/sublessor 'as lessee of the site, maintained control over and responsibility for the use of the property and, essentially, stood in the shoes of the property owners.'" With regard to operations associated with oil and gas development on leased land, the oil and gas lessee has the exclusive right of control over the property and would therefore be an "owner" under CERCLA § 107(a).

The oil and gas lessee would also be an "operator" under CERCLA § 107(a). In Nurad, Inc. v. William E. Hooper & Sons Co., 966 F.2d 837 (4th Cir. 1992), the court stated that a lessee of property could qualify as a CERCLA operator if they had the "authority to control the facility . . . ." The court in Nurad observed that "the tenant defendants need not have exercised actual control in order to qualify as operators under . . . [CERCLA] so long as the authority to control the facility was present." Therefore, the mere power to act is all that is required; a failure to exercise the authority to control will not insulate against CERCLA operator status.

Although the Nurad "authority to control" approach creates a broad definition of "operator," the court ultimately held the
lessees in that case were not operators of the "facility" at issue. The facility included various underground storage tanks that leaked mineral spirits, a hazardous substance. Nurad was the current owner of the real estate where the tanks were located. In addition to suing previous owners of the real estate, Nurad sued previous tenants who leased buildings located on the real estate. The court found that the leases between the property owners and their tenants did not confer any express or implied right to possess or use the underground storage tanks. The court defined the "facility" as the "area" where hazardous substances have "come to be located" which in this case "is in and around the storage tanks . . . ." The court applied the "authority to control" test to the "facility" involved and held:

The fact that those tenants may have had control over a building that was adjacent to the USTs is irrelevant under the statute; a defendant operates a 'facility' only if it has authority to control the area where the hazardous substances were located. Thus, . . . liability . . . extends only to those who have authority over the area where hazardous wastes are stored.

The typical oil and gas lease gives the lessee the right to enter the land encompassed by the lease to conduct exploration, development, and production activities. So long as the lessee is pursuing oil and gas development activities, the lessee will have the "authority to control" any site it selects to conduct operations. This "authority" can extend to pre-existing well sites located on the leased land. Employing the Nurad analysis, the lessee need not actually exercise its authority to be considered an "operator". However, under the oil and gas lease the lessee's authority is limited to activities it pursues on the leased land that are consistent with the granting clause of the lease—typically activities reasonably necessary to efficiently explore for and develop the oil and gas in the leased land. Therefore, the lessee arguably must take affirmative development action, consistent with the lease terms, before its CERCLA "operator" status can be defined. It would also seem as though similar affirmative action would be required to define the lessee's CERCLA "owner" status.

For example, assume that in 1940 § 30 was leased to Acme Oil Company and Acme drilled four wells on the leased land. Each well had an associated drilling pit and salt water evaporation pit. In 1965 all production ceased from § 30, Acme's lease terminated, and Acme vacated the premises. In 1993 New Age Oil Company obtains an oil and gas lease covering § 30. Prior to conducting any activities on the property, a release of hazardous substances associated with the drilling pits used by Acme becomes the focus of a CERCLA cleanup. Although Acme and its assignees would be "operators" at the time of disposal, they have long since vanished into history. The surface owner of the property is a current
"owner" of the pits, and may have been an owner at the time of disposal.

Although New Age has the power to use the prior well sites to conduct new development operations, it also has the ability to define the areas on which it will, and will not, exercise its surface and subsurface easement rights. This is different from the situation contemplated by the court in Nurad. In Nurad the lessee's total rights were defined by the lease—nothing was left for selection or definition by the lessee. The very nature of the easement rights granted by the oil and gas lease are left for definition by the lessee's subsequent development activities. Employing such an analysis, New Age would not be an "owner" or "operator" of the Acme sites unless New Age actually exercised control over the problem areas. However, a counter argument to such an analysis would be whether the lessee had the power to exclude others from using such surface locations. If the lessee does, it could be argued the lessee has a sufficient interest in the property to be classified as an "owner" or "operator."

The foregoing arguments suggest a drafting technique the lessee may want to use to try and limit its "ownership" and "operating" control over pre-existing contaminated surface locations. When entering into a new lease the lessee may want to try and define more precisely the nature of its surface and subsurface rights. The primary exclusive right lessees require is the right to produce oil and gas from the property. Therefore, if the lease covers all of § 30, 640-acres, the lessee must ensure it has the exclusive right to produce oil and gas from § 30 so nobody else, including the lessor, can claim any right to the oil and gas not recognized by the oil and gas lease.

The lessee also requires access to surface and subsurface areas of the leased land to explore for, develop, and produce the oil and gas. However, when lessees obtain blanket rights in the surface of the land, they risk being drug into a CERCLA suit as an "owner" or "operator." The risk is particularly high when there are pits, wells, and other pre-existing oil and gas facilities on the property at the time the new lease is given. In such cases the lessee, at a minimum, may want to exclude such facilities from inclusion in its leasehold rights. The goal is to draft the lease so the lessee has no right to control or ownership over such facilities and the surface and subsurface area they impact. However, although the lessee does not have any right in the pre-existing facilities, the lease should make it clear such facilities cannot be used to interfere with the lessee's exclusive right to produce oil and gas found within § 30.

The guiding principle is simple: take only what is needed to accomplish the client's goals and in taking what is needed, try and ensure interests that may have CERCLA or similar problems are not included. Even under the Nurad analysis, the court recognized the
benefit of the tactical acquisition: since the lease did not give the lessees any authority over the underground storage tanks, the lessees were neither owners nor operators of the tanks. Since the oil and gas lessee's surface easement rights are the main source of lessee CERCLA problems, they should be carefully crafted to give the lessee only the surface rights necessary for effective development and operation of the leased land. APPENDIX C, at pages I-37 to I-38 to this article contains a partial Oil & Gas Lease Form that includes language demonstrating the drafting techniques discussed in this subsection.

C. Lease Assignments and Farmout Agreements

The prospective assignee or farmee of an oil and gas interest must approach the transaction with the same caution as any other property purchaser. The assignee or farmee will become an "owner" of the assigned interest. Therefore, they must assess the environmental condition of the affected leasehold interests and apply the environmental risk management techniques discussed previously. The farmee will want to include representations, warranties, assumptions of liability, and indemnities in the farmout agreement coupled with the right to avoid the transaction altogether if an assessment of the property reveals unacceptable environmental risks. The farmee should also practice the basic rule that "more" is not necessarily "better" when defining the interests they will earn under the farmout.

If the assignor is retaining an interest in the assigned leasehold interest, the assignor's position is similar to that of a lessor that is permitting another to enter their property to conduct operations. The farmor is in a similar position under a farmout agreement. In each case, the assignor or farmor must structure the transaction to ensure the assignee or farmee does not engage in activities on the assigned interest that create new environmental liabilities or aggravate existing environmental problems. The assignor and farmor will need to employ the same sort of techniques discussed previously in this article with regard to protecting the interests of the surface owner and oil and gas lessor. This will include limitations on the rights granted, rights of re-entry, restrictive covenants, and indemnities.

The farmor must also address how its potential back-in rights will be administered. As with real property conveyances, the farmor should avoid automatic conversions; the farmor may prefer to remain an overriding royalty interest owner and avoid becoming a working interest owner. Also, the farmor may not want to become a party to the joint operating agreement which would govern the parties' relations following pay-out and conversion of the farmor's overriding royalty. If the farmee has incurred environmental liabilities prior to pay-out, the farmor may want to avoid becoming a working interest owner and party to an operating agreement for fear a court may impose liability under joint venture, partnership,
mining partnership, sublease, or agency theories.

D. Operating Agreements

Parties to an operating agreement must address three types of environmental liability. First, the parties to the agreement may be liable as "owners" of contaminated leases contributed to the "contract area" governed by the operating agreement. Second, the parties to the agreement may be liable as "operators," "generators," and "arrangers" for the environmental practices of their operator. Third, the parties to the agreement may be liable for the operator's actions under theories of joint venture, partnership, mining partnership, or agency. Each type of liability requires attention by parties considering joint operations.

To address the potential ownership liability, the parties to the operating agreement must evaluate the environmental status of each lease that will be contributed to the contract area. Each contributing lessee should provide the other parties with appropriate representations, warranties, assumptions of liability, and indemnities concerning potential or known environmental risks associated with the property. If the environmental risks associated with a lease are unacceptable, the lease should be excluded from the contract area.

Although the parties to the operating agreement designate one of the parties to serve as the "operator," each party to the agreement could be classified as an "operator" for CERCLA purposes. The operating agreement "operator" will most likely be viewed as simply the contractor for the non-operator parties to the agreement. Since the operator is the contractor for development of the contract area, all parties to the operating agreement could be liable for the off-site disposal of hazardous substances as "generators" or "arrangers."

The operator could also be characterized as the "agent" of the non-operators. For example, in Branch v. Mobil Oil Corp., 788 F. Supp. 531 (W.D. Okla. 1991), the court held that a unit operator was "merely the agent for the lessees who form the unit" and "during the time that ARCO was a working interest owner in the Unit, ARCO is liable as a principal for the operator-agent's actions . . . unless the operator was acting outside the scope of its authority." To address these potential environmental liabilities, the parties need to carefully select their operator and impose appropriate restrictions on how the operator will conduct operations. In most cases this will require substantial revision to the Model Form operating agreement to address such matters as operator development practices, operator liability for environmental problems, and operator removal for environmental misdeeds.

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E. Pooling and Unitization Agreements

The primary environmental concern under pooling and unitization agreements is the prospect that a party contributing a property to the pooled or unitized area will become an "owner" of each property contributed to the area. Whether the act of pooling or unitizing the interests will be deemed a cross-conveyance should depend on the express terms of the applicable agreement or statute. However, there is always a likelihood that non-parties to the agreement, pool, or unit will argue that for purposes of CERCLA each party contributing an interest to the pool or unit has an ownership interest in the entire pool of unit. The only way to effectively deal with this risk is to assess the properties being contributed and exclude those that pose unacceptable environmental risks. The process of screening the properties, obtaining warranties, allocations of liability, and indemnities, will be similar to the approach taken with the "contract area" under the operating agreement. Parties to the unit operating agreement will also have concerns identical to those of working interest owners to an operating agreement. The unit operating agreement should be similarly revised to address environmental concerns.

F. Drilling and Service Contracts

Any contractor that is given access to land has the potential to acquire environmental liabilities and aggravate the liabilities of parties that own an interest in the land. Therefore, each party must take action to protect their respective interests. The current "owners" of the property must ensure that contractors entering the leased land perform their services in an environmentally acceptable manner. For example, the lessee must ensure the drilling contractor properly manages materials and wastes associated with drilling operations. If the drilling contractor disposes of hazardous substances in a drilling pit, the surface owner, mineral owner, and leasehold interest owners will all suffer the increased risk of environmental liability. The lease operator who employs contractors should specify their environmental obligations in the appropriate drilling or service contracts and then monitor their activities to ensure their obligations are properly discharged. The working interest owners should also inquire about the contractor's off-site disposal activities since the working interest owners may be viewed as the "generators" or "arrangers" of wastes dealt with by their contractors.

The contractor should also structure their agreements to deal with their potential environmental liability. Depending upon the contractor's degree of control over an area and operation, they may be deemed an "operator." The court's holding in Kaiser Aluminum & Chemical Corp. v. Catellus Development Corp., 976 F.2d 1338 (9th Cir. 1992), demonstrates the substantial risk facing a contractor
when they enter a customer's contaminated site to perform their work. Catellus sold land to the City of Richmond and the City hired James L. Ferry & Son to excavate and grade a portion of the land for a proposed housing project. Ferry, in the process of performing the assigned task, excavated soil containing hazardous substances and spread the contaminated soil over other parts of the property. When the contamination was discovered, the City sued Catellus to recover part of the cost of removing the contaminated soil from the property. Catellus then filed a third-party action for contribution against Ferry, asserting Ferry was a liable party under CERCLA.

Denying Ferry's motion to dismiss, the court held that Ferry was an "operator" under CERCLA. The court noted that Ferry "had authority to control the cause of the contamination at the time the hazardous substances were released into the environment." The court therefore concluded that Ferry's activities on the land "tend to show that Ferry had sufficient control over this phase of the development to be an 'operator' under section 9607(a)(2) [CERCLA § 107(a)(2)]." The court also held that in moving and spreading the contaminated soil Ferry "disposed" of a hazardous substance and was therefore an "operator" "at the time of disposal" under CERCLA. At some point in time, most drilling or service contractors will have "authority to control" activities on the leased land that can give rise to potential disposal and release problems.

In addition to liability as an "operator" at the time of disposal, the court held Ferry could be liable as a "transporter" since it moved the hazardous substance to a site on the property selected by Ferry. The court concluded:

[L]iability may be imposed under section 9607(a)(4) [CERCLA § 107(a)(4)] for transporting hazardous material to an uncontaminated area of property, regardless of whether the material was conveyed to a separate parcel of land. Catellus's allegations that Ferry excavated the contaminated soil from one area of the property and moved it to another are sufficient to allege potential liability predicated upon 42 U.S.C. § 9607(a)(4).

The Kaiser Aluminum case demonstrates the need for any contractor to carefully evaluate the site on which it will be operating and the need to train personnel to be alert for unusual soil conditions. It also means the contractor must try and obtain contractual protection from their employer to allocate the environmental risks they will encounter every time they enter the leasehold to perform their services. As with other phases of the development process, the parties to drilling and service contracts must address their respective environmental obligations and negotiate for the best position possible under the circumstances.
VII. Conclusion

Persons owning or participating in the development of oil and gas interests are subject to significant environmental risks. However, proper transaction planning and property management can substantially reduce the risks. At this stage of industry's environmental evolution, the key will be recognizing the potential for such liabilities so they can be addressed or avoided.
APPENDIX A
Conveyances of Oil & Gas Interests
Environmental Check List

THE BASIC TASK:

When creating new rights in property, each party should consider how their environmental ownership risks can be magnified by the rights being granted or retained by the other party.

Matters that should be addressed in the mineral deed include:

1. Restrict or limit the use of surface and subsurface water found on the property.
2. Limit or prohibit development activities on the property that are likely to create environmental liabilities.
   
   (a) Restrict or prohibit the use of pits to support drilling, reworking, or production operations.
   (b) Require prompt cleanup and reclamation of all drill sites.
   (c) Restrict or prohibit the placement of oil storage tanks on the property.
   (d) Restrict or prohibit the placement of other production-related equipment on the property such as separators, heater-treaters, dehydrators, compressors, processing equipment, and similar equipment not required to bring production to the surface.
   (e) Restrict or prohibit the placement of any injection or disposal well on the property.
   (f) Prohibit the placement, disposal, or discharge of any waste material on the property, or on adjacent lands that may impact the property.
   (g) Prohibit the storage of pipe, chemicals, equipment, or other material on the property that is not for immediate use.
   (h) Remove all development structures and equipment and clean up and reclaim any production site within sixty days following the cessation of production operations associated with the site.
   (i) Consider rigorous specifications for any flow lines, gathering
lines, and other pipeline facilities associated with a well.

3. Manage risks associated with development activities that take place on the property.

(a) Require mineral grantee to assume all liability associated with any exploration, development, or production operations on the property.

(b) Require mineral grantee to indemnify grantor against any liability or loss the grantor may suffer due to any exploration, development, or production operations on the property.

(c) Prior to any exploration or development activity, require that a bond be posted, by the mineral grantee or their lessee, for a specified amount that is adequate to secure the proper plugging of wells and the cleanup and reclamation of exploration, development, and production operation sites on the property.

(d) Make any assumption of liability, and the obligation to indemnify, binding upon all of the mineral grantee's successors and assigns of any interest in the mineral estate—to include an oil and gas lessee.

(e) Avoid using defeasible term mineral interests which result in an automatic reversion of the interest to the grantor; if there is a desire to terminate the interest upon the occurrence of a certain condition, consider using a fee simple subject to a condition subsequent with a power of termination.

4. Manage risks associated with previous development activities on the property.

(a) Require mineral grantee, upon accepting their grant, to assume all liability associated with any past exploration, development, or production operations on the property.

(b) Evaluate the environmental status of the property at the time the mineral interest is conveyed to identify a baseline for defining future contributions to environmental liabilities.
APPENDIX B

Applying the Check List to the Drafting Process

To properly articulate these concerns, and incorporate them into the conveyance document, the attorney will need to select the appropriate mix of conditions, covenants, allocations of liability, and indemnities.

For example, assume Doc Hillard is the owner of the property in fee simple absolute and he desires to convey the oil, gas, and similar hydrocarbon substances to Acme Oil Company. However, if Acme fails to comply with various financing requirements specified in the deed, Doc wants the mineral interest to revert back to Doc. Doc is advised that he does not want an automatic reversion but instead an option to terminate the interest. This will give Doc an opportunity to evaluate whether it would be better to maintain Acme's ownership status instead of terminating Acme's interest. Doc is also advised to include various covenants in the deed that restrict what Acme can do on the property being conveyed. The conveyance should also include a clear statement allocating environmental risks and provide for indemnity.

The general structure of the deed might look as follows:
MINERAL DEED
(the "conveyance")

Doc Hillard, a single person ("Doc"), for valuable consideration and subject to the terms and conditions contained in this Mineral Deed, grants and conveys to Acme Oil Company ("Acme"): All the oil, gas, and similar hydrocarbon substances (excluding any gas and similar hydrocarbon substances produced from coal seams) in and under Section 30, Township 36 South, Range 10 East, in Eureka County, Texas (the "Conveyed Property"), but on condition that Acme will pay to Doc, on or before the 10th day of January of each year, the sum of $5,000. In the event Acme fails to comply with this condition, Doc is given the power, at Doc's option, to re-enter the Conveyed Property and terminate Acme's estate. Doc's power of termination can be exercised by providing Acme with written notice stating the required payment was not made pursuant to the condition and that Acme's interest has terminated.1

For purposes of this conveyance, the phrase "area encompassed by the Conveyed Property" includes the surface and subsurface areas encompassed by the legal description defining the surface boundaries of the Conveyed Property.

This conveyance is made subject to the following terms:

1. NO WARRANTY. Doc is conveying only such right or title Doc may have in the Conveyed Property. Doc makes this conveyance without any warranty, express, implied, or statutory; Acme accepts the Conveyed Property AS IS, WITH ALL FAULTS.

2. EXCEPTIONS TO THE GRANT. There is excepted from this conveyance, and reserved to Doc, the following property interests:

a. Doc's Surface Use--General. The right to construct any structure or improvement, at any location selected by Doc, anywhere on or in the area encompassed by the Conveyed Property. The rights granted by this conveyance will not restrict in any manner Doc's ability to use the surface of the Conveyed Property. Any activities by Acme must accommodate fully Doc's use of the area

1This clause is included to demonstrate how a fee simple subject to a condition subsequent can be used instead of a fee simple determinable. For a helpful guide to drafting a fee simple subject to condition subsequent, see Restatement of Property § 44 (1936).
encompassed by the Conveyed Property, even though such uses are not commenced until some future date after the effective date of this conveyance. 

b. Doc's Surface Use--Agriculture. The right to raise livestock and to initiate or continue irrigation and other agricultural activities on the area encompassed by the Conveyed Property. If Doc is currently using, or elects in the future to use, all or any part of the area encompassed by the Conveyed Property to raise livestock, Acme will construct the necessary fence gates and cattle guards, and fence all drill sites and other drilling or production facilities on the Conveyed Property, and otherwise adjust its operations to accommodate Doc's use of the Conveyed Property for raising livestock. If Doc decides to conduct agricultural activities on the area encompassed by the Conveyed Property, to include irrigation and recognized soil conservation practices, Acme will adjust its operations to accommodate Doc's agricultural use of the Conveyed Property.

c. Surface and Subsurface Use--Mining. The right to use the surface and subsurface rights associated with the Conveyed Property as may be reasonably necessary to explore for, extract, and market minerals (other than minerals conveyed to Acme by this conveyance) from the area encompassed by the Conveyed Property.

d. Water. The right to all water found on or in the area encompassed by the Conveyed Property except for Produced Water. "Produced Water" means any water that is necessarily produced in conjunction with the prudent production of minerals conveyed to Acme by this conveyance. Title to Produced Water will be in Acme when removed from the oil or gas producing strata.

[additional exceptions to the grant]

3. RESTRICTIVE COVENANTS. Acme promises to comply with the following restrictions concerning the Conveyed Property, which shall be deemed covenants that run with the Conveyed Property:

a. Pits. No pits, ponds, or other surface impoundments

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2Since the mineral conveyance creates an implied right to make reasonable use of the surface for mineral development, the grantor should consider excepting from the conveyance those surface rights which they may want to retain. This would include any activity by the grantor that may interfere with the grantee's implied easement rights.
will be used in developing or operating the Conveyed Property.\(^3\)

b. Production-Related Equipment and Storage Tanks. No above ground or underground storage tanks will be placed on the area encompassed by the Conveyed Property. No equipment designed to separate, treat, dehydrate, compress, or process the Conveyed Property will be placed on the area encompassed by the Conveyed Property.\(^4\)

c. Injection and Waste Disposal. No injection or disposal well will be placed on the area encompassed by the Conveyed Property. No solid, liquid, or gaseous waste will be stored or disposed of on the area encompassed by the Conveyed Property.

d. Hazardous Substances. No substance, defined as a "hazardous substance" (now or in the future) under the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), the Texas statutory counterpart to CERCLA, and any amendments or substitutions for CERCLA and its Texas counterpart, will be brought onto the area encompassed by the Conveyed Property.\(^5\)

e. Storage of Equipment or Material. No pipe, chemicals, or other material or equipment will be placed on the area encompassed by the Conveyed Property except items that are on-site for immediate use in operations. Equipment or material placed on

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3 Prohibiting the use of pits may be objectionable to the grantee. In such cases, the attorney may try to specify pit construction and lining parameters, or simply require compliance with the strictest level of protection required by state law. For example: "Any pits, ponds, or other surface impoundments used in connection with the development or operation of the Conveyed Property shall comply with all applicable local, state, and federal standards and in any case shall meet or exceed the standards for such structures located within a wellhead protection area as defined by the federal Safe Drinking Water Act or any state law counterpart."

4 If this is objected to by the grantee, the next step would be to identify the activities that are essential for location on site and then specify how those activities will be managed to minimize environmental concerns. There may also be new environmental risks created by a restriction. For example, if the grantee cannot locate oil storage tanks and treatment equipment near the well, they will have to transport production, by pipeline, off-site for treatment and storage. The pipeline would then present a risk that may require attention in the conveyance.

5 This may be unworkable since many commercial products that are brought to the drill site are "hazardous".

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site for longer than five consecutive days will be deemed not to be for immediate use in operations.

f. **Restore Development and Production Areas.** Within five days after a development or production operation is completed, all the associated development structures, equipment, and any other material brought to or generated at the site will be removed from the site. If any topsoil has been disturbed by the operation, the area will be graded to its original contour, and the topsoil replaced, properly seeded, fertilized, and maintained until the original cover in the affected area is reestablished.

g. **Set-Back Requirements.** No equipment, material, or operation site will be located within 300 feet of any house, garage, barn, stream, creek, pond, lake, or other structure, improvement, or water source located on the area encompassed by the Conveyed Property.

[additional covenants]

Acme acknowledges that Doc may, in addition to damages and any other remedy at law or equity, obtain injunctive relief to enforce the covenants specified in this conveyance.

4. **ACME'S ASSUMPTION OF LIABILITY.** Acme assumes the following liabilities associated with the Conveyed Property:

a. **Condition of the Area Encompassed by the Conveyed Property.** Acme acknowledges that it is purchasing the Conveyed Property without relying on any representations by Doc concerning the condition, environmental or otherwise, of the Conveyed Property or the area encompassed by the Conveyed Property. Instead, Acme is relying solely upon its independent investigation to determine the status of the Conveyed Property and the area encompassed by the Conveyed Property. As partial consideration for this conveyance, Acme agrees to assume all liabilities it may incur as an owner or operator of the Conveyed Property and the area encompassed by the Conveyed Property, including any environmental cleanup obligations that may be imposed under any local, state, or federal law, including the common law. Acme further agrees to hold Doc harmless from any claim Acme may have or acquire, in contribution or otherwise, associated with the condition of the property or Acme's liability as an owner or operator. This includes, without limitation, any claim or cause of action Acme may have at common law or under any local, state, or federal statute such as CERCLA or a state or local counterpart.

b. **Activities on the Area Encompassed by the Conveyed Property.** Acme agrees to assume all liabilities associated with any activity conducted on the Conveyed Property or the area encompassed by the Conveyed Property, by Acme, its lessees,
contractors, and any other person or entity exercising or purporting to exercise rights through Acme or on Acme's behalf. In addition to such liabilities, Acme will be strictly liable for any damage to: cultivated land, growing crops, pasture land, unimproved land, livestock, fences, roads, ditches, culverts, trees, turf, terraces, springs, water wells, groundwater, personal property, fixtures, and improvements located now or in the future on the area encompassed by the Conveyed Property.

[additional liabilities]

5. Acme's Indemnity of Doc. Acme will protect, indemnify, hold harmless, and defend Doc against any claim, demand, cost, liability, loss, or damage suffered by Doc, including Doc's reasonable attorney fees and litigation costs, associated with or arising out of one or more of the following events:

a. Breach of Covenant. A breach of any restrictive covenant contained in paragraph numbered 3 of this conveyance.

b. Recognize Limits on the Interest Conveyed. A failure to recognize Doc's right of re-entry or any other right excepted by Doc in paragraph numbered 2 of this conveyance.

c. Assumption of Liability. Any matter encompassed by Acme's assumption of liabilities, including environmental liabilities, under paragraphs numbered 1 and 4 of this conveyance.

d. Specific Operations.

(1) Any activity expressly or impliedly authorized or required by this conveyance.

(2) Plugging and abandonment of producing wells, nonproducing wells, existing wellbores, or previously plugged wellbores.

(3) Management, use, and disposal of produced water and wastes or substances associated with the development or operation of the Conveyed Property.

(4) The generation, processing, handling, transportation, storage, treatment, recycling, marketing, use, disposal, release or discharge, or threatened release or discharge, of oil, natural gas, natural gas liquids, all other petroleum substances, any waste material, or any "hazardous substance" or "pollutant or contaminant" as those terms are defined (now or in the future) under the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), the Texas statutory counterpart to CERCLA, and any amendments or substitutions for CERCLA and its Texas counterpart.
e. Other Matters. Any matter relating to Acme's ownership, use, or occupancy of the Conveyed Property or the area encompassed by the Conveyed Property.

[additional indemnities]

Although Acme may fail to meet the conditions to this conveyance, Acme's obligations to indemnify, hold harmless, and defend, as specified in this paragraph numbered 5, are continuing obligations which will be enforceable by Doc even after Doc exercises the right to re-enter and terminate Acme's estate.

6. BINDING EFFECT. This conveyance, and all its terms and conditions, are binding upon the heirs, personal representatives, successors, and assigns of Doc and Acme.

SIGNED AND DELIVERED _____ March 1993.

________________________
Doc Hillard
123 Mineral Lane
Oiltown, Texas  75275

SIGNED AND ACCEPTED _____ March 1993.

Acme Oil Company

________________________
by: Martha Rhodes, President
Acme Oil Company
456 Gusher Street
Oiltown, Texas  75275

ACKNOWLEDGMENTS

________________________
County, Texas

This MINERAL DEED was acknowledged before me on _____ March 1993 by Doc Hillard.

________________________
Notary Public
My Commission Expires:_______

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County, Texas

This MINERAL DEED was acknowledged before me on March 1993 by Martha Rhodes as President of Acme Oil Company, a Texas corporation.

Notary Public
My Commission Expires:_____

Although the foregoing deed is drafted to maximize the grantor's position, the grantee must also be alert to its environmental risks. For example, if there are environmental problems on the surface of the property at the time of the conveyance, the mineral grantee may become liable since it owns an easement authorizing it to use the surface to conduct mineral operations. The grantee must therefore scrutinize the transaction, and negotiate for appropriate deed language, to minimize environmental risks associated with becoming an "owner" and "operator" of the property.
APPENDIX C

Consider the following "New Age" lease granting clause:

OIL & GAS LEASE
("Lease")

Doc Hillard and Maude Hillard, husband and wife ("LESSOR") and New Age Oil Company ("NEW AGE"), for valuable consideration, agree to the following:

LESSOR leases and conveys to NEW AGE, subject to the terms of this Lease, the rights described in SECTION 1.

SECTION 1. SCOPE OF GRANT

A. The "Leased Land".

For purposes of this Lease, the land described by SECTION 1.A.1. and A.2 will be collectively referred to as the "Leased Land."

1. Surface Boundaries of Leased Land. The surface boundaries of the Leased Land are described in EXHIBIT A attached to this Lease.

2. Depth Limitations on Leased Land. There are no depth limitations. This lease covers all depths within the surface boundaries of the Leased Land.

B. Granted Substances in the Leased Land.

Substances in the Leased Land which are subject to the terms of this Lease include: Oil, gas, and similar hydrocarbon substances. For purposes of this Lease, the listed substances will be referred to as the "Leased Substances." The term "Leased Substance" is used to identify any one of the listed substances.

C. Purpose of the Grant.

NEW AGE is given the exclusive right to explore for, extract, and market Leased Substances from the Leased Land, pursuant to the terms of this Lease.

D. Surface Rights and Limitations.

1. LESSEE's Surface and Subsurface Rights. Subject to the terms of this SECTION, NEW AGE is given the right to use so much of the surface and subsurface of the Leased Land as is consistent
with the purposes stated in Subsection C. From the Effective Date of this Lease until it is terminated, LESSOR will not construct any structure or improvement, or pursue, permit, or authorize any activity on the Leased Land that restricts, impairs, or diminishes in any manner NEW AGE’s ability to use the surface or subsurface as provided for in this Lease. For purposes of this subsection, any activity which may increase NEW AGE’s potential environmental liability concerning NEW AGE’s surface and subsurface rights will be deemed an impermissible act that "restricts, impairs, or diminishes" NEW AGE's ability to use the surface or subsurface as contemplated by this subsection.

2. LESSEE's Surface Limitations.

a. Existing Well Bores, Drilling and Operating Pits, and Other Development Facilities. NEW AGE shall have no right, title, ownership interest, operational control, or authority whatsoever over any well, well bore, drill site, pit, aboveground or underground storage tank, or other oilfield structure or facility that is located on or in the Leased Land as of the Effective Date of this Lease.

b. Defined Surface Right Area. NEW AGE’s authority to exercise surface rights provided for in Subsection D.1. extends only to those areas in which NEW AGE declares a Surface Site pursuant to this subsection. In the event NEW AGE elects to exercise its rights under this Lease, it will notify LESSOR in writing of the proposed activity and define the surface area on the Leased Land it plans to use in conducting the activity. The surface area defined in the LESSOR notification will constitute the Surface Site for the proposed activity.

1Depending upon the circumstances, the lessee may want the option to use these areas or facilities by including them in a Surface Site designation provided for in subsection 2.b. However, to the extent the lessee has any option to control these areas it will make it easier for third parties to make a CERCLA owner/operator argument.
APPENDIX D

Limitation on Assignment and Surrender. Regardless of the other provisions contained in this lease, LESSEE can assign or surrender all or any part of this Lease. However, as to the assigned or surrendered interest, Lessee will remain obligated for the proper performance of all express and implied Lease obligations. Lessee's liability for the non-performance of lease obligations, including the obligation to indemnify Lessor, will be in addition to the liability of any assignee obtaining an interest through the Lessee or any assignee obtaining an interest through Lessee's assignee.

Any person or entity obtaining an assignment of rights in the Lease: (1) Is deemed to have accepted liability for the non-performance of any express or implied Lease obligations, including the obligation to indemnify Lessor, accruing prior to the date of assignment; and (2) Is liable for the proper performance of express and implied lease obligations, including the obligation to indemnify Lessor, from and after the date of assignment. The liability of Lessee and all assignees transferred an interest in the Lease is joint and several. For purposes of this section the term "assign" means a written transfer of rights in the Lease, whether classified as an assignment or sublease.

Pursuant to a broad environmental indemnity clause added to the oil and gas lease.
APPENDIX E

The assignment clause at APPENDIX D contemplates the lessor will negotiate a broad indemnity clause as part of the oil and gas lease. A rather simple indemnity clause might provide:

B. Indemnity by LESSEE.

LESSEE will protect, indemnify, hold harmless, and defend LESSOR against any claim, demand, cost, liability, loss, or damage suffered by LESSOR, including reasonable attorney fees and litigation costs, arising out of or associated in any way with the following activities conducted by LESSEE (or those having a contractual relationship with LESSEE) on or impacting the Leased Land:

1. Any activity expressly or impliedly authorized or required by this Lease.

2. Plugging and abandonment of producing wells, nonproducing wells, existing wellbores, or previously plugged wellbores.

3. Management, use, and disposal of produced water and wastes or substances associated with Lease activities.

4. The generation, processing, handling, transportation, storage, treatment, recycling, marketing, use, disposal, release, or threatened release, of oil, natural gas, natural gas liquids, all other petroleum substances, any waste material, or any "Hazardous Substance" or "Pollutant or Contaminant" as those terms are defined by the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) at CERCLA § 101 (14) and (33), 42 U.S.C. § 9601 (14) and (33) (1988).

5. Any failure by LESSEE to comply with an express or implied obligation created by this Lease.

LESSEE's indemnity also includes any environmental problem associated with oil and gas exploration, drilling, development, production, treating, storage, transportation, marketing, processing, abandonment, and related activities at any site existing on the Leased Land as of the Effective Date of this Lease.

LESSEE's obligations created by this SECTION are continuing obligations which will continue in effect, and
be enforceable by LESSOR, even after the Lease terminates or otherwise ceases to burden the Leased Land.

In conjunction with the indemnity clause, the lessor should consider a general provision addressing the lessee's environmental responsibilities, such as: "Lessee agrees to conduct its operations in strict compliance with all federal, state, and local environmental, health, and safety laws." This would then become one of the express covenants of the oil and gas lease that upon breach would trigger the lessee's indemnity obligation under subsection B.5. of the indemnity clause.
APPENDIX F
ENVIRONMENTAL MANAGEMENT
OF
ROUTE OIL & GAS TRANSACTIONS

A Look at Trends and Developments in the Oil & Gas and Environmental Law Areas

Sponsored By:
WASHBURN UNIVERSITY SCHOOL OF LAW

Presented By:
PROFESSOR DAVID E. PIERCE

Wednesday, November 2, 1994
2:30 to 5:30 P.M.
Topeka, Kansas
Mills Building
ITV Room/Board Room
Kansas State Board of Education

Liberal, Kansas
Seward County Community College

LIABILITY-DRIVEN ENVIRONMENTAL STATUTES

- Environmental goals achieved by imposing cleanup liability on persons having a defined relationship to a problem area.
- Liability does not depend upon any negligence or wrong-doing.
- Liability depends upon whether a person comes within a statutorily-defined relationship to the problem area.
- The relationships triggering liability generally include a relationship with either:
  - The contaminated area: E.g., a past or present "owner" or "operator"; or
  - A contaminating substance: E.g., a generator, someone who arranged for its disposal, or a transporter.
- Liability based upon your "status" as someone having a defined relationship with the contaminated area or the contaminant.
"STATUS" LIABILITY STATUTES

1. Comprehensive Environmental Response, Compensation and Liability Act (CERCLA); also known as the "Superfund" Law.


4. Oil Pollution Act (OPA).

5. State law counterparts.

CERCLA PETROLEUM EXCLUSIONS
RCRA E & P ASSOCIATED WASTE EXEMPTIONS

* For planning purposes:

FORGET THEY EVEN EXIST!

* It is a safe assumption that if you are able to dodge liability under one statute, another will often fill the void resulting in the same sort of cleanup liability.
CERCLA LIABILITY IN A NUTSHELL

* If a "hazardous substance" is found in the environment, chances are persons related to the area where the hazardous substance is found, and persons related to the substance, will all be liable for cleanup of the problem.

CERCLA LIABILITY: THE BASIC ELEMENTS

1. Hazardous Substance.
2. Release or Threatened Release.
3. From a Facility.
4. Into the Environment.
5. Justifying a Cleanup.
6. Requisite Relationship to the Facility or the Hazardous Substance.
THE CERCLA RELATIONSHIPS

Relationships to a "Facility":

* Current "Owner"
* Current "Operator"
* Prior Owner at the "Time of Disposal"
* Prior Operator at the "Time of Disposal"
* Prior owner that learned of a prior release or threatened release but failed to disclose the fact to their purchaser.

Relationships to a "Hazardous Substance":

* Created (generated) It
* Arranged for its Disposal
* Transported it and Selected the Disposal Site

THE OIL & GAS CONTEXT

The CERCLA "Facility"

* Find a CERCLA "hazardous substance" and you have most likely found a CERCLA "facility."

* Abandoned or active drilling, reserve, evaporation, or other type of pit where a hazardous substance has been placed.

* Areas at or near the well site where chemicals have been used in reworking, testing, fracing, acidizing, or otherwise treating the well.

* A compressor, dehydrator, separator, storage tank, or processing plant site where chemicals have been used or wastes disposed.

* Mercury from meters; naturally occurring radioactive material (NORM) from equipment or operations.
THE OIL & GAS CONTEXT

The CERCLA "Owner"

* "Owner" does not require ownership of a fee simple absolute in the facility.

* Something less than all the sticks in the bundle can give rise to "ownership" status.

* The trick is identifying what stick or sticks will elevate the holder to CERCLA owner status.

* A general rule of thumb: if the interest gives the party some authority to control the facility, it can be argued they are an "owner."


POTENTIAL OWNERS IN THE OIL & GAS CONTEXT

* Surface Owners
* Mineral Owners
* Oil and Gas Lessees
* Assignees
* Farmees
* Interest Owners in a JOA "Contract Area"
* Interest Owners in a Pooled Area
* Interest Owners in a Unitized Area
* Nonparticipating Royalty Owners?
* Overriding Royalty Owners?
RECENT CERCLA "OWNER" DEVELOPMENTS


  Easement to run pipeline across property where contaminated site was located did not make the easement owner a CERCLA owner.

  "[W]e read the statute as incorporating the common law definitions of its terms."

  "The common law does not regard an easement holder as the owner of the property burdened by it."

  Examined California law of property to define the nature of an easement.

  "[W]e see no basis for holding that easement holders are owners for purposes of CERCLA liability."

  Support their position relying upon "sound public policy" to avoid every easement owner in the nation becoming a potential CERCLA owner.

  "[B]ecause easement holders exercise no control over the owner of the servient estate beyond preventing him from interfering with the easement, it's not clear how easement holders could stop the pollution if they did discover it."


  Easement for ingress and egress over land on which a loading dock and contaminated land were located did not make the easement owner a CERCLA owner.

  Michigan's state CERCLA counterpart expressly excluded easement owners from definition of "owner" under Michigan's law.

  Rely upon a Black's Law Dictionary definition of "owner":

  "The person in whom is vested the ownership, dominion, or title of property; proprietor; he who has dominion of a thing, real or personal, corporeal or incorporeal, which he has a right to enjoy and do with as he pleases, even to spoil or destroy it, as far as the law permits, unless he be prevented by some agreement or covenant which restrains his rights."

  The court, without much analysis, concludes:

  "The only entity which owns the easement property in this sense is Grand Trunk as holder of the fee interest in the land, and possibly Blue Diamond, as to the portion of the easement property that it leased from Grand Trunk, as the holder of a leasehold interest in that property."
THE OIL & GAS CONTEXT

The CERCLA "Operator"

* Oil and Gas Lessee
  - Lessor Agency/Contractor Analysis
  - Option to Develop vs. Obligation to Develop

* Nonoperating Working Interest Owner

* Operator
  - Nonoperator Agency/Contractor Analysis

Includes anyone that exercises control, or has the right to control, the facility.


Could also include the bulldozer contractor hired to prepare a drill site—since they have, for a brief moment, limited control over the work site.

Kaiser Aluminum & Chemical Corp. v. Catellus Development Corp., 976 F.2d 1338 (9th Cir. 1992).
MANAGING STATUS LIABILITY

* Avoid the "status".
- To do this, you need information.
- Information about the environmental condition of property your client plans to acquire.

* Can often avoid the status but obtain the essential rights necessary to conduct business.
- Avoid acquiring any "right to control" over problem areas.
- Right to extract oil and gas from under land does not require the right to use the surface of the entire area.

MANAGING STATUS LIABILITY

* Police activities conducted on the property by anyone having a concurrent right in the property.

* Allocate known and unknown environmental liabilities among the parties supplemented with agreements to reimburse (indemnify) one another for defined situations.
**RESTRUCTURING ROUTINE TRANSACTIONS**

* Mineral Conveyances
  - Implied Easement to Make Reasonable Use of the Surface
  - What is "Reasonable Use" in light of potential CERCLA liability?

* Retained Rights of the Surface Owner
  - Potential impact on oil and gas lessee.

When transferring any rights in property, each party should consider how its ownership risks can be magnified by the rights being granted to the other party.

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**SPECIAL CONCERNS OF OIL AND GAS LESSEES**

* A lessee can be a CERCLA owner.
  - Someone that "exercised a degree of site control over the Property . . ." A & N Cleaners.
  - Someone that had the "authority to control the facility . . ." Nurad, Inc.

* Limit ownership or operation of potential "facilities".
  - The Nurad analysis.

The goal is to draft the lease so the lessee has no right to control or ownership over contaminated facilities and the surface and subsurface area they impact.
LEASE ASSIGNMENT AND FARMOUT AGREEMENTS

* The assignee or farmee will become an "owner" of the assigned interest.

* The assignor or farmor may retain an ownership interest in the property.

- Avoid automatic conversions.

  Ownership of the leased area.

  Party to the contract area under JOA.

OPERATING AGREEMENTS

* "Contract Area" Liability

* Operator Liability

* Non-Operator Liability

* Non-Consenting Party Liability

Will state common law notions of agency, joint venture, and mining partnership be employed or will a federal common law be used to determine the scope of each party's liability for operator activities?
THE TYPES OF LIABILITY TO ADDRESS

1. "Owners" of contaminated leases contributed to the contract area.

2. "Operators", "generators", and "arrangers" through the acts of the designated operator.

3. Traditional notions of vicarious liability.

ADDRESSING JOA OWNER LIABILITY

* Evaluate the environmental status of each lease that will be contributed to the contract area.

* Each contributing lessee should provide the other parties with appropriate representations, warranties, assumptions of liability, and indemnities concerning potential or known environmental risks associated with the property.

* If the identified environmental risks are unacceptable, exclude the lease from the contract area—or the unneeded rights associated with the lease that cause the problem.

* Off-site disposal liability as a generator. Need to know how operator will deal with drilling wastes.

    - Appropriate restrictions to control operator-created environmental risks.

    - Change of operator provisions.
The AAPL Forms Committee, in the July/August 1994 Issue of The Landman at page 22 addresses mediation, Order 636, and environmental issues concerning the 1989 Form.

Offer an indemnity provision that can be added to give a non-consenting non-operating working interest owner indemnity by the drilling parties for environmental problems associated with the non-consenting party’s relinquished interest.

Basic problem—somebody will contribute a contaminated property to the pooled or unitized area.

Cross-conveyance problems.

To what extent will courts, applying CERCLA, look to contractual characterizations of the relationship or state statutory characterizations of the relationship?

Remember, the inquiry is whether they are an owner or operator as defined by federal law—CERCLA.

Must employ similar protective techniques used under the operating agreement to screen the contract, pooled, or unitized area.
THE FORCED POOLING PROBLEM

* New issues for the oil and gas Commissions to address—what is "fair and reasonable" in light of the environmental risks?

* Forced surface use?

* Special protection in the pooling order.

DRILLING AND SERVICE CONTRACTS

* Any contractor that is given access to land has the potential to acquire environmental liabilities and aggravate the liabilities of parties that own an interest in the land.

* Must ensure the drilling contractor, and others, properly manage the hazardous substances and wastes they use in their work.

  - On-site problems.

  - Off-site problems.

* The lease operator who employs contractors should specify their environmental obligations in the appropriate drilling or service contracts and then monitor their activities to ensure their obligations are properly discharged.

* The working interest owners should also inquire about the contractors off-site disposal activities since the working interest owners may be viewed as the "generators" or "arrangers" of wastes dealt with by their contractors.
Contractor must seek protection from entering a contaminated lease and becoming a CERCLA operator, arranger, or transporter by merely conducting its contracted services of building roads, digging pits, and drilling the well.

Kaiser Aluminum & Chemical Corp. v. Catellus Development Corp., 976 F.2d 1338 (9th Cir. 1992).

IS THE NONPARTICIPATING INTEREST THE "SAFEST"?

• Yes.

• Ideal situation is a royalty or overriding royalty entitling the owner of the interest to nothing but a share of cash.

  Retain a contractual right to payment that just happens to be measured by what comes out of a wellbore.

  Avoid any right to take the production in kind. This makes the nonparticipating interest seem more like a joint party to the venture—it also makes the lessee seem more like the nonparticipating interest owner’s contractor.

• To the extent state law recognizes a right in the nonparticipating interest owner to compel the lessee to develop, their position will be weakened.
SUMMARY

1. Persons owning or participating in the development of oil and gas interests are subject to significant environmental risks.

2. However, these risks can be managed, reduced, or eliminated by:
   * Proper Transaction Planning
     - Acquire Information
     - Avoid Known Problem Areas
   * Leverage Known and Unknown Risks
     - Representations & Warranties
     - Allocation of Specific Risks
     - Indemnity Agreements
   * Active Property Management
     - Concurrent Owners
     - Contractors

2. LESSEE’s Surface Limitations.

a. Existing Well Bores, Drilling and Operating Pits, and Other Development Facilities. NEW AGE shall have no right, title, ownership interest, operational control, or authority whatsoever over any well, well bore, drill site, pit, aboveground or underground storage tank, or other oilfield structure or facility that is located on or in the Leased Land as of the Effective Date of this Lease.

b. Defined Surface Right Area. NEW AGE's authority to exercise surface rights provided for in Subsection D.1. extends only to those areas in which NEW AGE declares a Surface Site pursuant to this subsection. In the event NEW AGE elects to exercise its rights under this Lease, it will notify LESSOR in writing of the proposed activity and define the surface area on the Leased Land it plans to use in conducting the activity. The surface area defined in the LESSOR notification will constitute the Surface Site for the proposed activity.
How to Deal Effectively with Environmental Liability

Property Currently Subject to Development Rights

1. Inform yourself about current operations and potential environmental problems that may currently exist on the property.

2. Identify existing land use restrictions specified in the mineral deed or oil and gas lease.

3. Determine whether current or contemplated operations fall within the scope of "reasonable use" of the surface to support environmentally sound mineral development.

4. Determine whether there are state statutes or regulations that require the mineral developer to reclaim development sites and plug wells.

5. Don't wait until the lease is assigned or abandoned to focus on cleanup, plugging, and other environmental issues.

6. Demand that the developer adequately address environmental concerns as part of its development activities.

7. Evaluate the developer's compliance with existing regulations governing environmental protection.

8. Attempt to leverage your existing liability in subsequent transfers.

Property Not Currently Subject to Development Rights

1. Decide whether you want to be a concurrent owner of the property. (Convey surface and minerals and merely retain a nonparticipating royalty?)

2. Select a financially-strong and responsible lessee or mineral grantee.

3. Place land use restrictions in the mineral deed or oil and gas lease that are designed to minimize the environmental impact of development on your land.

4. Clearly allocate environmental liabilities to the lessee or mineral grantee.

5. Require the lessee or mineral grantee to indemnify you for any loss you may incur resulting from past, present, or future mineral development activities on the land.

6. Have the lessee or mineral grantee agree to post a bond or other security (in the event development is actually pursued on the property) to ensure there will be money available to comply with plugging, reclamation, and environmental requirements.

7. Bind the lessee or mineral grantee to the deed or lease covenants even though their interest may be subsequently conveyed or assigned.
2. Right's Excepted from this Farmout Agreement

Excepted from this Farmout Agreement is any right, title, ownership interest, operational control, or authority whatsoever over the surface and subsurface area in the following described land: NE1/4 of the NE1/4 of § 30, T 11 S, R 16 E, from the 6th P.M. in Shawnee County, Kansas (the "Excepted Tract"). Without limiting the scope of this exception to the granted rights, NEW AGE shall have no right, title, ownership interest, operational control, or authority whatsoever over any well, well bore, drill site, pit, pond, aboveground or underground storage tank, or other oilfield structure or facility that is located on the Excepted Tract.

However, NEW AGE shall have the exclusive right, without entering the surface or subsurface area of the Excepted Tract, to develop and extract any oil and gas from the Farmout Depths encompassed by the Excepted Tract. The exception created by this section will in no way confer any rights to such oil and gas in place, or when extracted, on any party other than NEW AGE. Subject to any limitations contained in the Oil and Gas Leases covering the Excepted Tract, NEW AGE will have the power to pool or unitize the oil and gas rights in the Excepted Tract and NEW AGE will be credited with the working interest rights in the Excepted Tract for purposes of spacing, pooling, prorationing, and unitization.