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Recent Developments in the Law of Oil and Gas

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RECENT DEVELOPMENTS IN THE LAW OF OIL AND GAS

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I. BASIC PROPERTY LAW ISSUES

A. Future Interests and the Rule Against Perpetuities

1. ***Stalcup v. Detrich***, 27 Kan. App.2d 880, 10 P.3d 3 (2000). Distinguishing a vested remainder from a contingent remainder.

    a. Grant to "Amy McCoy for and during her natural life, and upon her death, then said premises to go to the heirs of the said Amy McCoy."

    b. Creates a contingent remainder in the "heirs of the said Amy McCoy."

    c. Unable to determine Amy's heirs until she dies.

    d. The remainder is contingent because a person can take as an "heir" of Amy only if they meet a condition precedent: survival of Amy.

    e. Trial court erred by equating the term "heirs" to the term "children."

f. Had the term "children" been used the children living at the time of the conveyance would have a vested remainder subject to partial divestment to let in additional children born to Amy prior to her death.

g. In the event Amy dies without heirs, there is a reversion to the grantor. Remember: whenever there is a contingent remainder, or an executory interest, there is always the potential of a reversion to the grantor.

2. The Rule Against Perpetuities

a. Applies to contingent remainders and executory interests.

b. The interest must vest, if at all, within a life or lives in being plus 21 years.

c. NOTE: no problem in ***Stalcup*** because the interest will either vest, or not vest, within a life in being–Amy's. At Amy's death the contingency, the condition precedent, to succeeding to the interest will be known.

3. What is the Applicable Rule Against Perpetuities in Kansas?

a. In 1992 the Kansas Legislature enacted the Uniform Statutory Rule Against Perpetuities to mitigate and, in some cases eliminate, the common law rule against perpetuities.

b. Senate Bill No. 624, which was used to enact the Uniform Statutory Rule Against Perpetuities, contained *three* subjects:

(1) rule against perpetuities;

(2) conservation easements; and

(3) bulk sales.

4. Kansas Constitution Article 2, § 16 provides: ***"No bill shall contain more than one subject. . . ."***

a. Senate Bill No. 624 appears to violate the Kansas Constitution.

b. Effect of violating Article 2, § 16: all laws enacted under the Bill are void.

c. It appears the Kansas Statutory Rule Against Perpetuities is void.

5. ***PRACTICE POINTER:*** Continue to draft to avoid the common law rule against perpetuities whenever possible and use a savings clause. I have used the following clause in documents that may raise a perpetuities issue (such as a preferential right to purchase):

> **PERPETUITY SAVINGS CLAUSE.** Grantor and Grantee believe that pursuant to the Kansas Uniform Statutory Rule Against Perpetuities, all interests created by this Deed are exempt from the statutory rule against perpetuities

pursuant to K.S.A. § 59-3404(1) (1994), and the common law rule against perpetuities pursuant to K.S.A. § 59-3408 (1994). However, if any interest(s) created by this Deed are held to be subject to the statutory rule, the parties acknowledge that the 90-year wait-and-see provision of K.S.A. § 59-3401 (1994) would apply as well as the reformation provisions of K.S.A. § 59-3403 (1994). Although the parties do not believe that any interest created by this Deed would violate the common law rule against perpetuities, ***in the event for any reason the Kansas Uniform Statutory Rule Against Perpetuities is held not to apply, or held not to be effective, and a violation of the common law rule is found to exist by the court, the Grantor and Grantee intend that the following course of action be pursued:*** The court will reform the interest(s) that violate the rule in such a way as to approximate most closely the intent of the Grantor to give maximum effect to the interests created by this Deed for the maximum duration possible under the rule.

B. Successive Interests and the Allocation of Principal and Income

1. Absent authority from the grantor creating a life tenancy, neither the life tenant, nor the remainderman, have the ability to develop, or authorize the development, of minerals.

   a. Life Tenant (present right of possession but cannot commit waste).

   b. Remainderman (no present right of possession but right to prevent

waste).

2. Assuming the life tenant and remainderman are able to agree on authorizing development, the next problem is how to divide lease benefits.

   a. If addressed by the grantor, in the document creating the life tenancy, the grantor's wishes will govern how development and lease benefits are divided.

   b. For example, in ***Stalcup*** one of the granting documents provided:

      "Amy McCoy is to have the use and income from said premises including all the income from any and all oil and gas produced from said land and said Amy McCoy is to receive any and all rentals [bonus?] for the execution of oil and gas leases on said land including any and all delay rentals and in the event oil or gas or either is produced from said land is to receive all the oil and royalty payments belong[ing] to said land."

3. What if the grantor in *Stalcup* had not addressed these matters?

   a. Would the Uniform Principal and Income Act apply?

   b. No. Not a trust; not an estate in administration.

4. Then how do we determine how lease revenues will be divided between the life tenant and remainder interests?

a. Open Mine Doctrine–did the grantor enter into the lease prior to the conveyance creating the interest? If so, life tenant takes all revenue.

b. If the Open Mine Doctrine and the Uniform Principal and Income Act do not apply:

(1) **Delay Rental**: belongs to life tenant.

(2) **Royalty**: is treated as part of the corpus (principal) belonging to the remainder interests which must be invested for their benefit with the income earned on the royalty proceeds payable to the life tenant.

(3) **Bonus**: not sure in Kansas. Some states treat it like delay rental; others treat it like royalty.

5. What if the Uniform Principal and Income Act (UPIA) Applies?

a. The 2000 Kansas Legislature adopted the 1997 version of the Uniform Principal and Income Act. 2000 Session Laws of Kansas, Chapter 61, pp. 254-271. Codified at K.S.A. §§ 58-9-101 to 58-9-603 (Supp. 2000).

b. New allocation between present and future interests: "If the amount received as royalty, shut-in-well payment, take-or-pay payment, bonus, or delay rental is more than nominal, 90 percent must be allocated to principal and the balance to income." K.S.A. § 58-9-411(3) (Supp. 2000).

c. Scope of the Act: Applies to a "fiduciary" which is defined as "a personal representative or a trustee." K.S.A. § 58-9-102(3) (Supp. 2000).

(1) "Except as expressly provided in a will or terms of the trust ***or this act***, this act applies to every trust or decedent's estate existing on the effective date of this act [July 1, 2000]." K.S.A. § 58-9-601 (Supp. 2000) (emphasis added–consider K.S.A. §58-9-411(d): discussed below).

(2) The Act would not apply to the typical life estate unless it is created by trust or the document creating the life estate provides for application of the Act.

d. Which UPIA applies?

(1) K.S.A. § 58-909 (repealed): **22%** Principal; **78%** Income.

(2) K.S.A. § 58-9-411 (Supp. 2000): **90%** Principal; **10%** Income.

e. Eliminates the Open Mine Doctrine:

K.S.A. § 58-9-411(c): "This act applies whether or not a decedent or donor was extracting minerals, water, or other natural resources before the interest became subject to the trust."

6. Problem created for trustees by K.S.A. § 58-9-411(d):

   "If a trust owns an interest in minerals, water, or other natural resources on the effective date of this act [July 1, 2000], the trustee ***may*** allocate receipts from the interest as provided in this act [§ 58-9-411(a)] or in the manner used by the trustee before the effective date of this act [§58-909 (repealed)]. If the trust acquires an interest in minerals, water, or other natural resources after the effective date of this act, the trustee ***shall*** allocate receipts from the interest as provided in this act."

   a. K.S.A. § 58-9-601: "Except as expressly provided in a will or terms of the trust or this act [such as 58-9-411(d)], this act applies to every trust or decedent's estate existing on the effective date of this act."

   b. This creates a big problem for the trustee since it gives them discretion to essentially take away 68% of the mineral assets from one beneficiary and give them to another.

7. **One Certainty Under the UPIA Regime:** The allocations probably are nowhere near what the settlor or decedent would have selected had they thought about it.

C. Defining the Scope of the Mineral Interest: Should We Apply Accretion Rules to a Severed Mineral Estate? ***Siegert v. Seneca Resources Corp.***, 28 S.W.3d 680 (Tex. Ct. App.–Corpus Christi 2000) (yes).

1. The ***Siegert*** facts:

   a. 1932 conveyance reserved to the grantor the mineral interest in 100 acres of land.

   b. 81 acres of land were added to the 100 acres through accretion.

2. The issue: Should accretion apply to riparian severed mineral interests the same way it does to riparian surface lands and unsevered minerals? Yes.

3. The reasoning:

   a. Court follows the approach applied by another Texas Court of Appeals, the Montana and Oklahoma Supreme Courts, and Alberta.

   b. Severed mineral estate is a property interest of "equal dignity" to a surface estate.58-9-411(d):

   c. Location of the mineral estate boundary as it existed can only be determined at the river's shore.

   d. Another rule would create impossible administrative problems.

e. There is no equitable reason for treating unsevered riparian mineral interests different from severed riparian mineral interests.

D. Defining the Scope of the Mineral Interest: Coalbed Methane. ***Rogers v. Ambassador Oil Corp.***, Case No. C-94-43 (D.C. Haskell County, Okla. Jan. 19, 2001).

1. The facts:

   a. Day 1: **A** conveys to **B** the "oil, gas and other mineral rights" in § 30.

   b. Day 2: **A** conveys to **C** the "coal rights" in § 30.

2. The issue: Who has the right to produce the coalbed methane gas found in coal seams on § 30? **A**? **B**? **C**?

3. The holding: **B** owns the coalbed methane gas.

4. The reasoning:

   a. Focused on the physical attributes of "gas" as a substance that is not part of the coal in which it is found.

   b. Rejected the plaintiff's "container theory" that the owner of the container–the coal owner–owned all that was within the container.

   c. Inconsistent with concept that person can own the right to extract gas without owning the rock structure in which it is contained.

d. Inconsistent with the rule of capture that gives the developer rights in production that migrates from adjacent lands (containers).

e. Adopts reasoning of Montana Supreme Court that "gas" refers to fluid and gaseous hydrocarbons that do not include coal.

f. Rejects contrary holdings of the Pennsylvania and Alabama Supreme Courts.

E. Defining the Scope of the Mineral Interest: Is "Oil" and "Gas" Included in a Reservation of "Other Minerals"? ***McCormick v. Union Pacific Resources Co.***, 14 P.3d 346 (Colo. 2000) (yes).

1. The facts & issues:

   a. 1906 **A** conveys to **B** "all coal and other minerals . . . ."
   Who owns the oil and gas?

   b. 1909 **A** conveys to **B** "all oil, coal and other minerals . . . ."
   Who owns the gas?

2. The holding: "Other minerals" by itself includes oil and gas as a matter of law.

3. The reasoning:

   a. "Based on our study of Colorado precedent, custom, usage, and learned commentary thereon, we hold that a deed reservation for

'other minerals' reserves oil and gas."

b. Concurring Justices–no need to consider "custom, usage, and learned commentary . . . ."

4. The critique: What about the other words?

a. "all coal and . . . ."

b. "all oil, coal and . . . ."

5. Contrast the Kansas Approach:

a. **A** conveys to **B** "all minerals."

(1) Does it include oil and gas?

(2) ***Roth v. Huser***, 147 Kan. 433 (1938) (sometimes).

b. **A** conveys to **B** "all coal and other minerals."

(1) Does it include oil and gas?

(2) ***Davis v. Plunkett***, 187 Kan. 121 (1960) ("Volcanic Ash, and all other minerals or mineral derivatives" does ***not*** include oil and gas).

6. The Real Interpretive Problem:

   a. The mineral grantee obtains an implied easement to make reasonable use of the surface to extract the granted mineral.

   b. If the owner of the mineral is not required to pay for any necessary disruption of the surface to extract the granted mineral, title to the mineral may substantially devalue the retained surface estate.

   c. Courts have struggled to limit the scope of a grant of "minerals" to try and minimize the grantee's implied easement rights.

7. The Kansas Situation:

   a. Kansas clearly recognizes the implied easement analysis.

   b. Not so clear is whether the party exercising the easement must compensate for surface disruption.

   c. Most states addressing the issue have held there is no obligation to compensate for reasonable use.

   d. This has been altered by statute in many states.

   e. Kansas has not addressed whether compensation will be required.

   f. See generally: *Toward a Functional Mineral Jurisprudence for Kansas*, 27 Washburn L. J. 223 (1988).

8. ***PRACTICE POINTER:*** If you desire to truly include "all" minerals in a mineral conveyance or reservation impacting Kansas land, any specific mineral your client is interested in should be listed followed by statements that will satisfy each of the tests used by Kansas courts to resolve the "mineral" and "other mineral" issues. I have used the following clause in documents to create the broadest possible, all-inclusive, conveyance of minerals:

DEFINITION OF "MINERAL ESTATE." As used in this Deed the term "Mineral Estate" shall include all mineral substances on, in, or under the Land, to include, without limitation, all the following:

(1) oil, natural gas, all petroleum substances, coal, coalbed methane gas, carbon dioxide, nitrogen, helium, hydrogen, limestone, gypsum, sand, gravel, clay, sulfur, uranium, zinc, lead;

(2) water which is not required to support agricultural activities associated with the Surface Estate;

(3) minerals in any physical form or phase, whether a liquid, solid, or gas;

(4) minerals that may require the significant destruction of the surface for their economical exploration, development, or production;

(5) minerals, whether currently known to exist in the area or community;

(6) minerals, whether currently known to have any particular commercial value;

(7) any substance that could be classified by the sciences as a mineral.

F. Adverse Possession of Mineral Interest. ***Cornelius v. Moody Bible Institute***, 2001 WL 168105, Case No. 93467 (Okla. Civ. App. Div. 1, No. Feb. 21, 2001).

1. The facts:

a. 1945: **A** leases land to Oil Co.

b. 1960: **A** conveyed the oil and gas in § 30 to **B**.

c. 1966: **A** dies leaving **C** as her only heir.

d. 1967: **C** begins taking all royalties under the oil and gas lease, and pays taxes on the interest, for the next 29 years.

e. 1970: Secondary recovery unit formed in which 20 acres of the 70-acre severed mineral interest participates; no production well on the 20-acre tract.

f. 1996: **C** files quiet title action asserting title by adverse possession.

2. The holding: No adverse possession.

3. The reasoning:

   a. No open, visible, continuous and exclusive action–nothing to put the owners on notice.

   b. Receipt of royalties not enough.

   c. Payment of taxes not enough.

   d. Off-tract wells on unitized acreage not enough.

   e. "In order for a person to adversely possess a severed mineral estate, he must actually open a well on a tract of land and reduce the minerals under that tract to possession for the statutory period."

II. OIL & GAS LEASE ISSUES

A. Habendum Clause Issues: The Temporary Cessation Doctrine. *Natural Gas Pipeline Co. v. Pool*, 30 S.W.3d 618 (Tex. Ct. App.–Amarillo 2000) (cessation not temporary, leases terminated).

1. The facts:

   a. Lease entered into in 1937 for "as long thereafter as natural gas is produced and marketed from any well on said land."

   b. Two wells drilled during primary term and a third well was drilled in 1996.

   c. Suit filed in 1998 asserting lease terminated due to a cessation of production.

   d. Lessors went to the Railroad Commission and found the wells had not produced during:

      August 1959
      July-August 1960
      June-July 1961
      June-October 1963
      July-August 1964
      June 1969

   e. No cessation clause in the lease so the temporary cessation doctrine

applies.

2. Analysis:

   a. Lessee failed to offer evidence to prove the cessations qualified under the temporary cessation doctrine.
   b. Temporary cessation doctrine: "due to a sudden stoppage of the well or some mechanical breakdown of the equipment used in connection therewith, or the like," and production must be resumed within a "reasonable time."

   c. Lessee could not explain why the wells were not producing. Prior employee suggested it was a deliberate failure to market during the Summer months so as to over-produce during the Winter months.

   d. Court limits the doctrine to "some mechanical breakdown or something similar . . . ."

   e. Laches not available in a trespass to try title case.

3. Holdings:

   a. Jury found trespass was in bad faith because NGPL was aware of the title issue but continued possession and drilled the 1996 well.

   b. Since NGPL's original entry was permissive, adverse possession required a clear manifestation to the owner it was repudiating the owner's title.

c. No basis for jury's fraud finding. NGPL had no duty to inform landowner's their lease had terminated; no fiduciary relationship between lessor and lessee.

B. Habendum Clause Issues: The Temporary Cessation Doctrine. ***Krabbe v. Anadarko Petroleum Corp.***, 2001 WL 128160, Case No. 07-99-0456-CV (Tex. Ct. App.–Amarillo, Feb. 15, 2001) (cessation temporary).

1. The facts:

a. Leases entered into in 1926 and 1930 and consolidated in 1935.

b. No cessation clause or shut-in royalty clause.

c. Two producing wells on the lease.

(1) Gas sales contract dispute on well #1 resulting in shut-in from May 17, 1985 through January 1987.

(2) Gas sales interrupted on well #2 while gas plant connected to well was being serviced. No sales for 92 days from August to October 1985 and for 61 days from May through June 1986.

d. Plaintiff argued temporary cessation doctrine should not consider events that take place beyond the point of sale of the gas.

e. Plaintiff argued lessee should have constructed a pipeline around the plant to by-pass it.

2. The analysis & holding:

   a. Court rejects argument the cause of the cessation must occur prior to the point of sale or must be limited to physical or mechanical problems.

   b. Court rejects argument the cause of the cessation must be unforeseeable and unavoidable.

   c. Routine maintenance at the gas plant owned by a third party was an event encompassed by the temporary cessation doctrine.

   d. Lessee carried its burden of proof to show the lack of production was within the doctrine and exercised diligence to regain production within a reasonable time.

C. Habendum Clause Issues: Operations Clause. ***Utley v. Marathon Oil Co.***, 31 S.W.3d 274 (Tex. Ct. App.–Waco 2000) (good faith operations).

1. The facts:

   a. Lease ran for 5 years from February 12, 1974.

   b. Operations clause provided the lease would remain in effect if Marathon was:

      "[E]ngaged in operations for drilling, mining or reworking any well or mine thereon, this lease shall remain in force so long as such operations . . . are

commenced and prosecuted (whether on the same or successive wells) with no cessation of more than ninety (90) consecutive days."

c. Drilling began December 14, 1978, the target depth was reached March 22, 1979 [primary term expired February 12, 1979], and testing continued until April 16, 1979.

d. From April 16, 1979 through September 24, 1979 Marathon attempted to complete the well in the targeted Cotton Valley Lime formation.

e. On September 24, 1979 Marathon completed the well in the higher Bossier Sand.

f. Lessors argue that operations from April 16 through September 24, 1979 were not in good faith and were therefore not "continuous operations."

g. Experts presented by each side concerning whether Marathon's $440,000 expenditure trying to make the Cotton Valley Lime formation produce was prudent.

2. The analysis and holding:

a. Jury found for Marathon; court upholds the jury's verdict.

b. Jury also awarded Marathon $750,000 in attorney fees which were

reduced to $150,000 by the trial judge.

c. Court notes: "There is nothing sinister about a decision to hold acreage by operations as a business alternative."

d. Case demonstrates how multiple savings clauses applied to the various activities and wells on the lease can fill-in the gaps to maintain the lease in effect.

D. Royalty Clause Issues: Role of Implied Covenant to Market in Calculating Royalty. ***Yzaguirre v. KCS Resources, Inc.***, 2001 WL 690435, Case No. 00-0829 (Tex. June 21, 2001).

1. The facts:

a. 1973 lease contained the following royalty clause:

"The royalties to be paid by Lessee are: . . . on gas, including casinghead gas or other gaseous substance, produced from said land and sold or used off the premises or for the extraction of gasoline or other product therefrom, the market value at the well of one-eighth of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-eighth of the amount realized from such sale."

b. 1979 the lessee entered into a 20-year gas purchase agreement with Tennessee Gas Pipeline Co. as the buyer (the "Gas Contract").

c. The Gas Contract provided for a point of sale at a processing plant

located several miles away from the leased property.

d. Because the sales were "off the premises" it triggered the "market value at the well" portion of the royalty clause.

e. At all relevant times the Gas Contract proceeds received by the lessee were in excess of the current market value of the gas.

f. The lessee paid the lessor 1/8th of the current market value of the gas instead of 1/8th of the higher sums it received.

g. Lessee's argument: express terms of the lease describe the royalty due: 1/8th of the "market value at the well."

h. Lessor's argument: the implied covenant to market imposes on the lessee the obligation to obtain for the lessor the best price possible.

2. Analysis and holding:

a. There is no room for the implied covenant to operate under the facts.

b. "In this case, the parties entered into a lease requiring a market-value royalty. Because the lease provides an objective basis for calculating royalties that is independent of the price the lessee actually obtains, the lessor does not need the protection of an implied covenant. Depending on future market behavior, this may be financially beneficial to the lessor, as it was in *Vela*, or it may be less advantageous, as here. In either event, the parties have received the

benefit of their bargain."

c. "[T]here is no implied covenant when the oil and gas lease expressly covers the subject matter of an implied covenant."

d. "Essentially, the Royalty Owners wish to use an implied marketing covenant to negate the express royalty provisions in the leases and transform the 'market value' royalty into a 'higher of market value or proceeds' royalty. . . . The implied covenant to reasonably market oil and gas serves to protect a lessor from the lessee's self-dealing or negligence. . . . It does not override the express terms of the oil and gas lease whenever a lessee negotiates a sales contract that turns out to be especially lucrative. We will not now rewrite the lease's plain terms to give the Royalty Owners the benefit of a bargain they never made."

3. What does "market value" mean?

a. "[T]he price property would bring when it is offered for sale by one who desires, but is not obligated to sell, and is bought by one who is under no necessity of buying it. To determine the market value of gas, the gas should be valued as though it is free and available for sale."

b. "Market value is the prevailing market price at the time of delivery and is not affected by a price set at the time the lessee enters into a long-term sales contract with the buyer."

c. The trial court properly excluded evidence offered by the lessors'

expert to the effect that the Gas Contract price was evidence of market value.

d. "According to the 1979 GPA, Tennessee was obligated to purchase KCS's gas at an ever-escalating price, regardless of its value on the open market. The gas was not free and available for sale, and its price was negotiated in 1979, not contemporaneously with the deliveries. Under the circumstances, the GPA price is not evidence of market value, and the trial judge properly excluded it."

4. **NOTE:** the only state that applies a purer form of the "market value royalty" rule than Texas–is Kansas.

a. In a 1990 article I discussed the scenario that ultimately came to be litigated in ***Yzaguirre v. KCS Resources, Inc.*** and noted one of the few cases that addressed the issue was ***Holmes v. Kewanee Oil Co.***, 664 P.2d 1335 (Kan. 1983). See David E. Pierce, ***Royalty Calculation in a Restructured Gas Market***, 13 **Eastern Mineral Law Institute** 18-1, 18-32 (1990).

b. As I noted in the article: "In ***Holmes***, the Supreme Court affirmed that portion of the trial court's judgment awarding mineral owners 'increased royalty payments' of $272,391.68. The leases provided for payment of royalty based upon the 'prevailing market rate' which the court held required payment of the price at the current rate prevailing when the gas is delivered rather than the proceeds or amount realized under a gas purchase contract. The gas contracts had been entered into in 1929 and the gas prices in the contracts failed to keep pace

with the current market value of the gas, resulting in the $272,391.68 liability.

"The trial court also granted the royalty owners 'prospective relief based on the section 108 price for the duration of regulation and thereafter the highest price paid for natural gas in Barber County.' The Supreme Court held that the trial court had erred in granting prospective relief because it would have unlawfully amended the lease, which provided for payment of royalty based upon *current* market values. The Supreme Court explained its position stating: 'The Okmar Contract and the section 108 price are the evidence of market price *in this case*. They are factual in nature and not controlling on future cases *because the market price might fluctuate*.' Since the court rejected the calculation of royalty applying 'the highest price,' the only way the market price could 'fluctuate' would be a decrease in price. *Holmes*, therefore, supports the proposition that a market value royalty clause permits the lessee to retain any amount attributed to the royalty share of gas that is in excess of current market values. The only instance in which this could legitimately occur would be where the lessee sells the gas under a contract providing for a price greater than the current market value. The additional 'value' realized by the lessee would not be attributable to the gas but to the lessee's contract."

Pierce, ***Royalty Calculation in a Restructured Gas Market***, 13 **Eastern Mineral Law Institute** at 18-32 to 18-33.

E. Royalty Clause Issues: Role of Implied Covenant to Market in Calculating Royalty. ***Rogers v. Westerman Farm Company***, 2001 WL 741944, Case No. 99SC293 (Colo. July 2, 2001).

1. The facts:

   a. The court identifies four types of royalty clause:

      (1) "lessee shall pay to lessor a sum equal to one-eighth (1/8th) of the gross proceeds received from the sale of such produced substances where the same is sold at the mouth of the well or, if not sold at the mouth of the well, then one-eighth (1/8) of the market value thereof at the mouth of the well, but in no event more than one-eighth of the actual amount received by the lessee for the sale thereof."

      (2) "lessee shall pay lessor as royalty, 1/8 of the proceeds from the sale of gas as such at the mouth of the well where gas, condensate, distillate or other gaseous substance is found."

      (3) "pay lessor for gas of whatsoever nature or kind produced and sold, or used off the premises, or used in the manufacture of any products therefrom, one-eighth, at the market price at the well for the gas sold, used off the premises, or in the manufacture of products therefrom."

      (4) "pay one-eighth (1/8) of the proceeds received for gas sold from each well where gas only is found, or the market value at the well

of such gas used off the premises . . . ."

b. Court notes that all the leases "provide, with some variation, for royalties to be paid based on the gas "at the well" or "at the mouth of the well."

c. Some of the gas was sold at the well, some was sold away from the well where a gathering system entered an interstate pipeline, some of the gas was used "in kind" by the lessors.

d. The gas is "dry" and "sweet" as it emerges from the well.

e. 1970s most of the gas contracts provided for a sale of the gas to a pipeline purchaser buying the gas at the well.

f. Beginning in the 1980s, and through the 1990s, many gas sales took place at a point removed from the wellhead, in addition to some continuing wellhead sales.

g. Lessor Claim #1: when lessees entered into a wellhead sale of the natural gas to a third party it breached the implied covenant to market because the gas was not "marketable" yet.

   (1) Although the gas was, in fact, marketed.

   (2) Essentially the lessor is claiming the lessee has an implied obligation to seek out a particular downstream market at the lessee's sole cost to maximize the lessor's royalty.

(3) "[T]he lessors argue that the royalties they received for these sales were much lower than the royalties they would have received had the gas been sold away from the wells."

h. Lessor Claim #2: when lessees entered into sales at the interstate pipeline, they could not deduct any of the gathering, compression, and dehydration costs associated with moving the gas from the wellhead to the interstate pipeline delivery point.

(1) Their theory is the gas is not "marketable" until it is delivered to the interstate pipeline at which point it will be in "marketable condition."

(2) They argue the lessee is obligated, under the implied covenant to market, to place the gas in "marketable condition" and that does not occur until it is "pipeline quality" gas that can be delivered to an interstate pipeline.

i. Lessee defenses:

(a) The gas was "marketable" at the well so a sale at the well was appropriate.

(b) For sales away from the well, the gathering, compression, and dehydration expenses were incurred to enhance the value of an already marketable product and therefore the lessee should be able to deduct those expenses to calculate the value of the gas "at the well" as called for in the royalty clauses.

2. Analysis and holding:

   a. In effect, the court holds that to determine whether gathering, compression, and dehydration costs are deductible, you ignore the lease language "at the well" and instead rely upon the implied covenant to market.

      (1) "Specifically, all of the leases contemplate that the royalties are to be computed 'at the well' or 'at the mouth of the well.'. . . [W]e conclude that all of the leases are, in fact, silent with respect to allocation of costs."

      (2) Instead, the court looks solely to the implied covenant to market analysis under the marketable product rule.

      (3) The court notes that the Kansas Supreme Court, in ***Sternberger v. Marathon Oil Co.***, took a different approach:

      "[T]he Kansas Supreme Court found that a lease directing royalty payments of 'one-eighth (1/8) of the market price at the well for gas sold or used' was silent with respect to deductions, however, the Kansas Supreme Court concluded that the lease was not ambiguous, and that the language at issue specifically provided the point of valuation for the royalty payments. . . . Because that court concluded that the royalty valuation point was at the physical location of the well, it further concluded that both lessees and lessors were responsible for their proportionate shares of costs to transport gas away from the well location to the market.

In the case before us, the court of appeals arrived at the same conclusion."

b. With regard to the "market value" leases, the court stated:

"While this portion of the lease suggests that the royalties be paid based on the market value, there is no indication as to how such value is to be determined."

(1) In Texas, and Kansas, there should be no problem with the market value leases. You merely determine what the market value of the gas is at the location identified in the lease–for example, market value "at the well."

(2) In Texas and Kansas, apparently unlike Colorado, "market value" has a well understood meaning: what a willing buyer would pay a willing seller. Although in some cases it may be difficult to ascertain market value, the standard is clear and is triggered by the use of lease language such as "market value" or "market price."

(3) The Colorado Supreme Court simply ignores the express "market value" language, much in the same way it ignores the express "at the well" language.

(a) The Colorado Supreme Court reveals somewhat its motivation in ignoring the express market value and at the well language with its discussion regarding the unequal bargaining positions of the lessor and lessee.

(b) It appears the Colorado Supreme Court gives the express lease language little attention so it can resort to the implied marketing obligation it creates to govern the rights and obligations of the parties; equitable intervention to make a contract which provides greater benefits to the lessor–at the reciprocal expense of the lessee.

(c) This is perhaps the best way to distinguish the Colorado approach in ***Rogers*** from the Texas approach in ***Yzaguirre***. As the Texas Supreme Court stated:

"Essentially, the Royalty Owners wish to use an implied marketing covenant to negate the express royalty provisions in the leases . . . . We will not now rewrite this lease's plain terms to give the Royalty Owners the benefit of a bargain they never made."

The Colorado Supreme Court "interprets" the lease to achieve the "silence" on the issue necessary to trigger its implied covenant analysis.

c. Definition of "Marketable Condition" and the New Colorado Marketable Product Rule:

(1) "[M]arketability includes both a reference to the physical condition of the gas, as well as the ability for the gas to be sold in a commercial marketplace."

(2) "In defining whether gas is marketable, there are two factors to consider, condition and location. First we must look to whether the gas is in a marketable condition, that is, in the physical condition where it is acceptable to be bought and sold in a commercial marketplace. Second, we must look to location, that is, the commercial marketplace, to determine whether the gas is commercially saleable in the oil and gas marketplace."

(a) Note that in addressing the "location" factor the court does not consider the express lease terms that provide for valuation "at the well."

(b) Instead, the court is fashioning its own rule under the auspices of an implied covenant to market.

(3) The court relies heavily on the writings of Professor Owen Anderson. At footnote 20 the court states: "Anderson implies that both marketable condition and marketable location are required in order to obtain a first-marketable product." Professor Anderson informs me he has written the Justices asking them to delete this footnote because it does not accurately reflect his views on the subject.

(4) The court states: "It may be, for all intents and purposes, that gas has reached the first-marketable product status when it is in the physical condition and location to enter the pipeline." Although the court does not state that the relevant location is the pipeline, it offers several examples where the pipeline location was used.

(5) The court follows its observations with the emphatic statement that the determination of marketability is a question of fact.

(a) The court rejects decisions from other states, including Kansas, where it appeared the court was holding that certain costs, like compression, were not deductible as a matter of law.

(b) Instead, the marketability of gas must be determined on a case-by-case basis.

(6) "Gas is marketable when it is in the physical condition such that it is acceptable to be bought and sold in a commercial marketplace, and in the location of a commercial marketplace, such that it is commercially saleable in the oil and gas marketplace."

(7) "We have defined marketability as requiring that the gas be in a physical condition acceptable to be exchanged in a commercial market, and also in a location, the commercial marketplace, where the gas is commercially saleable."

d. What is a "commercial marketplace"?

(1) An actual sale to a third party is not necessarily indicative of a commercial marketplace.

(2) "While we agree that a single purchaser, in a good faith purchase of gas, is evidence that there is a market for the gas, we do not

agree that such a purchase exclusively establishes a market. The determination of whether a market exists is an issue of fact to be decided by a jury, based on the facts and circumstances, which may include factors other than a single purchase of gas."

(3) "Gas is not marketable merely because it is sold."

(4) "There is a difference between marketing and selling a product. . . . For marketing, there must be a market, which has been defined as 'an established demand for an identified product.'. . . With respect to sales, 'almost anything can be sold, if the price is no consideration.' . . . Thus, the gas must be more than merely sold in order for the lessee to meet the duty to market the gas. Instead, . . . the gas must meet the standard of being suitable for a commercial market."

e. Once a "marketable product" is achieved:

(1) "Marketability [or "value"?] of the product may be affected because the quality of the raw gas is impaired by the presence of impurities. In this instance, it should be necessary to determine if there is a commercial market for the raw gas. If there is a commercial market, then a marketable product has been produced and further processing to improve the product should be treated as refining to increase the value of the marketable product."

(2) "Costs incurred to make the gas marketable are to be borne solely by the lessee. Alternatively, costs incurred subsequent to the gas

being marketable are to be shared proportionately between the lessee and the lessor."

f. Summary of the ***Rogers*** approach:

(1) The factual issues have been expanded.

(2) The key factual issue under ***Garman***: whether the quality of the gas, at whatever location it was offered for sale, attracted a legitimate buyer for the gas.

(3) The new factual issue added by ***Rogers***: is the sale of the gas of such a nature as to constitute a "commercial market" for the gas.

(4) Express lease language suggesting the relevant valuation point is "at the well" is of no importance and should be ignored.

(5) Express lease language suggesting royalty should be based upon the market value of the gas is of no importance and should be ignored.

(6) The issues will be governed by the implied covenant to market.

(7) Courts should favor royalty owners because lessees know more and in the past some of them have behaved badly.

F. Royalty Clause Issues: Deduction of Costs to Calculate Carbon Dioxide Royalty. ***Creson v. Amoco Production Co.***, 10 P.3d 853 (N.M. Ct. App. 2000), *cert. denied*, Sept. 13, 2000.

1. The facts:

   a. Unit Agreement for development of 750,000-acre carbon dioxide unit provided for royalty based on:

      "The net proceeds derived from the sale of Carbon Dioxide Gas at the well whether such sale is to one or more parties to this agreement or to any other party or parties."

   b. Another clause of the Unit Agreement stated:

      "Royalty Owners Free of Cost. This Agreement is not intended to impose, and shall not be construed to impose, upon any Royalty Owner any obligation to pay Unit Expense unless such Royalty Owner is otherwise so obligated."

   c. Most of the carbon dioxide was sold far downstream from the point of production.

   d. Costs associated with moving carbon dioxide from the wellheads to the point of sale were deducted from the sales proceeds to calculate the "net proceeds derived from the sale of Carbon Dioxide Gas at the well . . . ."

e. Lessors argue that the compression, dehydration, gathering, and pipeline depreciation expenses are "unit expenses" that cannot be charge to them by the Unit Agreement.

f. Lessees argue the "net proceeds" and "at the well" language require that royalty be based on the value of the carbon dioxide gas "as it emerges from the wellhead."

2. Analysis and holding:

a. The Court reasons:

"We are not persuaded, however, that deductions for the costs of compression, gathering, dehydration, and capital depreciation used to establish 'net value at the well' for downstream sales is equivalent to requiring Plaintiffs to pay for or bear these costs."

b. "Instead, these costs are used as a means of calculating the value of the carbon dioxide gas at the wellhead for those sales that occurred downstream. Because there is no 'net proceeds at the well' for downstream sales, it is necessary to reconstruct this value for these sales. Use of these costs for this limited purpose, in our view, is not equivalent to assessing those costs directly to the royalty owners."

3. Observations by the court concerning Kansas law:

a. "In this appeal, Plaintiffs have conceded that the carbon dioxide

gas was marketable at the wellhead and that some small portion of the gas was actually sold at the wellhead."

b. "Even under cases from other jurisdictions, such as ***Garman*** [Colorado] and ***Sternberger*** [Kansas], the costs of compression, gathering, and dehydration in this case would be deductible."

4. This case gives effect to the express "at the well" language by identifying the specific location where "net proceeds" will be determined.

G. Royalty Clause Issues: "At the Mouth of the Well" Indicates the Location At Which Carbon Dioxide Royalty Will Be Calculated. ***Atlantic Richfield Co. v. Farm Credit Bank of Wichita***, 226 F.3d 1138 (10th Cir. 2000).

1. Court examines several issues regarding the calculation of royalty on carbon dioxide production.

2. Modified leases that provide for royalty based upon the "highest current market price at the time the gas is produced and sold" considering the highest price "paid in Huerfano County, the price used by the MMS, or the amount received by lessee for its share of the gas.

3. Issue whether these prices were to be adjusted to reflect values "at the mouth of the well."

4. If the "at the mouth of the well" language is operative, it would permit

the deduction of costs:

"By itself, the phrase 'at the mouth of the well necessarily incorporates a transportation deduction, since the nearest market for CO2 from the SMU [unit area] is 400 miles away in West Texas."

5. The ***Daubert/Kumho*** Tire Issue:

   a. Lessor's expert offered to testify that fair market value of the gas should be determined using his "profit maximization" theory that predicts the price a buyer would pay for carbon dioxide considering the "net economic benefit that carbon dioxide generates in use."

   b. Trial court excluded the testimony as unreliable because it did not consider actual sales or comparable sales–but instead relied solely on the witness' hypothetical transactions.

   c. Held: Affirmed (close call though).

   d. ARCO filed motion in limine on *Daubert/Kumho* Tire grounds.

      (1) District court judge held an in camera evidentiary hearing where the witness testified and was subject to cross-examination.

      (2) Court held the witness had "disregarded the actual sales data of carbon dioxide gas in West Texas" and "failed to look to

comparable sales of CO2 in other markets."

e. ***Daubert*** Factors Applied by Judge:

(1) Opinions formed specifically for this litigation.

(2) Profit maximization theory had not been employed previously.

(3) Opinions had not been published or subject to peer review in scholarly journals.

f. Court of Appeals Notes:

(1) "While expert testimony based on hypothesis can . . .be used to establish market value, courts tend to prefer evidence derived from actual sales.". . . "'[C]omparable sales or current market price is the best' and 'by far the preferable method' for determining value."

(2) "Accordingly, even if the relevant market is not perfectly competitive, 'it still makes better sense to begin with the collective judgment expressed in the market price' that to start with 'a wholly subjective pronouncement of worth.'"

H. Royalty Clause Issues: Effect of Unit Agreement on Royalty Calculation. ***Antelope Co. v. Mobil Rocky Mtn., Inc.***, 2001 WL 546491 (Colo. App. May 24, 2001).

1. The facts:

   a. Mobil was the lessee under an oil and gas lease covering an undivided one-half interest in Sections 20 and 30.

   b. These sections were made a part of the Anschutz Ranch East Unit along the Wyoming-Utah border.

   c. Mobil sold gas to its gas purchaser, Natural Gas Pipeline Company of America (NGPL).

   d. Under a prior ruling, it was held Mobil was marketing gas on behalf of other working interests pursuant to the terms of the Unit Operating Agreement.

   e. Under the Unit Operating Agreement 20% of the gas sales would be credited to Mobil.

   f. The royalty owners asserted they were not subject to the Unit Operating Agreement and therefore all the gas produced and sold by Mobil was subject to the payment of royalty–resulting in an 80% underpayment.

2. The court holds the royalty owners were bound by the terms of the Unit Operating Agreement pursuant to the following lease clause:

> "***Lessee also shall have the right to unitize***, pool, or combine all or any part of the above described lands with other lands in the same general area ***by entering into a cooperative or unit plan of development or operation*** approved by any governmental authority. . . . In such event, the terms, conditions, and provisions of this lease ***shall be deemed modified to conform to the terms, conditions, and provisions of such approved cooperative or unit plan of development or operation***. . . ."

I. Royalty Clause Issues: No Royalty Due on Take-Or-Pay Settlement. ***Goss Family Limited Partnership v. Wood***, 15 P.3d 517 (Okla. Civ. App. 2000), *cert. denied* Oct. 10, 2000.

1. The facts:

   a. Lease provided for royalty on gas "produced and sold or used off the premises or used in the manufacture of products therefrom . . . ."

   b. Lessee entered into gas sales contract with Southern Natural Gas Company; Southern ceased taking gas and to settle contract issues paid lessee $3,000.

   c. Lessee released Southern of all liability under the contract and agreed to terminate the contract.

d. In take-or-pay vernacular, this was a "non-refundable" ["non-recoupable"] "buy-out."

(1) It was a ***buy-out*** because the contract between the parties was terminated.

(2) It was ***non-refundable*** because there was no way Southern could recover the lump sum it was paying by, for example, taking gas in the future to recoup all or part of the lump sum payment (non-recoupable).

2. Analysis and holding:

a. Court applies Oklahoma Supreme Court's holding in ***Roye Realty & Developing Co. v. Watson*** and holds no royalty is due on the sums paid to the lessee.

b. The royalty clause of the lease is the critical document and it provides for a royalty only on gas "produced and sold or used . . . ."

c. "The Court [in *Roye*] made no distinction between recoupable and non-recoupable settlements, rather, the Court based its decision on the lease entered into by the parties . . . . The Court held that a royalty owner is not entitled to share in take-or-pay settlements unless it is clear from the four corners of the lease that the lessor is entitled to share in those proceeds."

J. Royalty Clause Issues: No Royalty Due on Take-Or-Pay Settlement. ***EEX Corp. v. U.S. Dept. of Interior***, 111 F. Supp.2d 24 (D.D.C. 2000).

1. The facts:

   a. EEX entered into a take-or-pay settlement with Natural Gas Pipeline Company of America (NGPL) and received over $7 million in settlement proceeds.

   b. The Minerals Management Service (MMS), on behalf of the Department of Interior, sought a share of the settlement proceeds as royalty.

   c. Some of the leases dedicated to the NGPL contracts were on the outer continental shelf and governed by the Outer Continental Shelf Lands Act.

   d. Federal government entitled to a royalty on "***the amount or value of the production saved, removed, or sold***" by the lessee.

2. The other federal lands/take-or-pay cases:

   a. ***Diamond Shamrock v. Hodel*** (5th Cir. 1988)

      No royalty due until and unless the gas is actually severed from the ground ("produced"). This will not occur until gas purchaser actually takes make-up gas.

b. ***IPAA v. Babbitt*** (D.C. Cir. 1996)

No royalty due on gas sold to third parties following lump-sum take or pay settlement with gas purchaser; no contractual obligation exists to credit a settlement or take-or-pay payment to the severed gas.

c. ***Century Offshore Management Corp.*** (6th Cir. 1997)

As part of settlement between lessee and gas purchaser, gas purchaser was able to continue purchasing gas under a new set of contracts simultaneously executed in conjunction with the settlement.

(1) The court thought there was an adequate nexus between the settlement payment and the subsequent production to make it royalty-bearing.

(2) The court felt the situation was analogous to make-up gas under a recoupable take-or-pay settlement arrangement.

3. The EEX/NGPL settlement:

a. Cash payment to terminate certain contracts, modify others.

b. NGPL prospectively given right to make firm offer to purchase gas which EEX could accept of reject.

c. NGPL subsequently purchased about 46% of the gas at prices substantially less than under the terminated/modified contracts.

d. Remaining 54% of the gas volumes were sold to third parties.

4. Determining the Scope of the IPAA Decision:

   a. Reasoning applies not only to sales of gas to third parties but also to sales to the original gas purchaser.

   b. Issue is whether the subsequent gas payments are in fact a recoupment or make-up of the settlement payment.

5. Analysis and holding:

   a. "As the [***IPAA***] Court noted, 'a nonrecoupable settlement payment is never credited as payment for any gas actually severed from the ground. When gas is actually severed and sold to a substitute purchaser the settlement payment does not serve as payment for the gas.'"

   b. "Here, there is no agreement that all or a portion of the settlement payment would be applied to future production taken by NGPL or any other purchaser."

   c. MMS's assessment of royalties on the settlement payment by NGPL to EEX was arbitrary and capricious.

K. Royalty Clause Issues: Lessee Violated Implied Covenant to Market Through Various Affiliate Transactions. ***Seeco, Inc. v. Hales***, 22 S.W.3d 157 (Ark. 2000).

1. The facts:

   a. Southwestern Energy Company is the holding company for all the stock in:

      (1) SEECO, a production company; and

      (2) Arkansas Western Gas Company (AWG), a public utility that provides gas service to consumers.

   b. SEECO entered into a take-or-pay contract to sell gas to AWG.

   c. SEECO, to varying degrees, failed to enforce the pricing and take-or-pay provisions of its gas contract and it was sued, in a class action, by its royalty owners.

   d. Basic theory was SEECO breached its implied covenant to market gas for the mutual benefit of lessor and lessee.

   e. Lessors also asserted deceit, constructive fraud, fraudulent concealment, interference with a contractual relationship, and civil conspiracy.

   f. Jury awarded $93 million in damages and interest.

2. Analysis and holding:

   a. Supreme Court of Arkansas affirms the jury.

   b. Even the reduced contract prices paid by AWG to SEECO were attacked by the state public utility commission under its least-cost purchasing statute.

   c. AWG defended this administrative attack by having SEECO offer evidence SEECO had already given-up $295 million in unasserted claims under its gas contract with AWG

   d. Jury was unimpressed with the pass-through clause in the AWG/SEECO gas contract.

   e. Court notes that jury must have concluded there was a confidential or special relationship between SEECO and its royalty owners that imposed on SEECO an affirmative duty to disclose facts to its royalty owners regarding the gas contract and SEECO's actions regarding the contract.

   f. SEECO's witness testified it had a fiduciary duty to its royalty owners.

L. Royalty Clause Issues: Most Favored Nations Royalty Clause. ***Stinnett v. Colorado Interstate Gas Co.***, 227 F.3d 247 (5th Cir. 2000).

1. Dispute concerning settlement agreements regarding royalty due under most favored nations royalty clause.

2. Royalty owner Masterson wanted to make sure none of his neighbors ever got paid a higher royalty.

   a. "In the event that [CIG] should, at any time after July 1, 1967, voluntarily pay to any of its lessors in the West Panhandle Field royalty for gas produced from the West Panhandle and Red Cave Formations at a rate based on a price per Mcf higher than that price upon which royalties are then being computed and paid to Masterson hereunder, [CIG] agrees to pay to Masterson royalties at the rate of one-eighth (1/8) of such higher price from and after such time through the remainder of the lease."

   b. Gas contractors would call this as a "two party" favored nations clause.

M. Royalty Clause Issues: Expanded Termination Clause Included Failure to Pay Royalty. ***Coastal Oil & Gas Corp. v. Roberts***, 28 S.W.3d 759 (Tex. Ct. App.–Corpus Christi 2000).

1. The facts:

   a. Lessee insisted that lessor sign a division order as a condition to the lessee distributing the lessor's royalty.

   b. Lessor refused and made written demand for payment.

   c. After 30 days lessor asserted the lease terminated.

2. Analysis and holding:

   a. Usually failure to pay royalty is merely a breach of covenant that will not result in lease termination.

   b. But--Special lease clause:

      "If Lessee wrongfully or unreasonably withholds any such [royalty] payment or payments due to Lessor for a period of thirty (30) days after written demand for payment is made by Lessor on Lessee at the above address (or other such address as may be specified in writing hereafter by Lessee), at the election of Lessor this lease may be terminated."

   c. Lease terminated.

d. Lessor did not need to explain the particulars of the breach in his notice.

e. By Texas statute, the lessee can suspend royalty payments until a proper division order is signed (that complies with the statutory guidelines).

f. The boiler-plate indemnity clause in the tendered division order, in light of the "without warranty" lease, made it "wrongful" for lessee to rely on this as a basis for not paying royalty.

g. The statutory division order form applies only to oil, not gas.

h. When does a lessee typically send out a division order?

(1) When they have just finished drilling a successful well.

(2) Now they don't own a lease covering this lessor's interest in the well.

III. MISCELLANEOUS CASES OF INTEREST

A. Industry Custom and Usage Evidence in Oil and Gas Cases. *Energen Resources MAQ, Inc. v. Dalbosco*, 232 S.W.3d 551 (Tex. Ct. App.–Houston 2000).

1. The facts:

   a. Dalbosco farmed out leases to Energen for development.

   b. Energen drilled a well, operated it for several years, and then plugged it when it ceased producing.

   c. No operating agreement.

   d. Dalbosco sued Energen saying Energen should have given Dalbosco notice it proposed to abandon the well.

   e. Trial court refused to consider Dalbosco's offered custom and usage evidence that farmees give their farmors notice prior to plugging–and an opportunity to take-over the well.

   f. Trial court granted summary judgment to Energen.

2. Analysis and holding

   a. On appeal, reversed and remanded: "We held that the existence of custom and usage was an issue of fact and remanded to the trial court

for further proceedings."

b. On remand, trial court considered custom and usage evidence and the jury held: "(1) custom and usage in the oil and gas industry in 1981 imposed a contractual duty on Energen to give notice to Dalbosco of its intent to plug and abandon the well; and (2) Energen failed to comply."

c. Jury awarded Dalbosco $216,000 in damages and $140,000 in attorney fees.

d. Second Appeal: Affirmed.

e. Farmout agreement was not fully integrated.

f. "Evidence of custom and usage is admissible to add to a contract that is silent on a particular matter."

B. Scope of the Clean Water Act: Defining "Waters of the United States." ***Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers***, 531 U.S. 159 (2001).

1. The facts:

a. Clean Water Act regulates activities associated with "navigable waters."

b. Navigable Waters defined as: "waters of the United States, including

the territorial seas."

c. The Act's major programs are limited to activities associated with "waters of the United States." § 311, § 402, § 404

d. Corps, by regulation, defined "waters of the United States" broadly and asserted jurisdiction over "an abandoned sand and gravel pit in northern Illinois which provides habitat for migratory birds."

e. Issue: did Congress intend to regulate such activities under the Clean Water Act?

f. § 404(a) gives the Corps authority to issue permits "for the discharge of dredged or fill material into the navigable waters at specified disposal sites."

g. Corps' definition of "waters of the United States" includes:

"[W]aters such as intrastate lakes, rivers, streams (including intermittent streams), mudflats, sandflats, wetlands, sloughs, prairie potholes, wet meadows, playa lakes, or natural ponds, the use, degradation or destruction of which could affect interstate or foreign commerce . . . ."

h. Corps' clarification of its jurisdiction stated its authority extended to all intrastate waters:

"a. Which are or would be used as habitat by birds protected by Migratory Bird Treaties; or

b. Which are or would be used as habitat by other migratory birds which cross state lines; or

c. Which are or would be used as habitat for endangered species; or

d. Used to irrigate crops sold in interstate commerce."

i. The Corps determined the abandoned gravel pit was "waters of the United States" because it was visited by migratory birds.

j. The County wanted to use the area to build a site for baled non-hazardous solid waste.

k. Corps denied the County a § 404 permit.

l. 7th Circuit: the Act reaches as many waters as the Commerce Clause allows, including these.

2. Analysis and holding:

a. "In order to rule for [the Corps] here, we would have to hold that the jurisdiction of the Corps extends to ponds that are *not* adjacent to open water."

b. "We cannot agree that Congress' separate definitional use of the phrase 'waters of the United States' constitutes a basis for reading the term 'navigable waters' out of the statute."

c. "The term 'navigable' has at least the import of showing us what Congress had in mind as its authority for enacting the CWA: its traditional jurisdiction over waters that were or had been navigable in fact or which could reasonably be so made."

d. Court avoids the commerce clause issue:

"Permitting [the Corps] to claim federal jurisdiction over ponds and mudflats falling within the "Migratory Bird Rule" would result in a significant impingement of the States' traditional and primary power over land and water use."

3. Importance of the opinion to the oil industry: CWA § 311 is the part of the Act regulating oil spills and the Spill Prevention Control and Countermeasure Plan (SPCC Plan) program. The scope of § 311 is also defined, or limited, by the required nexus with "waters of the United States."

   a. Also impacted by the § 404 program which requires a permit to develop in areas classified as "wetlands."

   b. Also impacted by the § 401 NPDES permitting program which addressing discharges into "waters of the United States," including storm water discharges.

C. **Scope of the Oil Pollution Act of 1990: Defining "Waters of the United States."** ***Rice v. Harken Exploration Co.***, 2001 WL 422051, Case No. 99-11229 (April 25, 2001).

1. The facts:

   a. Landowners sue oil and gas operator seeing $38,537,500 in remediation expenses to address oil spills, salt water spills, and related soil and groundwater contamination.

   b. OPA: "navigable waters" = "waters of the United States"

2. Analysis and holding:

   a. Congress intended the terms to have the same meaning in the OPA as they have in the CWA.

   b. Groundwater is not included.

   c. Spills onto dry land are not included.

   d. "[A] generalized assertion that covered surface waters will eventually be affected by remote, gradual, natural seepage from the contaminated groundwater is insufficient to establish liability under the OPA."

   e. OPA permits action based upon a discharge or a "threat" of a discharge.

f. "[T]he Rices have failed to produce evidence of a close, direct and proximate link between Harken's discharges of oil and any resulting actual, identifiable oil contamination of a particular body of natural surface water that satisfies the jurisdictional requirements of the OPA."

D. Kansas Legislature Amends Compulsory Fieldwide Unitization Statute to Make it Easier to Unitize. K.S.A. § 55-1305.

1. Reduces the consent level from 75% to 63% of all working interest owners and royalty interest owners when the justification for unitization is enhance recovery following primary production.

2. Reduces the consent level from 75% to 63% of all working interest owners (however, royalty interest owner consent remains at 75%) when the justification for unitization is other than for enhanced recovery.

3. Overriding royalty interests are not "royalty" interests.

4. K.S.A. § 55-1308 provides a procedure through which the Kansas Corporation Commission can determine the "prevailing industry practice in the area" regarding the size of the royalty fraction to determine unleased mineral interest owner's designated royalty interest for voting purposes.