Chapter 1. Unmanned Aircraft Operations in the Energy and Mining Industries: An Overview of the Legal and Regulatory Landscape
Eric J. Murdock, Hunton & Williams LLP

Chapter 27. Clearing the Path to Unionizing America's Workforce: The NLRB's New Rules Governing Union Elections and Bargaining Units
Gregory B. Robertson and Kurt G. Larkin, Hunton & Williams LLP

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Preface

On behalf of the Energy and Mineral Law Foundation (EMLF), I am proud to present to you a compilation of the outstanding papers prepared in conjunction with the 36th Annual Institute of the EMLF held on June 21-23, 2015 at the Omni Amelia Island Plantation Resort in Florida.

The EMLF continues to attract a talented group of experienced energy law practitioners as reflected in the quality of research and resource material included in this volume.

The contributions to this year's edition reflect the continuing efforts of many volunteers who serve the EMLF with dedication and distinction. In particular, our Annual Institute Program Chair was Daniel W. Wolff, the Oil and Gas Chair was Joseph K. Reinhart and the Coal Chair was M. Shane Harvey.

My personal gratitude is extended to each of them for their hard work, good judgment and oversight in developing an outstanding program.

The EMLF extended its programming reach in 2015 by developing what we believe was the first ever stand-alone Midstream Conference in the Appalachian Basin. The Midstream Conference was held in April of 2015 in Canonsburg, Pennsylvania and was developed and chaired by Natalie N. Jefferis.

Our calendar of events also included the annual Kentucky Mineral Law Conference in October in Lexington. This conference was ably chaired by Timothy J. Hagerty, with Amber Nisbet Hodgon serving as Oil and Gas Chair and Nick S. Johnson as Coal Chair.

Each of these programs was well attended and continued the EMLF's reputation for excellent program content.

The EMLF excels in large part due to the devoted leadership of Executive Director Sharon Daniels, who has guided the EMLF for decades. Sharon is the heart and soul of the EMLF.

She receives excellent support from Carolyn B. May, long time CLE and Membership Coordinator. Sharon's commitment to the EMLF is unwavering as she pushes the organization toward an evolving and bright vision for the future.

In that regard, Sharon coordinated the development of the organization's 2014 strategic plan that resulted in the creation and revival of various subcommittees.

For example, despite challenging times for the energy industry, the EMLF added several new members in 2015 in large part due to the efforts of the Membership Committee led by co-chairs Joseph Tarantelli and Frank B. Harrington.

Our Programming Committee focused on developing long range planning for sustainable programming and was chaired by Daniel Wolff. The Law School Committee worked to enhance the organization's relationship with member law schools and was chaired by Natalie Jefferis. The Leadership Planning Committee was chaired by David Morrison and focused on succession planning. Our Governance Committee (which focused on reviewing the organization's by-laws) was chaired by Timothy Gresham. Finally, our Finance Committee, chaired by Erin Magee, continues to be a fine steward of the EMLF's endowment and other funds.

The EMLF also benefits from the service of a strong and dedicated Executive Committee that has successfully guided the organization through the challenging times facing the energy industry.

The EMLF remains fiscally strong and is dedicated to exceeding the expectations of its members and expanding its energy reach beyond traditional oil and gas and coal energy areas. We were pleased to award $50,000 in scholarships to deserving law students and to visit law schools throughout the country to promote careers in energy law.

The year was marred by the sudden death of one of our Executive Committee members, Russell L. Schetroma. Russ had been a devoted member and contributor to the EMLF for decades and the impact of his loss to the organization is difficult to overstate.

In fact, Russ's devotion to the EMLF will continue in perpetuity because his estate created a trust to assist law students with the expenses associated with attending future EMLF Annual Institutes. Separately, the EMLF has also set up a special Legacy Fund to honor Russ and other dedicated members of the EMLF who have passed away. A special tribute to Russ prepared by J. Thomas Lane is included in this edition.

I want to acknowledge once again the dedication and assistance of the EMLF's strong Executive Committee, Officers, Program Chairs, Executive Director and staff, and countless members who have given of their time and resources. In fiscal 2016, I am pleased that Vice-President/President-Elect G. Brian Wells assumes the responsibility for ably leading the EMLF during times of change and challenge.

We hope you will continue to support the EMLF and we thank the sustaining and other members of the EMLF for your financial as well as professional support.

Kevin K. Douglass
Babst Calland
President, 2014-2015

On May 9, 1986, Russ Schetroma appeared for the first time as a speaker at the 7th Annual Institute of what was then the Eastern Mineral Law Foundation. The meeting was in Charleston, West Virginia.

Dressed in a three-piece black suit, white shirt and tie, Russ, then unknown to most in the audience, took the podium. With his dark eyes and somewhat somber appearance, the audience wondered what it was in for.

His topic was "Oil and Gas Royalties: Apportionment as Achieved by State Law, Contract, and Administrative Action," a topic and article that remain timely to this day. The first glimpse of the "performance" we were in for came when Russ's wry smile lit up his face and for the next hour Russ both taught and entertained in a highly unique and effective way.

If the EMLF had a Speaker of the Year Award, Russ would have won it hands down.

On that day, the Foundation was introduced to one of its most popular, dynamic and entertaining speakers of all time. In his first hour, he set the bar for excellence as a speaker at any seminar anywhere. He was asked, and accepted, invitations to speak the very next year in 1987, and then again in 1990, 1998, 2003, 2009 and 2013.

Note: This tribute was given by J. Thomas Lane at the 36th Annual Institute held June 21-23, 2015 at Amelia Island, Florida.

Each presentation surpassed the last one. In short time, the ancillary problem that arose was that no one wanted to be slotted to speak opposite the slot Russ had.

Russ taught each of us many lessons; he enriched our lives and his superb papers will endure long into the future as a valuable resource.

When our dinner speaker could not show, Russ filled in at this annual dinner just one year ago and provided an insightful history of the EMLF.

Russ' scholarship was not limited to the EMLF. He published law review articles in the *Dickinson Law Review,* the *Annual Proceedings* of the Rocky Mountain Mineral Law Foundation and gave a multitude of presentations at special institutes and other venues.

As a lawyer, Russ was a founding member of Culbertson, Weiss, Schetroma and Shug, Meadville, Pennsylvania (1972 – 2010). In August 2010, his firm merged with Steptoe & Johnson where Russ served as the managing member of the Meadville and Houston offices and on the firm's Executive Committee.

Russ embraced his new firm and it seemed Russ' horizons expanded and his opportunities were unlimited at Steptoe. He grabbed hold tight and took full advantage.

Despite the demands of a busy practice and schedule, Russ undertook pro bono legal work and received special recognition from the Pennsylvania Bar Association.

His civic life in his hometown of Meadville was rich and Russ was fully engaged. For 35 years he served the town as solicitor. In this capacity he voluntarily drafted the municipal code for Third Class Cities in Pennsylvania.

Russ was an active member of the Stone United Methodist Church in Meadville where he served many years as a lay leader.

In addition to being recognized by the Pennsylvania Bar for Outstanding Contributions to Pro Bono Services, he was selected as a top lawyer by *Best Lawyers in America* and most significantly Russ received the John L. McClaugherty Award, the highest honor and recognition made by this Foundation.

Russ' untimely death prompted many members of this Foundation to seek a means to remember Russ with a financial contribution. The result was the creation of the EMLF Legacy Fund which will be a permanent vehicle for members and friends to make living and testamentary contributions to the EMLF. A permanent tribute has been recorded for Russ with a dedicated account which is expected to reach $14,000 in the near future.

The fund can be used at the discretion of the Executive Committee with special consideration given to providing stipends for law students for research and writing, to funding research, presentations and writing by professors or other recognized speakers and for scholarships.

Through hard work and scholarship, Russ made himself one of those we call the top one percenters.

As lawyers and landmen we come to know intimately who the really good lawyers are, the go-to people if we need good advice. Russ was that kind of lawyer.

This room, though, is filled with members who follow Russ' example of scholarship. I suggest that by your attendance here and your scholarship you, also, are top one percenters.

This Foundation has a primary goal of education, and accomplishes it in spades with members like Russ Schetroma. But, it has evolved to have a highly important secondary function, and that is to provide a meeting place for some of the best lawyers in America. Look around; you are here.

It is here that we make acquaintances, know who the good lawyers and landmen are and often make lasting friendships. This is how I had the privilege of becoming a good friend with Russ Schetroma.

To offer a little snippet of that friendship: In 2002, I was preparing a lecture for my Coal, Oil and Gas course at the College of Law at West Virginia University. The topic was mineral ownership and I was curious whether Pennsylvania still adhered to the *Dunham* rule as modified in *Bundy* where the Pennsylvania Court held that oil and gas are not "minerals." So, I sent an email to Russ.

> The answer was pure Russ: "We still follow the *Dunham* rule with the *Bundy* qualification — it's a matter of intent of the parties, so you basically always have an ambiguity with the potential for parol [evidence].
>
> I had a wonderful old county case that I have not been able to locate the last several times I have wanted it, but have a better rule ("Russ Rule"): If an instrument is drawn by a lawyer "minerals" does not include oil or gas, because lawyers should know the *Dunham* rule; if an instrument is drawn by a non-lawyer, "minerals" does include oil and gas, because everybody but lawyers would assume that it did!"

How do I sum up all of this and say who Russ was and what he stood for? If I were to use Russ' own words as a dog lover, he would say, "I can only hope to have been as good a person as each of my canine friends thought I was."

Who Russ was is stated more poignantly in *what he did*. Russ was a philanthropist and his last testament created a permanent charitable endowment with the Crawford Heritage Community Foundation in Crawford, Pennsylvania.

He left the bulk of estate to this Foundation for the support in perpetuity of the Meadville Public Library, the Chautauqua Institution's Department of Religion and to the EMLF.

As to the EMLF, the funds are to be used to *provide travel and lodging assistance to law students seeking to attend the EMLF Annual Institutes*.

Think about that: To law students so that they can travel and attend this meeting. Stated more broadly, it will enable the youths who follow each of us to be introduced to the benefits of the highest quality education programs available, to the values of this Foundation and to the best lawyers and landmen in America who attend these meetings.

I am reminded of the poem, *The Bridge Builder*.* It is about an old man who must cross a chasm vast and deep and wide through which was flowing a sullen tide.

According to the poem, the old man crossed without fear. But, from the other side he built a bridge to span the tide.

The poem concludes with a query from a fellow pilgrim:

"Old man," said a fellow pilgrim, near,
"You are wasting strength with building here;
Your journey will end with the ending day;
You never again will pass this way;
You've crossed the chasm, deep and wide.
Why build you this bridge at the evening tide?"

"Good friend, in the path I have come," he said,
"There followeth after me today,
A youth, whose feet must pass this way.

This chasm, that has been naught to me,
To that fair-haired youth may a pitfall be.
He, too, must cross in the twilight dim;
Good friend, I am building this bridge for him."

In his final testament Russ challenged each of us: What bridges will we build for those young pilgrims who follow us?

---

* *The Bridge Builder* was written by Will Allen Dromgoole, 1900.

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Chapter 1

Unmanned Aircraft Operations in the Energy and Mining Industries: An Overview of the Legal and Regulatory Landscape

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§ 1.01. Introduction.

In recent years, the combination of improved capabilities and reduced cost has made the use of unmanned aircraft systems (UAS) an attractive technology for a wide range of commercial and industrial applications. Once the exclusive province of the military and hobbyists, UAS (commonly known as "drones") are now being used for motion picture and television filming and general aerial photography, surveying and mapping, monitoring and inspection of vertical and linear infrastructure, such as oil rigs and pipelines, and large scale landscapes such as surface mines and farm land. Some envision the use of UAS to deliver packages and pizza, and are actively pursuing research and development to that end.

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Although the technology is readily available and increasingly inexpensive, the operation of UAS within the National Airspace System — which for UAS means pretty much anywhere out-of-doors — requires compliance with (or exemption from) Federal Aviation Administration (FAA) regulations and implicates a number of other legal considerations. As can be expected with the opening of any new technological frontier, a conflict has arisen between the goals of commerce and those of government. Businesses are looking to maximize the commercial uses of UAS and expedite innovation. Although federal, state and local governments share the interest in promoting economic growth, they are also responsible for ensuring national security and public safety and are increasingly under pressure to address concerns about individual privacy as well. This chapter will provide an overview of the developing legal and regulatory landscape for the use of unmanned aircraft in commercial applications in the United States, in particular in the energy and mining sectors.

§ 1.02. Unmanned Aircraft Systems.

Unmanned aircraft come in many shapes and sizes depending on their function. UAS used in military applications, such as the "Predator" drone, can be as large as manned aircraft and capable of carrying (and delivering) large payloads. At present, unmanned aircraft used in the commercial sector are typically much smaller, and are similar in size and appearance to the kinds of "model" aircraft used for recreational purposes and available for purchase at many hobby shops and retail electronic stores (although often employing substantially more sophisticated technology). As discussed below, for regulatory purposes, the FAA defines a "small" UAS as one that weighs less than 55 pounds.[1] This category covers most UAS currently used in commercial and industrial applications and accommodates the use of cameras or sensing equipment on the aircraft. This chapter will focus on the small UAS category.

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1 FAA Modernization and Reform Act of 2012, 49 U.S.C.A. § 40101 Sec. 331. Definitions (6).

Small UAS take one of two basic forms. Most common are "rotor craft" which operate much like a manned helicopter, with vertical take-off and landing and capability to hover in place and move in any direction in three-dimensional space. The least expensive rotor craft targeted to hobbyists typically use four rotors, but more sophisticated aircraft intended for serious commercial and industrial applications often use six or even eight rotors for increased reliability and operational capability even if one of the rotors should fail. Less common, but still appropriate for certain applications (such as extended flights along a linear corridor), are fixed wing unmanned aircraft. These are typically launched using a small catapult or even by hand, and land like a conventional manned fixed wing aircraft, albeit somewhat less gracefully.

Most small UAS operate using electric motors with on-board batteries (along at least one company is marketing a solar powered fixed wing aircraft). Payload limitations constrain the battery capacity which means that flying times are typically limited to no more than an hour or two. The aircraft are operated remotely by radio frequency using a ground-based command station (which may be simply a laptop computer or tablet). They can be operated manually much as a pilot would control a manned aircraft, but in most commercial applications operation is governed by pre-programmed GPS coordinates. More sophisticated systems include "homing" capability that directs the aircraft to a safe landing at a pre-determined location if the communication link to the command station is lost.

§ 1.03. UAS Applications for the Energy and Mining Sectors.

Unmanned aircraft are already being used for a variety of applications in the energy and mining industries. In general, UAS are well suited for tasks that are dirty, dull, or dangerous. Several large electric utility companies have obtained FAA approval to use UAS to inspect transmission line corridors and monitor conditions within linear rights-of-way on both a routine basis and in response to outages.[2] Oil and gas companies have obtained FAA

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[2] As discussed *infra* at § 8.04 [2], at present, all commercial UAS operations must be approved by the FAA on a case-by-case basis. The FAA maintains a listing of all such

approval to use UAS to inspect flare stacks and monitor remote drilling and extraction operations. Several UAS operators have obtained FAA approval to inspect and survey surface mining operations. For these applications, UAS operations are generally safer, more efficient, and less expensive than the use of manned aircraft or other means. As the technology develops, and regulatory flexibility expands, many more commercial and industrial applications for UAS are likely to be found.

§ 1.04. FAA Regulation and Integration of UAS into the National Airspace System.

[1] — Background.

The Federal Aviation Act of 1958 established the FAA and charged the agency with responsibility for regulating the use of "navigable airspace" within the United States.[3] The FAA views its primary mission to be the safe and efficient of operation of aircraft — with safety always the top priority. To accomplish this mission, the FAA established the National Airspace System (NAS), which consists of both infrastructure — a network of air navigation facilities, air traffic control facilities, and airports — and operational rules and regulations. Known collectively as the Federal Aviation Regulations (or FARs), these rules govern, among other matters, the certification of aircraft, pilot qualifications, and aircraft operations.[4]

The FAA considers UAS to be "aircraft" subject to the FARs, and in 2007 the agency issued a notice stating that "no person may operate a UAS in the National Airspace System without specific authority."[5] The FAA's regulatory authority under the Federal Aviation Act applies to "the navigable airspace," which is defined as "the minimum altitudes of flight prescribed by regulations" issued pursuant to the statute.[6] The FARs specify certain

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authorizations, and provides access to the authorization documents, at the following web site: http://www.faa.gov/uas/legislative_programs/section_333/333_authorizations/.

3 49 U.S.C. §40103(b).

4 14 C.F.R. Parts 1-199.

5 Federal Aviation Administration, "Unmanned Aircraft Operations in the National Airspace System," 72 Fed. Reg. 6689-6690 (Feb. 13, 2007).

6 49 U.S.C. §40102(a)(32). The FAA thus has discretion to set the geographic limits of its own regulatory authority.

minimum altitudes for aircraft operations — for example, 500 feet above the ground surface in uncongested areas (except as necessary for takeoff or landing).[7] Arguably, in such areas (and away from airports) the space below 500 feet — where many UAS operations occur — is not within the "navigable" airspace, and thus not subject to the FAA's statutory jurisdiction. The FAA plainly takes a different view, however, at least with respect to UAS, having recently pursued a successful enforcement action against a UAS operator for allegedly reckless operations as low as 10 feet above the ground.[8] As a practical matter, therefore, anyone operating a UAS anywhere out-of-doors should expect to comply with the FARs.[9]

Unfortunately, the FARs were developed in the context of manned aircraft and in certain respects do not translate well to UAS. A core principle under the FARs is the requirement that "vigilance shall be maintained by each person operating an aircraft so as to see and avoid other aircraft."[10] Given the absence of an on-board pilot, however, UAS cannot be presumed to be capable of meeting this requirement. Similarly, the lack of on-board pilot and communications capabilities means UAS cannot receive and respond to instructions from air traffic control operators. In addition, the physical constraints of small UAS preclude compliance with some requirements under the FARs, such as the requirement to maintain documentation on board the aircraft. As a consequence, other than for strictly recreational purposes, UAS cannot be operated legally in the navigable airspace of the United States without specific authorization from the FAA providing relief from the provisions of the FARs that cannot be met.

It has been recognized for years that this situation presents a significant obstacle to realizing the substantial benefits from the commercial use of

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7 14 C.F.R. §91.119(c).

8 *See* Huerta v. Pirker, NTSB Order No. EA-5730, Docket CP-217 (2014).

9 The term "National Airspace System" refers to the FAA's "system" for regulating aircraft operations, and does not define a geographic space. The only term defined by statute or regulation delineating the geographic scope of FAA jurisdiction for aircraft operations, and thus the real-world space within which the National Airspace System functions, is "navigable airspace."

10 14 C.F.R. §91.113(b).

UAS technology. Congress sought to address this problem in the Federal Aviation Administration Modernization and Reform Act ("FMRA") of 2012 by tasking the Secretary of Transportation with developing a comprehensive plan for the full integration of UAS into the National Airspace System by September 30, 2015.[11] Although the FAA is behind schedule to meet that deadline, it has been making progress. It created the Unmanned Aircraft Systems Integration Office and in 2013 issued a "road map" outlining the plan to move from the initial accommodation of UAS on a limited basis to full integration into the NAS. In the fall of 2014, the FAA issued the first "exemption" pursuant to Section 333 of the FMRA authorizing the use of UAS on a case-by-case basis. On February 23, 2015, the FAA published a notice of proposed rulemaking to establish a new regulatory program that would generally authorize the operation of small UAS under certain conditions. These latter two developments are discussed further in the next sections.

[2] — Section 333 Exemptions.

Section 333(a) of the FMRA directs the Secretary of Transportation (acting through the FAA) to "determine if certain unmanned aircraft systems may operate safely in the national airspace before completion of the plan and rulemaking required by section 332 of this Act."[12] Relying on this authority, the FAA has established an "exemption" process for granting individual authorizations for the operation of UAS on a case-by-case basis as an interim measure until the FAA promulgates regulations providing for the general operation of UAS in the National Airspace System.[13]

There are three elements to the exemption process. First, where warranted by the specific circumstances, the FAA relies on express authority under Section 333(b) of the FMRA to waive the requirement for an airworthiness

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11 FMRA, § 332(a), Pub. Law 11-95 (Feb. 14, 2012).

12 FMRA § 333(a).

13 *See* FAA Home – Unmanned Aircraft Systems – Key Initiatives – Section 333; http://www.faa.gov/uas/legislative_programs/section_333/.

certification for a particular model of UAS.[14] This eliminates the need for a detailed evaluation of the aircraft by the FAA to determine that it has the necessary capabilities to operate safely in the National Airspace System, a process that typically takes several years. Second, the FAA relies on existing statutory and regulatory authority to grant exemption from specific FARs upon a finding that such exemption is in the public interest.[15] Finally, the petitioner must obtain a Certificate of Waiver or Authorization ("COA") from the local FAA Air Traffic Organization for the specific UAS operation in the National Airspace System.

A petition to the FAA for exemption from the FARs must (i) identify the specific sections of the FARs from which exemption is sought, (ii) describe the extent of and reason for the relief sought, (iii) explain how granting the exemption would benefit the public as a whole (*i.e.*, why it is in the public interest), and (iv) explain how an equivalent or greater level of safety will be achieved by the grant of the exemption.[16] In practice, Section 333 exemption petitions for UAS operations typically include information about the specific aircraft, including technical specifications and user manuals, and describe the specific purpose and geographic locations of the proposed UAS operations. The petition also typically includes some kind of flight operating protocol

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14 FMRA § 333(b) (requiring the Secretary to determine "which types of unmanned aircraft systems, if any, as a result of their size, weight, speed, operational capability, proximity to airports and populated areas, and operation within visual line of sight do not create a hazard to users of the national airspace system or the public or pose a threat to national security," as well as whether an airworthiness certification is required for any such unmanned aircraft systems).

15 The FAA Administrator is authorized by several statutory provisions to issue exemptions from the FARs in appropriate circumstances. For example, the Administrator "may grant an exemption from a regulation prescribed in carrying out sections 40103(b)(1) and (2), 40119, 44901, 44903, 44906, and 44935-44937 of this title when the Administrator decides the exemption is in the public interest." 49 U.S.C. § 40109(b). Likewise, the Administrator "may grant an exemption from a requirement of a regulation prescribed under subsection (a) or (b) of this section or any of sections 44702-44716 of this title if the Administrator finds the exemption is in the public interest." 49 U.S.C. § 44701(f). Pursuant to these statutory authorities, the FAA regulations allow a party to request relief from the FARs by submitting a petition for exemption to the FAA. 14 C.F.R. § 11.61.

16 14 C.F.R. § 11.81.

that outlines operator qualifications, pre-and post-flight safety check and maintenance procedures, and in-flight operating parameters and limitations as a basis for demonstrating that the proposed operations will provide for at least an equivalent level of safety as would be achieved through compliance with the requirements from which relief is sought.

The FAA granted the first Section 333 exemptions in September and October of 2014 authorizing the operation of UAS for closed-set motion picture and television filming. Over the next several months, the FAA issued additional exemptions for aerial surveying and photography, flare stack inspections, agricultural analysis, aerial monitoring of controlled access oil and gas facilities, and bridge inspections, among other uses. All of these exemptions, which are valid for two years, include the same general terms, conditions and limitations. The exemption only authorizes the use the specific aircraft identified in the petition. The initial exemptions limited the UAS operations to the specific purpose described in the petition. More recent exemptions, for which the FAA has developed a more or less standard list of conditions, do not expressly limit the purpose for which the UAS operation is authorized, although the exemption document elsewhere notes the specific purpose described in the petition. For these more recent exemptions, it is unclear whether the UAS operation is strictly limited that the petitioner's stated purpose or whether other uses are authorized as long as they comply with all of the specified operational limitations.

The operational limitations are largely the same for each exemption, regardless of the aircraft to be used or the specific purpose of the operations. The primary requirement, which is intended to satisfy the "see and avoid" requirement, is the use of both an operator and a visual observer each of whom must have a visual line of sight to the UAS at all times. Other standard operational conditions and limitations include: (i) a maximum speed of 87 knots (100 miles per hour), (ii) a maximum altitude of 400 feet above ground level, (iii) operations only during daylight hours and under conditions of good visibility, (iv) no operations within 5 miles of an airport without written permission from the airport operator, (v) no operations within 500 feet of any nonparticipating persons, vessels, vehicles or structures (subject to certain exceptions where adequate safety measures are taken), and (vi) all

operations must be conducted over private or controlled-access property with permission from the property owner. In addition, the operator must hold at least a private, recreational, or sport pilot's license from the FAA.

Through mid-March of 2015, the FAA had granted 37 individual exemptions. These first exemptions prompted a wave of additional applications and a backlog quickly developed. To address this problem, in early April the FAA began to use what it described as a "summary grant" process to streamline its review of Section 333 exemption petitions. Under this process, the FAA issues exemptions based on the analysis conducted for exemptions previously granted for essentially the same kind of operations using the same or similar aircraft. Employing this new process, the FAA has significantly accelerated pace of its review. As of June 30, 2015, nearly 700 exemptions had been granted, although hundreds more remain in the queue as the early approvals have sparked interest from other prospective users of UAS for commercial purposes. In a further effort to expedite the use of UAS, the FAA announced in late March of 2015 that it would begin issuing a "blanket" COA with each Section 333 exemption that would authorize the operation of UAS below 200 feet and beyond certain minimum distances from airports, thus eliminating the need to obtain an individual COA for UAS operations occurring within these geographic limits, which likely accommodate the majority of such operations as presently authorized under Section 333 exemptions.

[3] — Proposed Rule to Authorize the Operation of Small UAS.

On February 23, 2015, the FAA published a notice of proposed rulemaking concerning the operation of small UAS.[17] The proposed rule would create a new regulatory program within the FARs applicable to UAS weighing less than 55 pounds. Under the rule, the operation of such aircraft would be generally authorized subject to certain standard limitations similar, but not identical, to the limitations typically imposed in connection with

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17 80 Fed. Reg. 9544 (Feb. 23, 2015).

Section 333 exemptions. These conditions and limitation include: (i) visual line of sight operations only (but no requirement for a visual observer), (ii) no flight over any persons not directly involved in the operation, (iii) operations only during daylight hours and visibility of at least three miles from the control station, (iv) maximum speed of 87 knots (100 miles per hour); (v) maximum altitude of 500 feet above ground level; (vi) operations allowed in Glass G airspace without need for COA from local Air Traffic Organization. The proposed rule would not require an airworthiness certification for small UAS, and would not require the operator to have a pilot's license, but would require an unmanned aircraft operator certificate with a small UAS rating to be issued under a new certification program.

In its proposal, the FAA requested public comment on a variety of topics, and approximately 4500 comments were submitted by the time the comment period closed on April 24, 2015. The FAA is under no legally imposed deadline to take action on the proposed rule. However, an agency official recently advised a House panel that the small UAS rule is expected to be finalized by June of 2016.[18]

If the rule is issued as proposed, it would likely accommodate a wide range of potential applications in the energy and mining sectors. Nonetheless, as outlined below, some of the proposed limitations could significantly constrain such applications.

[a] — Visual Line of Sight Limitations.

The proposed rule would impose fairly strict "visual line of sight" (VLOS) limitations. Although the proposal would not require the UAS operator to maintain actual visual contact with the aircraft at all times, the operator must be "capable" of visual contact with the UAS at all times, even if a visual observer is used. Although the FAA is aware of the advancements in "first person view" technology by which the operator would view images

18 Testimony of Michael Whitaker, FAA Deputy Administrator, Hearing, "Drones: The Next Generation of Commerce?" before U.S. House of Representatives Committee on Oversight and Government Reform, June 17, 2015.

from a camera mounted on the UAS,[19] it believes this technology is not sufficiently advanced to satisfy the "see-and-avoid" requirement that is "at the heart of the FAA's regulatory structure mitigating the risk of aircraft colliding in midair."[20] The VLOS requirement substantially limits the distances that can be covered by UAS operations during a given flight.

[b] — No Operations from a Moving Aircraft or Land-Borne Vehicle.

The proposed rule would prohibit the operation of UAS from a moving aircraft or land-based vehicle.[21] This reflects the FAA's approach for mitigating the risk of loss of positive control over the aircraft by constraining the lateral extent of UAS operations. As with the VLOS requirement described above, this restriction by design limits substantially the distances that can be covered by UAS operations during a given flight. For a linear facility, such as a pipeline, the operation of UAS from a vehicle traveling within the right-of-way corridor could greatly enhance the efficiency of the operation, with seemingly little if any adverse effect on the safety of the operation. In its proposal, the FAA acknowledged that it "is considering alternatives for regulation of the operation of small UAS from moving land vehicles, while protecting safety"[22] and specifically invited comments on a regulatory framework for such operations.

[c] — Daytime Operations Only.

In line with the standard limitations specified for Section 333 exemptions, the proposed rule would limit UAS operations to daylight hours (official sunrise to sunset hours, local time). This restriction is intended to ensure

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19 "First person view" refers to real-time video images of the surrounding airspace from on-board cameras that provide a perspective similar to that of an on-board pilot.

20 80 Fed. Reg. at 9560.

21 Unlike the Section 333 exemption grants to date, the proposed small UAS rule would permit the operation of the UAS from a water-borne vehicle based on the rationale that a loss of positive control of an aircraft over water would be less likely to injure a person or property.

22 80 Fed. Reg. 9544, 9562 (Feb. 23, 2015).

the visibility of the aircraft, the surrounding airspace, and even people on the ground. While noting that existing federal aviation regulations impose extensive lighting requirements on manned aircraft operations (that could be quite cumbersome for UAS), the FAA invited comments on how to mitigate the risk of UAS operations during low-light or nighttime operations.

§ 1.05. Privacy Considerations.

The rapidly expanding use of UAS by hobbyists, businesses, and government agencies has raised concerns about the use (or misuse) of the technology in a way that threatens personal privacy interests.[23] No one welcomes the prospect of a camera-equipped drone hovering outside a bedroom window, although existing "peeping Tom" prohibitions presumably would apply to such an activity. UAS technology also provides new perspectives that implicate novel privacy considerations. For example, outdoor activities behind a backyard wall or fence that are generally shielded from public view by someone observing from the ground can be brought into plain view by means of a drone operating 100 feet above a neighboring property. As discussed Section 1.06 below, a number of states have enacted or are considering new laws to address this circumstance by restricting or prohibiting the use of UAS to capture images of third parties without their consent.

The FAA has taken a neutral stand, imposing no standards or limitations related to privacy in either its proposed small UAS rule or in setting the terms and conditions for Section 333 exemptions.[24] However, another federal agency has been charged with the task of coordinating efforts between various public and private stakeholders to develop privacy standards for commercial UAS use. On March 4, 2015, in response to a directive from the President, the U.S. Department of Commerce's National Telecommunications and

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23 As used here, "privacy" refers to the interest of an individual in avoiding observation by others when engaging in conduct for which such individual has a reasonable expectation of privacy, as well as avoiding the recording and dissemination of images of identifiable persons engaging in such private conduct.

24 The FAA expressly stated that privacy issues were "beyond the scope" of its small UAS proposed rulemaking. 80 Fed. Reg. at 9552.

Information Administration (NTIA) announced a multi-stakeholder process seeking comments on best practices concerning privacy, transparency, and accountability issues related to commercial and private use of UAS. As part of this process. NTIA plans to convene a series of public meetings following the initial round of comments, which were due by April 20, 2015. Where this process will lead remains to be seen. One possibility is the development of set of general standards that businesses can adopt as part of their own privacy policies for UAS operations. In light of the many new state laws designed to protect against invasion of privacy by means of UAS, commercial UAS operators would be well advised to adopt policies making clear that they do not use the technology to observe or record identifiable persons not involved in the operation.

In addition, recently filed litigation seeks to compel the FAA to weigh in on privacy issue despite its desire to remain neutral. On March 31, 2015, the Electronic Privacy Information Center (EPIC) filed a petition with the U.S. Court of Appeals for the D.C. Circuit alleging that the FAA unlawfully failed to address privacy in its proposed rule for small UAS, and challenging the FAA's denial of EPIC's petition requesting the agency to issue rules to protect against threats to privacy and civil liberties from the operation of UAS in the United States.[25] This litigation is still in the early stages, and the outcome remains to be seen.

§ 1.06. State and Local Laws and Regulations.

Over the past couple of years, prompted primarily by privacy concerns, many states have enacted or are actively considering legislation to regulate the use of UAS. Much of this legislation is focused on the use of UAS for surveillance by state and local law enforcement agencies, and involve restrictions on the collection and retention of surveillance data, but in many cases the prohibitions also apply to private or commercial UAS operations. For example, in April of 2015, the state of Florida enacted legislation that prohibits *any person* (in addition to any state agency or political subdivision)

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25 Electronic Privacy Information Center v. FAA, No. 15-1075 (D.C. Cir. Mar. 31. 2015).

from using UAS to capture images of private real property or individuals on such property under circumstances where a reasonable expectation of privacy exists without written consent from the affected parties.[26] The law creates a presumption that a person has a reasonable expectation of privacy on any private property which cannot be seen by persons located at ground level from a place where they have a legal right to be, and creates a private right of action for compensatory and punitive damages for a violation of the prohibition.[27] The bill also creates an exception to this prohibition for the use of UAS by an electric, water, or natural gas utility for operation and maintenance of utility facilities.[28]

Some state laws governing UAS operations go beyond prohibitions against unauthorized surveillance. For example, in 2014, North Carolina enacted a law that requires any person operating UAS for commercial purposes to obtain a license from the Division of Aviation of the state Department of Transportation.[29] This is in addition to the pilot licensing requirements imposed by the FAA. At the state level, the legal landscape regarding the operation of UAS likely will continue to change over the next few years, and businesses operating UAS will need to pay close attention to state and local legal requirements to ensure that such operations fully comply with the law.[30]

§ 1.07. Property Rights.

Because UAS are typically operated at altitudes much lower than manned aircraft, the integration of UAS into the National Airspace System likely will result in new legal conflicts between the rights of property owners and the

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[26] Enacted as Senate Bill 766, the law amends the "Freedom from Unwarranted Surveillance Act" codified at § 934.50 of the Florida Statutes.

[27] Fla. Stat. § 934.50(3)(b),(5) (2015).

[28] Fla. Stat. § 934.50(4)(f) (2015).

[29] House Bill 1099 (amending Chapter 15A of the North Carolina General Statutes to add a new Article 16B, "Use of Unmanned Aircraft Systems").

[30] There are a number of web sites that track state UAS laws. For example, the National Conference of State Legislatures maintains such a site at http://www.ncsl.org/research/civil-and-criminal-justice/2014-state-unmanned-aircraft-systems-uas-legislation.aspx.

rights of persons operating UAS for otherwise lawful purposes. A central question is whether, and to what extent, a property owner has a legal right to prohibit UAS from flying over his property. As noted above, commercial UAS operations authorized by a Section 333 exemption require the property owner's permission. The proposed small UAS rule, however, imposes no such requirement and would generally authorize the operation of UAS in any airspace not subject to air traffic control (Glass G airspace). The rule also would confirm that the "navigable airspace," at least for UAS, extends to altitudes below 500 feet, where conflicts between UAS operations and the use and enjoyment of the underlying land are most likely to arise. This section outlines the issues and discusses some of the competing legal claims with which courts and legislatures will have to contend.

English common law provided the legal background for the American concept of airspace rights through the writings of such authors as Edward Coke and William Blackstone. Perhaps the most famous maxim of English law that was carried through to modern times is "*cujus est solum, ejus est usque ad coelum*" (whoever has the land possesses all the space upwards to an indefinite extent).[31] This rule remained an important concept of property law until the invention of the airplane and the birth of the aviation industry.

Early cases in American history dealt with airspace rights in close proximity to the ground, such as who owned the fruit falling from overhanging tree branches[32] and whether a landowner could enjoin the stringing of telephone lines over his property.[33] Landowners often prevailed, but even in the case of pears falling from overhanging tree branches onto another person's property, the court held that the landowner was only entitled to remove the branches, not to convert the branches or fruit to his own use.[34] Eventually, technological advancements would force the courts to define

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31 Robert R. Wright, *The Law of Airspace*, 7 (1968).

32 *See* Lyman v. Hale, 11 Conn. 177 (1836) (finding that a landowner was entitled to remove overhanging branches on his property but was not entitled to keep the fruit from the branches since he did not own it).

33 *See* Butler v. Frontier Telephone Co., 109 App Div 217, 95 NYS 684 (1905) (allowing a landowner to eject telephone lines strung above his property).

34 *Lyman*, 11 Conn. at 184.

the limits of airspace rights more precisely and balance the interests of landowners against the claims of aviation. Several theories of airspace rights have been advanced at different times and places throughout U.S. history, including the following: absolute ownership of all airspace above the land, ownership of airspace subject to a public privilege of flight, ownership up to a fixed height, ownership up to the landowner's ability to take effective possession, and no ownership except for the space that the landowner actually occupies.[35]

The U.S. Supreme Court eventually set an important precedent regarding airspace rights in *U.S. v. Causby*,[36] a case involving U.S. military flights over a chicken farm located near a municipal airport. The landowner claimed that flights at altitudes as low as 83 feet above ground by large and loud military aircraft amounted to a taking of his property because the flights disrupted his daily activities, frightened his animals, and eventually forced him to shut down the chicken farm.[37] The Court held that the common law doctrine that a property owner holds rights to an infinite extent in the airspace above his property "has no place in modern world," but nonetheless concluded that the landowner had a property interest in "at least as much of the space above the ground as he can occupy or use in connection with the land" and had a right to "exclusive control of the immediate reaches of the enveloping atmosphere."[38] Applying that standard, the Court ruled that flights at altitudes so low as to prevent the landowner from continuing to use the property to raise chickens was an invasion of the landowner's property rights.

In reaching this decision, the Court considered the competing interest of the public in air navigation. At that time, "navigable airspace" was defined by statute as "airspace above the minimum safe altitudes of flight prescribed by the Civil Aeronautics Authority," and the minimum safe altitude during daylight hours was set by regulation at 500 feet.[39] In the Court's view, the

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35 Wright, *supra* at 145.

36 U.S. v. Causby, 328 U.S. 256 (1946).

37 *Id*. at 259.

38 *Id*. at 264.

39 *Id*. at 260.

public aviation easement established by federal law did not extend below the designated 500-foot minimum altitude for safe flight, and thus the take-off and landing operations at issue were deemed to occur outside of the "navigable airspace." The Court thus avoided the need to resolve any conflict between the landowner's rights to the airspace above his property and the navigable airspace that Congress had placed within the public domain.

Under the current FAA regulations, the minimum safe altitude for air navigation is 500 feet above the ground, which presumably defines the floor for the navigable airspace. Most UAS operations take place in the very airspace that is not typically used for navigation by manned aircraft, and thus not traditionally considered part of the navigable airspace, at least as interpreted by the Supreme Court in *Causby*. As noted above, however, the FAA has asserted regulatory jurisdiction for UAS below 500 feet, raising a question about what currently constitutes navigable airspace. Moreover, if the small UAS rule is issued as proposed, then the minimum safe altitude defined by regulation, and thus the "navigable airspace," would extend all the way to the ground, at least for UAS. In that event, the public right of transit through the navigable airspace established by federal statute would appear to authorize the use of UAS over any property at any altitude, regardless of the property owner's objection.[40]

Against this background, it is uncertain whether a landowner would be able to maintain an action for trespass against a person who operates a drone

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40 This issue is illustrated by a current legislative effort in California to define the circumstance when the flight of an unmanned aircraft over private property may be considered a trespass. As originally drafted, the bill in question (SB 142) targeted flights below the "navigable airspace" as defined by federal law. A law professor at Pepperdine University, Gregory McNeal, commenting on the proposal, pointed out that, at least for UAS, the FAA considers the navigable airspace to extend down to the ground surface, in which case the proposed law would not achieve its objective. *See* Http://www.forbes.com/sites/gregorymcneal/2015/02/16/californias-drone-trespass-bill-is-great-except-for-one-fatal-flaw/. At Professor McNeal's suggestion, the bill was subsequently amended to draw the line for trespass at 350 feet above the ground, so as to leave room for UAS overflights in the space between 350 and 500 feet. The amended bill was passed by the California Senate on May 5, 2015, and was referred to the California State Assembly for consideration. Even if this bill is eventually enacted into law, a question remains whether it would be preempted by federal law purporting to define "navigable airspace" for UAS all the way to the ground.

over his property without his permission. An alternative approach that may avoid some of these unsettled property rights questions would be a claim for nuisance to prevent incursions into the space above private land. A nuisance claim typically requires the landowner to demonstrate some interference with the use and enjoyment of the land, but does not require a claim of property right to the airspace in which the UAS operates. Common factors in airspace nuisance claims involve excessive noise, dust, smoke, health issues, fear of injury, diminution in property value, and the loss of the use of the premises for certain purposes.[41] As a practical matter, however, the ability to prosecute a nuisance abatement suit could be hampered by the difficulty in identifying the offending UAS operator.

There may also be some self-help measures available to property owners concerned about unauthorized UAS operations over their land. Various UAS "counter-technologies" are beginning to appear in the marketplace, including drone detection via acoustics, electronic signal detection and disruption, and even devices for physical UAS interdiction (although it is worth noting that if a UAS is considered "aircraft" by the FAA then it could be a federal crime to attack or destroy one). Some counter-technologies concentrate on detecting a UAS, either by perceiving the sound the UAS makes during flight or sensing the electronic signals that are sent to and from the UAS. For example, one company claims that its equipment can detect the radio frequencies and GPS signals used for UAS operations.[42] These electronic signals could be detected and possibly disrupted under certain circumstances, but jamming devices in the United States are strictly controlled and typically limited only to government use. Another company has designed a product that detects wireless surveillance devices, such as a UAS-mounted camera or sensor that is attempting to use the landowner's wireless network to stream data to another location, and prevents them from connecting to the landowner's network.[43] This at least prevents surveillance data from being streamed to the trespassing party over the landowner's own network. Possible methods

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41 Wright, *supra* at 158.

42 Drone Detector, http://www.dronedetector.com/.

43 Cyborg Unplug, https://plugunplug.net/.

of physical UAS interdiction include everything from UAS interceptors that drop a tangle line into the rotors of the offending UAS,[44] to falcons,[45] to shotguns.[46]

As a body of law develops around the use of drones and landowners resort to various self-help methods, physical countermeasures may become more commonplace and legally authorized in certain situations. The issue may come down to whether the courts view unwanted UAS in a landowner's airspace more like an overhanging tree branch that can be cut off or an aircraft flying at the FAA approved altitude within a public right of way.

§ 1.08. Conclusion.

Unmanned aircraft systems are already being used by energy and mining companies for tasks such as inspection, monitoring, and surveying of remote facilities and hard-to-access infrastructure. In these applications, UAS are generally safer, more effective, and less expensive than manned aircraft or other means for accomplishing such tasks. The technology is evolving rapidly, expanding the capabilities while at the same time bringing down costs. It is reasonable to expect that UAS could become commonly employed for a wide range of applications in the energy and mining industries — in particular, tasks that are dirty, dull, or dangerous. At the same time, the operation of UAS for commercial purposes raise a number of legal considerations, from FAA regulation, to state laws protecting privacy interests and property rights, to potential liability for property damage or personal injury. Companies wishing to take advantage of the benefits of UAS technology also should pay close attention the legal and regulatory landscape as it continues to evolve along with the technology.

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44 *Popular Science*, (Jan. 16, 2015), "Rapere is an Anti-Drone Interceptor," http://www.popsci.com/rapere-anti-drone-interceptor.

45 *Popular Science*, (Dec. 5, 2014), "Can Birds Be Trained To Bring Down Drones?," http://www.popsci.com/can-birds-be-trained-attack-drones.

46 *Popular Science*, (Sept. 30, 2014), "New Jersey Man Accused of Shooting Down Neighbor's Remote Control Drone," http://philadelphia.cbslocal.com/2014/09/30/new-jersey-man-accused-of-shooting-down-neighbors-remote-control-drone/

Chapter 2

The Endangered Species Act Moves East

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§ 2.01. Introduction and Overview.

Since its passage in 1973, the Endangered Species Act has primarily affected the western United States. Because of the high amount of federal ownership of western land, which triggers federal government obligations under the Act, and the volume of listed species and designated critical habitat in the western states, the Endangered Species Act is a routine consideration in most western development projects. Recently, the U.S. Fish and Wildlife Service has been listing more species and designating more critical habitat in the eastern part of the country. As the volume of eastern listed species and extent of eastern critical habitat rises, the Endangered Species Act has become increasingly relevant in a range of eastern development projects, ranging from oil and gas to wind development projects. This chapter provides a basic grounding in the Act, explores the reasons for the eastern "migration" of the Act, and highlights new developments in the regulatory implementation of the Act.

§ 2.02. Predecessors of the Endangered Species Act.[2]

Before 1900, control over wildlife generally remained with the States. Based on the Supreme Court decision in *Geer v. Connecticut*,[3] states had the right "to control and regulate the common property in game," which was to

2 For a detailed discussion of the development of federal wildlife law, *see* Michael J. Bean and Melanie J. Rowland, *The Evolution of National Wildlife Law* (3 ed. 1997). *See also* Donald C. Baur and Wm. Robert Irvin, *Endangered Species Act – Law, Policy, and Perspectives* (2d ed. 2010).

3 Geer v. Connecticut, 161 U.S. 519 (1896).

be exercised "as a trust for the benefit of the people."[4] However, Congress soon acted to protect wildlife using its constitutional powers over interstate commerce and expanded that power under other constitutional principles, including its treaty-making authority and the Property Clause.

[1] — Early Wildlife Conservation Efforts and Building Blocks of the ESA.

The Endangered Species Act of 1973 builds on concepts of federal wildlife control that had been developing over three quarters of a century. These concepts tested and expanded federal power over wildlife using a variety of constitutional powers.

[a] —The Lacey Act of 1900 and the Commerce Clause.

Prompted by the decline and eventual extinction of the passenger pigeon, the Lacey Act of 1900[5] became the first federal legislation to promote wildlife conservation, and it became the foundation for subsequent federal wildlife legislation. The Lacey Act focuses on control of trade and relies upon the Commerce Clause as a source of federal control over wildlife. Specifically, it prohibits the shipment of unlawfully acquired wildlife in interstate commerce. As such, Congress designed the act primarily to support state game laws and enforcement. The Lacey Act also authorized the Secretary of Agriculture to reintroduce birds that had become locally extinct.

[b] — The Migratory Bird Treaty Act of 1918 and the Treaty Power.

In 1916, the United States and Great Britain signed the Migratory Bird Treaty out of concern of over-hunting birds.[6] The Migratory Bird Treaty

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4 *Id*. at 528–29.

5 Lacey Act of 1900, 31 Stat. 187 (codified as amended at 16 U.S.C. §§ 701, 3371–78 and 18 U.S.C. § 42).

6 Convention for the Protection of Migratory Birds, U.S.-Gr. Brit., Aug. 16, 1916, 39 Stat. 1702.

Act of 1918[7] (MBTA) served as the implementing legislation for the treaty. The MBTA relied upon the federal treaty-making power of the Constitution as an additional source of power to control wildlife. The Supreme Court in *Missouri v. Holland*[8] upheld the statute, which was deemed to have supremacy over State laws because it was enacted under the treaty power of the federal government.

The MBTA imposed a "take" prohibition, which made it a federal crime to do any of the following, unless and except as permitted by regulation: "pursue, hunt, take, capture, kill . . . [or transport] any migratory bird, any part, nest or egg of such bird."[9] The MBTA also introduced the concept of exceptions to a take prohibition. The statute expressly authorizes the Fish and Wildlife Service to regulate "takes" by issuing permits.[10] To date, the Fish and Wildlife Service has developed permitting regimes for intentional takes under the MBTA, *i.e.*, hunting and depredation permits,[11] but has only recently begun a process that may lead to a permitting regime for incidental takes, *i.e.*, those takes that result from otherwise lawful activity that has the incidental impact of "taking" a migratory bird.[12]

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7 Migratory Bird Treaty Act of 1918, 40 Stat. 755 (codified as amended at 16 U.S.C. §§ 703–12).

8 Missouri v. Holland, 252 U.S. 416 (1920).

9 16 U.S.C. § 703.

10 *Id*. § 704.

11 *See, e.g*., 50 C.F.R. Part 20, supbarts A–J and L and Part 21 (generally applicable hunting regulations); 50 C.F.R. Part 20 subpart K (establishing hunting seasons, hours, bag limits, etc. annually). *See also* Fish & Wildlife Service, Depredation Frequently Asked Questions, http://www.fws.gov/pacific/migratorybirds/permits/dprd.html (last updated Mar. 17, 2015) (guidance on depredation permits).

12 *See* 80 Fed. Reg. 30,032 (May 26, 2015) (explaining the Fish and Wildlife Service's intent to evaluate the potential environmental impacts of a proposal to authorize incidental take of migratory birds under the MBTA). Thus far, the Service has merely issued a notice that it will begin to examine the issue by evaluating the environmental impacts of a variety of regulatory mechanisms in a National Environmental Policy Act (NEPA) document. When that process is complete, the Service may choose to propose regulations via the Administrative Procedure Act.

[c] — Federal Lands and Resources and the Property Clause.

In the western parts of the lower 48 states and in Alaska, the federal government is a significant landowner, which has given rise to a different constitutional justification for federal control of wildlife. In a line of cases beginning with *Hunt v. United States*[13] and extending through *Kleppe v. New Mexico*,[14] the Supreme Court expanded the federal role by recognizing the power to control wildlife to protect federal land as well as wildlife itself. In *Hunt v. United States*, the court held that despite any state game laws, the federal government had the power to protect its lands and property within a national game preserve by permitting the killing of deer where the deer became overpopulated and stressed the resources of the preserve.[15] And in *Kleppe v. New Mexico*, the court ruled that the federal government had the power to protect wild horses and burros on federal public lands under the Property Clause.[16] In *Kleppe*, the State of New Mexico had removed wild burrows from federal land and sold them at auction. New Mexico argued that the Property clause could only be applied to protect federal lands but the Supreme Court determined that the power granted under that clause extended to wildlife found on federal land.[17]

[d] — Convention of Nature Protection and Wildlife Preservation in the Western Hemisphere of 1940.

Over the first half of the 20th century, species declines and extinction continued to occur, with the Carolina parakeet and heath hen following the passenger pigeon. By the early 1940s, the whooping crane was on the verge of extinction. This contributed to the first treaty designed to avoid extinction and protect habitat, the Convention on Nature Protection and Wildlife

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13 Hunt v. United States, 278 U.S. 96 (1928).
14 Kleppe v. New Mexico, 426 U.S. 529 (1976).
15 *Hunt*, 278 U.S. 96, 100 (1928).
16 *Kleppe*, 426 U.S. 529 (1976).
17 *Id*. at 545.

Preservation in the Western Hemisphere of 1940.[18] This treaty sought to protect sufficient habitat to avoid extinction and recognized the need for international cooperation due to the migratory nature of species.

[e] — The Department of the Interior's Redbook.

The U.S. Department of the Interior's Bureau of Sport Fisheries and Wildlife,[19] began to conduct research and conservation programs for imperiled species. Through this effort, an administrative program within the federal government began to emerge for the conservation of imperiled species. Originally, the agency gave priority attention to the whooping crane.

In 1958, Congress enacted legislation to promote a research and management program at the U.S. Department of the Interior. In 1964, the Department published a list of 63 rare and endangered species, called the "Redbook." The Redbook, prepared by a committee of nine biologists within the Bureau, thus became the precursor for the listing of species under the Endangered Species Act. Listing under the Redbook did not bring with it any regulatory consequences, but that would change two years later with the enactment of the first federal legislation to protect endangered species.

[2] — Endangered Species Legislation.

The Endangered Species Act of 1973 was preceded by a number of congressional and international efforts with the specific aim of preserving and conserving endangered species.

[a] — Endangered Species Preservation Act of 1966.

In 1966, Congress enacted the first law directing the Secretary of the Interior to carry out a program to conserve, protect, restore, and propagate species threatened with extinction, the Endangered Species Preservation Act of 1966.[20] This act instructed the Secretary to identify and list endangered

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18 Convention on Nature Protection and Wildlife Preservation in the Western Hemisphere, Oct. 12, 1940, 56 Stat. 1354.

19 The Bureau of Sport Fisheries and Wildlife is now known as the Fish and Wildlife Service.

20 Endangered Species Preservation Act of 1966, Pub. L. No. 89-669, 80 Stat. 926 (repealed 1973).

native species in the Federal Register,[21] and it authorized the use of the Land and Water Conservation Fund to acquire land for the preservation of these species.[22]

[b] — Endangered Species Conservation Act of 1969.

Congress later expanded the conservation effort with the Endangered Species Conservation Act of 1969 after recognizing the international dimension of the issue and the role played by commerce in the United States.[23] This act prohibited the importation of endangered species, except for limited purposes; it created an international list of species; it was not limited to vertebrates; and it directed the Secretary of the Interior to seek an international meeting to develop a treaty on endangered species conservation.[24]

[c] — Marine Mammal Protection Act of 1972.

In 1972, Congress enacted the Marine Mammal Protection Act (MMPA),[25] due largely to the threat to whales from commercial exploitation and the uneven regulation of marine mammal stocks generally. The centerpiece of the MMPA as originally passed was a moratorium on taking marine mammals and marine mammal products.[26] Congress has amended the moratorium over time to allow certain exceptions, including exceptions for authorized incidental take.[27] The MMPA focused increased attention on the plight of individual species and gave further impetus to Congress to enact sweeping endangered species legislation.

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21 *Id*. at § 1.

22 *Id*. at § 2(a).

23 Endangered Species Conservation Act of 1969, Pub. L. No. 91-135, 83 Stat. 275.

24 *Id*. at § 2 (importation); *id*. at 3(α) (international list of species); *id*. (not limited to vertebrates); and *id*. at 5(β) (directing the Secretary of the Interior to seek an international meeting to develop a treaty on endangered species conservation).

25 Marine Mammal Protection Act of 1972, Pub. L. 92-522, 86 Stat. 1027 (codified as amended at 16 U.S.C. §§ 1361–1421h).

26 16 U.S.C. § 1371.

27 *Id*.

[d] — Convention on International Trade in Endangered Species of Wild Fauna and Flora of 1973 (CITES).

The mandate of the Endangered Species Act of 1969 led to the Convention on International Trade of Wild Fauna and Flora of 1973 (CITES).[28] CITES imposes trade restrictions on various classifications of at risk species. These classifications distinguish between the degrees of vulnerability among various at-risk species.[29] Each signatory state implements the Convention, and the quality of implementation has varied.[30]

§ 2.03. Endangered Species Act of 1973 — General.

The enactment of the MMPA and the success in developing CITES led to pressure in the United States to do more domestically for species conservation. This pressure resulted in the Endangered Species Act of 1973,[31] which, with subsequent amendments in 1978 and the early 1980s, is essentially the law in effect today.

[1] — Building Blocks from Precursor Conservation Efforts.

The Endangered Species Act of 1973 pulled together many of the key concepts from species conservation programs during the previous 75 years and combined them into a comprehensive program. It used as a foundation all three of the constitutional powers from previous Supreme Court rulings — the Commerce, Treaty, and Property Clauses. The principles drawn from earlier laws included the following:

- The development of a list of species to be protected;
- Control of trade;
- Habitat acquisition;

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28 Convention on International Trade of Wild Fauna and Flora, March 3, 1973, [1975] 27 U.S.T. 1087, T.I.A.S. No. 8249.

29 *See id.*, art. II §§ 1–3.

30 Michael J. Bean and Melanie J. Rowland, *The Evolution of National Wildlife Law* 499, n.157 (3 ed. 1997).

31 Endangered Species Act of 1973, Pub. L. No. 93-205, 87 Stat. 884 (codified at 16 U.S.C. §§ 1531–43).

- Research;
- International cooperation;
- Species propagation and reintroduction;
- Prohibition on take and exceptions thereto; and
- Prohibition on import and export.

[2] — New Concepts of Endangered Species Protection.

In addition to these concepts, Congress added new principles and requirements. These new conservation tools became some of the most significant and controversial aspects of the Act. These were

- *Federal preemption of State laws*: The Act establishes federal management for listed species, displacing the traditional role of the States in managing wildlife.
- *Designation and protection of critical habitat*: The Act mandates designation of critical habitat for listed species and implements protections for critical habitat.
- *Interagency consultation to inform action agency decision-making*: The Act requires federal agencies to consult with either the U.S. Fish and Wildlife Service or the National Marine Fisheries Service[32] about the impact of the proposed actions on listed species or habitat.
- *Prohibition on causing "jeopardy" or adversely modifying critical habitat*: The Act prohibits federal agencies from taking any action that will jeopardize the continued existence of a listed species or adversely modify critical habitat.
- *Prohibition on "take" in the form of habitat modification*: The Act defines "take" to include "harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect, or to attempt to engage in any such conduct."[33] This has been interpreted to include habitat modification that has the effect of causing actual harm.

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[32] The statute charges the "Secretary" to undertake these responsibilities and defines the term as the Secretary of the Interior or the Secretary of Commerce. 16 U.S.C. § 1532(15). The Secretaries have delegated their responsibilities to the U.S. Fish and Wildlife Service and the National Marine Fisheries Service, respectively.

[33] 16 U.S.C. § 1532(19).

- *Incidental take permits for private lands*: The Act provides a mechanism by which a private landowner may obtain advance incidental take authorization.
- *Recovery plans*: The Act requires the U.S. Fish & Wildlife Service and the National Marine Fisheries Service to develop recovery plans for listed species.

[3] — Purposes of the Act.

The principal purpose of the Act is to "provide a means whereby the *ecosystems* upon which endangered species and threatened species depend may be conserved, to provide a program for *conservation* of such endangered and threatened species, and to take such steps as may be appropriate to achieve the purposes of the treaties and conventions [to implement the Act]."[34] "Conservation" means the measures needed to bring species to a point of not being on the Endangered Species list, or to achieve species "recovery."[35]

[4] — Administration of the Act.

[a] — Species Covered.

Any member of plant or animal kingdom may be protected under the Endangered Species Act. However, as discussed below, the type of protection available differs between vertebrates and non-vertebrates and between plants and animals.

[b] — Administering Agencies.

The U.S. Fish and Wildlife Service, within the U.S. Department of the Interior, has jurisdiction over all terrestrial species, certain marine mammals (*e.g.*, sea otters and manatees) and freshwater fish. The National Marine Fisheries Service, within the U.S. Department of Commerce, has jurisdiction over marine species (*e.g.*, fish, whales, seals) and anadromous fish (*e.g.*, salmon).

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34 *Id*. § 1531(b)(emphasis added).

35 *Id*. § 1532(3).

[5] — General Mandates of the Act.

The courts have interpreted the Endangered Species Act stringently to give maximum protection to species. The lead case, *TVA v. Hill*,[36] is commonly known as the snail darter case. In that case, the Supreme Court affirmed, "[I]t is beyond a doubt that Congress intended endangered species to be afforded the highest of priorities."[37] The case arose when the Fish and Wildlife Service determined that the construction of the Tellico Dam on the Little Tennessee River would extirpate the snail darter, a newly discovered and newly listed species, that was believed at the time to exist only in in the section of the Little Tennessee River that would be inundated by the lake resulting from the dam. The Supreme Court held that the Endangered Species Act prohibited construction of the dam because it would jeopardize—indeed, completely destroy—the species. The Supreme Court explained that the Act does not create a balancing test; the law is to be construed in favor of the species where there is a doubt. About twenty years later, in *Sweet Home Chapter of Communities for a Greater Oregon v. Babbitt*,[38] or the spotted owl case, the Supreme Court reaffirmed the general principles of *TVA v. Hill*.

More recently, the Supreme Court has recognized a limit to the Endangered Species Act. In *National Association of Homebuilders v. Defenders of Wildlife*,[39] the Supreme Court held that federal conservation obligations under Section 7 of the Endangered Species Act (which require federal agencies to consult on the impact of their actions and prohibit them from jeopardizing listed species or adversely modifying critical habitat) do not trump other non-discretionary federal obligations. Put simply, an agency need not comply with the procedural requirements of Section 7 if it has a non-discretionary duty to take an action regardless of what the result of the Section 7 consultation may be.

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36 TVA v. Hill, 437 U.S. 153 (1978).

37 *Id*. at 174.

38 Sweet Home Chapter of Communities for a Great Oregon v. Babbitt, 515 U.S. 687 (1995).

39 National Ass'n of Home Builders v. Defenders of Wildlife, 551 U.S. 644 (2007).

§ 2.04. Listing Process: Endangered Species Act, Section 4.[40]

[1] — The Listing Concept.

All protections of the Endangered Species Act flow from the act of "listing" a species—or portion thereof—as "endangered" or "threatened," or the designation of a species' "critical habitat." The listing process is a standard Administrative Procedure Act notice-and-comment rule-making. The U.S. Fish and Wildlife Service or the National Marine Fisheries Service, as applicable based upon the agency with jurisdiction over the species, promulgates each listing rule. The list of threatened and/or endangered species and their designated critical habitat is found at 50 C.F.R. Part 17, Subpart B.

[2] — Scope of Listing and Critical Habitats.

The Endangered Species Act defines "species" to include "subspecies" and "any distinct population segment [(DPS)] of any species of vertebrate fish or wildlife which interbreeds when mature."[41] Thus, the Services may list the entire species, a subspecies, or a DPS as threatened or endangered.

The Act defines an "endangered species" as a species "in danger of extinction throughout all or a significant portion of its range."[42] A threatened species is one that is "likely to become an endangered species within the foreseeable future throughout all or a significant portion of its range."[43] Finally, Congress defined "critical habitat" as those "specific areas within the geographical area occupied by the species . . . [which are] essential to the conservation of the species and . . . which may require special management considerations or protection."[44]

Almost all of these statutory terms have been litigated over time. For example, in *Defenders of Wildlife v. United States Dep't of the Interior*, the court found that the Fish and Wildlife Service relied on an improper

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40 16 U.S.C. § 1533; 50 C.F.R. § 424.
41 16 U.S.C. § 1531(16).
42 *Id*. § 1532(6).
43 *Id*. § 1532(20).
44 *Id*. § 1532(5).

definition of "significant portion of its range."[45] Another court took the Fish and Wildlife Service to task for interpreting the "foreseeable future" too broadly where the listing was motivated by the anticipated impacts of climate change over the next century.[46]

The Services have encountered substantial controversy when listing DPSs because the statutory definition of DPS is subject to multiple interpretations. For example, in *National Association of Homebuilders v. Norton*,[47] the Ninth Circuit upheld the Fish and Wildlife Service's application of its distinct population segment policy to a listing decision for the cactus ferruginous pigmy-owl and agreeing with the agency's holding that the Arizona population of the owl was discrete. The court nevertheless held that the Service arbitrarily found the population to be significant because the agency failed to show that loss of the Arizona population would create a significant gap in the range of its taxon or because it differed markedly in its genetic characteristics from the Northwestern Mexican pigmy owls.

The Services have acknowledged that the statutory definition of DPS is unclear, but to date have not proposed a formal rule to resolve that ambiguity. In 2014, the Services included a discussion of the phrase "which interbreeds when mature" in the preamble of a proposal to amend the regulations on designating critical habitat.[48] There, the Services claimed that they interpreted to phrase to mean "members of the same species or subspecies in the wild that would be biologically capable of interbreeding if given the opportunity, but all members need not actually interbreed with each other."[49] The Services have not yet finalized the rule nor responded to comments on the discussion of the DPS definition in the preamble to the rule. However, as the Services characterized this discussion as an explanation of their long-standing

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45 Defenders of Wildlife v. United States Dep't of the Interior, 354 F. Supp. 2d 1156 (D. Or. 2005).

46 Alaska Oil & Gas Assoc. v. Pritzker, No. 4:13-cv-00018-RRB, 2014 U.S. Dist. LEXIS 101446 (D. Ak. July 24, 2014).

47 National Ass'n of Homebuilders v. Norton, 340 F.3d 835 (9th Cir. 2003).

48 79 Fed. Reg. 27,066, 27,070 (May 12, 2014).

49 *Id*.

interpretation of the phrase, presumably they are applying this interpretation now in any listing decisions related to DPSs.

[3] — Protections Applied.

The protections provided by the Endangered Species Act vary depending on what status the species is granted. Endangered species are automatically subject to the full protections of the Act, including the "take" prohibition discussed in section 2.07.

Threatened species do not have automatic "take" protection. Instead, the statute provides that they are protected by "such regulations as . . . [are] necessary and advisable" to provide for their conservation.[50] These rules, known as 4(d) rules, are generally as protective as those applied for endangered species. The Fish and Wildlife Service has a blanket regulation that extends the provisions protecting endangered species to all threatened species unless the Service adopts a species-specific rule;[51] the National Marine Fisheries Service applies protections to threatened species on a species-by-species basis. Separate 4(d) rules have been promulgated by both Services for individual threatened species, providing species-specific protective prescriptions.[52]

[4] — Factors Considered for Listing.

Section 4 of the Endangered Species Act mandates that the decision to list a species be assessed under five factors, based upon the "best scientific and commercial data available."[53] These five factors are:

- Present or threatened destruction, modification, or curtailment of species habitat or range;
- Overutilization for commercial, recreational, scientific, or educational purposes;
- Disease or predation;

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50 16 U.S.C. § 1533(d).

51 50 C.F.R. § 17.31(a).

52 *See, e.g.*, 80 Fed. Reg. 17,974 (Apr. 2, 2015) (listing the northern long-eared bat as threatened with interim final 4(d) rule).

53 16 U.S.C. § 1533(a)(1)(A)-(E).

- Inadequacy of existing regulatory mechanisms; and
- Other natural or man-made factors affecting the species' continued existence.

A species need not warrant listing on account of all five factors—any one factor may be sufficient to drive a listing decision. Notably, economic impacts are not considered as part of species listing. Both a decision to list a species and a decision not to list a species may be challenged in court.

Courts will generally defer to the Services' scientific expertise when assessing these factors and making the determination of whether a species, subspecies, or DPS meets the statutory definition of "endangered" or "threatened." A court examines listing decisions under the Administrative Procedure Act's generous "arbitrary and capricious" standard.[54] However, on occasion, a listing decision may be so fundamentally flawed that it is remanded to the agency for lacking a rational basis. For example, in *Northern Spotted Owl v. Hodel*,[55] the court found that the agency's record declining to list the northern spotted owl was not supported by a rational basis where all expert opinions supported listing and the Fish and Wildlife Service's record failed to offer a "credible alternative explanation."[56]

[5] — Factors Considered for Critical Habitat Designation.

The Services must designate critical habitat at the time of listing to the extent it is "prudent and determinable."[57] Unlike listing, critical habitat designation can be denied if the designation is not necessary to prevent extinction and if the "benefits of . . . exclusion outweigh the benefits of specifying such area as part of critical habitat."[58] The balancing

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54 Administrative Procedure Act of 1946, Pub. L. 79-404, 60 Stat. 237 (codified as amended at 5 U.S.C. § 701-708).

55 Northern Spotted Owl v. Hodel, 716 F. Supp. 479 (W.D. Wash. 1988).

56 *Id*. at 483.

57 16 U.S.C. § 1533(a)(3). *See also* NRDC v. U.S. Dept. of Interior, 113 F.3d 1121 (9th Cir. 1997) (finding that critical habitat for the California gnatcatcher must be designated at the time of listing, and that a state habitat protection program's existence did not justify a decision to not designate).

58 16 U.S.C. § 1533(b)(2).

determination the statute imposes on the Services calls for an analysis of the economic impacts that will be associated with the protective provisions imposed under the designation. Thus, unlike a listing itself, for a critical habitat designation, the Services must analyze the economic impact of the proposed critical habitat.

How and when the Services should consider economic impacts remains a subject of considerable controversy. In *New Mexico Cattle Growers Ass'n v. United States Fish & Wildlife Service*,[59] the Tenth Circuit held that meaningful economic analysis must be conducted as part of critical habitat designation. Specifically, the court held that the Service may not rely on a so-called "baseline" approach which assumes all economic impacts occur at the listing stage, and therefore there are no separate economic consequences from critical habitat designation. However, this decision may conflict with a recent 2013 rule jointly promulgated by the Services regarding the proper approach to economic impacts analyses.[60] Among other things, the new rule requires the Services to make economic impact assessments publicly available concurrently with the proposed critical habitat designation.

Even more fundamentally, the Services and the courts continue to struggle with the appropriate definition of critical habitat and "adverse modification" of habitat. Both the Fifth Circuit and the Ninth Circuit invalidated the existing regulatory definition of "destruction or adverse modification" of critical habitat because it (a) set too high a threshold, and (b) did not adequately address the conservation, or recovery, purpose of critical habitat.[61] As discussed later, the Services have recently proposed a series of new rules to replace this definition and better define critical habitat decisions.

Recent district court cases have highlighted challenges related to the concept of critical habitat. For example, in *Alaska Oil & Gas Ass'n v. Salazar*,[62] the court vacated the critical habitat designation for the polar

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59 New Mexico Cattle Growers Ass'n v. FWS, 248 F.3d 1277 (10th Cir. 2001).

60 78 Fed. Reg. 53,058 (Oct. 30, 2013) (codified at 50 C.F.R. § 424).

61 *See* Sierra Club v. FWS, 245 F.3d. 434 (5th Cir. 2001); Gifford Pinchot Task Force v. FWS, 378 F. 3d. 1059 (9th Cir. 2004).

62 Alaska Oil & Gas Ass'n v. Salazar, 916 F. Supp. 2d 974 (2013) (appeal docketed, briefing ongoing).

bear because the record lacked evidence of physical or biological features necessary to protect the polar bear in two of the areas designated as critical habitat. In contrast, in *Markel Interests, LLC v. United States Fish & Wildlife Service*,[63] the court upheld the designation of unoccupied critical habitat for the dusky gopher frog on private property even though the species had not been sighted on the property since the 1960s and the record showed significant likely adverse impacts.

[6] — Procedures for Listing and Critical Habitat Designation.

Either listing or delisting a species or imposing or removing a critical habitat designation can be achieved by a rulemaking action initiated by the applicable Service or by a petition from a third party.[64] After reviewing the petition, the Service may then begin a listing process. A notice-and-comment rulemaking procedure is used for both listing and critical habitat decisions. The Services further rely upon a detailed "Listing Handbook" for this purpose.[65] Listing can also be undertaken on an "emergency basis" when there is a significant risk to the well-being of the species. They remain in effect for 240 days, unless extended under normal listing requirements.[66]

As a practical matter, most listings are prompted by petitions. The petition process is governed by stringent timeframes set forth in the statute. The Services have 90 days to make an initial review of the petition and 12 months from the receipt of the petition to make an ultimate determination that the petitioned action (*i.e.*, to list a species) is (a) warranted, (b) not warranted, or (c) warranted but precluded by other higher priorities. If an action is "warranted," then the Services must then proceed with a standard listing process. If an action is "warranted but precluded," then the species is treated as a "candidate species" and re-evaluated every year. In theory, a

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63 Markle Interests, LLC v. FWS, Nos. 13-324, 13-362, & 13-413, 2014 WL 4186777 (E.D. La. Aug. 22, 2014) (appeal docketed and submitted).

64 16 U.S.C. § 1533(b)(3)(A); 50 C.F.R. § 424.14(b)(1).

65 FWS, Endangered Species Listing Handbook (1994), http://training.fws.gov/resources/course-resources/esa-overview/documents/pdf/FWS-Listing-Handbook.pdf.

66 16 U.S.C. § 1533(b)(7).

species could remain a candidate species indefinitely if each annual review indicated that listing was warranted but precluded by other higher priority species.

Non-governmental organizations have used the statutory deadlines to bring litigation compelling the Services to act on petitions. This strategy was first successful in *Biodiversity Legal Foundation v. Badgley*, in which the court found that a "warranted/not warranted/warranted-but-precluded" decision on a petition filed by an "interested person" to list a species must be completed within 12 months.[67] Prior to this ruling, the Services were extending "warranted decisions" beyond the 12-month statutory deadline based on the "maximum extent practicable" discretion afforded to the agencies at the 90-day initial review of the petition.[68] Other "deadline" suits followed.[69]

In 2011, the Fish and Wildlife Service attempted to stem the tide of deadline litigation by entering into two "mega-settlements" with the Center for Biological Diversity and WildEarth Guardians. In these settlements, the Fish and Wildlife Service agreed to a negotiated schedule under which it would make a decision to list or not to list a total of 757 candidate species between 2011 and 2018.[70] In exchange, the Center for Biological Diversity and WildEarth Guardians agreed to limit the number of additional deadline

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[67] Biodiversity Legal Foundation v. Badgley, 309 F.3d 1166 (9th Cir. 2002).

[68] 16 U.S.C. § 1533(b)(3)(A).

[69] *See, e.g.*, Save Our Springs Alliance v. Norton, 361 F. Supp. 2d 643 (W.D. Tex. 2005) (successfully challenging the Fish and Wildlife Service's failure to make timely findings under Endangered Species Act Section 4(b)(3)(A) with respect to the plaintiffs' petition to list the karst spider as endangered or threatened).

[70] *In re* Endangered Species Act Section 4 Deadline Litig., Order Granting Joint Motion for Approval of Settlement Agreement and Order of Dismissal of WildEarth Guardians' Claim, Case No. 1:10-mc-00377 (D.D.C. Sept. 9, 2011); *In re* Endangered Species Act Section 4 Deadline Litig., Order Granting Joint Motion for Approval of Settlement Agreement and Order of Dismissal of Center for Biological Diversity's Claim, Case No. v. Salazar, 1:10-mc-00377 (D.D.C. Sept. 9, 2011). *See also* Listing Workplan Overview *available at* http://www.fws.gov/endangered/improving_ESA/listing_workplan.html.

suits they would bring in that time. The "mega-settlements" have been subject to numerous challenges, some of which remain pending.[71]

§ 2.05. Recovery Plans.[72]

[1] — Purpose of Recovery Plans.

Recovery plans are intended to be the federal blueprint for removing a species from Endangered Species Act listing. The Services must prepare them unless the Secretary finds they "would not promote the conservation of the species."[73] A court has found that a recovery plan must include, to the maximum extent practicable, site-specific management actions necessary for recovery and objective, measurable criteria to assess progress toward delisting.[74]

[a] — Discretionary Nature of Recovery Plans.

Although the Endangered Species Act requires the Services to develop recovery plans, unlike a listing decision, the plans themselves lack the force and effect of law. Instead, recovery plans serve as guidelines. They are unenforceable in and of themselves.[75] That said, recovery plans can inform the Endangered Species Act's other substantive standards, such as jeopardy.

[b] — Public Review.

Recovery plans are developed with the help of advisory teams, usually consisting of technical experts and stakeholders.[76] Their advice must be

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71 *See, e.g.*, Hutchinson v. U.S. Dept. Interior, No. 1:15-cv-00253 (D.D.C., as part of MDL No. 2165) (previously No. 4:14-cv-509, N.D. OK filed Aug. 27, 2014); State of Oklahoma v. U.S. Dept. Interior, No. 1:15-cv-00252 (D.D.C., as part of MDL No. 2165) (previously No. 4:14-123, N.D. OK. filed Mar. 17, 2014); FIM Corp. v. U.S. Dept. Interior, No. 3:14-cv-00630 (D. N.V. filed Dec. 4, 2014).

72 16 U.S.C. § 1533(f).

73 *Id.* § 1533(ϕ)(1).

74 Fund for Animals v. Babbitt, 903 F. Supp. 96 (D.D.C. 1995).

75 *See* Friends of Blackwater v. Salazar, 691 F.3d 418 (D.C. Cir. 2012) (finding that recovery plan compliance not is binding in de-listing); Fund for Animals, Inc. v. Rice, 85 F.3d 535 (11th Cir. 1996) (determining that the recovery plan for Florida panther does not have force of law).

76 16 U.S.C. § 1533(f)(2).

reviewed independently and then formulated into a plan by the applicable Service. Plans are subject to public review and comment.[77] However, judicial review has proven limited because recovery plans are discretionary. For example, in *Grand Canyon Trust v. Norton*,[78] a substantive Administrative Procedure Act challenge to a recovery plan for the humpback chub was dismissed because the recovery plan was not considered "final agency action."

§ 2.06. Consultation and Jeopardy.[79]

The Endangered Species Act imposes on federal agencies both an affirmative duty to support recovery of listed species and a negative duty to take specific steps to avoid jeopardizing the continued existence of listed species.

[1] — Affirmative Duty

Section 7(a)(1) imposes an obligation on all federal agencies to "utilize their authorities in furtherance of the purposes of this [Act] by carrying out programs for the conservation of endangered and threatened species" of the Endangered Species Act.[80] A separate, somewhat stronger duty is imposed on the Secretaries of Commerce and the Interior in that they must review the other programs they administer and "utilize such programs in furtherance of the purposes of this *chapter*."[81] These duties have not been applied very rigorously by the courts, although the Fifth Circuit held in *Sierra Club v. Glickman*[82] that agencies must create or implement conservation programs where not previously done.

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77 *Id*. § 1533(f)(4); *see also* Friends of Blackwater v. Salazar, 691 F.3d 418 (D.C. Cir. 2012).

78 Grand Canyon Trust v. Norton, 2006 WL 167560 (D. Ariz. June 13, 2005).

79 16 U.S.C. § 1536; 50 C.F.R. pt. 402.

80 16 U.S.C. § 1536(a)(1).

81 *Id*.

82 Sierra Club v. Glickman, 156 F.3d. 606 (5th Cir. 1996).

[2] — Prohibition on Federal Action Without Consultation.

Section 7(a)(2) requires all federal agencies, in consultation with the Secretary (*i.e*., the Fish and Wildlife Service or National Marine Fisheries Service as appropriate), to insure that any action authorized, funded, or carried out by such agency is not likely to jeopardize the continued existence of any endangered species or threatened species or result in the destruction or adverse modification of critical habitat for such species.[83] The strength of this provision was dramatically demonstrated in *TVA v. Hill*,[84] where the Supreme Court held that the Fish and Wildlife Service's determination that constructing the Tellico Dam would jeopardize the snail darter meant that the action—which was funded by Congress—could not move forward.

While the statutory list of agency actions for which Section 7 consultation is required is broad, it is not limitless. Consultation is not required where an agency is not taking affirmative action. In *Western Watersheds Project v. Matejko*[85] the Ninth Circuit held that Section 7 consultation was not required for application to pre-existing water permits, unless and until the agency affirmatively acts on the permits. Consultation is also not required before an agency undertakes a non-discretionary obligation required by another statute. In *National Association of Homebuilders v. Defenders of Wildlife*,[86] the Supreme Court held that the Environmental Protection Agency was not required to undertake Section 7 consultation where it had a non-discretionary obligation to transfer authority to a state agency.

Neither "jeopardy" nor "adverse modification" is defined by the Act. The Services adopted the following regulatory definition of "jeopardy": an

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83 16 U.S.C. § 1536(a)(2).

84 TVA v. Hill, 437 U.S. 153 (1978).

85 Western Watersheds Project v. Matejko, 456 F.3d 922 (9th Cir. 2006); *see also* California Sportfishing Prot. Alliance v. FERC, 472 F.3d 593 (9th Cir. 2006) (finding that FERC had no duty to consult under Section 7 on previously permitted hydroelectric project where FERC took no affirmative action on existing license).

86 National Ass'n of Homebuilders v. Defenders of Wildlife, 551 U.S. 644 (2007); *see also* Alaska Wilderness League v. Jewell, 788 F.3d 1212 (9th Cir. 2015) (applying the *Homebuilders* analysis to determine that Section 7 consultation is not required when the Bureau of Safety and Environmental Enforcement approves an individual operator's oil spill response plan).

action that "directly or indirectly reduces appreciably the likelihood of both the survival and recovery in the wild."[87] The Services had also promulgated a regulatory definition of adverse modification,[88] but that definition was struck down by both the Fifth and the Ninth Circuits[89] on the grounds that it failed to distinguish between survival and recovery. As the Fifth Circuit explained, because the statutory definition of "critical habitat" uses the term "conservation," which is equated with recovery, adverse modification must be measured on what is necessary to achieve the recovery of the species and cannot be simply equated with jeopardy.[90] The Services proposed a new regulatory definition in 2014 and have stated that rule may be finalized in the summer of 2015.[91]

[3] — Consultation Procedure.

To determine if there will be jeopardy or adverse modification, action agencies must "consult" with the applicable Service to achieve either a "no effect" finding, or issuance of a "biological opinion" which concludes that, even though there is an effect, jeopardy or adverse modification do not exist, or can be mitigated to a permissible level, or in rare cases that the action must be halted.[92] Procedures for consultation are set out in regulations[93] and the Services' consultation handbook.[94]

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87 50 C.F.R. § 402.02.

88 The invalidated regulatory definition of adverse modification defined the term to mean, "[D]irect or indirect alteration that appreciably diminishes the value of critical habitat for both survival and recovery." *Id*. § 402.02.

89 Gifford-Pinchot Task Force v. FWS, 378 F.3d 1059 (9th Cir. 2004); Sierra Club v. FWS, 245 F.3d. 434 (5th Cir. 2001).

90 *Sierra Club*, 245 F.3d 434, 443 (5th Cir. 2001).

91 79 Fed. Reg. 27,060 (proposed July 11, 2014).

92 For example, the Ninth Circuit recently upheld a biological opinion which concluded that Bureau of Reclamation operation of the Central Valley Project would jeopardize endangered salmonids under the Bureau changed pumping practices. San Luis & Delta — Mendota Water Auth. v. Locke, 776 F.3d 971 (9th Cir. 2014).

93 50 C.F.R. § 402.

94 NMWS & FWS, Endangered Species Consultation Handbook (1998), https://www.fws.gov/ENDANGERED/esa-library/pdf/esa_section7_handbook.pdf.

For species that have been listed or critical habitat that has been designated, this process is called "consultation." For species that have been proposed for listing or areas that have been proposed for designation, the process is called a "conference" and has slightly different standards.[95]

[a] — May Affect/Informal Consultation.

The first step when species are present is to determine if the action "may affect" the listed species or designated habitat. This is done through "informal consultation" and may involve the preparation of a "biological assessment" by the action agency.[96] An assessment is required for "major construction activities."[97] If the assessment concludes, and the Service concurs, that adverse effects are not likely, Section 7 is satisfied. If such effects are expected, then "formal consultation" is required.

[b] — Formal Consultation

When formal consultation is required, the Service will review all available data and issue a "biological opinion."[98] Consultation must be conducted on the basis of the best scientific and commercial data available.[99] The Fourth Circuit recently set aside a biological opinion because of the agency's failure to explain its reliance on outdated studies or data.[100]

This process is governed by statutory time frames (about six months), but is subject to extension is some cases.[101] These time periods are important because the proposed action generally cannot move forward until

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95 *Id*. at E-18.

96 50 C.F.R. §§ 402.12, 402.13.

97 *Id*. § 402.12(b)(1).

98 *Id*. § 402.14.

99 16 U.S.C. § 1536(a)(2); 50 C.F.R. § 402.14(g).

100 Dow Agro Sciences v. NMFS, 707 F.3d. 462 (4th Cir. 2013) (setting aside a NMFS biological opinion that found that EPA's proposed registration of certain pesticides would jeopardize survival of certain salmonid species because the agency did not explain its reliance on outdated studies and data).

101 16 U.S.C. § 1535(b)(1)(B). *See also* FWS & NMFS, Endangered Species Consultation Handbook 4-5 to 4-7 (1998) for more information on the Services' goals and procedures with respect to timelines for consultation.

formal consultation is complete. Section 7(d) prohibits any "irreversible or irretrievable commitment of resources" while consultation is under way.[102]

A biological opinion is a substantial document that will consider the "direct," "indirect," and "cumulative effects" of the proposed action on the species and/or habitat. It will contain an advisory opinion by the applicable Service on whether the proposed action with jeopardize the listed species or adversely modify critical habitat. An action agency need not accept this conclusion, but strong deference is given to the Service's determination. If the biological opinion determines jeopardy or adverse modification will occur, then the biological opinion will define "reasonable and prudent alternatives" (RPAs) that avoid such an impact. Compliance with a "reasonably prudent alternative" avoids the Section 7(a)(2) prohibition. Regardless of the jeopardy/adverse modification determination, the biological opinion will include "conservation recommendations," which are advisory measures to promote the affirmative duties under Section 7(a)(1). If the proposed action is expected to "take" listed species, then the biological opinion will also include an "incidental take statement" (ITS), which sets forth reasonable and prudent measures (RPMs) that, if complied with, provide permission for the otherwise prohibited take of species under Section 9. Finally, consultation must be reinitiated when take levels are exceeded, new effects are discovered, the action is modified to cause a new effect, or new species are listed or critical habitat designated.[103]

In *Bennett v. Spear*,[104] the Supreme Court held that the issuance of a biological opinion is subject to review under the Administrative Procedure Act and that parties with an economic interest may litigate. Numerous courts have rejected biological opinions for failure to evaluate an action's impact on recovery.[105]

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102 16 U.S.C. § 1536(d).

103 50 C.F.R. § 402.16.

104 Bennett v. Spear, 520 U.S. 154 (1997).

105 *See, e.g.*, Wild Fish Conservancy v. Salazar, 628 F.3d 513, 527 (9th Cir. 2010) (finding FWS's jeopardy analysis inadequate in part because it did not identify recovery "tipping point" and whether that tipping point would be reached as a result of agency operations); Nat'l Wildlife Fed'n v. NMFS, 524 F.3d 917 (9th Cir. 2008) (finding NMFS's jeopardy analysis

[4] — Exemption Process ("God Squad").

An action found to present jeopardy can be exempted from the Section 7(a)(2) prohibition through the review of a special Cabinet level committee when there are no "reasonable and prudent alternatives," the benefits of allowing the action exceed the impacts, and the action is of regional or national importance.[106] This mechanism was added to the Act immediately after the *TVA v. Hill* decision blocked the completion of the Tellico Dam because Congress wanted to ensure that there would be a procedure to override the Endangered Species Act's "highest priority" given to species if the public interest warranted. However, this process is seldom invoked.[107]

§ 2.07. Take/Import Prohibition, Penalties, and Citizen Suits.[108]

[1] — Take Prohibition.

Section 9 of the Endangered Species Act prohibits any action that results in the "take" of any member of an endangered species.[109] This prohibition has been extended by regulation to most threatened species as well. The prohibition applies to private parties, as well as government agencies.[110] It does not apply to listed plants, except on federal lands, or on nonfederal lands

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contrary to law because it did not address the prospects for recovery of the listed species and NMFS did not know the in-river survival levels necessary to support recovery).

106 16 U.S.C. § 1536(g).

107 The committee took up the issue of the Tellico Dam but declined to issue an exemption. Endangered Species Comm. Decision on Tellico Dam and Reservoir Application (Feb. 7, 1979). Congress later exempted the dam from the Endangered Species Act in a rider to an appropriations bill. Pub. L. No. 95-367, 94 Stat. 1331 (1980).

108 16 U.S.C. § 1538.

109 *Id*. § 1538(a)(1)(B), (C). Note that one recent decision held that the Commerce Clause will not support regulation of take of an entirely *intrastate* species (in that case the Utah prairie dog) and that the Necessary and Proper Clause could not provide the required constitutional support for such regulation in the absence of interstate commerce. PETA v. FWS, 2014 WL 5743294 (D. Utah, Nov. 5, 2014). This case may be an outlier and appears to conflict with National Association of Homebuilders v. Babbitt, 120 F.3d 1041 (D.C. Cir. 1997) and Gibbs v. Babbitt, 214 F.3d 483 (4th Cir. 2000).

110 For example, the First Circuit held that the state's licensing of commercial fishing made the Massachusetts fishery agency itself liable for take of right whales caused by fishermen. Strahan v. Coxe, 127 F.3d 155 (1st Cir. 1997).

in violation of state law.[111] Section 9 also prohibits other actions, including import, export, possession, or sale of unlawfully taken species.[112]

[a] — Take Definition.

The Endangered Species Act defined "take" to mean "to harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect, or attempt to do so."[113] The key terms of this statutory definition have been defined by regulation.

The Services define "harass" as "an intentional or negligent act or omission which creates the likelihood of injury to wildlife by annoying it to such an extent as to significantly disrupt normal behavioral patterns which include, but are not limited to, breeding, feeding, or sheltering."[114]

"Harm" means "an act which actually kills or injures wildlife. Such act may include significant habitat modification or degradation where it actually kills or injures wildlife by significantly impairing essential behavioral patterns, including breeding, feeding, or sheltering."[115] This definition is notable because it includes harm to the species inflicted by modification to the species' habitat. This element of the regulatory definition was challenged and ultimately upheld by the Supreme Court, but with an important narrowing construction. In *Sweet Home Chapter of Communities for a Greater Oregon v. Babbitt*, the Supreme Court emphasized that habitat modification must be the proximate cause of death or injury to the species to satisfy this regulatory definition.[116] Although take can be established by indirect evidence, the likelihood of take cannot be speculative.

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111 16 U.S.C. § 1538(a)(2); *see also* N. Cal. River Watch v. Wilcox, 633 F. 3d. 766 (9th Cir. 2011) (take of endangered plants extends only to "areas under federal jurisdiction" and does not extend to plants removed from private wetlands subject to regulation by the Army Corps of Engineers).

112 16 U.S.C. § 1538(a)(1)(A), (D)–(G).

113 *Id*. § 1632(19).

114 50 C.F.R. § 17.3.

115 *Id*. § 17.3; 50 C.F.R. § 222.103.

116 Sweet Home Chapter of Communities for a Great Oregon v. Babbitt, 515 U.S. 687 (1995).

Finally, activities that can be shown to lead to take can be enjoined in advance provided reliance evidence of anticipated take is presented. For example, the Ninth Circuit enjoined timber harvest due to the likely "harm" to marbled murrelet because the logging would cause by impairing breeding and increasing the risk of predation,[117] but the First Circuit rejected a proposed injunction on the use of lead shot on the basis that it was too speculative to conclude that bald eagles might consume lead pellets and die.[118]

[b] — Exceptions to Take Prohibition.[119]

[i] — Section 7: Federal Action Exception Through Incidental Take Statement.

Where a federal agency action goes through the Section 7 consultation process *and* results in the issuance of a biological opinion, "take" that is anticipated from that proposed action can be authorized in an Incidental Take Statement. The Incidental Take Statement is generally included in the biological opinion document.

The Endangered Species Act requires that the Service make the following findings when issuing an Incidental Take Statement:[120]

- Action must not cause jeopardy or adverse modification;
- Take must be "incidental" to an otherwise lawful activity;
- Level of take allowed must be provided;
- Reasonable and prudent measures (RPMs) must be set forth; and
- Terms and conditions to carry out Reasonable and Prudent Measures must be set forth.

Determining the level of take associated with a given proposed action has proven controversial. In *Arizona Cattle Growers Association v. United States Fish and Wildlife Service*,[121] the Ninth Circuit invalidated a biological

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117 Marbled Murrelet v. Babbitt, 83 F.3d 1060 (9th Cir. 1996).

118 American Bald Eagle v. Bhatti, 9 F.3d 163 (1st Cir. 1993).

119 16 U.S.C. §§ 1536(b)(4), (o), 1539.

120 16 U.S.C. § 1536(b)(4); 50 C.F.R. § 402.14(i).

121 Arizona Cattle Growers Ass'n v. FWS, 273 F.3d 1229 (9th Cir. 2001).

opinion for a grazing allotment because the Fish and Wildlife Service failed to prove the presence of the species or the likelihood of take. The court held that an Incidental Take Statement must specify the actual level of take.

The Services have recently promulgated a rule that would codify the use of surrogates, in appropriate circumstances, to identify the anticipated level of take.[122] Some species are difficult to observe such that it may be challenging to verify the amount of take caused by an action with direct observation. A "surrogate" may be defined as habitat, ecological conditions, or similarly affected species.

[2] — Section 10: Non-Federal Action Exception Through Incidental Take Permit.

When no federal agency action is involved—and therefore no Section 7 consultation process is completed—take may be authorized through a separate process under Section 10 of the Act. This section authorizes the Services to issue permits to private parties for otherwise lawful activities that will result in "incidental take."

The Section 10 process has historically been used primarily to address take by "harm" through habitat modification on nonfederal lands and waters. To obtain an Incidental Take Permit, the project proponent must prepare a habitat conservation plan (HCP).[123] A habitat conservation plan is a prerequisite to obtaining an incidental take permit. The HCP must specify the impact from the taking, the steps to be taken by the applicant to minimize and mitigate such impacts (including funding) the alternative actions considered and the reasons rejected, and other measures required by the Secretary.[124]

Before the Service may issue an Incidental Take Permit, it must undertake a public review process that results in the following findings:[125]

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122 80 Fed. Reg. 26,832 (May 11, 2015) (amending 50 C.F.R. § 402.14)(i)(1)(i) to clarify the use of surrogates).

123 16 U.S.C. § 1539(a)(1)(B), (2); FWS & NMFS, Habitat Conservation Planning Handbook http://www.fws.gov/midwest/endangered/permits/hcp/hcphandbook.html.

124 *Id*. § 1539(a)(2)(A).

125 16 U.S.C. § 1539(a)(2)(B).

- Taking will be incidental;
- HCP has adequate funding;
- Applicant will mitigate to maximum extent practicable;
- Taking will not result in jeopardy; and
- Specified measures are set forth to implement permit.

Notably, the habitat conservation plan need not further a *recovery* purpose. In *Friends of Endangered Species, Inc. v. Jantzen*,[126] the Ninth Circuit upheld a habitat conservation for the mission blue butterfly in the San Bruno Mountains, holding that there was no need to prove that the species would be improved by the plan.[127] Further, when evaluating the term "maximum extent practicable," the court clarified that it does not mean "to the extent possible" or "how much the applicant can afford." Instead, the court found that it was a test of reasonableness or proportionality, where the amount practicable is related to the quantity and degree of incidental take and the quality of habitat diminished.[128]

The Incidental Take Permit process has been criticized as being too cumbersome. Due to the need to enlist the use of private lands to advance the conservation and recovery goals of the Endangered Species Act and the desire to establish flexibility in the Act's take prohibition, numerous reforms and innovations have been attempted to make the Incidental Take Permit process more attractive including the following:

- Prelisting Agreements/Candidate Conservation Agreements — These agreements allow the inclusion of species in a habitat conservation plan *before* the species is listed so the plan need not be revised upon a listing.
- Multi-species HCPs — Incidental Take Permits can cover numerous species to encourage large land areas to be used.

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126 Friends of Endangered Species, Inc. v. Jantzen, 760 F.2d 976 (9th Cir. 1983).

127 *See also* Spirit of Sage Council v. Kempthorne, 411 F. Supp. 2d 31 (D.D.C. 2007) (upholding validity of the No Surprises rule and holding that habitat conservation plans are not required to promote the recovery of the species).

128 National Wildlife Federation v. Norton, CIV-S-03-0278 DFL/JFM (E.D. Cal. February 3, 2004).

- "No Surprises" Rule — Federal government guarantees that the permit holder will not be required to make new commitments of money, land outside the terms of the permit.
- "Safe Harbor" — No Endangered Species Act prohibitions will apply if habitat is improved for purpose of attracting species.
- Low Effect Habitat Conservation Plans — Streamlined approval process for habitat conservation plans that involve small areas of land and minimal effect on species.

[3] — Take Exceptions Other Than Incidental Take Permit.[129]

Other, targeted exceptions to the take prohibition exist. These include permits for scientific research; species propagation and enhancement; hardship exemptions; special permission for take of species necessary to establish reintroduced experimental populations in locations necessary to advance recovery or where allowing take is necessary to gain political acceptance of relocation and provide flexibility of management; take by Alaska native populations for subsistence or handcraft purposes; and species parts taken before 1973 or part of antique articles.

[4] — Penalties and Enforcement.[130]

[a] — Civil Penalties.[131]

The Endangered Species Act establishes three levels of civil penalties predicated on different levels of culpability:

- Any person who *knowingly* violates any provision of the Act, or any provision of any permit or certificate issued pursuant to the Act, or of any regulation issued to implement Section 1538(a) (1) and (2), and certain other provisions of Section 1538, may be assessed a civil penalty of not more than $25,000 for each violation.

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129 16 U.S.C. § 1539(a)(1), (b), (e), (f), (h), (y).

130 16 U.S.C. § 1540.

131 16 U.S.C. § 1540(a).

- Any person who *knowingly* violates any provision of any other regulation issued under the Endangered Species Act may be assessed a civil penalty of not more than $12,000 for each violation.
- Any person who otherwise violates any provision of the Act, or any regulation, permit, or certificate issued pursuant to it, may be assessed a civil penalty of not more than $500 for each such violation.

Several cases involving a "direct" taking (*e.g*., shooting or poaching) have interpreted the Endangered Species Act's "knowing" standard.[132] These courts have held that the Act is a general intent statute. In other words, the government need only show that a defendant knowingly engaged in the conduct that resulted in the unauthorized take, and that the activity was the reasonable and proximate cause of the harm to the listed species.[133]

[b] — Criminal Penalties.[134]

The Endangered Species Act also provides that any person who *knowingly* violates any provision of the Act, of any permit or certificate issued thereunder, or any regulation issued in order to implement Section 1538(a)(1) and (2), as well as certain other provisions of Section 1538, may be fined up to $50,000 or imprisoned up to one year, or both. Any person who *knowingly* violates any other provisions of any other regulation issued pursuant to the Act may be fined up to $25,000 or imprisoned up to six months, or both.

[5] — Citizen Suits.[135]

Section 11(g) of the Endangered Species Act authorizes any person to bring a civil suit to enjoin a violation of the Act or any regulation promulgated

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132 *See e.g*., United States v. McKittrick, 142 F.3d 1170 (9th Cir. 1998); United States v. Ivey, 949 F.2d 759 (5th Cir. 1991); United States v. St. Onge, 676 F. Supp. 1044 (D. Mont. 1988).

133 *See, e.g.,* McKittrick, 142 F. 3d at 1177; Ivey, 949 F.2d at 766; St. Onge, 676 F. Supp. at 1045.

134 16 U.S.C. § 1540(b).

135 *Id*. § 1540(g).

thereunder. An injunction may be sought against any person for violations of Act and against the Secretary of Interior or Commerce for breach of nondiscretionary duty.[136] However, the First Circuit has clarified that Congress did not displace the traditional four equitable factors in deciding on injunctive relief.[137]

In addition to demonstrating the traditional four equitable factors, to obtain an injunction, a plaintiff must show a "reasonably certain threat of imminent harm" to a listed species.[138] This demonstration must include a showing that the species is present in the area of the proposed action. For example, in *Defenders of Wildlife v. Bernal*, the Ninth Circuit denied an injunction in the absence of scientific proof confirming the presence of listed owl species in within the habitat that was proposed to be modified.[139]

Further, the Act authorizes federal courts to award attorney's fees and other costs of litigation where appropriate.[140] Citizen suits often seek to enjoin a pending land use activity where it can be shown that the activity is reasonably certain to injure a listed species.

Generally, a citizen suit to enforce the Endangered Species Act must be preceded by 60-days written notice of the alleged violation to the violator and either the Department of the Interior for violations involving terrestrial species or the Department of Commerce for violations involving marine and anadromous species.[141] This 60-day-notice requirement is jurisdictional. A failure to comply strictly with the notice requirement acts as an absolute bar to bringing suit under the Endangered Species Act.[142] The Ninth Circuit

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136 Animal Welfare Inst. v. Martin, 623 F. 3d. 19 (1st Cir. 2010).

137 *Id*.

138 American Bald Eagle v. Bhatti, 9 F.3d 163 (1st Cir. 1993); Marbled Murrelet v. Pacific Lumber, 83 F.3d 1060, 1066 (9th Cir. 1996).

139 Defenders of Wildlife v. Bernal, 204 F.3d 920, 926-27 (9th Cir. 1999).

140 16 U.S.C. §1540(g)(1).

141 *Id*. §1540(g)(2)(A).

142 *See* Citizens Interested in Bull Run, Inc. v. Edrington, 781 F. Supp. 1502 (D. Or. 1991) (rejecting plaintiff's argument that the court may waive the 60-day notice requirement in equity or by finding that the claims arise under the Administrative Procedure Act instead of the Endangered Species Act); Kanoa Inc. v. Clinton, 1 F. Supp. 2d 1088 (D. Haw. 1998) (dismissing compliant for failure to comply with notice requirement).

explained in *Southwest Center for Biological Diversity v. U.S. Bureau of Reclamation*, that the purpose of the 60-day notice provision is to put agencies on notice of a perceived violation of the statute and an intent to sue, thereby giving the agency an opportunity to cure any violation.

§ 2.08. The Endangered Species Act Moves East.

As discussed at the beginning of this chapter, until recently the impact of the Endangered Species Act was felt primarily in the west. However, as a result of the settlements discussed in section 2.04[6] above, the Act is has become newly relevant in the east.

Although the settlements have been challenged, those challenges have not slowed the progress of the Fish and Wildlife Service along the "work plan" the agency negotiated with the Center for Biological Diversity and WildEarth Guardians.[143] The work plan identifies the order in which the Fish and Wildlife Service must consider listing and habitat designations for approximately 1,000 candidate species.[144] This work plan deviates from the "priority" numbers the Fish and Wildlife Service had previously assigned to the species.

Many of the species on the list are found primarily in the eastern United States.[145] If these species are ultimately listed under the Act, energy project developers and operators of current projects will be required to evaluate their compliance with the Act, often for the first time. Before the mega-settlements,

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143 For more information on the development of the work plan see http://www.fws.gov/endangered/improving_ESA/listing_workplan.html.

144 The listing work plan is available at http://www.fws.gov/endangered/improving_ESA/listing_workplan_FY13-18.html.

145 These species include, but are not limited to Georgia Aster, Bog Asphodel, Yadkin River Goldenrod, Kittlitz's Murrelet, Spectaclecase, Sheepnose, Pigtoe Mussel, Sandshell Mussel, Ebonyshell Mussel, Kidneyshell Mussel, Pearlshell Mussel, Choctaw Bean Mussel, Diamond Darter, Slabside Pearlymussel, Florida Semaphore Cactus, Aboriginal Prickleyapple, Cape Sable Throughwort, Rabbitsfoot Mussel, Red Knot, Black Pine Snake, Florida Bristle Fern, Kentucky Arrow Darter, Massasauga Rattlesnake, White Fringeless Orchid, Sprauge's Pipit, Highlands Tiger Beetle, Black Warrior Waterdog, Big Sandy Crayfish, American Eel, Florida Pineland Crabgrass, Fowler's Cave Beetle, Ichetucknee Silt Snail, Barbour's Map Turtle, Bicknell's Thrush, Eastern Hellbender, Black Rail.

many eastern counties were not known to include habitat for listed species, so Endangered Species Act compliance was a simple matter of confirming that listed species were not likely to be found in the area and determining that the Act was not applicable to the project.

However, as new species are listed throughout the east, project developers must consider whether Section 7 consultation is required for any federal permit they may require, and both operating and developing projects must consider whether they need to pursue incidental take authorization — either through Section 7 consultation or a Section 10 permit — to obtain legal authorization for the potential of incidental take. It is critical to be aware that the Endangered Species Act does not "grandfather" in existing projects. Project operators must be aware of the species on the work plan in their vicinity and prepare for appropriate permitting in the event that those species are listed.

The species now being listed and for which critical habitat determinations are being made range throughout the eastern United States. A few examples demonstrate the geographic breadth of the decisions to be made under the work plan:

- The eastern Massasauga rattlesnake (scheduled for a listing decision in fiscal year 2015) ranges throughout the upper Midwest and Great Lakes region.
- Florida pinelands crabgrass (scheduled for a listing decision in fiscal year 2015) is found in southern Florida and the keys.
- The white fringeless orchid (scheduled for a listing decision in fiscal year 2015) is found in South Carolina, Georgia, Alabama, Tennessee, and Kentucky.
- The spectaclecase mussel (listed as endangered in 2012) is currently found in streams in Alabama, Arkansas, Illinois, Iowa, Kentucky, Minnesota, Missouri, Tennessee, Virginia, West Virginia, and Wisconsin.
- The black warrior waterdog (scheduled for a listing decision in fiscal year 2015) is found only in a small area of Alabama.
- The northern long-eared bat (listed as threatened in 2015) ranges throughout most of the eastern states and Midwestern states.

The northern long-eared bat, which was recently designated as a threatened species, demonstrates the significance of the changed regulatory environment in the eastern United States. On April 2, the Fish and Wildlife Service listed the species as threatened and, concurrent with the listing decision, issued an interim 4(d) rule that identifies the actions the Fish and Wildlife Service has determined will "take" the species.[146] The 4(d) rule does not affect the Section 7 consultation requirements, which would apply to federal agency action — both new actions and ongoing actions for which a federal agency maintains discretionary control.

The 4(d) rule is designed to protect the northern long-eared bat while streamlining, as much as possible, the regulatory burden of the listing. This is demonstrated by the Service's guide to whether a permit for an activity is needed under the 4(d) rule.[147] The 4(d) rule specifies that a project outside the range of the species (as defined by a Fish and Wildlife Service map[148]) does not need a permit. For projects within the range, if the project is timed such that bats are not likely to be in area (*i.e.*, takes place during a time a year when bats are not present in the area), no permit is needed. For those projects that could affect northern long-eared bats, some purposeful take (*i.e.*, removal of bats from a human structure) and incidental take outside of the "White-nose Syndrome Buffer Zone" may be undertaken without a permit. The "White-nose Syndrome Buffer Zone" is defined by a Fish and Wildlife Service map and includes the entire northeastern section of the United States (*i.e.*, parts or all of states ranging from Minnesota to Maine to Nebraska to Louisiana and South Carolina).[149] Within those areas, specified activities (forest management, native prairie management, minimal tree removal, hazardous tree removal, and right of way maintenance) may be undertaken without a permit. All other activities that may incidentally take northern long-

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146 80 Fed. Reg. 17974 (Apr. 2, 2015).

147 The FWS guide to the 4(d) rule is available at http://www.fws.gov/midwest/endangered/mammals/nleb/Interim4dRuleKeyNLEB.html.

148 The FWS's map of the northern long-eared bat's range is available at http://www.fws.gov/midwest/endangered/mammals/nleb/pdf/WNSBufferZone.pdf.

149 The FWS's map of the White-nose Syndrome Buffer Zone is available at http://www.fws.gov/midwest/endangered/mammals/nleb/pdf/WNSBufferZone.pdf.

eared bats — including wind projects, mining, and oil and gas operations — would need to obtain authorization for potential incidental take under the 4(d) rule. For many operators, including those with existing projects, this will be the first time the Endangered Species Act applies to their projects.

Operators of existing and developing projects should develop relationships with state, local, and federal wildlife managers to (i) identify protected species that may be affected by the project, (ii) identify any best management practices or mitigation measures that can be employed to minimize the likelihood of take, and (iii) stay on top of changes of status for species in the vicinity of the project, so timely permits, if necessary, can be obtained. For developers of new projects, failure to do so could result in delays for either consultation or litigation. For operators of existing projects, failure to do so could result in civil or criminal enforcement for take of a listed species, and/or injunctions against operation as a result of citizen suit or pending the completion of consultation if a federal agency retains discretionary control over the project.

§ 2.09. Developing Issues.

[1] — Endangered Species Act and Climate Change.

In recent years, many cases have raised questions about how the Endangered Species Act interacts with climate change. These cases have affirmed that the Services and federal agencies must consider the impacts of climate change when conducting required Endangered Species Act analyses.[150] The Ninth Circuit has clarified that climate change must be a factor in considering whether to list a species and when modeling baseline species status and anticipated impacts.[151]

Climate change was the primary risk factor driving the recent listings of the polar bear and certain seal species. However, courts have challenged the Services where the science does not support their conclusions. For example, the D.C. Circuit held that climate change modeling does not allow the Fish

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150 Center for Biological Diversity v. Salazar, 804 F.Supp.2d 987 (D. Ariz. 2011).

151 Greater Yellowstone Coal. v. Servheen, 665 F.3d 1015 (9th Cir. 2011); *see also In re*: Consolidated Salmonid Cases, 791 F.Supp.2d 802 (E.D. Cal. 2011).

and Wildlife Service to draw a causal connection between greenhouse gas emission from a given facility and effects to listed species and their habitat.[152] And another court vacated a listing that was based on anticipated impacts to sea ice 50 years in the future on the grounds that such analysis was too speculate and remote to satisfy the statutory definition of a threatened species, *i.e.*, one that may become endangered "within the foreseeable future."[153]

[2] — Endangered Species Act v. Water Rights.

In times of water scarcity, the survival and recovery needs of listed aquatic species can conflict with other water uses. Because water law is, itself, a complicated subject, this can lead to difficult and sometimes conflicting decisions.

For example, consider the question of takings. Water rights are property rights. Where owners of those rights are precluded from exercising them because of restrictions enacted to protect listed species, court have come to opposing conclusions on whether holders of those water rights have suffered a Fifth Amendment taking.[154] In another twist on the takings analysis, the Federal Court of Claims held that the Bureau of Reclamation's directive to install a fish ladder and divert water to the fish ladder should be analyzed under the physical takings rubric.[155]

Separately, both the Ninth and Tenth Circuits have issued decisions affirming the primacy of the Endangered Species Act as against other water

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152 *In re* Polar Bear Endangered Species Act Listing and 4(d) Rule Litigation, 709 F.3d 1 (D.C. Cir. 2013).

153 Alaska Oil & Gas Assoc. v. Pritzker, No. 4:13-cv-00018-RRB (D. Ak. 2014).

154 *Compare* Tulare Lake Basin Water Storage District v. United States, 49 Fed. Cl. 313 (2001) (finding that federal and states agencies' restriction on water pumping to protect listed fish species constituted a takings) *with* Klamath Irrig. Dist. v. United States, 67 Fed. Cl. 504 (Fed. Cl. Aug. 31, 2005), modified, 68 Fed. Cl. 1999 (Fed. Cl. Sept. 23, 2005) (holding that water users could not pursue Fifth Amendment takings claims for alleged deprivation of water rights due to Endangered Species Act constraints and that the remedy, instead must be pursued through contract claims). *But see* Klamath Irrig. Dist. v. United States, 75 Fed. Cl. 677 (March 16, 2007) (rejecting contract claims).

155 Casitas Municipal Water Dist. v. United States, 543 F.3d 1276 (Fed. Cl. 2008).

uses. In *Rio Grande Silvery Minnow v. Keys*,[156] the Tenth Circuit held that the Bureau of Reclamation had the discretion to reduce contract water deliveries to state and local entities and restrict water diversions in order to meet the agency's duties under the Act. In a similar decision, the Ninth Circuit reversed a lower court decision and upheld a biological opinion covering joint state and federal water projects in the California Bay Delta that required substantial water reductions to Southern California for drinking and irrigation to protect the Delta smelt.[157] The opinion recognized the "enormous practical implications" of its decision in terms of the impacts the reductions would have on urban populations and agriculture in Southern California, but held that the reductions were required by the Act.[158]

[3] — Endangered Species Act Liability for Regulatory Authorities.

A number of courts have upheld Endangered Species Act liability resulting from state regulatory activities. Some of these cases imposed Endangered Species Act liability for a state's regulation of an otherwise activity that incidentally takes listed species, such as fishery regulation where the fishing equipment may incidentally take listed whales,[159] or for forestry activities on private lands in habitat suitable for spotted owl habitat.[160] In another case, the Eleventh Circuit upheld a plaintiff's ability to proceed against a county for inadequate regulation of artificial beachfront lighting, which the plaintiff alleged constituted a take of sea turtles.[161] Bucking the trend, however, in a recent decision the Fifth Circuit held that the Texas Commission on Environmental Quality's actions in administering licenses to take water did not foreseeably and proximately cause the death of endangered whooping cranes.[162]

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156 Rio Grande Silvery Minnow v. Keys, 333 F.3d 1109 (10th Cir. 2003).

157 San Luis & Delta-Mendota Water Authority v. Jewell, 747 F.3d 581 (9th Cir. 2014).

158 *Id. at 593*.

159 Strahan v. Coxe, 127 F.3d 1231 (1st Cir. 1997).

160 Seattle Audubon Soc'y v. Southerland, No. C06-160MJP (W.D. Wa. 2007).

161 Loggerhead Turtle v. Volusia, 148 F.3d 1231 (11th Cir. 1998).

162 Aransas Project v. Shaw, 756 F.3d 801 (5th Cir. 2014).

§ 2.10. Upcoming Administrative Actions.

The U.S. Fish and Wildlife Service and National Marine Fisheries Service have undertaken a series of administrative reforms intended to improve implementation of the Endangered Species Act.[163] Actions that have already been completed include the following:

- A regulatory revision to require the Services to make an economic analysis of the impact of a critical habitat designation available at the time of listing;[164]
- Adopting a joint policy on the definition of the phrase "significant portion of its range" which is part of the statutory definition of "endangered species" and "threatened species";[165] and
- Regulatory revisions regarding Incidental Take Statements to (a) codify the use of surrogates to express the amount or extent of anticipated incidental take, and (b) refine the basis for the basis of Incidental Take Statements in programmatic actions.[166]

The Services have announced a number of pending actions that are described below.

[1] — Proposed Rule on Critical Habitat.

The Services have proposed a rule that would make several changes to designation of critical habitat. These changes involve the Services' processes as well as changes to regulatory definitions, and clarify the criteria for designating critical habitat. The Services accepted public comment on the proposed rule in 2014 and state that they anticipate finalizing the rule in the summer of 2015.[167]

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163 For an overview see http://www.fws.gov/endangered/improving_ESA/index.html.

164 50 C.F.R. § 424.19, effective Oct. 30, 2013.

165 79 Fed. Reg. 37,578 (July 1, 2014).

166 80 Fed. Reg. 26,832 (May 11, 2015).

167 *See* Designating Critical Habitat, U.S. Fish and Wildlife Serv., www.fws.gov/endangered/improving_ESA/DCH.html.

[2] — Proposed Critical Habitat Policy.

The Services announced a proposed policy on exclusions from critical habitat. The statute allows Services to exclude geographic areas from critical habitat. The proposed policy is intended to provide the Services' position on how they will make exclusion decisions for conservation plans both permitted under Section 10 of the ESA and non-permitted conservation plans, tribal lands, military lands, and federal lands. The policy further addresses how the Services will consider economic impacts in the exclusion process. The Services accepted comments on the proposed policy in 2014 and anticipate finalizing the policy in the summer of 2015.[168]

[3] — Proposed Rule on Definition of "Adverse Modification."

The Services have proposed a rule that would revise the regulatory definition of "adverse modification" for purposes of Section 7 consultation on the impacts of a proposed action to designated critical habitat. The current regulatory definition has been invalidated by court decisions; this rule is designed to replace that definition. The proposed definition would focus the Services' Section 7 consultation on the impact of the proposed action to the "conservation value" of critical habitat. The Services accepted comments on the proposed rule in 2014 and anticipate finalizing the rule in the summer of 2015.[169]

[4] — Proposed Prelisting Conservation Policy.

The Services announced a draft policy to provide incentives for landowners to conserve candidate species by obtaining conservation credits that could be used (or sold to a third party) if the species is later listed to either offset or mitigate actions that could be detrimental to the species. The Services accepted comment on the draft policy in 2014 and anticipate finalizing the policy in the summer of 2015.[170]

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168 *See* Designating Critical Habitat, U.S. Fish and Wildlife Serv., www.fws.gov/endangered/improving_ESA/CHE.html.

169 *See* Definition of Destruction or Adverse Modification, U.S. Fish and Wildlife Serv., www.fws.gov/endangered/improving_ESA/AM.html.

170 *See Prelisting conservation Policy, U.S. Fish and Wildlife Serv.,* www.fws.gov/endangered/improving_ESA/prelisting-conservation.html.

[5] — Proposed Rule on Petition Standards.

On May 18, 2015, the Services announced a proposed rule that would revise regulations regarding petitions to list or delist species or designate or remove a designation for critical habitat. The proposed rule would require petitioners to coordinate with state fish and wildlife agencies to gather any relevant information prior to submitting petitions for domestic species. The proposed rule would also limit petitions to a single species. Finally, the proposed rule would provide detailed information regarding the level of information required in a petition for it to be deemed complete. The Services are accepting public comment on the proposed rule through September 15, 2015.[171]

[6] — Actions Announced in Press Release on Proposed Petition Standards.

The May 18, 2015, press release announcing the proposed rule on petition standards also announced the Services' intent to undertake additional actions to the following four goals: (1) improving science and increasing transparency; (2) incentivizing voluntary conservation efforts; (3) focus resources to achieve success; and (4) engaging the states.[172]

[7] — Proposed Rule on Experimental Populations.

On August 2, 2015, the Services published a proposed rule to amend and establish procedures for establishing experimental populations of listed species.[173] Authorized under section 10(j) of the Act, experimental populations are established outside the current ranges of the species for the purpose of furthering the conservation of these species.[174] In an effort to avoid local opposition for the establishment of new populations of protected species, section 10(j) relaxes certain restrictions otherwise applicable to the listed species, including by allowing directed taking of members of the population

171 *See* www.fws.gov/endangered/improving_ESA/petitioner-regulations.html; 80 Fed. Reg. 42465 (July 17, 2015) (reopening public comment on the proposed rule).

172 The press release is available at www.fws.gov/endangered/improving_ESA/petitioner-regulations.html.

173 80 Fed. Reg. 45924 (Aug. 2, 2015). *See* section 2.07[b][3].

174 16 U.S.C. § 1539(j).

and by relaxing the requirements of section 7 (treating all members of a population essential to species conservation as threatened, and nonessential populations as proposed for listing).[175] The proposed rules would define key terms used in section 10(j) and clarify procedures for identifying such populations and undertaking consultations under section 7.

§ 2.11. Conclusion.

Although it has been in effect for over 40 years, the Endangered Species Act continues to be a "work in progress." The Services remain active in developing new regulations to interpret the provisions of the Act and policy guidance to clarify how the statute and regulations will be applied. Litigation remains a hallmark of the law, and Congress continues to raise the prospect for legislative reform. While all of these legal and policy activities play out with considerable uncertainty as to the final outcome, one trend under the Endangered Species Act is clear — this law, and the controversies it entails, is no longer limited in application to the west. Species listings under the Endangered Species Act are now occurring with increasing frequency in the east, including for several species that have a significant relationship to landowner and development actions. As a result, parties undertaking resource utilization and land development activities in the eastern states must now be mindful of the Act's stringent requirements and the procedures that are available to achieve compliance. While the Endangered Species Act is undoubtedly one of the most restrictive environmental laws, it also has had the benefit of extensive "creative thinking" and administrative measures designed to make the law work as efficiently and effectively as possible, allowing development activities to go forward while protecting listed species. All parties with an interest in Endangered Species Act application in the east should stay abreast of the many current and evolving developments under the Endangered Species Act and look for opportunities to undertake proactive compliance measures that avoid delay, conflict, controversy and expense, while minimizing litigation risk.

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175 *Id*.

Chapter 3

What Does WOTUS Really Mean? Practical Consequences for Mining and Oil and Gas Operations

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1 The opinions expressed in this chapter are the authors' alone and should not be attributed to Crowell & Moring LLP. Nothing in this chapter should be construed as legal advice.

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§ 3.01. Introduction and Overview.

Agency rulemakings rarely attract the type of controversy as the joint U.S. Environmental Protection Agency's (EPA) and the U.S. Army Corps of Engineers' (the Corps) rulemaking to revise the definition of "waters of the United States" or "WOTUS" under the Clean Water Act (CWA). The WOTUS rule defines the scope of the waters protected under the CWA based on the agencies' interpretation of the statute, the science, and trio of Supreme Court decisions.[2] Depending on how the WOTUS rule is ultimately interpreted and applied in the field, it could dramatically expand agency jurisdiction under the CWA.

The agencies repeatedly have disclaimed any intent to expand their CWA jurisdiction, claiming instead that the final WOTUS rule — also called the Clean Water Rule — was intended to provide clarity and regulatory certainty.[3] Many stakeholders who generally support the rule have similarly expressed the view that the rule has not significantly changed the scope of

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2 The agencies jointly proposed the rulemaking in April 2014 and finalized the rule in June 2015. *See* Definition of 'Waters of the United States' Under the Clean Water Act, 79 Fed. Reg. 22,188 (Apr. 21, 2014) (proposed rule); Clean Water Rule: Definition of "Waters of the United States," 80 Fed. Reg. 37,054 (June 29, 2015) (final rule).

3 *See, e.g.,* 80 Fed. Reg. at 37,054 ("The scope of jurisdiction in this rule is narrower than that under the existing regulation. Fewer waters will be defined as 'waters of the United States' under the rule than under the existing regulations, in part because the rule puts important qualifiers on some existing categories such as tributaries. In addition, the rule provides greater clarity regarding which waters are subject to CWA jurisdiction, reducing the instances in which permitting authorities . . . would need to make jurisdictional determinations on a case-by-case basis.").

CWA jurisdiction. The final rule's terms, however, are sufficiency ambiguous to cast doubt on the resulting scope of the CWA's jurisdiction. The rule thus has drawn harsh criticism from the mining and oil and gas industries (among others), whose nationwide operations potentially stand to be affected by increased compliance and permitting costs, increased enforcement actions, and citizen suits that force them to defend a narrow interpretation of the vague definitions in the rule.

This chapter provides an overview of the current definition of waters of the United States[4] and the new WOTUS rule's significant changes to that definition, which will be effective for all CWA programs on August 28, 2015. It also explores whether the rule provides the clarity championed by the agencies and its possible implications for the mining and oil and gas industries. This chapter concludes by briefly examining ways in which those industries can prepare to comply with, and defend their interpretation of, the final rule.

[1] — Current Legal Landscape.

The Clean Water Act, 33 U.S.C. § 1251 *et seq*., applies to "navigable waters," which the Act defines simply as "waters of the United States."[5] Defining which water features are covered under the Act has long been the focus of agency regulations and guidance, and judicial scrutiny.

Current regulations define "waters of the United States" to include "a laundry list of features (from wetlands to intermittent streams to wet meadows), 'the use, degradation or destruction of which could affect interstate or foreign commerce.'"[6] That definition extends beyond waters that

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4 The recently promulgated WOTUS rule does not take effect until August 28, 2015. Thus, for purposes of this chapter, the "current" definition is the one that appears in the Code of Federal Regulations at the time this chapter was prepared (July 2015).

5 C.W.A. Section 502(7); 33 U.S.C. § 1362(7) (defining "navigable waters" as "the waters of the United States").

6 W. Parker Moore, *et al.*, "Mining Through the Proposed CWA Jurisdiction Changes and Impacts," *ABA SEER*, Mining and Mineral Extraction Committee Newsletter, at 3 (July 2014), *available at* http://www.americanbar.org/content/dam/aba/publications/nr_newsletters/mn/201407_mn.authcheckdam.pdf.

are actually navigable to include headwater streams, lakes, and wetlands.[7] Specifically, 33 C.F.R. § 328.3(a), currently defines "waters of the United States," as follows:

(1) All waters which are currently used, or were used in the past, or may be susceptible to use in interstate or foreign commerce, including all waters, which are subject to the ebb and flow of the tide;

(2) All interstate waters including interstate wetlands;

(3) All other waters such as 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 including any such waters:

(i) Which are or could be used by interstate or foreign travelers for recreational or other purposes; or

(ii) From which fish or shellfish are or could be taken and sold in interstate or foreign commerce; or

(iii) Which are used or could be used for industrial purpose by industries in interstate commerce;

(4) All impoundments of waters otherwise defined as waters of the United States under the definition;

(5) Tributaries of waters identified in paragraphs (a) (1) through (4) of this section;

(6) The territorial seas;

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7 EPA and the Corps, Questions and Answers – Waters of the U.S. Proposal, at 1, *available at* http://www2.epa.gov/sites/production/files/2014_09/documents/q_a_wotus.pdf.

(7) Wetlands adjacent to waters (other than waters that are themselves wetlands) identified in paragraphs (a) (1) through (6) of this section.

(8) Waters of the United States do not include prior converted cropland. Notwithstanding the determination of an area's status as prior converted cropland by any other Federal agency, for the purposes of the Clean Water Act, the final authority regarding Clean Water Act jurisdiction remains with EPA.

Waste treatment systems, including treatment ponds or other lagoons designed to meet the requirements of CWA (other than cooling ponds as defined in 40 CFR 423.11(m) which also meet the criteria of this definition) are not waters of the United States.[8]

On its face, the text of the current rule sets forth only two exclusions—prior converted cropland and waste treatment systems. Preambles to the current regulations, however, explain that the agencies generally will not assert CWA jurisdiction over numerous features (*e.g*. certain ditches, artificial ponds, etc.), but the agencies nevertheless retain the ability to assert jurisdiction on a case-specific basis.[9] In practice, the agencies generally have not regarded most waters' on-site industrial waters to be jurisdictional.

The current WOTUS rule was the subject of three decisions from the United States Supreme Court.[10] Following those decisions, the agencies had attempted to clarify the scope of CWA jurisdiction through various informal

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8 33 C.F.R. § 328.3(a); *see also* 40 C.F.R. § 122.2.

9 *See* 53 Fed. Reg. 20,764, 20,765 (June 6, 1988); 51 Fed. Reg. 41,206, 41,217 (Nov. 18, 1986).

10 *See* Rapanos v. United States, 547 U.S. 715, 759-87 (2006) (Kennedy, J., concurring) (proposing a significant nexus test for jurisdictional waters); Solid Waste Agency of N. Cook Cnty. v. U.S. Army Corps of Eng'rs (SWANCC*)*, 531 U.S. 159 (2001) (rejecting the regulation of "isolated waters" based on migratory bird use); United States v. Riverside Bayview Homes, Inc., 474 U.S. 121 (1985) (upholding regulation of wetlands adjacent to or "inseparately bound up with" navigable waters).

guidance documents[11] up until this new rulemaking. As the Agencies explained:

> After U.S. Supreme Court decisions in SWANCC (*Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers*, 531 U.S. 159 (2001)) and Rapanos (*Rapanos v. United States*, 547 U.S. 715 (2006)), the scope of waters of the US protected under all CWA programs has been an issue of considerable debate and uncertainty. The Act has a single definition for waters of the United States. As a result, these decisions affect the geographic scope of all CWA programs. SWANCC and Rapanos did not invalidate the current regulatory definition of waters of the United States. However, the decisions established important considerations for how those regulations should be interpreted, and experience implementing the regulations has identified several areas that could benefit from additional clarification through rulemaking. EPA and the U.S. Army Corps of Engineers are developing a proposed rule for determining whether a water is protected by the Clean Water Act. This rule would clarify which water bodies are protected under the Clean Water Act.[12]

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11 Lewis B. Jones, "The Necessity of Rulemaking in CWA Jurisdiction," *Law360* (Feb. 7, 2011), http://www.law360.com/articles/222982/the-necessity-of-rulemaking-in-cwa-jurisdiction?article_related_content=1; Edgar B. Washburn, et al., "Don't Go Near the Water," *Law360* (May 13, 2011), http://www.law360.com/articles/245037/don-t-go-near-the-water-?article_related_content=1.

12 Office of Information and Regulatory Affairs, Office of Management and Budget, Statement of Need, http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201410&RIN=2040-AF30 (last visited May 10, 2015). For additional context and analysis of the proposed rule, *see* 79 Fed. Reg. at 22,191-92; Anthony Cavendar, et al., "Waters Redefinition Will Muddle Enviro Compliance for O&G" (Nov. 12, 2014), http://www.law360.com/articles/595162/waters-redefinition-will-muddle-enviro-compliance-for-o-g; Kristin Clark, "Navigating Through the Confusion Left in the Wake of Rapanos: Why a Rule Clarifying and Broadening Jurisdiction Under the Clean Water Act is Necessary," 39 *Wm. & Mary Envtl. L. & Pol'y Rev.* 295 (2014); James Murphy, "Muddying the Waters of the Clean Water Act: *Rapanos v. United States* and the Future of America's Water Resources," 31 *Vt. L. Rev.* 355 (2006); W. Parker Moore, et al., "Mining Through the Proposed CWA Jurisdiction Changes and Impacts," *ABA SEER*, Mining and Mineral Extraction Committee Newsletter, at 3 (July 2014), *available at* http://www.americanbar.org/content/dam/aba/publications/nr_newsletters/mn/201407_mn.authcheckdam.pdf.

When the agencies proposed to revise the definition of WOTUS in 2014, they proclaimed that they intended to focus on, "interpret[ing] and apply[ing] the 'significant nexus' test established in Supreme Court decisions, based consistently on the law and science."[13] To meet that goal, the agencies asserted that the new rule had to "ensure that waters are protected under the CWA in circumstances where science supports an important and identifiable chemical, physical, or biological effect on downstream traditional navigable waters."[14]

EPA and the Corps issued the proposed WOTUS rule for public comment on April 21, 2014.[15] In response to numerous requests, the agencies extended the public comment period twice. The comment period ultimately closed on November 21, 2014, after the agencies received over a million comments. Although the vast majority of those comments were form letters, the agencies received a large number of substantive comment letters.

[2] — 2014 Proposed WOTUS Rule.

The agencies' 2014 proposal defined "waters of the United States" as follows:

(1) All waters which are currently used, were used in the past, or may be susceptible to use in interstate or foreign commerce, including all waters which are subject to the ebb and flow of the tide;

(2) All interstate waters, including interstate wetlands;

(3) The territorial seas;

4) All impoundments of waters identified in paragraphs (1)(i) through (iv) of this definition;

(5) All tributaries of waters identified in paragraphs (1)(i) through (iv) of this section;

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13 EPA and the Corps, Questions and Answers – Waters of the U.S. Proposal, at 2, *available at* http://www2.epa.gov/sites/production/files/2014-09/documents/q_a_wotus.pdf.

14 *Id*.

15 *See* 79 Fed. Reg. 22,188 (Apr. 21, 2014).

(6) All waters, including wetlands, adjacent to a water identified in paragraphs (a)(1) through (5) of this definition; and

(7) On a case-specific basis, other waters, including wetlands, provided that those waters alone, or in combination with other similarly situated waters, including wetlands, located in the same region, have a significant nexus to a water identified in paragraphs (a)(1) through (3) of this definition.[16]

Waters identified in categories (1) through (6) would be jurisdictional "by rule." In other words, no additional analysis of significant nexus would be required for waters in each of those categories to be jurisdictional.[17] For waters in those six categories, the agencies determined that "the nexus, alone or in combination with similarly situated waters in the region, is significant based on data, science, the CWA, and caselaw."[18] "Other waters" (in category 7) would not be jurisdictional *per se*, but could be determined to be jurisdictional on a case-by-case basis through a significant nexus analysis.

The agencies proposed to exclude from CWA jurisdiction the following categories of waters:

(1) Waste treatment systems, including treatment ponds or lagoons, designed to meet the requirements of the Clean Water Act.

(2) Prior converted cropland. Notwithstanding the determination of an area's status as prior converted cropland by any other Federal agency, for the purposes of the Clean Water Act the final authority regarding Clean Water Act jurisdiction remains with EPA.

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16 *See, e.g.,* 70 Fed. Reg. at 22,262-63.

17 *Id*. at 22,189. Those categories were designed to alleviate the need for the agencies to conduct resource-intensive case-by-case jurisdictional determinations. The proposed rule would preserve a case-by-case analysis for "other waters" deemed to have a significant nexus to jurisdictional waters.

18 *Id*.

(3) Ditches that are excavated wholly in uplands, drain only uplands, and have less than perennial flow.

(4) Ditches that do not contribute flow, either directly or through another water, to a water identified in paragraphs (1)(i) through (iv) of this section.

(5) The following features:

(i) Artificially irrigated areas that would revert to upland should application of irrigation water to that area cease;

(ii) Artificial lakes or ponds created by excavating and/or diking dry land and used extensively for such purposes as stock watering, irrigation, settling basins, or rice growing;

(iii) Artificial reflecting pools or swimming pools created by excavating and/or diking land;

(iv) Small ornamental waters created by excavating and/or diking dry land for primarily aesthetic reasons;

(v) Water-filled depressions created incidental to construction activity;

(vi) Groundwater, including groundwater drained through subsurface drainage systems; and

(vii) Gullies and rills and non-wetland swales.[19]

Importantly, these exclusions were intended to be absolute. In other words, "[w]aters and features that are determined to be excluded . . . will not be jurisdictional under any of the categories in the proposed rule . . . , even if they would otherwise satisfy the regulatory definition."[20]

The agencies claimed the proposal would reduce confusion about the scope of the CWA's protection[21] and repeatedly disavowed any intention

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19 *See, e.g.*, 70 Fed. Reg. at 22,264.

20 *Id*. at 22,193; *see also id*. at 22,263, 22,217. This is known as the "no recapture clause."

21 79 Fed. Reg. at 22,188.

to expand CWA authority or eliminate exceptions to waters of the United States.[22] Although a variety of stakeholders welcomed a rulemaking (as opposed to guidance) to revise the definition of "waters of the United States," including Congress, industry, the public, state and local governments, agriculture, hunters and fishermen, and environmental non-governmental groups or ENGOs,[23] many stakeholders were not pleased with the result.

Industry generally believed that the proposed rule would actually compound the inconsistency and confusion surrounding CWA jurisdiction.[24] Industry also believed that, even if the agencies did not intend to expand jurisdiction, ambiguity in many of the proposal's definitions left wide room for the rule to be misinterpreted as greatly expanding CWA jurisdiction. That ambiguity was significant because it would affect all CWA programs, *e.g.*, the Section 404 program regulating discharges of dredged or fill material; the Section 402 National Pollutant Discharge Elimination System

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22 *See* EPA and the Corps, Questions and Answers – Waters of the U.S. Proposal, at 1, *available at* http://www2.epa.gov/sites/production/files/2014-09/documents/q_a_wotus.pdf ("The agencies are not expanding the CWA. The proposed rule does not add protection to any new types of waters that have not historically been covered by the CWA, not does the rule in any way limit current regulatory and statutory exemptions and exclusions. Simply put, if an activity was exempted or excluded before this proposal, it will remain exempted or excluded. If you didn't need a permit for a type of activity before, you won't need one now."); *see also* EPA, Ditch the Myth, at 3, *available at* http://www2.epa.gov/sites/production/files/201407/documents/ditch_the_myth_wotus.pdf; House Transportation and Infrastructure Water Resources and Environment Subcommittee, Hearing on the CWA Jurisdictional Rule, Panel 1, 113th Cong., 19-20 (June 11, 2014) (statements of Assistant Secretary of the Army (Civil Works), Jo-Ellen Darcy, and Deputy Administrator of the U.S. EPA, Bob Perciasepe); Juan Carlos Rodriguez, "EPA Head Tells Panel CWA Jurisdiction Rule No Power Grab," *Law360* (Feb. 4, 2015), *available at* http://www.law360.com/articles/617532.

23 *See* EPA, Waters of the U.S. Proposed Rule Presentation (Apr. 7, 2014), http://water.epa.gov/learn/training/wacademy/upload/wous-webcast.pdf; *see also* EPA, Persons and Organizations Requesting Clarification of "Waters of the United States By Rulemaking, http://www2.epa.gov/sites/production/files/2014-03/documents/wus_request_rulemaking.pdf (last visited May 7, 2007).

24 The proposed rule was also politically controversial. *See* Spencer Chase, "Senators introduce bill to repeal controversial WOTUS rule," *Agri-Pulse* (Apr. 30, 2015), *available at* http://www.agri-pulse.com/Senators-introduce-bill-to-repeal-controversial-WOTUS-rule-04302015.asp; Juan Carolos Rodriguez, "Senate Bill Would Force EPA, Corps to Redo Water Rule," *Law360* (Apr. 30, 2015), *available at* https://www.law360.com/articles/649490/senate-bill-would-force-epa-corps-to-redo-water-rule.

(NPDES) permit program; the Section 401 state water quality certification process; the Section 311 oil spill program; and the Section 303 water quality standards and total maximum daily load programs. As a result, industry groups, numerous state and local governments, and even the Small Business Administration urged the agencies to withdraw the proposed rule to better engage stakeholders and to focus on science and relevant case law in revising their proposal.[25]

Rather than withdraw the proposal, EPA and the Corps finalized the rule after a relatively short interagency review period. The agencies signed the prepublication version on May 27, 2015. In addition to the rule itself, the agencies released a lengthy technical support document, an economic analysis of the rule, a Finding of No Significant Impact, and a voluminous response to comments document.[26]

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25 *See, e.g.,* Comment submitted by Amanda E. Aspatore, Associate General Counsel, National Mining Association (NMA), at 3 (Nov. 14, 2014), *available at* Regulations.gov [Dkt. ID EPA-HQ-OW-2011-0880-15169]; Comment submitted by Roger E. Claff, Senior Scientific Advisor, and Amy Emmert, Senior Policy Advisor, American Petroleum Institute (API), at 5, *available at* Regulations.gov [Dkt. ID EPA-HQ-OW-2011-0880-15115]; Comment submitted by Deidre G. Duncan, Hunton & Williams LLP, on behalf of the Water Advocacy Coalition (WAC), at 1, 3 *available at* Regulations.gov [Dkt. ID EPA-HQ-OW-2011-0880-17921]; Commenters also believe that the agencies have misinterpreted Supreme Court precedent governing the definition of "waters of the United States." *See* Comment submitted by Roger E. Claff, Senior Scientific Advisor, and Amy Emmert, Senior Policy Advisor, American Petroleum Institute (API), at 1-23, *available at* Regulations.gov [Dkt. ID EPA-HQ-OW-2011-0880-15115]; Comment submitted by Deidre G. Duncan, Hunton & Williams LLP, on behalf of the Water Advocacy Coalition (WAC), at 15-24, *available at* Regulations.gov [Dkt. ID EPA-HQ-OW-2011-0880-17921]. Industry also contends that the agencies have abandoned their prior interpretation of that precedent without any reasoned basis. *See* Comment submitted by Roger E. Claff, Senior Scientific Advisor, and Amy Emmert, Senior Policy Advisor, American Petroleum Institute (API), at 28-32, *available at* Regulations.gov [Dkt. ID EPA-HQ-OW-2011-0880-15115]. Although those comments are significant, this presentation focuses on the practical effects of the rule on extractive operations, not the legal justification (*vel non*) for the rule.

26 Supporting documents, *available a*t http://www2.epa.gov/cleanwaterrule/documents-related-clean-water-rule (last visited July 13, 2015).

§ 3.02. Final WOTUS Rule.

The final WOTUS rule was published in the Federal Register on June 29, 2015, and it will become effective 60 days after publication, on August 28, 2015.[27] The final rule establishes six categories of jurisdictional waters that are jurisdictional by rule, two categories of case-specific waters that may be jurisdictional through a significant nexus analysis, and thirteen categories of waters that are *per se* excluded from jurisdiction.

[1] — Categorically Jurisdictional Waters.

The final rule identifies the following six categories of waters that are *per se* jurisdictional or jurisdictional by rule.

(1) All waters currently used, were used in the past, or may be susceptible to use in interstate or foreign commerce, including all waters subject to the ebb and flow of the tide;[28]

(2) All interstate waters including interstate wetlands;

(3) Territorial seas;

(4) All impoundments of waters otherwise identified as jurisdictional;[29]

(5) All tributaries to waters listed in (1) through (3), which are newly defined to include anything that contributes flow, directly or indirectly, to a water in (1) through (3) and that has a bed, banks, and an ordinary high water mark (OHWM); and

(6) All waters (not just wetlands) that are adjacent to a water in (1) through (5).[30]

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27 *See* 80 Fed. Reg. 37,054.

28 Categories (1), (2), and (3) are unchanged from the current WOTUS definition.

29 Category (4) is technically unchanged from the current WOTUS definition, but will *de facto* be broader due to the expansion of Categories (5) and (6) in the final rule and the addition of Categories (7) and (8).

30 All adjacent waters include wetlands, ponds, lakes, oxbows, impoundments and similar waters adjacent to Category (1) through (5) waters.

As discussed below, the scope of CWA jurisdiction may significantly increase as a result of the new definition of "tributary," the categorical assertion of jurisdiction over all "adjacent" *waters* (not just wetlands), and the new definition of "neighboring," which is a term used within the definition of "adjacent."

[a] — New Definition of Tributary.

The preamble to the final WOTUS rule notes that the current rule "regulates all tributaries without qualification."[31] The final rule defines "tributary" for the first time to mean:

> a water that contributes flow, either directly or through another water (including an impoundment . . .), to a water identified in paragraphs (a)(1) through (3) [*i.e.*, a traditional navigable water, territorial sea, or interstate water of this section that is characterized by the presence of the physical indicators of a bed and banks and an ordinary high water mark [(OHWM]).[32]

OHWM is now defined for all CWA programs using the Corps' longstanding definition in Title 33 of the Code of Federal Regulations, which means:

> that line on the shore established by the fluctuations of water and indicated by physical characteristics such as a clear, natural line impressed on the bank, shelving, changes in the character of the soil, destruction of terrestrial vegetation, the presence of litter and debris, or other appropriate means that consider the characteristics of the surrounding areas.[33]

Notably, during the comment period for the WOTUS rule, the Corps was revising its guidance on OHWM delineation without providing formal

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31 80 Fed. Reg. at 37,075.

32 *See, e.g., id*. at 37,104.

33 *Id*. at 37,106.

notice or an opportunity for members of the public to comment.[34] Because the OHWM concept is of critical importance to the "tributary" definition, as well as the definition of "adjacent" (see below), these recently released guidance documents could play an important role during implementation and enforcement of the final WOTUS rule.

A tributary may have flow that is perennial, intermittent, or ephemeral.[35] It can also be natural, man-made, or man-altered and can contribute flow through a non-jurisdictional feature.[36] Breaks (either natural or man-made) do not sever jurisdiction so long as physical indicators of a tributary (bed, banks, and OHWM) are identifiable upstream.[37] Moreover, the definition of "tributary" plainly encompasses ditches, unless they fall within one of the narrow ditch exclusions discussed below.

A field observation may establish that physical indicators of a bed, bank, and ordinary high water mark are present, but the agencies also can use "desktop tools" like remote sensing and mapping technology and aerial photographs.[38] Such tools can be used to identify beds, banks, and the OHWM, and they include lake and stream gage data, flood predictions, historic records of water flow, and statistical evidence.[39] The ability to use desktop tools to establish jurisdiction has been sharply criticized by the regulated community because those physical indicators of a bed, banks, and

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34 *See* Matthew K. Mersel, et al., *A Guide to Ordinary High Water Mark (OHWM) Delineation for Non-Perennial Streams in the Western Mountains, Valleys, and Caoast Region of the United States* (Aug. 2014), *available at* http://acwc.sdp.sirsi.net/client/search/asset/1036027; Matthew K. Mersel, *et al.*, *Occurrence and Distribution of Ordinary High Water Mark (OHWM) Indicates in Non-Perennial Streams in the Western Mountains, Valleys, and Coast Region of the United States* (Aug. 2014), *available at* http://acwc.sdp.sirsi.net/client/search/asset/1036025; Matthew K. Mersel, *et al.*, *A Review of Land and Stream Classifications in Support of Developing a National Ordinary High Water Mark (OHWM) Classification* (Aug. 2014), *available at* http://acwc.sdp.sirsi.net/client/search/asset/1036026.

35 80 Fed. Reg. at 37,076.

36 *Id*. at 37,076.

37 *Id*. at 37,078.

38 *Id*. at 37,076-77.

39 *Id*. at 37,077.

OHWM "may not even be visible to the human eye, or . . . existed historically but are no longer present."[40]

All waters that fall within the new definition of "tributary" are jurisdictional *per se* and thus, there is no need for further analysis of significant nexus to establish CWA jurisdiction. Determining which waters fall within the definition, however, will often be challenging given the inherent difficulty in delineating OHWMs and the lack of predictability as to how regulators will use desktop tools.

[b] — Expanded Definition of Adjacent Waters.

The final rule continues to define "adjacent" as "bordering, contiguous, or neighboring," but it expands the concept of adjacency in comparison to the current regulations by deeming all adjacent *waters* (wetlands, ponds, lakes, oxbows, impoundments, and similar water features) to be jurisdictional, as opposed to just adjacent *wetlands*.[41] Waters need not be located laterally to a Category (1) through (5) waters to be adjacent.[42] Adjacent waters also include those that connect segments of a Category (1) through (5) water, or are located at the head of a Category (1) through (5) water and are bordering, contiguous, or neighboring such water.[43]

The final rule contains a new definition of "neighboring" that encompasses (i) waters where *any* portion is within 100 feet of the OHWM of a Category (1) through (5) water; (ii) waters where *any* portion is within the 100-year floodplain of a Category (1) through (5) water and less than 1,500 feet of the OHWM of such water; (iii) waters where *any* portion is within 1,500 feet of the high tide line of a traditional navigable water or territorial

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[40] American Farm Bureau Federation, "Final 'Waters of the U.S.' Rule: No, No, No! No Clarity, No Certainty, No Limits on Agency Power (June 11, 2015), http://www.fb.org/tmp/uploads/Final_Rule_No_No_No-Condensed_Version-Copy.pdf.

[41] 80 Fed. Reg. at 37,080.

[42] *See, e.g., id*. at 37,105.

[43] *Id*.

sea; and (iv) waters where *any* portion is within 1,500 feet of the OHWM of the Great Lakes.[44]

Because the definition of "adjacent" relies heavily on the OHWM concept, the uncertainty over OHWM delineation will carry over to adjacency. Moreover, the agencies acknowledge in the preamble that identification of the 100-year floodplain will not always be clear.[45] They specify use of FEMA Flood Zone Maps to identify the location and extent of the 100-year floodplain, yet they warn that "[i]t is important to recognize [] that much of the United States has not been mapped by FEMA and, in some cases, a particular map may be out of date and may not accurately represent existing circumstances on the ground."[46] Absent current, reliable FEMA floodplain maps, the agencies will look to other sources of information, such as "other Federal, State, or local floodplain maps, Natural Resource Conservation Service (NRCS) Soil Surveys (Flooding Frequency Classes), tidal gage data, and site-specific modeling."[47] Needless to say, there will be considerable confusion when the rule takes effect over how to determine what waters are "adjacent."

[2] — Case-Specific Jurisdiction.

Two additional categories will be jurisdictional on a case-by-case basis:

(7) Five types of specific regional water features that are determined to have a significant nexus to a water in (1) through (3) above: (i) prairie potholes; (ii) Carolina bays and Delmarva bays; (iii) pocosins; (iv) western vernal pools; and (v) Texas coastal prairie wetlands. These features are considered similarly situated by rule and will be aggregated within a watershed when analyzing significant nexus.

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44 *Id*. An entire water feature will be considered "adjacent" if any part of it is within the distance thresholds established in the "neighboring" definition. *Id.; see also id*. at 37,080-81.

45 *See* 80 Fed. Reg. at 37,081.

46 *Id*.

47 *Id*.

(8) All waters where *any portion* is within either of the following two categories that have a significant nexus to a water in Categories (1) through (3) above:

(i) Waters within the 100-year floodplain of a Category (1) through (3) water (but more than 1,500 feet from the OHWM);

(ii) Waters within 4,000 feet of the high tide line or OHWM of a (1) through (5) water.

For these two categories, "significant nexus" is the key to jurisdiction. It is defined in the rule as "a water, including wetlands, either alone or in combination with other similarly situated waters in the region, significantly affects the chemical, physical, or biological integrity" of a Category (1) through (3) water.[48] The rule also specifies nine functions that will be relevant to a significant nexus evaluation: (i) sediment trapping; (ii) nutrient recycling; (iii) pollutant trapping, transformation, filtering, and transport; (iv) retention and attenuation of flood waters; (v) runoff storage; (vi) contribution of flow; (vii) export of organic matter; (viii) export of food resources, and (ix) provision of life cycle dependent aquatic habitat, such as foraging, feeding, nesting, breeding, spawning, or use as a nursery area, for species located in a Category (1) through (3) water.[49]

Again, there will likely be a great deal of confusion over how to apply these provisions given, for instance, their reliance on the OHWM concept and the 100-year floodplain. Moreover, assertions of jurisdiction under these categories will hardly be case-specific □ once an aggregation analysis has been conducted with respect to one water body that results in a significant nexus determination, *all* waters that were aggregated will become jurisdictional.[50]

48 *See, e.g., id*. at 37,106.
49 *See, e.g., id*.
50 *See id*. at 37,095.

[3] — Exclusions.

Thirteen categories of waters are excluded from the definition of WOTUS, even where they would otherwise meet the definition of an impoundment, tributary, adjacent water, or a case-specific water. Water features excluded from jurisdiction are:

- Waste treatment systems, including treatment ponds or lagoons designed to meet the requirements of the CWA;
- Prior converted cropland;
- Ditches that (i) have ephemeral flow and are not a relocated tributary or excavated in a tributary; (ii) have intermittent flow and are not a relocated tributary, excavated in a tributary, or drain wetlands; (iii) do not flow, directly or indirectly, into a Category (1) through (3) water;
- Erosional features (gullies, rills, and other ephemeral features) that do not meet the tributary definition, non-wetland swales, and lawfully constructed grassways;
- Groundwater;
- Puddles; and
- The "dry land exclusions," which apply to the following areas created in dry land:
  - Artificially irrigated areas;
  - Artificial, constructed lakes and ponds, including settling basins and cooling ponds;
  - Artificial reflecting pools or swimming pools;
  - Small ornamental waters;
  - Water-filled depressions incidental to mining or construction;
  - Stormwater control features; and
  - Wastewater recycling features, such as detention and retention basins built for wastewater recycling; groundwater recharge basins; percolation ponds built for wastewater recycling; and water distributary structures built for wastewater recycling.[51]

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51 *See, e.g., id*. at 37,105.

The preamble explains that ditches relocate a tributary "when at least a portion of [the tributary's] original channel has been physically moved, or when the majority of its flow has been redirected."[52] In applying the exclusion for ditches with ephemeral flow, the agencies will assert jurisdiction over portions of those ditches that are actually excavated in a tributary or that relocate a tributary. The upstream and downstream portions of those same ditches would have to be evaluated further to determine whether they are jurisdictional or excluded.[53] The preamble further explains that ditches with intermittent flow drain a wetland when they "physically intersect" the wetland.[54] The portions of such ditches will be jurisdictional, but the upstream and downstream portions of those same ditches will need to be evaluated further to determine their jurisdictional status.[55] Application of the ditch exclusions is thus likely to generate much confusion on the ground.

The "dry land" exclusions also may be difficult to apply in some instances given the lack of clarity over what constitutes "dry land." The preamble states that "the agencies believe the term is well understood."[56] Yet in response to comments suggesting that the final rule provide a definition of "dry land," paradoxically, "[t]he agencies . . . determined that there was no agreed upon definition given geographic and regional variability."[57]

The final rule's exclusion for artificial, constructed lakes and ponds created on dry land improves upon the proposal's exclusion because the agencies have made it clear that the exclusion encompasses more than just agricultural ponds. The preamble states that the "list of ponds has always been illustrative rather than exhaustive," and thus, ponds used in the oil and gas and mining industries can fall within the exclusion.[58] Moreover, the language of the exclusion no longer requires that a pond be "used exclusively for" the specified purposes, which means that multi-purpose ponds can be

52 *See id*. at 37,098.
53 *See id*.
54 *Id*.
55 *See id*.
56 *Id*. at 37,098.
57 *Id*. at 37,098-99.
58 *Id*. at 37,099.

excluded.[59] The agencies stated that they recognize artificial lakes and ponds are often used for more than one purpose.[60]

The regulatory text of the exclusion for stormwater control features created on dry land appears to broadly encompass features used to convey stormwater, regardless of their flow regime. However, the agencies attempt to narrow the scope of that exclusion through preamble language, proclaiming that it only applies to "engineered stormwater control structures in municipal or urban environments."[61]

Finally, it is important to keep in mind that desktop tools will be relevant in determining whether a water feature is jurisdictional or whether it is excluded from jurisdiction. For example, regulators may rely on those tools to conclude that a ditch was, at some point in time, excavated in a tributary. The preamble clearly states that "[t]he agencies will determine historical presence of tributaries using a variety of resources, such as USGS and state and local maps, historic aerial photographs, local surface water management plans, street maintenance data, wetlands and conservation programs and plans, as well as functional assessments and monitoring efforts."[62] Similarly, the agencies could rely on desktop tools when determining whether a feature was actually constructed in "dry land."

§ 3.03. The Final Rule's Implications for Mining and Oil and Gas Industries.

The breadth and ambiguity in the final rule will make it challenging for the mining and oil and gas industries to discern which water features are jurisdictional. For starters, the categorical assertions of jurisdiction over all waters that fall within the new definitions of "tributary" and "neighboring" (as used in "adjacent") could mean that new water features in and around mine and oil and gas sites will now be jurisdictional. In addition, case-specific assertions of jurisdiction could sweep in additional waters. Perhaps most importantly, the final rule could potentially expand jurisdiction over on-site

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59 *See id*.
60 *See id*.
61 *Id*. at 37,100.
62 *Id*. at 37,098.

waters, ditches, and artificial ponds used by both the mining and oil and gas industries for treatment and operational uses previously not considered jurisdictional. These on-site waters will be the focal point of the analysis below. As a result of the final rule, the regulated community faces the risk of increased permitting and compliance costs, enforcement risks, and the federalization of previously non-federal activities.

[1] — The Final Rule Could Extend Jurisdiction to On-Site Water Management Features and Industrial Ponds.

On-site waters serve important operational functions in both industries. Mines use on-site stormwater and surface water management features like diversion and conveyance ditches, closed loop systems, on-site containment, sedimentation and treatment ponds and impoundments, and other components of water treatment facilities. Those water features are essential to manage, contain, convey, and treat on-site waters.[63] For example, ditches and conveyances are necessary to manage stormwater runoff from undisturbed areas to downstream waters, or to carry water from disturbed areas to ponds within the mine site where solids can settle out and water is subsequently beneficially reused or discharged pursuant to a National Pollution Discharge System (NDPES) Section 402 permit. Mine operators also use a variety of ponds and impoundments like sediment ponds, heap leach ponds, tailings impoundments, slurry impoundments, and pits that intercept ground water, all of which promote the settling of solids that are later removed for disposal or further treatment. Water is then evaporated, used in mining processes, or discharged to navigable waters pursuant to an NPDES permit.

Like mining operators, oil and gas operators use ditches to manage on-site stormwater. They also use on-site water features to satisfy other industrial needs, including raw water storage ponds, process water holding ponds, fire

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63 Under SMCRA, those features are part of required water diversion and drainage systems or, for coal slurry impoundments, are considered part of a coal preparation plan's water circuit. *See* 30 C.F.R. Part 816; 50 Fed. Reg. 41,296, 41,303 (Oct. 9, 1985). Other types of industrial ponds on mine sites that are not involved in water management and treatment but are nonetheless vital to an operation such as fire ponds may also be subject to regulation as waters of the United States.

water storage ponds, and other industrial water systems necessary to operate the facility but that are not designed to satisfy any particular environmental statute.

Those on-site features have not previously been considered to be jurisdictional. To illustrate, the agencies have recognized in prior guidance documents that most on-site waters like ditches and conveyances are within the scope of the waste treatment system exclusion.[64] EPA has considered on-site waters to be "treatment systems" that represent practicable control technology and best available technology economically achievable to manage process waste water required by the CWA or, in other cases, as part of required non-process and stormwater management systems.[65] The Corps also generally has not asserted jurisdiction over on-site ditches; in the rare instance where the Corps has asserted jurisdiction, it has done so on a case-by-case basis.

Despite the foregoing, certain terms in the final WOTUS rule are defined so broadly that most on-site water management features could be considered jurisdictional. The new definition of "tributary" is so broad that many (if not most) ditches and other water management features on mine and oil and gas sites would fall within the definition. Many such features contribute flow, however indirectly, to downstream jurisdictional waters. For that reason,

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64 *See, e.g.*, Grumbles, Benjamin H., Memorandum to Hon. John Paul Woodley, Assistant Secretary of the Army (Civil Works) (Mar. 1, 2006) (recognizing that some segment of the stream must be used to convey water from the fill to the sediment pond and is a component of the treatment system because it is required to convey water and provides initial treatment by settling some fraction of suspended sediment); Regas, Diane, et al., to EPA Director Region X CWA Regulation of Mine Tailings (May 17, 2002) (affirming revised definition of fill and discharge of fill material did not alter EPA's interpretation of waste treatment system exclusion from CWA regulation); Wilcher, LaJuana S., Memorandum to EPA Director Region X EPA CWA Regulation of Mine Tailings Disposal (Oct. 2, 1992) (clarifying that discharge of mine tailings for disposal/treatment into impounded waters for the purpose of containing and treating those materials does not require a permit but that any discharge from the waste treatment system requires a 402 permit).

65 *See* 42 Fed. Reg. 21,380 (Oct. 17, 1975); 44 Fed. Reg. 2,586 (Jan. 12, 1979); 46 Fed. Reg. 28,873 (May 29, 1981); 47 Fed. Reg. 45,382 (Oct. 13, 1982); 50 Fed. Reg. 41,296 (Oct. 9, 1985); 67 Fed. Reg. 3,370 (Jan. 23, 2002); 42 Fed. Reg. 3,843 (Jul. 12, 1977); 43 Fed. Reg. 9,808 (Mar. 10, 1978); 43 Fed. Reg. 29711 (Jul. 11, 1978); 47 Fed. Reg. 54,598 (Dec. 3, 1982); 53 Fed. Reg. 18,764 (May 24, 1988).

many of those features have NPDES permits authorizing their discharge to navigable waters.

On-site water features also could be deemed "adjacent" jurisdictional waters due to the final rule's broad new definition of "neighboring." Indeed, every water feature within the distance and floodplain thresholds would be jurisdictional unless otherwise excluded.[66] Jurisdiction could thus be interpreted to extend over on-site features by virtue of those thresholds, even when they are designed and operated to sever any surface connection between water within the permitted operation and offsite undisturbed waters. Alternatively, those features could be deemed jurisdictional even though any surface connection through discharge is managed under an NPDES permit.

Even if on-site water features are not categorically jurisdictional as "tributaries" or "adjacent" waters, they can nevertheless be jurisdictional under either of the case-specific approaches.[67] Again, the distance and floodplain thresholds set forth in the final rule could sweep in many on-site waters within the mining and oil and gas industries.

Operators face additional uncertainty because these definitions are not only broad and ambiguous, but their application will be left to agency staff in EPA regions and Corps districts. This will likely result in inconsistent application of the final rule.

[2] — The Final Rule's Exclusions May Not Apply to On-Site Waters.

Even if on-site waters meet the terms of WOTUS Categories (4) through (8), the final rule provides that an applicable exclusion would trump jurisdiction, unless the water body at issue is a traditional navigable water, interstate water, or territorial sea.[68] With respect to on-site waters, mining and oil and gas industries must therefore carefully evaluate the various exclusions in the final rule to determine whether they might apply. In addition to the exclusions discussed in this section, the waste treatment system exclusion is

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66 80 Fed. Reg. at 37,105.

67 *See id*.

68 *See id*. (declaring that various water features "are not 'waters of the United States' even where they otherwise meet the terms of paragraphs (a)(4) through (8) of this section").

likely to be of critical importance to the mining industry, in particular. That exclusion is discussed separately in Section 3.05.

[a] — Excluded Ditches.

Historically, ditches generally were not regulated as WOTUS, but were subject to case-by-case assertions of jurisdiction. Ditches are now expressly included in the definition of a jurisdictional "tributary" unless they qualify for one of the express exclusions under the rule.[69] However, the final rule defines the types of ditches excluded from CWA jurisdiction narrowly so that it is not clear whether on-site ditches would be excluded. The final rule exempts three types of ditches from the definition of waters of the United States that might otherwise qualify as tributaries: "(1) ditches with ephemeral flow that are not excavated in a tributary and do not relocate a tributary; (2) ditches with intermittent flow that are not a relocated tributary, excavated in a tributary, or drain wetlands; and (3) ditches that do not contribute flow, either directly or through another water, to a Category (1) through (3) jurisdictional water."[70]

None of these exclusions would apply if, for example, a ditch on a mine site (which is likely quite long given the average size of mine projects) intersects a "water of the United States" at any point. Many ditches also may not be eligible for the exclusion if they, at some point, modified a stream. Remember, the agencies can use "desktop tools" to determine whether a stream once existed, even if it is not discernible through a field inspection. It also is not clear how the agencies will distinguish a ditch from erosional features, whether the new definition is retroactive, or what showing a landowner must make to invoke the ditch exclusion.

[b] — Excluded Stormwater Control Features.

The regulatory text of the stormwater control features exclusion appears broad enough to encompass any feature that conveys, treats, or stores

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69 *See, e.g.*, 80 Fed. Reg. at 37,105 ("A tributary can be a natural, man-altered, or man-made water and includes waters such as . . . ditches not excluded under paragraph (b) of this section.").

70 80 Fed. Reg. at 37,105.

stormwater so long as it is created on dry land.[71] The preamble, however, makes it clear that the agencies created the stormwater exclusion for municipal stormwater treatment systems.[72] That exclusion thus would not extend to conveyances on mining and oil and gas sites. Even if the exclusion might apply, owners and operators might have difficulty establishing that such features were actually created on dry land, given the uncertainty over what constitutes "dry land" and how the agencies might use desktop tools to assert that the exclusion is inapplicable.

[c] — Excluded Artificial Ponds and Lakes.

Although the rule provides that artificial ponds and lakes, including those found on industrial sites, are not jurisdictional, to qualify for that exclusion they must have been constructed in dry land, which is not a defined phrase in the rule. It is not absolutely clear whether artificial ponds meet the requirement of being excavated on dry land if they are constructed within floodplains or within areas after ephemeral or intermittent drainages have been diverted, or where they share some sort of subsurface hydrological connection to a downstream jurisdictional water. It is thus possible that mine and oil and gas operators could be vulnerable to more onerous permitting and/or citizen jurisdictional challenges over their on-site artificial ponds and lakes.

[d] — Excluded Wastewater Recycling Structures.

Mining and oil and gas facilities may rely on different types of structures to reuse and recycle water, *e.g.*, retention basins, groundwater recharge basins, water distributary structures built for recycling wastewater. Such features are excluded from jurisdiction under the final rule, but only if they were constructed in dry land. The uncertainty over what constitutes "dry land" and the unpredictability as to how agency staff will employ desktop tools are again relevant in determining the applicability of this exclusion.

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71 *See id*.

72 *See, e.g.,* 80 Fed. Reg. 37,100.

[3] — The Rule Will Impose Substantial Permitting, Compliance, and Enforcement Costs.

In light of the many questions surrounding the rule, it is likely that the Rule will impose substantial permitting, compliance, and enforcement costs. The extractive industries are already heavily regulated under various state and federal statutory schemes, all of which may be affected by the final rule. For example, operators typically have to obtain CWA Section 402 and 404 permits, and State 401 certifications. Mining operators also must obtain comply with the Surface Mining Control and Reclamation Act (SMCRA) permitting scheme. Oil and gas operators must comply with CWA Section 311, as amended by the Oil Pollution Act of 1990, and must prepare and implement a Spill Prevention, Control, and Countermeasures (SPCC) Plan. In addition, activities regulated by these programs often are regulated under the Endangered Species Act (ESA) and are thus subject to the citizen suit provisions of the CWA and the ESA, which allow (and even encourage) enforcement by non-governmental parties.

If, as EPA and the Corps contend, the agencies do not intend to expand CWA jurisdiction through the rule, the rule nevertheless could be misconstrued to do so. The breadth and ambiguity of many of the definitions in the rule could be interpreted to encompass previously non-jurisdiction waters and treatment systems on mine sites and oil and gas operations across the county. Such an interpretation could subject operators to onerous administrative or judicial proceedings in which they bear the burden of disproving jurisdiction over water features.

Losing the exclusion for on-site water management features, ditches, and ponds would have severe consequences for extractive operations. Companies would have to contend with heavier permit burdens and obtain Section 402 and 404 permits and state Section 401 certifications more often. For example, if on-site water management ditches are waters of the United States, a company would need Section 404 dredge-and-fill permit coverage for any ditch maintenance, modification, move, or reclamation.

Due to this confusion, operators and regulatory authorities could be asked to modify existing NPDES permits to reflect new assessments on outfalls and receiving waters. Permitting authorities also could require permits for

previously unpermitted waters. Moreover, even if the permitting authorities do not attempt to assert jurisdiction over on-site waters, operators could be subject to citizen suits in federal court alleging unlawful internal, on-site discharges.

In addition, expanded jurisdiction could federalize actions that did not previously have a federal component. New federal actions could trigger compliance with other environmental statutes like the ESA and the National Environmental Policy Act.

Increased permitting costs and enforcement risks could be compounded by the costs industry may face as a result of delay. Profits may be delayed, opportunity costs may accrue, and companies may be forced to carry development capital for longer periods of time.

§ 3.04. Challenges and Risks for the Oil and Gas Industry.

In addition to the shared challenges posed to the regulatory industry discussed above, the oil and natural gas industry also faces particular increased costs and risks posed by the rule that do not apply to mine operators. Some of those challenges include potential exploration restrictions, the possibility that nationwide Section 404 permitting for mid-stream pipelines will be eliminated, and the specter of more onerous SPCC compliance. Those challenges could be more prevalent in the West and in areas like the Bakken play, which is located in the prairie potholes region.

[1] — Expanded WOTUS Jurisdiction May Limit Activities.

The WOTUS rule may restrict areas in which oil and natural gas exploration can be conducted. The upstream sector of the industry conducts exploration by drilling exploratory wells and subsequently drilling and operating the working wells that bring crude oil and/or natural gas to the surface. Exploratory and production areas require access roads, well pads, pipelines, and temporary storage areas. Expanded WOTUS jurisdiction and the increased density of development could make it difficult for upstream companies to avoid non-traditional waters of the United States for exploration drilling and accompanying infrastructure. As the Waters Advocacy Coalition cautioned in commenting on the proposed rule, "landowners will

have to carefully consider whether a feature is a 'water of the U.S.' before proceeding."[73]

At a minimum, companies should anticipate (and develop strategies to handle) more environmental screening of new sites, an increased number of permits resulting in increased costs and delay, and additional compensatory mitigation costs.

[2] — The Final Rule May Eliminate or Complicate Nationwide Section 404 Pipeline Permits.

Nationwide Corps Section 404 permits "have played an increasingly prominent role in the construction and permitting of interstate oil and natural gas pipelines."[74] Midstream oil and gas activities involve transportation, often via pipeline. Pipeline construction could be impacted by the increased jurisdictional scope of the rule, leading to more environmental site screening, permit delays, and/or the potential nullification of the use of nationwide permits for pipeline construction. Pipelines could also face additional compensatory mitigation costs.

[3] — SPCC Compliance May Become Increasingly Onerous.

Owners and operators of regulated facilities are required to comply with CWA Section 311(j)(1)(C), as amended by the Oil Pollution Act of 1990, which makes it is the policy of the United States "that there should be no discharges of oil or hazardous substances into or upon the navigable waters of the United States."[75] That prohibition has been interpreted as preventing unpermitted discharges to navigable waters and requiring oil and gas operators to develop effective oil spill prevention and response plans and to timely report oil

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73 Waters Advocacy Coalition, *Proposed WOTUS Rule Implications for All CWA Programs*, at 5, *available at* http://www.nssga.org/wp-content/uploads/2014/07/WAC-LP-Proposed-WOTUS-Rule-Implications-for-All-CWA-Programs-7-14-14.pdf.

74 Anthony Cavendar, *et al.*, "Waters Redefinition Will Muddle Enviro Compliance for O&G" (Nov. 12, 2014), http://www.law360.com/articles/595162/waters-redefinition-will-muddle-enviro-compliance-for-o-g.

75 33 U.S.C. § 1321(j)(1)(C).

spills.[76] In particular, EPA's Spill Prevention, Control, and Countermeasure ("SPCC") rule requires secondary containment for storage containers and a SPCC Plan.[77] It applies to most facilities with an aboveground oil storage capacity greater than 42,000 gallons or an underground storage capacity greater than 42,000 gallons, the location of which could "reasonably" be expected to discharge oil in "quantities that may be harmful" into or upon "navigable waters."[78] Like the other CWA programs, the SPCC rule is tied to "waters of the United States."[79]

Because the jurisdictional trigger for SPCC is whether facilities with stored oil above the threshold amounts "reasonably could be expected" to discharge spilled oil to navigable waters, defined as WOTUS, the final rule's apparent expansion of the scope of WOTUS could similarly broaden the reach of SPCC. Although the rule is silent on any impact to SPCC beyond saying that Section 311 is affected by the definitional changes, many facilities that did not previously need SPCC plans because they were located by isolated, non-jurisdictional waters may suddenly find themselves in proximity to newly designated jurisdictional waters, requiring a SPCC plan.[80] This may be especially true for Western facilities.

Commentators also anticipate that the WOTUS rule could complicate SPCC compliance responsibilities, making it more likely that enforcement authorities could question a determination that a particular body is located such that an oil spill may not be reasonably expected to enter navigable

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76 *See* 40 C.F.R. Part 110 (EPA's Oil Spill Rule); 40 C.F.R. Part 112 (EPA's Spill Prevention, Control, and Countermeasure (SPCC) Rule).

77 40 C.F.R. §§ 112.3, 112.7(c)

78 *Id*. § 112.1(b).

79 *See* 80 Fed. Reg. at 37,054.

80 As the Chamber of Commerce and an industry coalition predicted in their comments on the proposed rule, the emphasis on adjacent waters and the explicit inclusion of ditches in the definition of "tributary" unless expressly excluded "means that more operations will likely be required to maintain a SPCC plan for the first time." Comments by the Chamber of Commerce and Industry Coalition on the Proposed Rule, at 16 (Nov. 12, 2014). *available at* https://www.uschamber.com/sites/default/files/11.12.14-_multiorganization_comments_to_epa_and_usace_on_proposed_rule_definition_of_waters_of_the_united_states.pdf (hereinafter "Chamber Comments").

waters.[81] Moreover, even facilities that already have SPCC plans may be forced to alter those plans in response to the rule. SPCC plans that rely on on-site ditches or impoundments to collect spilled oil could require revision because those ditches and impoundments are at risk of being classified as WOTUS. If they become jurisdictional because, *inter alia*, they were not excavated in dry land, those facilities would be forced to revise their SPCC plans and would incur increased compliance and clean-up costs.[82]

§ 3.05. Challenges and Risks for the Mining Industry.

Apart from the concerns over on-site water management features that are shared by the mining and oil and gas industries, mining companies have drawn the agencies' attention to other risks and costs that could result from the proposed expansion of WOTUS jurisdiction. Those concerns are discussed below.

[1] — Uncertainty over the Waste Treatment System Exclusion.

The agencies stated in the preamble to the final rule that they made "no substantive changes" to the waste treatment system exclusion and thus, they declined "to make conforming changes to ensure that each of the existing definitions of the 'waters of the United States' for the various CWA programs have the exact same language with respect to the waste treatment system exclusion, with the exception of deleting the cross reference" to an EPA regulation (40 C.F.R. § 423.11(m)) that no longer exists.[83] In responding to comments on the proposed rule, the agencies indicated that the 200+ comments they received on the waste treatment system exclusion "are beyond

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81 Anthony Cavendar, *et al*., "Waters Redefinition Will Muddle Enviro Compliance for O&G" (Nov. 12, 2014), http://www.law360.com/articles/595162/waters-redefinition-will-muddle-enviro-compliance-for-o-g.

82 Chamber Comments at 16 ("Un-diked areas are required to have drainage systems to flow into ponds, lagoons, or catchment basins to retain oil and return such runoff to the facility. Under the proposed rule, if such catchment basins are within areas subject to periodic flooding," . . . SPCC plans could be required to be implemented or renewed.").

83 80 Fed. Reg. at 37,097.

the scope of the rulemaking."[84] The precise scope of the waste treatment system exclusion, however, has been the subject of much controversy and litigation over the years. Because the agencies declined to clarify that uncertainty in this rulemaking, the uncertainty that has plagued the application of the waste treatment system exclusion will continue to weigh on the mining industry (and many other industries that rely on that exclusion), regulators, and activist groups alike.

A major ambiguity in the scope of the exclusions stems from EPA's prior attempt to limit the exclusion in a 1980 revision to the definition of WOTUS in the regulations implementing the NPDES program, *i.e.*, 40 C.F.R. § 122.2.[85] The definition of WOTUS in that provision differs from the definitions found in all of the other Corps and EPA regulations implementing the CWA because it contains a sentence prescribing that "[the waste treatment system] exclusion applies only to manmade bodies of water which neither were originally created in waters of the United States (such as disposal area in wetlands) nor resulted from the impoundment of waters of the United States."[86] That sentence, however, is accompanied by a footnote explaining that it has been suspended since July 21, 1980.[87] Not surprisingly, the suspended sentence would have substantially narrowed the exclusion because many waste treatment systems (both in the mining industry and other industries) do, in fact, incorporate WOTUS. Despite the express suspension in the regulatory text, the limitation has been erroneously invoked activist groups and even federal courts.[88] Given the stated purpose of the rule to provide clarity, it is unclear why the waste treatment system in 40 C.F.R. § 122.2 retains this unique language.[89]

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84 Response to Comments at 51, *available at* http://www2.epa.gov/sites/production/files/2015-06/documents/cwr_response_to_comments_7_njd.pdf.

85 *See* 45 Fed. Reg. 32,655, 33,424 (May 19, 1980).

86 *See* 40 C.F.R. § 122.2.

87 *See id*.; *see also* 45 Fed. Reg. at 48,620.

88 *See, e.g*., Ohio Valley Envtl. Coal. v. U.S. Army Corps of Eng'rs, 2007 WL 2200686 (S.D. W. Va. June 13, 2007), *rev'd by* 556 F.3d 177 (4th Cir. 2009); United States v. TGR Corp., 171 F.3d 762, 765 (2d Cir. 1999).

89 *See* 80 Fed. Reg. at 37,114.

Another area of confusion is what exactly constitutes "treatment" for purposes of applying the exclusion. Those seeking to narrow the scope of the exclusion have argued that treatment only encompasses the addition of chemicals or the use of costly technologies such as ion exchange or reverse osmosis. Mining companies, however, rely on various other treatment methods including wastewater and stormwater retention, concentration (evaporation), settling, or active and passive treatments (in-situ or in-process) to remove or reduce pollutants. EPA and SMCRA permitting authorities have long recognized that, for example, collecting and retaining runoff in on-site water management features is an acceptable form of waste treatment.

Finally, whether waste treatment systems include linear conveyances that flow to and from ponds and impoundments used to treat wastewater is another area of dispute. In the past, the Corps and EPA have recognized that channels, ditches, feeder streams, and other water features are an important part of waste treatment systems,[90] yet neither the current regulatory text nor the proposed new rule expressly clarifies this.

[2] — Potential Inability to Comply with Other Regulatory Requirements.

Mining companies often must construct and maintain water management systems on mine sites to comply with various regulatory schemes, not just the CWA. For example, mine operators must comply with SMCRA requirements governing the protection of hydrologic balance within mine sites and adjacent areas.[91] To meet those requirements, mine operators rely on siltation structures such as sedimentation ponds, permanent and temporary

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90 *See*, *e.g.*, 42 Fed. Reg. 21,380 (Oct. 17, 1975); 44 Fed. Reg. 2,586 (Jan. 12, 1979); 46 Fed. Reg. 28,873 (May 29, 1981); 47 Fed. Reg. 45,382 (Oct. 13, 1982); 50 Fed. Reg. 41,296 (Oct. 9, 1985); 67 Fed. Reg. 3,370 (Jan. 23, 2002); 42 Fed. Reg. 35,843 (Jul. 12, 1977); 43 Fed. Reg. 9,808 (Mar. 10, 1978); 43 Fed. Reg. 29,711 (Jul. 11, 1978); *see also* Wilcher, LaJuana S., Memo. to U.S. EPA Director Region X, EPA CWA Regulation of Mine Tailings Disposal (Oct. 2, 1992); Regas, Diane, *et al.* to U.S. EPA Director Region X, CWA Regulation of Mine Tailings (May 17, 2002); Grumbles, Benjamin H., Memo. to Hon. John Paul Woodley, Ass't Sec'y of the Army (Civil Works) (Mar. 1, 2006).

91 *See* 30 U.S.C. § 1265(b)(10)(B)(i); 30 C.F.R. § 816.41.

ditches and impoundments, diversions, and other features.[92] Given how dynamic mining operations are, these structures are frequently moved around and modified, and they must be maintained until the SMCRA regulatory authority authorizes their removal and disturbed areas are stabilized and revegetated.[93] Given the broad new definitions in the WOTUS rule, mining operators may have difficulty complying with SMCRA requirements because they encounter delays in obtaining a Section 404 permit or, worse, are unable to obtain a permit.

§ 3.06. Next Steps for Industry.

The regulated industry must prepare to comply with the final rule by August 28, 2015.[94] The immediate concern will be determining what features may be newly jurisdictional. Facilities may wish to engage consultants to assess their existing operations to determine whether they will face new permitting obligations and whether the rule will affect their project timelines, particularly if they are forced to seek additional Section 404 permits. Operators will need to develop compliance plans to meet the rule's requirements and to obtain additional permits, as needed. In preparing for exploration or new operations, advance site analysis will become increasingly important.

Industry also may wish to engage with local agency staff early to ascertain how the agencies will interpret the provisions in the rule that remain ambiguous. Operators also should anticipate citizen suit challenges seeking to exploit those ambiguities and try to prepare for those challenges accordingly. If enforcement actions ensue, industry should determine whether an as-applied challenge to the rule would be appropriate. The meaning of a "water of the United States" is frequently a central issue in enforcement actions, and confusion over the final WOTUS rule all but ensures that such litigation will continue.

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92 *See id.*; *see also* 30 C.F.R. §§ 816.43 to 816.49.

93 30 C.F.R. § 816.46(b)(4).

94 Suits have been filed raising facial challenges to the rule but they are beyond the scope of this chapter.

Chapter 4

Citizen "Suit Yourself": New (and Very Real) Water Compliance Challenges for Coal Power Utilities

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§ 4.01. Introduction.

Compliance with federal, state, and even local environmental government enforcement initiatives is only the beginning of the story for coal power utilities. Citizen lawsuits to enforce environmental laws impose new and daunting compliance challenges. While citizen lawsuits have long existed, environmental non-governmental organizations (ENGOs) are beginning to utilize them with increasing frequency, often taking innovative approaches to expand their reach. Coal power utilities need to consider compliance not just from an agency perspective, but also with an eye toward deflecting, defending, or minimizing the likelihood of citizen lawsuits. This chapter addresses the rise in citizen suit enforcement and identifies several overarching citizen group initiatives and litigation battlegrounds, with a focus on coal power utility and water compliance. Finally, the chapter outlines several pre-emptive strategies that coal power utilities can use to defend against citizen enforcement actions.

§ 4.02. Background.

Citizen enforcement has not always been an aspect of modern environmental statutes. When Congress was initially passing environmental legislation in the 1960s, most statutes did not include a citizen suit provision. However, in the 1970s, Congress became concerned that federal agencies such as the United States Environmental Protection Agency (EPA) were not sufficiently motivated to enforce environmental statutes. Starting with the Clean Air Act (CAA), Congress added a provision giving the public the opportunity to bring lawsuits under the statute.[1] In short order, Congress added similar provisions to nearly every environmental statute.[2]

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1 42 U.S.C. § 7604(a)(1).

2 *See, e.g.*, Clean Water Act (CWA), 33 U.S.C. § 1365 (providing that "any citizen" may sue under the Clean Water Act); Toxic Substances Control Act (TSCA), 15 U.S.C.

Generally, the citizen suit enforcement provisions that were added to these statutes provided that "any person" could sue an operator for alleged violations of the statute or its regulations, as well as the EPA for failure to carry out nondiscretionary duties.[3] As described by the Supreme Court in the seminal case *Gwaltney of Smithfield v. Chesapeake Bay Foundation*, citizen suits were designed to *supplement*, not *supplant,* governmental enforcement.[4]

§ 4.03. Rise in Citizen Suits.

Due to a number of factors — including new rulemaking approaches, new technologies, and a ripe cultural environment — environmental citizen lawsuits now account for the vast majority of enforcement suits under environmental statutes.[5] More citizen suits have been filed pursuant to the Clean Water Act (CWA) than any other environmental statute.[6] These suits are increasing both in number and in scope.

[1] — Next Generation Compliance.

Underlying many of the changes that are giving way to increased citizen lawsuits are EPA's Next Generation Compliance policies. EPA describes these policies as "a modern approach to compliance" using five interconnected components.[7] EPA has said that it intends to use new tools,

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§ 2619; Endangered Species Act (ESA), 16 U.S.C. § 1540(g); Surface Mining Control and Reclamation Act (SMCRA), 30 U.S.C. § 1270; Resource Conservation and Recovery Act (RCRA), 42 U.S.C. § 6972; Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. § 9659; Emergency Planning and Community Right to Know Act (EPCRA), 42 U.S.C. § 11046.

3 *Id*.

4 Gwaltney of Smithfield v. Chesapeake Bay Foundation, 484 U.S. 49, 60 (1987).

5 *See e.g.*, "Now More Than Ever: Trends in Environmental Citizen Suits," at 30, 10 *Wid. L. Symp. J.* 1, 8 ("In the 30 years from 1973-2002, citizens [suits] accounted for more than 1,500 reported federal decisions in civil environmental cases. In the 10 years from 1993-2002, federal courts issued opinions in an average of 110 civil environmental cases a year. Of these, eighty-three a year, that is, roughly three in four (75 percent), are citizen suits.")

6 "Standing in the Ever-Changing Stream: The Clean Water Act, Article III Standing, and Post-Compliance Adjudication," 20 *Stan. Envtl. L.J.* 73, 75-76.

7 U.S. EPA Office of Enforcement and Compliance Assurance, "Next Generation Compliance: Strategic Plan 2014 – 2017" (October 2014), at 1, *available at*: http://

"while strengthening vigorous enforcement" of environmental laws by taking advantage of "the best thinking from inside and *outside* EPA."[8] Importantly, EPA sees an enhanced role of citizens in enforcement as central to its new enforcement strategy.

Each of the five components of EPA's Next Generation enforcement initiative incorporates a public role.[9] The components are:

1. Advanced Monitoring: Use and promote advanced emissions/ pollutant detection technology so that regulated entities, the government, and *the public* can more easily see pollutant discharges, environmental conditions, and noncompliance.
2. Electronic Reporting: Shift toward electronic reporting to help make environmental reporting more accurate, complete, and efficient while helping EPA and co-regulators better manage information, as well as improve effectiveness and *transparency*.
3. Transparency: Expand transparency by making information more accessible to *the public*.[10]
4. Innovative Enforcement: Develop and use innovative enforcement approaches (*e.g.,* publically attainable data analytics and targeting) to achieve more widespread compliance.
5. Regulation/Permit Design: Design regulations and permits that are easier to implement (*e.g*., relying on citizen enforcement), with a goal of improved compliance and environmental outcomes.

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www2.epa.gov/sites/production/files/2014-09/documents/next-gen-compliance-strategic-plan-2014-2017.pdf.

8 *Id*. (emphasis added).

9 *See generally*, Memorandum from Cynthia Giles, Assistant Administrator, U.S. EPA Re "Use of Next Generation Compliance Tools in Civil Enforcement Settlements" (January 7, 2015).

10 *See also* http://www.washingtonpost.com/politics/federal–goveernment/federal–eye-briefs-foia-distributed-records-to-go-online/2015/07/12/a449tab8-2719-11e5-aae2-6c4759b050aa–story.html.

A recent EPA settlement demonstrates how EPA is using these new strategies. In May 2015, EPA and Tonawanda Coke reached a settlement of Hazardous Air Pollutants (HAPs), CAA, and Resource Conservation and Recovery Act (RCRA) claims.[11] The agreement incorporates several Next Generation Compliance tools. Among other provisions, the settlement provides for the public release of pollution data and for third-party compliance audits.[12] In fact, in the press release for the consent decree, an EPA Regional Administrator praised the efforts of the public in collecting its own data on the company's emissions. "The community did their own air toxic monitoring, which revealed high levels of pollution. This fine example of citizen science spurred government action to protect the community."[13]

[2] — Self-Implementing Coal Combustion Residuals Rule.

The recent self-implementing Coal Combustion Residuals (CCR) Rule is another example of how EPA is not only encouraging, but relying on citizen enforcement. In EPA's words, in response to FAQs on the new CCR Rule:

> Citizens perform a crucial role in the implementation and enforcement of this rule . . . EPA has designed recordkeeping and Internet posting requirements as part of the final rule to help ensure transparency and to assist citizens in playing that role. . . The regulations promulgated today are "self-implementing," . . . EPA has no formal role in implementation nor can it enforce the requirements. Thus, enforcement of these requirements will be by citizen suits (or by States acting as citizens).[14]

Interestingly, while states can implement the CCR rule through state waste laws, such state rules will not bar citizen suits under the federal rule.

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11 U.S. v. Tonawanda Coke Corp. Consent Decree (May 11, 2015), *available at*: http://www.epa.gov/region02/capp/TCC/tonawanda_consent_decree_with_appendices.pdf.

12 *Id*. at 36.

13 U.S. Department of Justice Press Release, (May 11, 2015), *available at*: http://www.justice.gov/usao-wdny/pr/tonawanda-coke-pay-12-million-civil-penalties-facility-improvements-and-environmental.

14 *EPA Coal Ash Rule Frequently Asked Questions*, *available at*: http://www2.epa.gov/coalash/frequent-questions-coal-ash-rule.

This rule represents a novel form of enforcement of RCRA, placing direct enforcement responsibilities on citizens.[15]

[3] — Limited Agency Budgets/Culture of Citizen Supplementation.

While continuing budget cuts require EPA to identify enforcement priorities and employ new strategies, there is great societal interest in eco-awareness and enthusiasm for improving the environment. For example, environmental stewardship is a hallmark of the Millennials generation.[16] These interconnecting forces are playing a key role in the exponential increase in citizen suits.

§ 4.04. Unique Compliance Challenges.

While citizen enforcement offers EPA and other implementing agencies a cost-effective means to pursue wide-spread enforcement, it also raises significant new challenges for regulated industry. Unlike EPA's clearly identified enforcement priorities, which provide the regulated community a degree of predictability, citizen group enforcement lacks a unified enforcement agenda. Citizen enforcement also involves conflicting interpretations of statutes and regulations, as well as significant data accuracy issues. Finally, citizen enforcement does not pre-empt other environmental group litigation such as tort claims, creating greater uncertainty due to a lack of finality.

[1] — Lack of Unified Citizen Group Enforcement Agenda.

Regulated entities are increasingly facing the challenge of strategically focusing resources to serve compliance and pollution prevention goals, while

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15 75 Fed. Reg. 35128, 35136 (June 21, 2010) ("EPA has no role in the planning and direct implementation of solid waste programs under RCRA subtitle D."); *accord*, 80 Fed. Reg. at 21302 and 21310 ("EPA has no role in the planning and direct implementation of the minimum national criteria . . . under RCRA subtitle D, and has no authority to enforce the criteria.").

16 *See e.g.*, Boston Consulting Group Perspectives, "How Millennials Are Changing the Face of Marketing Forever," *available at*: https://www.bcgperspectives.com/content/articles/marketing_center_consumer_customer_insight_how_millennials _changing_marketing_forever/?chapter=3.

also minimizing risk of liability to a multitude of discrete citizen groups harboring disparate objectives.

The EPA maintains a list of national enforcement initiatives which it publishes approximately every three years.[17] Regulated entities can look to this list and can appropriately direct resources to address issues that fall within EPA's national enforcement initiatives. For example, EPA is currently prioritizing the reduction of air pollution, and specifically hazardous air pollutants, from the largest sources.[18] In the energy extraction realm, EPA is focused on ensuring energy extraction activities are conducted in compliance with environmental laws.[19] For the water sector, EPA is committed to enforcement related to keeping raw contaminated stormwater out of our nation's waters (which affects the mining industry via the decommissioning of coal production facilities) and preventing animal waste from contaminating surface and ground water.[20] Finally, in the hazard chemicals realm, EPA is focused on reducing pollution from mineral processing operations.[21]

Knowing EPA's main initiatives helps industry focus resources on ensuring compliance in high-impact areas, as identified by the agency through informed analysis. But there are no analogous overarching citizen group enforcement initiatives. Citizen groups frequently have varying, constantly evolving, and diverse enforcement goals. This requires regulated entities to devote greater time and resources to ensuring their actions are defensible to challenges from a broad range of citizen groups and interests.

While it is possible to analyze general trends and themes in citizen suit enforcement (as discussed further below), such assessment is by no means comprehensive. It takes time and effort, as well as discretion, to figure out environmental group initiatives — and to then assess resource distribution to address the same. Even then, surprises can occur.

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17 EPA National Enforcement Initiatives, *available at*: http://www2.epa.gov/enforcement/national-enforcement-initiatives.

18 *Id*.

19 EPA, National Enforcement Initiative: Ensuring Energy Extraction Activities Comply with Environmental Laws, *available at*: http://www2.epa.gov/enforcement/national-enforcement-initiative-ensuring-energy-extraction-activities-comply.

20 *Id*.

21 *Id*.

[2] — Inconsistent Interpretations.

Figuring out what initiatives citizen groups are focused on is a valuable way to appropriately direct resources, but it is not enough. Citizen groups often have differing interpretations, within those bigger picture initiatives, of what constitutes compliance.

The coal ash and coal mining water enforcement context provides a great example of the varied, and often disparate, enforcement priorities of different citizen groups. In the coal context, agency enforcers have actually become potential industry allies where industry and agencies are in agreement, but citizen groups seek to enforce *alternative* interpretations of regulatory requirements.

For example, in a recent CWA citizen suit, several citizen groups alleged a coal company had violated boilerplate provisions in its National Pollutant Discharge Elimination System (NPDES) permits.[22] The case centered on the ENGOs' novel interpretation of a standard permit condition that required compliance with total maximum daily limits (TMDLs) and TMDL implementation plans. The ENGOs insisted that this provision required immediate compliance with TMDLs developed after permit issuance, despite language in the TMDL document itself that the state agency would conduct a phased implementation.[23] In support of its defense, the coal company sought affidavits and assurances from the state agency that it was in compliance with its permits.[24] Based on this agency information, the court granted summary judgment to the coal company, stating:

> "[The company] has produced further evidence of [the agency's] interpretation of the permit language, as well as the opinions of agency officials that [the company] is in compliance with the permit conditions. Plaintiffs do not challenge the fact of the agency's interpretation of the permit conditions or the relevant statutes, but

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22 Southern Appalachian Mt. Stewards v. Red River Coal Co., 2015 U.S. Dist. LEXIS 48483, *1-3 (W.D. Va. 2015).

23 *Id*.

24 *Id*. at *3.

> merely [the company's] compliance with the permit. Therefore, there is no genuine issue of material fact to preclude summary judgment. I find that [the company] is entitled to summary judgment in its favor."[25]
>
> Coming up with an appropriate defense to alternative ENGO interpretations of environmental laws will be a critical challenge for industry in the coming years. Agencies who do not want to see their own hard work and interpretations undermined by these citizen suits may become important allies.

[3] — Questions about Accuracy of Data.

While industry is generally responsible for producing, verifying, and submitting environmental data to regulators, environmental groups have become increasingly sophisticated at harnessing this raw data to support their own enforcement efforts. It is imperative that industry continue to strive for precision in data production, but also that industry collect and disseminate data in such a way that minimizes opportunities for misinterpretation in the enforcement realm.

Moreover, environmental groups are collecting their own data by using new, unproven, non-standard sources.[26] That data can be compiled on public websites often without prior interpretation and analysis by trained personnel.[27] The very way in which data is generated often creates a recipefor misunderstanding – and potentially misdirected and costly enforcement.

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25 *Id*. at *4.

26 *See e.g*., Riverkeeper Citizen Testing Data, http://www.riverkeeper.org/water-quality/citizen-data/; *cf*, EPA Developer Central¸ http://developer.epa.gov/category/apps/ (last visited July 6, 2015) (describing several apps that utilize EPA data); *see also*, Virginia Department of Environmental Quality Draft 2014 305(b)/303(d) Water Quality Assessment Integrated Report, http://www.deq.virginia.gov/Portals/0/DEQ/Water/WaterQualityAssessments/IntegratedReport/2014/ir14_Integrated_Report_All.pdf (Dec. 15, 2014), at 3 (describing the Agency's screening criteria for using data collected by citizens. "Quality assurance and quality control (QA/QC) continue to be a concern for regulatory use of "outside" data, and DEQ has made a considerable effort to improve the data quality of outside data providers by reviewing monitoring protocols and holding training events.").

27 *See e.g*., *Clean Water Can't Wait*¸Sierra Club, http://content.sierraclub.org/coal/and-water (last visited July 6, 2015).

[4] — No Preemption of Other Citizen Lawsuits.

While a regulated entity may be defending statutory claims pursuant to environmental law, such claims do not necessarily preempt the filing of tort claims or even separate citizen suits regarding the same issues. Agency enforcement can act as a bar to citizen lawsuits, but a citizen suit does not similarly bar tort claims.[28] Frequently, citizen groups will use a mixture of statutory and tort claims, such as trespass and nuisance-based claims, to broaden the scope of litigation and the potential scope of relief. Similarly, a citizen suit would not statutorily bar a separate citizen lawsuit — for example, where various citizen groups do not agree on a legal interpretation.

In a seminal case, the Supreme Court found that the CWA did not prohibit state nuisance claims.[29] Recently, the Third Circuit similarly held that there is "nothing in the Clean Air Act to indicate that Congress intended to preempt source state common law tort claims."[30] The Supreme Court denied certiorari in the case, leaving the Third Circuit decision intact.[31] Environmental groups continue to use the Third Circuit precedent to bring tort claims under CAA.[32] The law in this area is a fast-moving target and thus particularly hard to defend against liabilities.

§ 4.05. Minimizing Citizen Enforcement Risks.

Given the many challenges associated with citizen enforcement, it is important that industry – particularly those associated with coal power production – try to get ahead of these risks, to the extent possible. The following "Top 10" enforcement initiatives in the water area reflect recent litigation initiatives by citizen groups. Based on these overarching themes, this chapter lays out potential strategies coal power utilities should consider in addressing these themes and minimizing risks associated with such themes.

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28 C.W.A. §§ 309(6)(A)(iii) and 505(b)(1)(B).

29 International Paper Co. v. Ouellette, 479 U.S. 481, 497-499 (1987).

30 Bell v. Cheswick Generating Station, 734 F.3d 188, 198 (3d Cir. Pa. 2013).

31 GenOn Power Midwest, L.P. v. Bell, 134 S. Ct. 2696 (June 2, 2014).

32 *See e.g.*, Luppe v. Cheswick Generating Station, 2015 U.S. Dist. LEXIS 9791 at **1-2 (W.D. Pa. Jan. 28, 2015).

[1] — Environmental Citizen Group "Top 10" Coal/Water Initiatives Cheat Sheet.

While it is infeasible to capture fully the agendas of all environmental citizen groups, synthesis — with focus on coal power utility and water initiatives — of a variety of citizen groups' messaging reveals a top 10 list of current initiatives for company consideration. These initiatives are being pursued by one or more of various ENGOs, including, for example, the Southern Environmental Law Center, Sierra Club, Clean Water Action, Earthjustice, and various Riverkeeper affiliates, among others. These initiatives demonstrate the multi-faceted attack on coal that is underway — addressing water inputs, waste and water outputs, alterative usages, etc. The following 10 areas have become enforcement priorities for ENGOs:

1. <u>Coal Mining/Mountaintop Removal</u> — focusing on impacts to waterways and eliminating coal as a power production source
2. <u>Coal Ash</u> — focusing on impacts to water ways and removal of ash to lined impoundments away from surface waters
3. <u>Coal Production and Water</u> — focusing on impacts to surface waters from coal power production and waste water discharges
4. <u>Stopping Coal Exports</u> — focusing on elimination of coal exportation (*e.g.*, as an alternative to coal power production in the United States)
5. <u>Water Supply</u> — focusing on protecting water supply and quality (*e.g.*, through involvement in disputes involving power production water sources such as the "Tri-State Water Wars" between Alabama, Georgia, and Florida)
6. <u>Nutrient Pollution</u> — focusing on water impacts from human sources of nitrogen, such as power production
7. <u>Stormwater Pollution</u> — focusing on stormwater impacts, including from industrial sectors (*e.g.,* power production/mining — particularly decommissioning activities) and construction projects (*e.g.*, linear power lines)
8. <u>Toxic Chemicals out of Waterways</u> — focusing on water impacts from toxic chemicals such as those associated with power production

9. Ocean Acidification — focusing on water impacts, such as ocean acidification and warming, resulting from carbon dioxide (such as that associated with coal power production)
10. Project/Area-Specific — focusing on project/area specific impacts (*e.g.*, plant construction, particularly in environmentally-sensitive areas)[33]

[2] — Citizen Lawsuit Battlegrounds.

Across these ENGO enforcement initiatives, common themes and strategies become apparent.

[a] — Narrative Conditions.

Many ENGOs are attempting to enforce narrative permit conditions, typically raising issues of interpretation and proof in such suits. Because narrative limits are not as easily applied as numeric limits where it is as simple as comparing Discharge Monitoring Report (DMR) data to permit limits, ENGOs are attempting to force their own interpretation of what they believe the narrative criteria should actually require via citizen lawsuits.

[b] — "Point Source" Expansion.

Many environmental groups have also pushed for continued expansion of the scope of what is considered a "point source" under the CWA. For example, in *Ecological Rights Found. v. Pac. Gas & Elec. Co.*, a citizen group claimed that stormwater running off of defendants' utility poles washed a wood preservative chemical from the poles to surface waters and alleged that such discharge established the power poles as point source dischargers.[34] The Ninth Circuit found that the power poles were not point sources because the generalized stormwater runoff from the poles did not represent a discretely collected and conveyed system discharging to waters

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33 *See generally*, Southern Envtl. Law Center. https://www.southernenvironment.org/our-programs; Sierra Club, www.sierraclub.org/about; Clean Water Action, www.cleanwateraction.org/about; Earth Justice, earthjustice.org/our_work; River Keepers, www.riverkeepers.org/index.php/base/page/about_us.

34 Ecological Rights Found. v. Pac. Gas & Elec. Co., 713 F.3d 502, 504 (9th Cir. Cal. 2013).

of the United States and that such runoff was in compliance with the CWA.[35] In another example, *Decker v. Northwest Environmental Defense Center*, the Supreme Court considered whether EPA's industrial stormwater regulations applied to stormwater from logging roads channeled into ditches, culverts, and channels that discharged into nearby rivers and streams.[36] The Court found that EPA reasonably interpreted its own regulations in excluding the type of stormwater discharges from logging roads at issue in the case and afforded EPA deference in its interpretation.[37]

[c] — Expansive WOTUS Definition.

Another battleground for citizen lawsuits is the scope of the definition of "waters of the United States" (WOTUS), the basis for CWA applicability.[38] This battle is being waged on various fronts, including groundwater, groundwater hydrologically-connected to surface water, and in EPA's new WOTUS Rule. For example, in *Cape Fear River Watch, Inc. v. Duke Energy Progress, Inc.*, the court considered CWA applicability to hydrologically-connected groundwater and held "that Congress did not intend for the CWA to extend federal regulatory authority over groundwater, regardless of whether that groundwater is eventually or somehow 'hydrologically connected' to navigable surface waters."[39] Similarly, in *Chesapeake Bay Found., Inc. v. Severstal Sparrows Point, LLC*, the court concluded that "discharge from migrations of groundwater . . . is not point source pollution, however, but nonpoint source pollution. . . . There is no basis for a citizen suit for nonpoint source discharges under the CWA."[40] However, there is conflicting law on this topic, in great part due to conflicting interpretations asserted in citizen

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35 *Id*. at 509-510.

36 Decker v. Northwest Envtl. Defense Ctr., 133 S. Ct.1326, 1330-1331 (Mar. 20, 2013).

37 *Id*.

38 80 Fed. Reg. 37054 (June 29, 2015).

39 Cape Fear River Watch, Inc. v. Duke Energy Progress, Inc., 25 F. Supp. 3d 798, 810 (E.D.N.C. 2014).

40 Chesapeake Bay Found., Inc. v. Severstal Sparrows Point, LLC, 794 F. Supp. 2d 602, 619-20 (D. Md. 2011).

suits.[41] Similarly, through EPA's recent WOTUS rulemaking and associated proceedings, citizen groups are pushing for an ever-broadening scope of what constitutes a "water of the United States."[42]

[d] — Compliance Demonstration.

Another area of significant legal development in citizen suits relates to case dismissal where there has been no prior agency enforcement due to agency finding of compliance. Under existing law, the CWA provides a 60-day waiting period following a citizen giving notice of its intent to sue.[43] This period is designed to give EPA and/or the state an opportunity to step in and commence its own enforcement action. However, the CWA does not provide a mechanism for EPA to demonstrate its finding that no enforcement is appropriate. An example of this can be found in the *Red River* case where, as discussed above, the agency deemed the company in compliance with the requirements that the citizen group alleged as violated.[44] Ultimately, the company successfully defended against citizen suit by filing with the court agency affidavits/declarations of compliance.[45]

[e] — Residual Liability.

ENGOs are also looking to expand residual liability — *i.e.*, redress for the impacts of wholly past violations, even when alleged violations have been addressed. *Gwaltney* firmly established that citizen suits do not provide relief for "wholly past" violations. [46] However, since *Gwaltney*, there has

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41 *See e.g.,* Friends of Santa Fe County v. LAC Minerals, Inc., 892 F. Supp. 1333 (D.N.M. 1995).

42 80 Fed. Reg. 37054, 37095-37096 ("Several commenters supported the approach that the single point of entry watershed was an appropriate scale to use to measure effect on traditional navigable waters, interstate waters, or the territorial seas. Other commenters felt the single point of entry watershed was too small to capture all the benefits that waters that do not meet the definition of adjacency contribute."); ("[c]ommenters suggested additional subcategories of waters be considered as jurisdictional or as similarly situated by rule, such as playa lakes, kettle lakes, and woodland vernal pools.")

43 33 U.S.C. § 1365(b).

44 Southern Appalachian Mt. Stewards v. Red River Coal Co., 2015 U.S. Dist. LEXIS 48483, *1-3.

45 *Id*.

46 *Gwaltney*, 484 U.S. 49 at 64.

been significant litigation attempting to impose residual liability, even after the cessation of allegedly unlawful activity, for penalties, injunctive relief, or other issues. For example, some courts have found they lack jurisdiction over citizen claims for civil penalties for wholly past violations of the CWA, but others have allowed claims for civil penalties even where violations have been resolved.[47]

[f] — Multiple Regulatory Frameworks.

Citizen groups are also challenging impacts regulated under one statutory framework under a separate agency framework. This presents unique situations for demonstrating compliance. For example, in recent coal ash litigation, the ENGO petitioner alleged CWA violations from a coal ash landfill rather than bringing RCRA claims.[48] The reverse, where an ENGO petitioner has brought RCRA claims based on impacts regulated under the CWA, has also occurred.[49] In yet another case, citizens asserted claims under the CWA for alleged impacts of air borne fugitive dust from rail cars.[50]

[g] — Permit Shield.

Another area of common attack is the scope of the CWA's Permit shield.[51] The CWA Permit shield provides that "[c]ompliance with a permit issued pursuant to this section shall be deemed compliance" for purposes of enforcement and citizen suits involving certain effluent limits, performance standards, and ocean discharges, but not toxic pollutants.[52] The permit shield's purpose is "to insulate permit holders from changes in various regulations during the period of a permit and to relieve them of having to

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47 *See e.g.*, Dubois v. United States Dep't of Agric., 20 F. Supp. 2d 263, 270 (D.N.H. 1998); *but see In re* Southdown, Inc., Litig., 2000 U.S. Dist. LEXIS 6220 at *24 (D. Ohio 2000).

48 *See e.g.*, Complaint at 17-18, Sierra Club v. Virginia Elec. and Power Co., 2:15-cv-112 (E.D.V.A 2015).

49 Goldfarb v. Mayor & City Counc. of Baltimore, 791 F.3d 500, 502 (4th Cir. Md. July 1, 2015).

50 Alaska Community Action v. Aurora Energy Servs., 940 F. Supp. 2d 1005, 1009 (D. Alaska 2013), *rev'd and remanded* 765 F. 3d 1169 (9th Cir. 2014).

51 *See e.g.*, OVEC v. Alex Energy, Inc., 12 F. Supp. 3d 844, 856 (S.D.W. Va. Mar. 31, 2014); OVEC v. Fola Coal Co., 2013 U. S. Dist. LEXIS 178319, at ** 10-11 (S.D.W. Va. Dec.19, 2013); OVEC v. Elk Run Coal Co., 2014 U.S. Dist. LEXIS 509 , at *7 (S.D.W. Va. Jan. 3, 2014).

52 33 U.S.C. § 1342(k).

litigate in an enforcement action the question whether their permits are sufficiently strict."[53]

The Fourth Circuit crafted a legal test defining the availability of the CWA permit shield.[54] In *Piney Run*, the Fourth Circuit held that a NPDES permit will shield subsequent enforcement if: (1) the permit holder complies with the express terms of the permit and the CWA's permit application requirements and (2) the permit holder's discharges were within the "reasonable contemplation" of the agency when the permit was issued.[55]

In recent years, the Fourth, Sixth, Seventh, and Ninth Circuits have issued opinions interpreting the scope of the permit shield, and in many cases limiting the permit shield or at least complicating its application. For example, a recent decision of the Sixth Circuit reinforces the importance of full disclosure to the permitting agency.[56] The Sixth Circuit found a coal company was shielded from CWA liability for discharges exceeding state water quality standards by a state NPDES general permit.[57] The decision stands in stark contrast to another prior Fourth Circuit decision — *Southern Appalachian Mountain Stewards v. A&G Coal Corp.* — with the primary difference being what was disclosed to, and within the reasonable contemplation of, the state when it issued the permit.[58]

The Seventh and Ninth Circuits have also addressed the permit shield. The Seventh Circuit held that Wisconsin's decision to regulate stormwater discharges through a mining permit (rather than through a separate NPDES permit) still allowed the permittee to invoke the protections of the permit shield, deferring to the state to determine which permit was appropriate for compliance.[59] In *Alaska Community Action on Toxics v. Aurora Energy*

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53 E.I. du Pont de Nemours & Co. v. Train, 430 U.S. 112, at n. 28 (1977).

54 Piney Run Pres. Ass'n v. Cnty. Comm'r, 268 F.3d 255, 259 (4th Cir. 2001).

55 *Id*., *see also*, *In Re* Ketchikan Pulp Co., 7 E.A.D. 605, 621 (EAB May 15, 1998) (holding that when a permittee makes "adequate disclosures" in a NPDES permit application, unlisted pollutants may be shielded even if they are not specific permit conditions.).

56 Sierra Club v. ICG Hazard, LLC, 781 F.3d 281, 286 (6th Cir. Jan. 27, 2015).

57 *Id*. at 288-289.

58 Southern Appalachian Mt. Stewards v. A&G Coal Corp., 758 F.3d 560, 565-567 (4th Cir. 2014).

59 Wisconsin Resources Protection Counc. v. Flambeau Mining Co., 727 F.3d 700, 704, 711 (7th Cir. 2013).

Services, the Ninth Circuit held that the "plain terms" of a general permit prohibited defendant's non-stormwater discharge of coal.[60] This litany of litigation over the scope of the CWA's permit shield illustrates just how active citizen groups are becoming on further refining CWA jurisprudence.

[h] — Other Procedural Grounds.

Standing and abstention are two additional areas — often asserted in defense of citizen suits — that are ripe grounds for argument in citizen lawsuits. Standing generally requires demonstration of injury in fact, fairly traceable to the actions of the defendant, and likely to be redressed by the court.[61] Courts have traditionally taken a broad view of standing.[62] As more and more citizen suits are filed, often where the harm to the plaintiff is much attenuated from the act carried out by the defendant, citizen groups continue to push for a broader interpretation of standing.

Similarly, abstention is frequently asserted in citizen suit defense. Under *Burford v. Sun Oil Co.,* federal courts should abstain from asserting jurisdiction over cases that primarily concern issues of state law where timely and adequate state-court review is available.[63] *Burford* abstention is proper if a case: (i) presents difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result then at bar, or (ii) if its adjudication in a federal forum would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern.[64] The Fourth Circuit exercised its *Burford* abstention authority in the context of a citizen suit brought under the CAA. In *Sugarloaf Citizens Ass'n v. Montgomery County, Md.,* the court upheld a district court's decision to abstain from hearing a case in which an environmental group challenged the decision of a state environmental agency

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60 Alaska Cmty. Action on Toxics v. Aurora Energy Servs., LLC, 765 F.3d 1169, 1172 (9th Cir. 2014)..

61 Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc., 528 U.S. 167, 180-181 (2000).

62 *See e.g., id*.

63 Burford v. Sun Oil Co., 319 U.S. 315, 317-318 (1943).

64 New Orleans Pub. Serv. Inc. v. Council of New Orleans, 491 U.S. 350, 361 (1989) (quoting Colo. River Water Conservation Dist. v. U.S., 404 U.S. 800, 814 (1976)).

to grant certain construction and disposal permits to the defendants.[65] The plaintiffs in *Sugarloaf* couched their claims as arising under a citizen suit provision of federal environmental law.[66] After analyzing the complaint, however, the Fourth Circuit held that the citizen suit "did nothing more than resurrect in a different forum objections to a proposed" state permit.[67]

§ 4.06. Defense Strategies.

With this list of citizen suit enforcement trends in mind, there are actions that companies can take now that could minimize risk of liability arising from citizen lawsuits.

[1] — Comprehensive Permit Applications/Conditions.

Coal power utilities should develop permit applications with an eye toward potential future citizen enforcement. The permit application process is when a utility begins building the administrative record that will serve as the basis for defense against citizen suits subsequent to permit issuance. Therefore, it is critical to fully disclose all material facts in permit applications. As discussed above, full disclosure is also vital to a permit shield defense.[68] Also, utilities should beware of overly broad "boilerplate" conditions.[69] Another good idea is to cross-reference to coverage of impacts under separate regulatory programs to shore up later defense.[70]

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65 Sugarloaf Citizens Ass'n v. Montgomery County, Md., 1994 U.S. App. LEXIS 21985, at *2 (4th Cir. 1994).

66 *Id*. at *4.

67 *Id*. at 24; *see also* Jamison v. Longview Power, LLC, 493 F. Supp. 2d 786, 791 (N.D. W. Va. 2007) (dismissing Clean Air Act suit under *Burford* abstention as collateral attack on West Virginia permit); *see also*¸ S. Alliance for Clean Energy v. Duke Energy Carolinas, LLC, 2009 U.S. Dist. LEXIS 56733, at *16 (W.D.N.C. 2009) (abstaining from case and instead deferring to state administrative review of air permits).

68 Southern Appalachian Mt. Stewards, 758 F.3d at 564. (4th Cir. 2014).

69 *See e.g*., Attachment 4 to Duke Energy Carolinas, LLC's Motion to Dismiss in Yadkin Riverkeeper Inc. v. Duke Energy, Case No. 1:14-cv-00753-LCB-JEP (N.C. M.D. 2015) (NPDES permit for the Buck Steam Station, which states: "The permittee shall conduct groundwater monitoring to determine the compliance of this NPDES permitted facility with the current groundwater Standards found under 15A NCAC 2L .0200. The monitoring shall be conducted in accordance with the Sampling Plan approved by the Division."); *see also*, Cape Fear River Watch, Inc. v. Duke Energy Progress, Inc., 25 F. Supp. 3d 798 (E.D.N.C. 2014) (bringing claims under the same provision).

70 *See e.g*., Complaint at 17, Sierra Club v. Virginia Electric and Power Co., 2:15-cv-112-RAJ-DEM (E.D.V.A 2015); *see also*, *Goldfarb*, 791 F.3d at 510-511 (4th Cir. Md. July 1, 2015)

[2] — Think Ahead About Potential Diligent Prosecution Bars.

Many environmental statutes include provisions that prohibit citizen suit enforcement when an agency is diligently prosecuting the permittee for the violations. The CWA diligent prosecution bar states that "No action may be commenced . . . if the Administrator or State has commenced and is diligently prosecuting a civil or criminal action . . ."[71] The diligent prosecution bar applies where EPA or the state has issued a final order under the CWA or a comparable state law.[72]

If a company finds itself as the unfortunate subject of civil or administrative prosecution, it should seek clear documentation of aspects of the enforcement *(e.g.,* penalties and other jurisdiction-specific factors) that will later help demonstrate that the state law is "*comparable*" to the CWA. This might later preserve a diligent prosecution bar against citizen lawsuits. For example, in a Maryland citizen suit alleging RCRA and CWA claims, the Fourth Circuit held that EPA and the state were diligently prosecuting the defendant and that "the CWA citizen suit provision 'does not require government prosecution to be far-reaching or zealous. It requires only diligence.' Thus, a citizen-plaintiff cannot overcome the presumption of diligence merely by showing that the agency's prosecution strategy is less aggressive than he would like or that it did not produce a completely satisfactory result."[73]

[3] — Maintain Good Relationships with Agencies.

More than ever, maintaining a good relationship with agencies is critical given the precipitous increase in citizen suits. As discussed above, agencies play a key role in developing usable diligent prosecution positions, as applicable. Even without enforcement, agency confirmation of compliance (without prosecution) could become key evidence in subsequent citizen

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(addressing cross-referenced requirements under RCRA and CWA permits and interpreting conflicting requirements between the two permits).

71 33 U.S.C. § 1365(b).

72 33 U.S.C. § 1319(g)(6)(A).

73 Chesapeake Bay Found., Inc. v. Severstal Sparrows Point, LLC, 794 F. Supp. 2d 602, 614, (D. Md. 2011) (*quoting* Piney Run Pres. Ass'n v. County Comm'rs, 523 F.3d 453, 459, (4th Cir. Md. 2008).

action, and permit application/condition negotiations with agencies are key to subsequent permit shield-based defense.

[4] — Set the Record Straight.

If a company is unlucky enough to receive a notice of intent to sue under an environmental citizen suit provision, the company should document inaccuracies in the allegations. One effective way to do this is to draft a formal written response before the 60-day notice period runs. If the citizen group proceeds, this could allow for later fee recovery.[74]

[5] — Consider Multi-Media Compliance Implications.

Even where compliant under one regulatory framework, coal power utilities should consider potential implications under alternative regulatory schemes (*e.g.*, state and federal, water and waste). For example, citizens have brought RCRA citizen suit claims based on impacts regulated under the water program, as well as CWA citizen suit claims based on impacts regulated under the waste program.[75] These cases illustrate the innovative, multi-media approaches ENGOs are taking to allege violations under alternative regulatory schemes.

[6] — Track Citizen Campaigns/Lawsuits.

As discussed above, EPA's enforcement initiatives are useful roadmaps for coal power utilities in allocating resources, but it is more difficult to identify citizen group priorities and tailor compliance efforts in the same way. Still, to the extent feasible, companies should seek to identify potentially applicable ENGO priorities by diligently tracking citizen group campaigns and lawsuits. Often citizen groups undertake systematic approaches to bringing cases that can provide some insight into future targets. For example,

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74 *See e.g.*, Sierra Club v. Energy Future Holdings Corp. and Luminant Generation Co., Case No. 12-CV-108 ¶¶ 7, 67-70, Memorandum Opinion and Order, , Final Order (W.D. Tex. Mar.28, 2014).

75 *See e.g.*, *Goldfarb*,791 F.3d at 502; Complaint at ¶¶ 12-13, Sierra Club v. Virginia Elect. and Power Co., 2:15-cv-112-RAJ-DEM (E.D.V.A 2015).

citizen groups have been systematically bringing stormwater citizen lawsuits through various industries and locations.[76]

Similarly, impacts from impoundments across various industries (*e.g.*, coal ash, but also those associated with mineral processing/fertilizer production) have been a recent focus of enforcement. There are lessons from these efforts that could be applied to other types of impoundments. Tracking current litigation efforts by ENGOs can provide insight into potential future citizen group enforcement priorities.

[7] — Coordinate on Defense.

Finally, just as environmental groups frequently form ad hoc coalitions to target particular issues of mutual interest, industry should consider coordinating its own defense of these same issues. Such an approach allows for a stronger and more unified voice of industry, sharing of insights, and pooling of resources. The industry's best defense will be a coordinated effort.

§ 4.07. Conclusion.

The coal industry is under attack from environmental groups. Compliance with agency requirements is no longer enough. Coal power utilities need to take a proactive approach to reducing the likelihood of citizen lawsuits by ENGOs. Early preparation during the permit application process, continuing to build good relationships with agency officials, and improving data accuracy are important early steps. However, other pre-emptive strategies such as tracking the enforcement agendas that ENGOs are carrying out, preserving compliance and due diligence demonstrations, and mounting a coordinated defense to these agendas are becoming increasingly necessary. Taking these steps will help better position coal power utilities for defending citizen lawsuits.

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76 *See e.g.*, Enforcement News & Archives, California Sportfishing Protection Alliance, http://calsport.org/news/category/campaigns/enforcement/ (last visited July 6, 2015).

Chapter 5

Hot Topics on Public Lands at End of Obama Era

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§ 5.01. Introduction.

As presidential candidates begin to declare for 2016, the Obama Administration is racing to the finish line to put in place regulations that candidate Obama declared in 2008 would "transform" U.S. energy policy. The Bureau of Land Management (BLM) at the U.S. Department of the Interior (Interior) has been at the center of that transformation. In March 2015 at the Center for Strategic and International Studies, Interior Secretary Sally Jewell, in a major speech outlining her energy priorities, declared, "I am determined to help make energy development safer and more environmentally sound in the next two years. Helping our nation cut carbon pollution should inform our decisions about where we develop, how we develop and what we develop."[1] With that she outlined a series of new regulatory reforms to be rolled out in the administration's last two years to regulate oil and gas and expedite renewable energy on public lands.

Perhaps to an unusual extent, public land issues have a unique impact on people who live and work in the 12 public land states. These issues also have a long legacy — stretching back to the founding of our country. For both reasons, passions have always run high when it comes to finding the "balance" in public land management. This chapter will begin with a summary of the foundation for public land law and policies. We will then look back at what the Obama Administration has put in place for public land energy and land use planning and what is ahead as this Administration leaves office. Throughout, we will consider the impact of these polices on industry, advocates and citizens of the West.

§ 5.02. Public Land Legal Basics.

[1] — The Public Lands.

Nearly one third of the United States' land mass is under the jurisdiction and management of the federal government.[2] The public lands are what

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1 Press Release, U.S. Department of the Interior, *Secretary Jewell Offers Vision for Balanced, Prosperous Energy Future* (March 17, 2015).

2 1 George Cameron Coggins and Robert L. Glicksman, *Public Natural Resources Law* § 1:1, 3 (2d. ed. 2015) [hereinafter Coggins & Glicksman].

remain in public hands of the 2.3 billion acres that make up the United States. The federal government now owns some 662 million acres, 29 percent of the total area of the United States and one half of the land in the 11 western states.[3] These lands are managed by four federal agencies, three within the United States Department of the Interior, and the Forest Service in the U.S. Department of Agriculture. In addition, the Bureau of Indian Affairs, within the U.S. Department of the Interior, works with over 300 tribal governments to manage their lands and energy resources.

The BLM manages 245 million acres of surface lands largely located in the 12 states west of the Mississippi and roughly 700 million acres of federal minerals throughout the U.S.[4] The U.S. Forest Service manages 193 million acres of forests, prairies and grasslands in 44 states and territories.[5] Of these roughly 700 million acres of onshore federal minerals, approximately 113 million acres are open and accessible for oil and gas leasing.[6]

[2] — Eras of Federal Land Management.

The philosophy and guiding principles of public land management in the United States have changed significantly over the nation's almost 240-year history and are often described as encompassing four eras: acquisition, disposition, retention, and management.[7] Understanding these different eras and the goals the federal government sought to achieve through the polices adopted during each era is key to understanding how we came to

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3 Karin P. Sheldon, "How Did We Get Here? Looking to History to Understand Conflicts in Public Land Governance Today," 23 *Pub. Land & Resources L. Rev.* 1, 3 (2002) [hereinafter cited as Sheldon].

4 BLM [hereinafter cited as BLM], *The Bureau of Land Management: Who We Are, What We Do*, http://www.blm.gov/wo/st/en/info/About_BLM.html.

5 U.S. Forest Serv., U.S. Dept. of Agriculture [hereinafter cited as USFS], About the Agency: Budget & Performance, http://www.fs.fed.us/about-agency/budget-performance.

6 U.S. Depts. of Interior, Agriculture, and Energy, "*Inventory of Onshore Federal Oil and Natural Gas Resources and Restrictions to Their Development (Phase III)* (May 2008), http://www.blm.gov/wo/st/en/prog/energy/oilandgas/EPCA_III.html.

7 1 Coggins, Wilkinson & Leshy, *Federal Public Land and Resources Law* 12, 44 (3d. ed. 1993); *see also* Robert B. Keiter, *Public Land Law: An Introduction*, Rocky Mountain Mineral Law Foundation Special Institute on Public Land Law, Regulation and Management, May 2014.

our current land management system and the current debates surrounding these management practices.

[a] — Acquisition.

The debate over the appropriate control and use of public lands is as old as the nation. In fact, one of the primary stumbling blocks to ratification of the Articles of Confederation was disparity between colonies with public land holdings and those without. As explained by Karin P. Sheldon:

> Seven of the original 13 colonies had western land claims; six did not. Maryland and five other states with no land claims felt at a distinct competitive disadvantage without lands to sell for revenue or political gain. These states refused to ratify the Articles of Confederation until the Continental Congress asked the states with western land claims to cede them to the Confederation to be held for the benefit of all and as a source for new states. Only when all the states agreed were the Articles of Confederation ratified . . . . The cessions created the first public domain of the United States, more than 237 million acres, and radically altered our form of government.[8]

Several years later, at the first Constitutional Convention, the new nation had to establish a mechanism for management and disposition of public domain lands. This was addressed through inclusion of the Property Clause of Article IV of the Constitution, which gives Congress "power to dispose of and make all needful Rules and Regulations respecting the . . . Property belonging to the United States."[9] Almost 150 years after the adoption of the Property Clause, in *Light v. United States*, the Supreme Court outlined the federal government's authority over public lands, holding that the federal government could retain public lands for broad national benefits, and that it could do so indefinitely.[10] In *Light*, a Colorado resident who had been

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8 Sheldon at 5.

9 U.S. Const. art. IV, § 3, cl. 2.

10 Light v. United States, 220 U.S. 523, 536-37 (1911) (Congress can do what it wishes with federal land including reserving it from disposal in a Forest reserve); *see also* Canfield v. United States, 167 U.S. 518, 525 (1897) ("the general government doubtless has a power over its own property analogous to the police power of the several states").

enjoined from grazing cattle on lands within the newly created National Forest System,[11] argued that Congress could not withdraw public lands from settlement without state consent. The Supreme Court disagreed, holding that the United States owns the public lands "and has made Congress the principal agent to dispose of property," which includes the right to "sell or withhold [public lands] from sale."[12] "[P]ublic lands of the nation are held in trust for the people or the whole country," and, as an owner and sovereign, "the United States can prohibit absolutely or fix terms on which its property can be used."[13]

The Property Clause applied to both the 237 million acres retained by the federal government in the Articles of Confederation, as well as any subsequently acquired federal lands.[14] By 1850, the United States had acquired an additional 781 million acres through various treaties and purchases with European sovereigns (including a vast swatch of the West obtained in 1803 through the Louisiana Purchase).[15] Of these 781 million acres, as of 1853, 613 million acres were in the public domain.[16]

[b] — Disposition.

The second era of public land management — disposition — focused largely on using public domain lands to incentivize settlement of newly acquired lands. Most of the public land laws passed in the 19th Century focused on disposition of public domain lands to individuals and corporations who committed to making capital investments on the properties.[17] This was the era of the "gold rush," the homesteader and railroads.

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11 *See* discussion *infra* § 5.02 [2](c),

12 *Light*, 220 U.S. at 537.

13 *Id*.

14 *Id*.

15 *Sheldon* at 5.

16 *Id*.

17 *See, e.g*., Udall v. Tallman, 380 U.S. 1, 19-20 (1965) (traditional "public land laws" from the disposition era were statutes "governing the alienation of public land"; however, the Supreme Court distinguished mining and mineral leasing laws from that category saying they were not included among the "disposition" statutes).

Chief among these laws was the General Mining Law of 1872,[18] which some supporters of its "self-initiation" principle for minerals discovery argue is the second most important law, after the Constitution. Enacted on May 10, 1872, the General Mining Law provides that every adult citizen of the United States has the right to locate a lode (hard rock) or placer (gravel) mining claim — a property right — on federal lands open to mineral entry as long as the claimant can demonstrate the mineral can be mined, removed, and marketed at a profit.[19] The claimant can then acquire fee title to the claim, and receive a patent, if the claimant demonstrates, among other things, there is a commercial mineral deposit, there are no prior claims to the land, annual fees have been paid, and improvements have been made to the claim.[20] Although Congress placed a continuing moratorium on issuance of new mining patents in 1994, the law remains largely intact today and has withstood several substantial revision efforts.[21]

Similar to the General Mining Law, the Homestead Act of 1862[22] allowed every adult citizen or "intended citizen" to obtain fee title to 160 acre parcels of unclaimed public domain lands, provided that they "improved" the land by building a dwelling or cultivating crops. After five years, the patentee would receive clear title to the land, including the minerals underlying the parcel.

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18 30 U.S.C. § 22. This law consolidated the Mining Act of 1866 and the Placer Mining Act of 1870.

19 United States v. Coleman, 390 U.S. 599, 602-603 (1968); *see also* Andrus v. Charlestone Stone Prod., Inc., 436 U.S. 604 (1978) (General Mining Law is limited to "valuable" minerals of certain types).

20 Belk v. Meagher, 104 U.S. 279, 283-84 (1881).

21 The Hardrock Mining and Reclamation Act has been introduced in Congress several times during the last decade, most recently in 2014, H.R. 5060, 113th Cong. The Act would have permanently stopped new patents for mining claims, imposed royalties on existing mining extraction from unpatented mining claims as well as all new mining operations. In 2007, a mining reform bill passed the House but was not taken up by the Senate and in 2009, Senator Harry Reid of mining-rich Nevada announced that the bill would not be acted upon by the Senate before the session expired. In 2014, with Senator Reid the Majority Leader, the bill failed to reach a vote in committee. *See* "1872 Mining Law reform passes House, still faces uphill battle," *Mining Engineering,* Vol. 59 Issue 12, p. 10 (Dec. 2007)*;* "Mining law reform will not happen this year," *Mining Engineering,* Vol. 62 Issue 4, p. 13 (April 2010).

22 43 U.S.C. §§161-164 (1862) (repealed 1976).

The Act also permitted the claimant to receive title after only six months if a fee of $1.25 per acre was paid. Between 1862 and 1904, the General Land Office (now part of the BLM) distributed 80 million acres to individuals under the Homestead Act.[23]

Public domain lands classified as valuable for coal were exempt from settlement and were made available for purchase ($$10-20 per acre) under the 1864 Coal Lands Act and the 1873 Coal Lands Act.[24] The lands were conveyed in fee without a reservation of the coal to the government. After fraudulent conveyances and a withdrawal of all "coal lands" by President Roosevelt in 1906, laws were passed in 1909 and 1910 reserving coal to the federal government.[25]

Also in 1909, Congress passed the Enlarged Homestead Act, which allowed individuals to obtain title to up to 320-acre parcels in the arid western states and territories in an effort to encourage "dry land" farming on the Great Plains.[26] Congress, however, did not reserve any of the mineral estate under this law. Seven years later, in 1916, Congress passed the Stock-Raising Homestead Act (SRHA), under which settlers could obtain title to 640-acre parcels for the purpose of raising stock, but not the mineral estate; "all coal and other minerals" were reserved to the federal government.[27] In *Watt v. Western Nuclear Inc.,* the Court considered the extent of the SRHA exemption.[28] The Court held that since Congress intended for SRHA lands to be used for ranching and farming only, "the mineral reservation in the Act [includes] substances that are mineral in character, that can be removed from the soil, [and] that can be used for commercial purposes."[29] As the Court explained, "While Congress expected that homesteaders would use the surface of SRHA lands for stock-raising and raising crops, it sought to ensure

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23 National Archives and Records Administration, *Teaching with Documents: Using Primary Sources From the National Archives*, p. 31 (1998).

24 Act of 1864, ch. 205, § 1, 13 Stat. 343; Act of 1873, ch. 279, § 1, 17 Stat. 607.

25 30 U.S.C. § 81 and §§ 83-85.

26 43 U.S.C. § 218, 35 Stat. 639, as amended (repealed 1976).

27 43 U.S.C. §§ 291-302, 39 Stat. 862, ch. 9, (repealed 1976), at § 299.

28 Watt v. W. Nuclear, 462 U.S. 36, 39-41 (1989).

29 *Id*. at 53.

that valuable subsurface resources would remain subject to disposition by the United States . . . It did not wish to entrust the development of subsurface resources to farmers and ranchers."[30] Ten years later, in a similar challenge to the reservations under the Coal Lands Acts of 1909 and 1910, the Court held that the federal reservation of coal, a solid mineral, did not include coalbed methane, a gaseous mineral.[31]

During the 19th and early part of the 20th Century the federal government passed a number of laws aimed at incentivizing the construction of railroads across the United States. Through the various railroad land grants, the federal government disposed of approximately 127 million acres of land, largely in checkerboard fashion wherein the railroad companies were granted odd-numbered sections of land running along the centerline of the railroad.[32] The federal government retained the even-numbered sections.[33] The earlier-enacted statutes granted the railroads an undivided interest in the surface and the minerals, while the later-enacted statutes granted the railroads either the surface only, or, under some acts, a mere right of way.[34] Today, land managers are challenged to manage the pieces of the checkerboard left in federal ownership.[35]

Newly created states also benefitted from federal land grants. Under the Northwest Ordinance of 1787, a specified number of sections in every township were reserved as "school lands," to be managed by the state for the benefit of state schools and institutions.[36] Each new state's enabling act would specify a certain number of sections of land to be granted to the states, typically one section in each township. The state was then responsible for

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30 *Id*. at 47.

31 Amoco Prod. Co. v. S. Ute Indian Tribe, 526 U.S. 865 (1999).

32 *Sheldon* at 10.

33 *Id*.

34 Marvin M. Brandt Revocable Trust v. United States, 134 S. Ct. 1257 (2014) (holding that rights granted under the General Railroad Right–of–Way Act of 1875 granted a mere right of way, which, upon abandonment for railway purposes reverted to the United States).

35 *See e.g*., Wyoming BLM at http://www.blm.gov/wy/st/en/programs/nlcs/Continental_Divide/ckrbrd.html.

36 1 Stat. 50 (1789).

completion of a survey of state lands, and title to the "school lands" would not vest in the state until completion of the survey. Prior to that time, the federal government was free to dispose of the designated sections to private parties. If disposal occurred, the states had the right to make in lieu selections of federally managed lands for their state school lands.[37]

[c] — Retention.

In the early part of the 20th Century, federal land management moved away from disposition of federal lands toward a policy of land retention. Under these new laws, which included the Taylor Grazing Act and the Mineral Leasing Act of 1920, the federal government retained title to lands, but permitted leasing or utilization of public lands for commodity development.

The Taylor Grazing Act of 1934[38] was signed by President Roosevelt and was intended to "stop injury to the public grazing lands [excluding Alaska] by preventing overgrazing and soil deterioration; to provide for their orderly use, improvement, and development; [and] to stabilize the livestock industry dependent upon the public range."[39] Under the Act, 80 million acres of public lands were withdrawn and placed into grazing districts managed by the federal government. Grazing permits could be issued for lands within grazing districts, while grazing leases could be issued for lands outside of the districts. Grazing permit preference was given to landowners and homesteaders in or adjacent to the grazing district lands.[40] While the permits were issued for a term of 10 years, many of these permits were renewed numerous times, passing along with family farms and ranches. Many ranching families came to think of these lands as part of the ranch itself. Yet, the Supreme Court has made clear that the Act gave no private ownership rights because the federal

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[37] *See* Utah v. Kleppe, 586 F.2d 756, 758-59 (10th Cir. 1978) (pursuant to the Taylor Grazing Act of 1934, 43 U.S.C. § 3159f, the Department of the Interior could classify lands as proper for school indemnity selection and had the discretion to refuse indemnity selection where the value of the land was "grossly disparate").

[38] 43 U.S.C. § 315n.

[39] BLM, The Taylor Grazing Act, http://www.blm.gov/wy/st/en/field_offices/Casper/range/taylor.1.html.

[40] *Id*.

government retained ownership of the lands[41] and a grazing permit does not constitute a property right.[42]

The Mineral Leasing Act of 1920[43] was enacted as a means to provide for more efficient development of federal oil, gas and coal deposits. In response to the rapid development of oil and coal deposits on federal lands during the early part of the 20th Century, Congress passed the Mineral Leasing Act of 1920.[44] This act implemented a system of competitive leasing for lands that contained "proven" deposits of oil and coal minerals rather than maintaining the system of location and sale of oil or coal lands. It exempted coal, oil, gas and oil shale from the claim staking process in the General Mining Law and substituted a more federally regulated leasing process.[45] The Act, as amended, remains the primary statute by which federal oil and gas and coal, among other leasable minerals, are leased. The Act limited the number of acres that could be leased, but provided that once production on a lease is established, the lease is deemed held and continues until production ceases or the lease is voluntarily terminated or otherwise cancelled by the federal government.[46] The Act also authorizes pipeline rights-of-way through federal lands to transport oil, natural gas, synthetic liquids, and gaseous fuels.[47]

At the same time that federal statutes were consolidating ownership of public domain lands and permitting resource extraction and grazing through permit, there was also a growing movement to set aside some public lands for recreation, preservation and protection of forest lands. It was at this time that the National Forest Reserves and National Park System were

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41 *See* Public Lands Council v. Babbitt, 529 U.S. 728, 731 (2000) (creation of a grazing district or the issuance of a permit did not create any right, title, interest, or estate in or to the lands).

42 United States v. Fuller, 409 U.S. 488 (1973); Diamond Ring Ranch, Inc. v. Morton, 531 F. 2d 1397 (10th Cir. 1976).

43 30 U.S.C. §§ 181, *et seq.*

44 30 U.S.C. §§ 181, *et seq.*

45 *Id.*

46 *Id.*

47 *Id.*

established.[48] Similar to other resources, early 19th century laws for federal timber had emphasized use and disposal.[49] In 1891, the Forest Reservation Amendment to the General Revision Act gave the President the power to set aside tracts of forest land to protect them from overuse.[50] Within two years, over 13 million acres of forests had been reserved under this provision.[51] In 1897, Congress passed the Forest Management Act of 1897 establishing the principle of "sustained yield" of the forest reserves.[52] In 1916, the National Park Service was created in the National Park Service Organic Act to "conserve the scenery and the natural and historic objects and wildlife . . . to provide for the enjoyment of the same in such manner . . . as will leave them unimpaired for the enjoyment of future generations."[53]

[d] — Management.

The fourth era of federal utilization of public lands is referred to by some as the management era. Through the enactment of the Federal Land Policy Management Act (FLPMA), BLM's organic act, and the Multiple Use Sustained Yield Act, regulating lands in the National Forest System, Congress stated that it is the policy of the United States to manage the public lands for multiple use.

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48 The National Forest Reserve Act signed by Theodore Roosevelt on March 3, 1891, 26 Stat. 1095, Ch. 561S; National Park Service Organic Act of 1916, 16 U.S.C. 1,3,9a,460 1-6a(e).

49 *See* Timber and Stone Act of 1878, Act of June 3, 1878, ch. 151, 20 Stat. 89 (repealed 1955), providing for the purchase of non-mineral lands primarily containing stone and timber and the Timber Cutting Act of 1878, Act of June 3, 1878, ch. 150, 20 Stat. 88, 16 U.S.C. §§ 604-606, allowing timber to be cut from mineral lands in several western states that had been entered for mining purposes.

50 16 U.S.C. § 471 (repealed 1976); *see also* United States v. Grimaud, 220 U.S. 506 (1911) (upholding the constitutionality of the Forest Reserve Act).

51 *See* P. Gates, *History of Public Land Law Development* 582 (1969); James Huffman, "A History of Forest Policy in the United States," *8 Envtl. L.* 239, 269 (1978).

52 Act of June 4, 1897, ch. 2, 30 Stat. 34, 16 U.S.C. §§ 473-481.

53 16 U.S.C. § 1.

In 1946, "Congress reorganized public lands management to reflect the new priorities of a closing frontier"[54] by merging the U.S. Grazing Service and General Land Office into the BLM. The patchwork of roughly 2,000 existing public land laws made public land management decentralized and "chaotic."[55] In 1976, FLPMA repealed most of the existing land management laws and created a comprehensive management scheme emphasizing the concept of multiple use, providing for commodity development, recreation, rights-of-way, and protection of ecological, environmental, and historical resources.[56] FLPMA's management policy would be formalized in the development and implementation of comprehensive land use planning for over 260 million acres of public lands.[57]

Land use planning was accomplished thorough enactment of Sections 201 and 202 of FLMPA. Section 201 of FLPMA[58] requires BLM to keep an up-to-date inventory of all BLM-managed lands, which identifies present and future uses of each area, as well as the associated environmental and natural resource values. Section 202 of FLPMA[59] requires the BLM to develop and implement Resource Management Plans (RMPs) for each area of BLM land. RMPs are generally developed for each BLM field office and outline the area's present and future uses, provide for protection of identified resource values, and provide management guidance to govern those resources and uses, including oil and gas lease stipulations. All future land use management decisions in the plan area must conform to the RMP. An RMP is generally

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54 Michael C. Blumm and Andrew B. Erickson, "Federal Wild Lands Policy in the Twenty-First Century: What A Long, Strange Trip It's Been," 25 *Colo. Nat. Resources, Energy & Envtl L. Rev.* 1, 31 (2014)[hereinafter *Blumm*].

55 Lujan v. Nat'l Wildlife Fed'n, 497 U.S. 871, 876 (1990).

56 43 U.S.C. §1707(a)(8).

57 *See generally* Blumm. As discussed in more detail *infra*, the enactment of FLPMA, with its centralized planning requirements, was met with significant resistance from certain members of the western public, and its enactment was a central factor fueling the Sagebrush Rebellion of the 1970s.

58 43 U.S.C. § 1711.

59 43 U.S.C § 1712; 43 C.F.R. § 1600; *see also* BLM Handbook H-1601-1, Land Use Planning (2005).

in place for 15-20 years; however, RMPs are often amended piecemeal in RMP amendments that focus on specific areas or resources.

The Multiple Use Sustained Yield Act (MUSYA)[60] was enacted in 1960 and directs the U.S. Forest Service to manage Forest System lands for a broad range of multiple uses. According to the Forest Service, the purpose of the MUSYA "was to ensure that all possible uses and benefits of the national forests and grasslands would be treated equally. The 'multiple uses' included outdoor recreation, range, timber, watershed, and wildlife and fish in such combinations that they would best meet and serve human needs."[61]

While the MUSYA sets out the Forest Service's broad multiple use goals, the National Forest Management Act of 1976 (NFMA) provides a framework to achieve this goal.[62] The NFMA is similar to FLPMA in that it requires the Forest Service to inventory its lands and prepare land and resource management plans for each forest, outlining permissible uses and management goals for lands within the plan area. As with RMPs, NFMA Forest Plans are intended to guide forest management decisions for 15-20 years.

It is important to note that the BLM manages all onshore federal minerals, including the minerals underlying land managed by a different surface management agency (SMA), such as the U.S. Forest Service.[63] Thus, when developing minerals underlying land managed by a non-BLM SMA, the BLM is responsible for regulating down-hole activities, while the SMA is responsible for surface-related considerations including whether or not to provide consent to leasing the federal minerals underlying its surface.[64]

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60 16 U.S.C. §§ 528-531; 36 C.F.R. § 272.1 *et seq*.

61 U.S.F.S., *The Fully Managed, Multiple-Use Forest Era*, 1960-1970, (June 9, 2008), http://www.foresthistory.org/ASPNET/ Publications/first_century/sec7.htm.

62 *See* Forest and Rangeland Renewable Resources Planning Act of 1974, 16 U.S.C. §§ 2, 13-16; 43 C.F.R. §§ 1600, 1611-1614.

63 *See* BLM, *The Bureau of Land Management: Who We Are, What We Do, Bureau of Land Management,* http://www.blm.gov/wo/st/en/info/About_BLM.html.

64 *See e.g*. 43 C.F.R. § 3101.7-1.

§ 5.03. Oil and Gas on Public Lands: 2010 Leasing Reforms and Regulatory Actions.

[1] — Background to Obama Oil and Gas Initiatives.

Each new Administration responds to and builds on the work of prior administrations. Candidate Obama's 2008 emphasis on a transformative energy policy to address the threat of climate change was a challenge to the fossil fuel-friendly approach of the Bush Administration and Congress. The Bush Administration's National Energy Policy (May 2001)[65] was a response to a natural gas supply shortage and focused on the development of additional domestic energy supplies. The culmination of the Bush National Energy Policy was the passage of the Energy Policy Act of 2005 (EPAct).[66]

The EPAct put in place several provisions to expedite oil and gas permitting on public lands,[67] provide funding for key BLM field offices in oil and gas development areas[68] and to exempt hydraulic fracturing ("fracking") from the Safe Drinking Water Act.[69]

Turning the page on the Bush oil and gas policies was an early theme of the Obama Administration. Nine days after the inauguration on January 29, 2009, Secretary Salazar came to Colorado to announce that as to oil and gas management, "There's a new sheriff in town" and "The anything goes era is over." Five days later, on February 4, 2009, Secretary Salazar announced he was taking the unprecedented step of cancelling 77 federal leases sold in a December 2008 BLM Utah lease sale, because he argued, the sale had been rushed without adequate environmental review. "I believe, as President

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65 *Reliable, Affordable, and Environmentally Sound Energy for America's Future: Report of the National Energy Policy Development Group*, National Energy Policy Development Group (May 16, 2001), http://wtrg.com/EnergyReport/National-Energy-Policy.pdf.

66 Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 660 (2005) (codified in scattered sections of U.S.C.) [hereinafter cited as EPAct].

67 EPAct, § 362 (best management practices for leasing and permitting), § 390 (categorical exclusions) and § 366 (APD permitting deadlines).

68 *Id*. at § 365 (pilot offices to improve permit coordination).

69 *Id*. at § 322; 42 U.S.C. § 300(h).

Obama does, that we need to responsibly develop our oil and gas supplies . . . but we must do so in a thoughtful and balanced way."[70]

[2] — BLM 2010 Leasing Reform.

[a] — The Prelude to Reform.

The Department began constructing its new approach to federal oil and gas development by first preparing two reports to examine how the 77 Utah leases were sold. The first report was issued by Deputy Secretary David Hayes on June 11, 2009[71] and recommended a site-specific analysis of the 77 leases by an inter-disciplinary team. The second report was issued by the inter-disciplinary team on October 8, 2009.[72] In September 2009, a General Accountability Office (GAO) report on the EPAct § 390 oil and gas categorical exclusions ("GAO Report")[73] found there was confusion in BLM on how to apply the EPAct categorical exclusions. These three reports, which Salazar called a "laboratory of learning," set the stage for the Interior oil and gas leasing reforms announced by the Secretary in 2010.

On January 6, 2010, Secretary Salazar announced two reform goals: 1) improve protections for land, water and wildlife; and 2) reduce potential conflicts that can lead to "costly and time-consuming" lease protests and litigation of leases.[74] The Secretary unflatteringly contrasted his new

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70 Press Release, U.S. Department of the Interior, *Secretary Salazar Restores Balance in Controversial Last-Minute Oil and Gas Lease Sale near Utah National Parks* (February 4, 2009). Later that year, Interior's Inspector General determined there was "no evidence of undue pressure." *See BLM Utah Lease Sale*, DOI-OIG Case file No. OI-OG-09-0173-I (December 29, 2009).

71 Press Release, U.S. Department of the Interior, *Interior Review Shines Light on Controversial Utah Oil and Gas Leases* (June, 10, 2009).

72 National System of Public Lands, *Final BLM Review of 77 Oil and Gas Lease Parcels offered in BLM-Utah's December 2008 Lease Sale*, (October 7, 2008), http://www.suwa.org/wp-content/uploads/BLM_Utah77LeaseParcelReport.pdf.

73 U.S. Gov't Accountability Office, GAO-09-872 *Energy Policy Act of 2005: Greater Clarity Needed to Address Concerns with Categorical Exclusions for Oil and Gas Development under Section 390 of the Act*, (September 16, 2009), http://www.gao.gov/new.items/d09872.pdf.

74 Press Release, U.S. Department of the Interior, Secretary Salazar Launches Onshore Oil and Gas Leasing Reforms to Improve Certainty, Reduce Conflicts and Restore Balance on U.S. Lands, U.S. Department of the Interior (January 6, 2010). For an analysis of lease

approach to that of the Bush administration, "[i]n the prior administration the oil and gas industry essentially were the kings of the world . . . our public lands were the essential candy store of the oil and gas industry, where they walk in and take whatever they wanted, and that's not the way it ought to be done."[75] The Secretary's announcement focused on two areas — oil and gas leasing reform and redefining the use of EPAct § 390 categorical exclusions.[76] The Secretary also issued a Secretarial Order, No. 3294, "Energy Management Reform" directing the creation of an Energy Reform Team to address federal energy development.[77]

[b] — Salazar Issues Reform: BLM Instruction Memorandum 2010-117.

On May 17, 2010, in the midst of the Deepwater Horizon blowout, Secretary Salazar announced the onshore oil and gas leasing reforms in the form of a BLM guidance document, Instruction Memorandum 2010-117 ("IM-2010-117").[78] IM-2010-117 has three main components: land use plan review; Master Leasing Plans; and an "improved" process for lease parcel nominations and issuance. Each component provided an opportunity for the Obama BLM to revisit and revise land use planning decisions made in the Bush era.

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protests, *see also* U.S. Gov't Accountability Office, GAO 10-670, Onshore Oil and Gas, BLM's Management of Public Protests to its Lease Sales Needs Improvement (July 30, 2010).

75 David O. Williams, "Salazar blasts oil industry while outlining new land-lease reforms," *The Colorado Independent*, January 7, 2010.

76 U.S. Department of the Interior, *New Oil and Gas Policy Fact Sheet*, (January 6, 2010). http://www.doi.gov/news/pressreleases/Secretary-Salazar-Launches-Onshore-Oil-and-Gas-Leasing-Reforms.cfm. (The CX reform was buttressed by a March 2010 settlement in Utah, in which BLM agreed to issue new guidance to require "extraordinary circumstances" review for EPAct categorical exclusions. Nine Mile Canyon Coalition v. Stiewig, Civil Nos. 2:08 CV 586 DB (D.C. Utah March 30, 2008)).

77 U.S. Department of the Interior, Order No. 3294, *Energy Management Reform* (January 6, 2010), http://www.doi.gov/news/doinews/upload/Order_3294.pdf.

78 BLM, Instruction Memorandum No. 2010-117, *Oil and Gas Leasing Reform — Land Use Planning and Lease Parcel Reviews* (May 17, 2010), http://www.blm.gov/wo/st/en/info/regulations/ Instruction_Memos_and_Bulletins/ national _instruction/2010/IM_2010-117.html.

The *land use plan review* requires BLM field officers to consider whether the RMP "adequately protects important resource values in light of changing circumstances, updated policies and new information."[79] The guidance reminds the BLM field officer that the "open for leasing" designation in a land use plan is not the determining factor in whether the lands should be leased — BLM retains the discretion not the lease.[80] The guidance encourages consistent lease stipulations, and directs the use of adaptive management and monitoring to address changing conditions on the ground.

The *Master Leasing Plan* (MLP) concept directs BLM, before leasing, to "reconsider RMP decisions pertaining to leasing" by analyzing likely development scenarios and varying mitigation levels at a site-specific level in an MLP.[81] The *mandatory* use of MLPs is limited to situations where these four criteria are present:

- A substantial portion of the area to be analyzed in the MLP *is not* currently leased;
- There is a *majority* federal mineral interest;
- There is an expressed interest in leasing and moderate or high potential for oil and gas *confirmed by the discovery* of oil and gas in the area; and
- Additional analysis is needed to address resource and cumulative impacts to multiple use resources, air resources and impacts on/to special places.[82]

The Master Leasing Plan process will consider phased leasing, phased development, and requirements to reduce or capture emissions, multiple wells on a single pad and additional mitigation for wildlife and other

insects.[83] BLM retained the option to use an MLP in other circumstances and environmental groups, in a non-public process, were successful in

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79 *Id*. at 2.
80 *Id*. at 3.
81 *Id*.
82 *Id*. at 4.
83 BLM, *Colorado Master Leasing Plans* (July 30, 2014), http://www.blm.gov/co/st/en/BLM_Programs/oilandgas/BLM_Colorado_Master_Leasing_Plans.html.

encouraging the administration to add over a dozen MLP analyses in areas that did not meet the mandatory MLP criteria. For example, in Colorado, five MLPs are approved for review in ongoing RMPs.[84] In Utah, five MLPs are approved for analysis.[85]

Lease Parcel Review is the final component of the oil and gas reform. The most significant change is the new requirement for an additional layer of National Environmental Policy Act (NEPA),[86] analysis after Plan-level NEPA. In the past, the BLM would rely on RMP-level NEPA and a "Determination of NEPA Adequacy" (DNA) to put a parcel up for sale. The new guidance requires all lease parcels to have parcel-specific NEPA — typically an EA before the parcel can be offered for sale.[87] In addition, each parcel must have an inter-disciplinary team review and provide for public comment.[88] The guidance directs a 30-day comment period for lease parcel EAs.[89] The parcel and NEPA document are posted on the BLM's state office website for at least 90 days prior to the lease sale.[90] That posting starts the

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84 Press Release, U.S. Department of the Interior, *BLM Releases Grand junction resource Management Plan Includes 700,900-acre Shale Ridges and Canyons Master Leasing Plan*, (April 10, 2015); BLM, *Kremmling Draft Resource Management Plan Revision* (March 21, 2014), http://www.blm.gov/co/st/en/BLM_Programs/land_use_planning/rmp/kfo-gsfo/kremmling.html; BLM, *White River Proposed RMP Oil and Gas Development Amendment FACT SHEET: Dinosaur Trail Master Leasing Plan*, http://www.blm.gov/style/medialib/blm/co/programs/land_use_planning/rmp/white_river/documents/proposed_oil_and_gas.Par.85107.File.dat/WRFO%20RMPA%20FACT%20SHEET%20MLP%203.27.15.pdf.; BLM, *Volume I: Final Environmental Impact Statement*, BLM Tres Rios Field Office (September 2013), http://www.blm.gov/style/medialib/blm/co/field_offices/san_juan_public_lands/land_use_planning/proposed_lrmp.Par.82467.File.dat/Volume_I_FEIS_FINAL_083013_Signed.pdf.

85 *See* BLM, Glen Canyon MLP Revision; Bookcliffs Divide MLP; San Rafael River MLP; Vernal MLP and Moab MLP,http://www.blm.gov/pgdata/etc/medialib/blm/ut/lands_and_minerals/oil_and_gas/mlp_-_master_leasing.html?ShowTree=/etc/medialib/blm/ut/price_fo/Images&tim=1340622083724&Start=/etc/medialib/blm/ut&.

86 42 U.S.C. §§ 4321-4327.

87 BLM, Instruction Memorandum 2010-117, *Oil and Gas Leasing Reform*, at 4. (May, 2010).

88 *Id*. at 3-4.

89 *Id*. at 5.

90 *Id*. at 5.

30-day lease protest clock which allows BLM 60 days prior to the lease sale to address and resolve lease protests.

[c] — BLM Instruction Memorandum 2010-118.

This second reform guidance responded to the 2009 GAO Report and captured the policy changes to the EPAct § 390 categorical exclusions agreed to in the settlement of the *Nine Mile Canyon* litigation.[91] The IM rewrote the criteria specified in the statute for two of the five categorical exclusions[92] and required the 'extraordinary circumstances' review process for all of the statutory categorical exclusions.

[d] — 2010 Leasing Reform Scorecard.

In 2011, The Wyoming Federal District Court[93] rejected the BLM's attempt to re-write the EPAct categorical exclusion provision because the court found BLM's guidance was a legislative rule and BLM had not complied with the Administrative Procedures Act notice and comment requirement. The BLM rescinded IM 2010-118.[94] The leasing reforms in IM 2010-117 were not challenged and have resulted in a lengthier lease sale process with fewer parcels being sold. The leasing process used to take three to six months, but now takes twelve to fourteen months. In order to meet the requirements of the leasing reform and comply with the Mineral Leasing Act[95] requirement to hold a minimum of quarterly lease sales, a BLM state office is now limited to four annual sales in geographic rotation around the

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91 Nine Mile Canyon Coalition v. Stiewig, Civil Nos. 2:08 CV 586 DB (D.C. Utah March 30, 2008).

92 BLM, Instruction Memorandum 2010-118, Section 390CX Policy Revision (May 17, 2010), http://www.blm.gov/wo/st/en/info/regulations/Instruction_Memos_and_Bulletins/national_instruction/2010/IM_2010-118.html.

93 Western Energy Alliance v. Salazar, No. 10-CV-237F (D. Wyo. 2011).

94 *See* BLM, IM 2012-146, *Rescinding Washington Office Instruction Memorandum, 2010118, Energy Policy Act Section 390 Categorical Exclusion Policy Revision* (2011) http://www.blm.gov/wo/st/en/info/ regulations/Instruction _Memos_and_Bulletins/national_instruction/2012/IM_2012-146.html.

95 Mineral Leasing Act of 1920 as amended by Federal Oil and Gas Leasing Reform Act of 1986, 30 U.S.C. § 226.

state. The MLP process, which remains a favorite of its environmental group proponents,[96] has resulted in a deferral of leasing in those areas of Utah and Colorado where an MLP process is on-going.[97] The Moab, Utah MLP would be the first stand-alone MLP to be completed and is expected summer 2015. Several other MLP analyses are proceeding as part of an overall land use planning process.[98] The Administration argues that the 2010 lease reforms have led to fewer protests, but the industry counters that fewer protests simply reflect a reduced amount of leasing.

A 2014 Congressional Research Service report (CRS) found that oil production fell on federal lands by six percent between 2009 and 2013. Over the same time, oil production increased by 61 percent on state and private lands. Natural gas production on federal lands decreased by 28 percent while it increased on non-federal lands by 33 percent during 2009-2013. The CRS, in a 2015 Report, found that federal Applications for Permits to Drill (APDs) were down and "the current Administration processed more APDs than it received from 2009-2013, [but] it received far fewer applications over that period than had been received annually from 2006-2008."[99]

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96 *Master Leasing Plans: A Responsible Process*, National Park Conservation Association, http://www.npca.org/protecting-our-parks/air-land-water/mining-and-fracking/a-responsible-process.html?referrer=https://www.google.com/; "*BLM Master Leasing Plan*, Earthworks, http://www.earthworksaction.org/issues/detail/blm_mlp#.VYmAJ_lVhBc (MLP is a new approach form the BLM to managing oil and gas activity on sensitive landscapes within its jurisdiction; *Master Leasing Plans: Eliminating the False Choice Between Energy and Conservation*, Western Values Project (November 14, 2013); http://westernvaluesproject.org/master-leasing-plans-eliminating-the-false-choice-between-energy-conservation/;, *The Case for Master Leasing Plans*, Southern Utah Wilderness Alliance (July 25, 2014), http://suwa.org/case-master-leasing-plans/; and, *Master Leasing Plans, doing energy right*, The Wilderness Society, http://wilderness.org/article/doing-energy-right.

97 *See* BLM Director Abbey's approval letter (Feb. 16, 2011), www.blm.gov/ut1st/en/prog/oil_and_gas/mlp.html.

98 Lander RMP Revision, Bureau of Land Management (May 13, 2015), http://www.blm.gov/wy/st/en/programs/Planning/rmps/lander.html; Kremmling, Colorado FO RMP Revision, Bureau of Land Management (March 21, 2014), http://www.blm.gov/co/st/en/BLM_Programs/land_use_planning/rmp/kfo-gsfo/kremmling.html.

99 Marc Humphries, Cong. Research Serv., R42342, *U.S. Crude Oil and Natural Gas Production in Federal and Non-Federal Areas*, 4-5 (April 3, 2015) (quoting BLM, Oil and Gas Statistics, 46,193 leases; 23,657 producing leases; 34.6 million acres under lease; 12.7

In response to these and similar findings, and in a rare instance of bi-partisan accord, the 113th Congress made permanent the EPAct Pilot Office Program by enacting a higher oil and gas fee ($9500) to be used to fund BLM oil and gas permitting in high-activity areas.[100]

[3] — Upcoming BLM Regulatory Reforms.

In her March 2015 energy reform speech, Secretary Jewell observed that, "Many in industry get that effective regulations and independent oversight of energy development not only help minimize risk, but are key to building the public confidence . . . But many of the regulations on the books haven't kept pace." The Secretary went on to detail a series of rulemakings that will be rolled out in the next two years that include a final rule on hydraulic fracturing, "standards to cut emissions and wasted gas," a proposal to give BLM "the flexibility to adjust royalty rates" and continued use of MLPs to open up access to resources in "the right places" and "identify places that are too special to drill."[101]

[a] — BLM Hydraulic Fracturing Rule.

On March 26, 2015, BLM promulgated a final hydraulic fracturing rule applicable to oil and gas operations on federal and Indian lands to become effective June 24, 2015.[102] The rule revises existing BLM regulations on hydraulic fracturing from the 1980's.[103] The rule was immediately challenged by the oil and gas industry and shortly thereafter by the states of North Dakota, Wyoming, Colorado and Utah in lawsuits filed in the Federal District Court of Wyoming. The industry and states argue the rule is not necessary

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million acres producing; 2.9 million leased acres not in production or exploration; percentage of leases producing 51 percent).

100 H.R. 3979 § 302, 1113th Cong. (2014).

101 Press Release, U.S. Department of the Interior, *Secretary Jewell Offers Vision for Balanced, Prosperous Energy Future* (March 17, 2015).

102 *Oil and Gas; Hydraulic Fracturing on Federal and Indian Lands*, 80 Fed. Reg. 16130 (March 26, 2015).

103 The final rule revises existing BLM well completion regulations at 43 C.F.R. § 3162.3-2 and adds a new section 3162.3-3.

and is a federal overreach into an area well-regulated by the states.[104] Several environmental groups represented by Earthjustice moved to intervene to support the agency. A motion for preliminary injunction was argued by all parties and the intervenors on June 23, 2015 and the court temporarily stayed nationwide implementation of the rule, the day before the effective date of the rule, until a new round of arguments in August, 2015.

The BLM publically began work on this rule in late 2010 and, as an indication of its importance; the President announced the development of the rule in the 2012 State of the Union address. BLM's first draft rule followed a few months later,[105] but the rule went through multiple iterations[106] to respond to concerns from states, environmental groups, tribes and industry. For example, while the 2012 proposal would have applied to all well stimulation activities including hydraulic fracturing, re-fracturing, acidizing and enhanced secondary and tertiary recovery, the final rule applies only to hydraulic fracturing. The earlier proposal provided for pre-completion disclosure of fracking fluids on a government website, but BLM's final rule provides for post-completion disclosure on FracFocus.[107] The 2013 rule would have allowed for the use of sample or "type" wells to avoid the cost of individual well testing, that concept was removed in the final rule. The final rule also provides for variances from specific regulatory provisions if state or tribal rules are equal to or more protective.[108]

The BLM's preamble to the rule summarizes its' features, "The final rule fulfills the goals of the initial proposed rules: To ensure that wells are properly constructed to protect water supplies, to make certain that the fluids that flow

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104 Independent Petroleum Association of America v. Jewell, 15-cv-00041 (D. Wyoming March 26, 2015); State of Wyoming v. Sally Jewell, Case: 15cv43-S (D Wyoming March 26, 2015). On June 8, 2015, the cases were consolidated [Independent Petroleum Ass'n of America v. Jewell, 15-cv-00041].

105 *Oil and Gas; Well Stimulation, Including Hydraulic Fracturing, on Federal Indian Lands,* 77 Fed. Reg. 27691 (May 11, 2012).

106 *Oil and Gas; Hydraulic Fracturing on Federal and Indian Lands; Supplemental Notice of Proposed Rule Making*, 78 Fed. Reg. 31636 (proposed May 24, 2013) (over 1.4 million comments were filed).

107 *Id*. at 16130.

108 43 C.F.R. § 3162.3-3(k).

back to the surface or are the result of hydraulic fracturing operations are managed in an environmentally responsible way, and to provide disclosure of the chemicals used in hydraulic fracturing fluids."[109]

The BLM's new requirements include:

Application Before fracturing commences, submit information including wellbore geology, the location of faults/fractures, depths to "usable water," (10,000 ppm), estimated volume of fluids to be used and estimate direction and length of fracturing in an APD or Sundry Notice and Report on Wells (Form 3160-5) or a Master Hydraulic Fracturing Plan.[110]

Cementing Design and implement a casing and cementing program to protect and isolate "useable" water. Operators must monitor and record flow rate, density and pump pressure and submit data to BLM 48 hours before fracking. Previously drilled wells must have documentation of adequate cementing and may be subject to additional testing. A mechanical integrity test must be performed before fracking and remedial actions are required if cement is inadequate.[111]

Monitoring Monitor annulus pressure during a fracking operation.[112]

Fluid Recovery Manage all recovered fluids in rigid, enclosed, covered or netted or screened above-ground [storage tanks]. Exceptions for pits will be "very limited."[113]

Disclosure Disclose the chemicals and proppants in hydraulic fracturing fluids to BLM and the public with limited exceptions for material "demonstrated through affidavit to be trade secrets." Operators must provide this information by posting it on the

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109 *Id*. at 1612(I).
110 43 C.F.R. § 3162.3-3(c),(d)(6).
111 43 C.F.R. § 3162.3-3(e).
112 43 C.F.R. § 3162.3-3(g).
113 43 C.F.R. § 3162.3-3(h).

FracFocus website within 30 days of completing fracking operations.[114]

Post-Completion Operational Information An operator must provide the source and location of water used in fracking, true vertical depth of well, the maximum surface pressure and rate at the end of each stage of fracking operations, actual fracture length and direction, measured depth of perforations, total volume of fluid recovered, how fluids were handled, and provide an operator's certification and Mechanical Integrity Test results.[115]

The Congressional Research Service in a 2015 Report predicts the rule could affect as many as 3,800 operations annually, with total annual compliance costs of $45 million.[116] The CRS report relies on BLM's cost estimate of $11,400 per frack job to derive the annual cost. The Western Energy Alliance, an industry association, disputes this figure and argues that the costs are closer to $97,000 per well.[117]

[b] — Royalty Reform (Rental, MinimumBids, Bonding and Penalty Reform, Too).

On April 21, 2015, the BLM began a rulemaking process to update royalties and other financial requirements.[118] BLM explains it is issuing the Advance Notice of Proposed Rulemaking (ANPR) "to solicit public comments and suggestions that may be used to update the BLM's regulations related to royalty rates, annual rental payments, minimum acceptable bids,

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114 43 C.F.R. § 3162.3-3(i).

115 *Id*.

116 Michael Ratner and Mary Tiemann, Cong. Research Serv., R43148, *An Overview of Unconventional Oil and Natural Gas: Resources and Federal Action*, 17 (April 7, 2015).

117 Press Release, *BLM Fracking Rule Imposes $345 Million Cost to Society*, Independent Petroleum Association of America, (July 22, 2013); Michelle Ye Hee Lee, "You can't trust the numbers on the new fracking regs," *The Washington Post*, March 30, 2015 (The *Washington Post* Awarded "Two Pinocchios" to the industry for what they saw as a questionable cost estimate in that BLM was requiring the use of current API standards for cementing).

118 *Oil and Gas Leasing; Royalty on Production, Rental Payments, Minimum Acceptable Bids, Bonding Requirements, and Civil Penalty Assessment*, 80 Fed. Reg. 22148 (proposed April 21, 2015) [hereinafter "ANPR"]. The comment period closed June 19, 2015.

bonding requirements, and civil penalty assessments for Federal onshore oil and gas leases."[119] In announcing the ANPR, Secretary Jewell added, "It's time to have a candid conversation about whether the American taxpayer is getting the right return for the development of oil and gas resources on public land."[120]

[i] — Royalty Rates.

The BLM began the effort to raise the onshore royalty rate in response to several investigations by the GAO and the Department's Inspector General.[121] The BLM wants a rule that would give it the flexibility to adjust royalty rates for competitive leases (non-competitive rates are set in the MLA) in response to changes in the oil and gas market "to ensure that the American people receive a fair return . . ."[122] The federal royalty rate for onshore oil and gas is set at 12.5 percent while the royalty rate for offshore oil and gas is currently 18.75 percent. In 2012, Secretary Salazar announced that he planned to increase the onshore royalty rate by 50 percent to equalize the royalty rate for federal oil and gas. More recently, Secretary Jewell has said she is concerned about unintended consequences from raising the onshore royalty to 18.75 percent and the "cost of doing business" on federal lands. Instead of moving forward with a rule raising the royalty rate, BLM is using the ANPR to seek more information.

In 2011, the BLM commissioned a comparative assessment of oil and gas systems in states, other countries and federal on and offshore oil and gas[123] and also reviewed an industry-prepared comparative study.[124] The two studies

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119 *Id*. at 22148.

120 Press Release, U.S. Department of the Interior, *Interior Department Seeks Public Dialogue on Reform of Federal Onshore Oil and Gas Regulations* (April 17, 2015).

121 ANPR at 22150, 22152.

122 *Id*. at 22148.

123 *Id*. at 22150, *citing* IHS CERA Comparative Assessment of the Federal Oil and Gas Fiscal System (October 2011), http://www.blm.gov/wo/st/en/prog/energy/comparative_assessment.html.

124 *Id*. 22150-22151.

showed a range of state royalty rates from 12.5 percent to 25 percent.[125] The BLM is seeking additional information because the inferences from these studies are "potentially contradictory."[126] The BLM is particularly interested in information on "the interplay between commodity prices and a royalty rate's impact on the relative attractiveness of Federal oil and gas leases."[127] In addition, the Department seeks comments on the quantified value of "potential environmental benefits" on Federal lands from any "potential production decreases resulting from higher royalty rates . . ."[128] The proposal would not apply to tribal lands.[129]

What is at stake? Public lands generated $8.5 billion in oil and gas royalty payments in FY2012. In a 2011 budget analysis, Interior concluded that increasing the royalty rate from 12.5 percent to 18.75 percent would raise an additional $1.25 billion over 10 years.[130]

[ii] — Annual Rental Payments.

The MLA requires lessees to pay an annual rent of "not less than" $1.50 per acre in years one through five and $2.00 per acre thereafter.[131] BLM states, "the intent of any potential increase in annual payments would be to provide a greater financial incentive for oil and gas companies to develop their leases promptly or relinquish them . . ."[132] The concept of "use it or lose it" has been a frequent proposal of the Obama Administration, environmental groups and among Democratic legislators.[133] The BLM further notes that

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125 *Id*. at 22151; s*ee* chart "Summary of State & Private Land Royalty Rates."

126 *Id*. at 22152.

127 *Id*.

128 *Id*.; s*ee, also,* questions at 22154-22155.

129 *Id*. at 22150.

130 U.S. Gov't Accountability Office, *Oil and Gas Resources: Actions Needed for the Interior to Better Ensure a Fair Return* (December 2013).

131 30 U.S.C. § 226 (d).

132 ANPR at 22148.

133 *See e.g.,* 2011 budget proposal of President Obama for a $4.00-per-acre "use it or lose it" fee on "idle" leases and a similar 2011 proposal from Senate Democrats, Fuelfix.com/blog/2011/03116/Senators-pitch-use-it-or-lose-it-fee-on-idle-oil-and-gas-leases/. *See also* Department of the Interior, *Oil and Gas Lease Utilization – Onshore and Offshore, Report to the President* (March 2011).

the rental rate has not changed in 28 years and needs to be updated. BLM is looking for information on rents charged by states and fee lessors.

[iii] — Minimum Acceptable Bid.

The MLA sets the "national minimum acceptable bid"[134] and set the minimum bid at $2.00 per acre for two years.[135] The MLA provides the Secretary with the authority to raise the minimum bid if two conditions are met: 1) to enhance financial returns to the [U.S.]; 2) to promote more efficient management of oil and gas resources on Federal lands.[136] BLM argues "the intent of any potential change is to ensure that the American taxpayers receive a fair financial return at BLM oil and gas lease sale auctions." BLM explains that its experience at auctions "suggest[s] the current minimum acceptable bid could be higher."[137] Any change in the national minimum bid has a MLA-required 90-day notification period to the House Natural Resources and Senate Energy committees.[138]

[iv] — Bonding.

The MLA[139] and BLM regulations[140] provide for a surety or personal bond to be submitted before surface disturbance to ensure the complete and timely reclamation of the lease tract and any lands adversely affected by oil and gas operations. BLM regulations provide for four types of bonds: 1) Lease/Individual bonds at not less than $10,000; 2) statewide bonds to cover all leases/operations in a state not less than $25,000; 3) nationwide bonds — all leases and operations in the U.S. at not less than $100,000; 4) unit operations bond at an amount set by the BLM authorized officer.[141]

The BLM states in the ANPR that, "[t]he BLM has not increased the minimum bond amounts provided in existing regulations since 1960 . . . those

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134 30 U.S.C. § 226(b)(1)(A).

135 30 U.S.C. § 226(b)(1)(B).

136 *Id*.

137 ANPR at 22148.

138 30 U.S.C. § 226(b)(1)(B).

139 30 U.S.C. § 226(g).

140 43 C.F.R. § 3104.1.

141 *Id*. at 22153.

minimums do not reflect inflation with the reclamation and restoration of any individual oil and gas operation."[142] BLM Director Kornze underscored the point, "Today's bonding rates were set when Dwight D. Eisenhower was President. We are long overdue to consider an update that will help us ensure that oil and gas sites are properly managed and reclaimed and that taxpayers aren't left picking up the tab."[143]

[v] — Civil Penalty Assessment.

The civil penalty provisions in the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA)[144] authorize BLM to assess civil penalties for several types of violations and provide for certain maximum daily penalties. BLM promulgated regulations that cap the total civil penalty that can be assessed.[145] The Department's Inspector General recently questioned whether these penalty levels, set in the mid-1980's, were an adequate deterrent in a time where per well drilling costs in North Dakota ranged between $8 and $12 million and recommended that BLM pursue increased monetary fines.[146]

[c] — Onshore Order No. 9 and NTL-4A, "Venting and Flaring."[147]

The BLM later this year is expected to publish a proposed rule to update Onshore Order No. 9, "Waste Prevention and Use of Produced Oil and Gas

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142 *Id*. at 22154; *see also*, U.S. Gov't Accountability Office, GAO-11-292, *Oil and Gas Bonds: BLM Needs a Comprehensive Strategy to Better Manage Potential Oil and Gas Liability* (February 25, 2011); U.S. Gov't Accountability Office, GAO 10-245, *Oil and Gas Bonds: Bonding Requirements and BLM Expenditures to Reclaim Orphaned Wells* (January 27, 2010).

143 Press Release, U.S. Department of the Interior, *Interior Department Seeks Public Dialogue on Reform of Federal Onshore Oil and Gas Regulations* (April 17, 2015).

144 30 U.S.C. § 1719.

145 *Id*.; 43 C.F.R. 3163.2(b), (e) and (f).

146 ANPR *citing* Inspector General Report, *Bureau of Land Management: Federal Oil & Gas Trespass and Drilling Without Approval*, No. CR-IS-BLM-0004-2014. (September 29, 2014).

147 BLM, Notice to Lessees and Operators of Onshore Federal and Indian Oil and Gas Leases: Royalty or Compensation for Oil and Gas Lost, effective Jan. 1, 1980 (updated January 16, 2013), http://www.blm.gov/style/medialib/blm/ca/pdf/pdfs/bakersfield_pdfs/minerals.Par.d4a404de.File.dat/ntl4a.pdf

for Beneficial Purposes"[148] and "Notice to Lessees and Operators of Onshore Federal and Indian Oil and Gas Lessees: Royalty or Compensation for Oil and Gas Lost" ("NTL-4A").[149] The policy driver for these revisions is the President's Climate Action Plan[150] to reduce greenhouse gas emissions. In early 2015, the President set a goal to cut methane from the oil and gas sector by 40-45 percent from 2012 levels by 2025.[151] Earlier in 2010, the GAO had issued a report that targeted BLM's management of vented and flared gas and argued that better management would increase royalties and decrease greenhouse gas emissions.[152]

The NTL-4A describes what portion of federal oil and gas production is not subject to royalty. This includes oil and gas used for "beneficial" purposes or what is "unavoidably lost." The proposal would instead identify "royalty-free use of oil and gas." The proposed rule, 43 C.F.R. § 3178, would replace the "beneficial use" portion of NTL-4A and the proposed rule 43 C.F.R. § 3179 would replace the NTL-4A provision that excused a royalty for vented or flared gas. The proposed Order and rules will delineate which activities qualify for beneficial use, minimize venting and flaring and establish standards for avoidable and unavoidable loss. The proposal focuses on sources of methane emissions during drilling, testing, completions, production, liquids unloading and leaks from poorly sealed equipment like valves and dehydrators. BLM will require methane tracking, monitoring and repair and may use infrared detection tools in spot inspections. The proposed rule,

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148 BLM Onshore Oil and Gas Orders and National Notices to Lessees (Jan. 13, 2011), http://www.blm.gov/nm/st/en/prog/energy/oil_and_gas/operations/onshore_orders.html.

149 Notice to Lessees and Operators of Onshore Federal and Indian Oil and Gas Leases, U.S. Department of the Interior (January 1, 1980), http://www.blm.gov/wy/st/en/programs/energy/Oil_and_Gas/docs/ntl_4a.html.

150 The President's Climate Action Plan, Executive Office of the President (June 25, 2013), https://www.whitehouse.gov/sites/default/files/image/president27sclimateactionplan.pdf.

151 Press Release, The White House, *FACT SHEET: Administration Takes Steps Forward on Climate Action Plan by Announcing Actions to Cut Methane Emissions*, (January 14, 2015).

152 U.S. Gov't Accountability Office, GAO 11-34, *Federal Oil & Gas Leases: Opportunities Exist to Capture Vented and Flared Gas Which Would Increase Royalty Payments and Reduce Greenhouse Gases* (November 29, 2010).

which BLM anticipates finalizing in 2016, will apply to Federal and Indian wells and to new and existing wells.

[d] — Other BLM Regulatory Updates

[i] — Onshore Order 1, Approval of Operations.[153]

This regulation will be updated to require electronic submission of an APD or Notice of Staking to speed BLM processing time, reduce the number of deficient submissions and provide current, on-line status of submittals to operators. BLM offices in Utah and New Mexico have been piloting the system which is expected to go "live" by summer 2015.

[ii] — Onshore Orders 3 (Site Security), 4 (Oil Measurement) and 5 (Gas Measurement).[154]

The BLM is proposing updates to these Orders to address recommendations from the GAO and the Interior Inspector General.[155] These Orders apply to all federal and Indian (not Osage Tribe) leases and were last updated in 1989. Order 3 provides for site security through a system for production accountability including the use of seals, meter bypasses, self-inspection, transportation documentation, record-keeping and identifies specific acts of noncompliance. Orders 4 and 5 provide standards for the measurement of oil and gas. Order 4 (oil) tracks 43 C.F.R. § 3162.7-2 for operating procedures for oil and storage and Order 5 (gas) tracks 43 C.F.R. § 3162.7-3 requirements for the measurement of gas. These revisions would incorporate current API standards that reflect new technology, allow enforcement actions against purchasers and transporters and immediate assessments for

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153 BLM, Onshore Order No. 1, Onshore Oil and Gas Orders and national Notices to Lessees (Jan. 13, 2011), http://www.blm.gov/nm/st/en/prog/energy/oil_and_gas/operations/onshore_orders.html.

154 *Id*. at Onshore Orders 3, 4 and 5.

155 Government Accountability Office, GAO 15-39, *Interior's Production Verification Efforts and Royalty Data Have Improved, but Further Actions Needed* (April 7, 2015), at 2-3 (listing audits in 2008, 2009, 2010 and 2011).

a variety of violations to prevent theft and loss and provide for more accurate measurement and production accountability.[156] BLM began discussing these changes with Tribes in 2011, held stakeholder meetings in 2013 and closed a comment process in May of that year. The draft proposal is anticipated in summer 2015, and the final Orders in August 2016.

[e] — BLM NEPA Greenhouse Gas Guidance.

In December 2014, the White House Council on Environmental Quality (CEQ) proposed new guidance on how federal agencies should consider greenhouse gas emissions (GHG) and the impacts of climate change in agency NEPA reviews.[157] The Council on Environmental Quality first issued draft guidance in 2010[158] and specifically excluded land and resource management actions from the guidance due to the lack of a federal protocol.

The 2014 Guidance changes course from the 2010 Draft to include land management actions and provides considerable new detail. The Council on Environmental Quality directs that agencies use the expected volume of an action's GHG emissions as a proxy for GHG environmental effects. The draft Guidance cautions agencies against discounting review of GHG emissions based on an argument that the proposed action is a "small fraction of global emissions."[159] CEQ identifies a threshold of 25,000 metric tons of CO_2-e annually, below which a *quantitative* analysis of GHG emissions is not recommended.

The CEQ Guidance also encourages an assessment of direct, indirect, and reasonably foreseeable connected actions that have a "reasonably close causal relationship" to the federal action including upstream and downstream

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156 Government Accountability Office, GAO 15-39, *Interior's Production Verification Efforts and Royalty Data Have Improved, but Further Actions Needed* (April 7, 2015) at 19; s*ee also* Onshore Orders 3, 4, 5 Side-by-Side Comparison of Significant Draft Proposed Changes (April 24, 2013), http://www.blm.gov/live/pdfs/sidebyside.pdf.

157 79 Fed. Reg. 77,802 (Dec. 24, 2014).

158 The White House Council on Environmental Quality, *Revised Draft Guidance for Greenhouse Gas Emissions and Climate Change Impacts* (Dec. 2014), https://www.whitehouse.gov/administration/eop/ceq/initiatives/nepa/ghg-guidance.

159 79 Fed. Reg. at 77,825 (Dec. 24, 2014).

emissions.[160] CEQ provides the example of an open-pit mine that would include emissions associated with land clearance and road construction, refining, processing and transporting the extracted mineral and downstream use of the resource.[161] This direction, in particular, has resulted in a number of comments. In addition, the Guidance instructs agencies to consider "enhanced energy efficiency," use of renewable energy, carbon capture or sequestration and beneficial use of GHG when developing alternatives or mitigation.[162] If mitigation measures are adopted to support a NEPA "Finding of No Significant Impact" or Record of Decision, the Guidance instructs that a monitoring program be established.[163] Finally, the CEQ recommends that agencies consider using the federal Social Cost of Carbon to monetize the cost/benefit of climate impacts from agency actions.[164] The comment period on the 2014 proposal closed in March 2015 and the Guidance is expected to go final by the end of 2015.

The duty of land management agencies to consider GHG in NEPA was underscored in a recent court decision. On June 27, 2014, a federal judge in Colorado required the federal government to demonstrate why it chose not to consider the potential economic impact of GHG emissions in its NEPA review of a proposed coal mine expansion.[165] The court rejected the government's argument that it could not calculate that impact and directed the agency to the federal Social Cost of Carbon methodology. On April 6, 2015, the U.S. Forest Service gave notice it would prepare a supplemental EIS to assess the impacts of the expansion of the coal mine on climate change.

The BLM is now developing comprehensive guidance on calculating the climate change impacts of mining and oil and gas development on public lands. A leaked BLM memo sent in April 2015, stated, "Anthropogenic

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160 *Id*. at 77,825-26; s*ee also* 40 C.F.R. § 1508.8 (direct/indirect); 40 C.F.R. § 1508.25 (connected).

161 79 Fed. Reg. at 77,826 (Dec 24, 2014).

162 *Id*. at 77,828.

163 *Id*.

164 *Id*. at 77,827; *see also*, Environmental Protection Agency, *The Social Cost of Carbon* (Nov. 26, 2013), www.epa.gov/climatechange/EPAactivities/economics/scc.html.

165 High Country Conservation Advocates v. U.S. Forest Service, 52 F. Supp. 3d 1174, 1193 (D. Colo. 201413-cv-1723 (D. Colo. June 27, 2014).

climate change is a reality. Please ensure that all discussions of climate change in BLM [NEPA] documents are consistent with this conclusion." The author of the memo went on to explain that the new BLM guidance will be consistent with the CEQ GHG Guidance and will provide direction on how to use the federal Social Cost of Carbon methodology.

§ 5.04. Expediting Green Energy on Public Lands.

Unlike federal oil and gas, where the Administration is promulgating several new regulatory requirements that will have the effect of slowing an already time-consuming process, when it comes to renewable energy, the Administration is seeking to expedite renewable energy permitting on public lands. In Secretary Jewell's energy reform speech in March, she stated, "We're using this comprehensive, landscape-level approach for renewable energy, too . . . Because of their early planning work, companies will see faster permitting times . . . [T]oday, we should be investing in incentives for industries that are still getting their foothold in our nation's energy sector, like wind and solar."[166] This focus on expediting renewable energy on public lands has been an early and consistent theme at Interior in the Obama Administration. More recently, the Administration has proposed regulations to cement their renewable energy legacy.

[1] — Public Land Green Energy Background.

Other than the 1970 Geothermal Steam Act,[167] there is no federal statute authorizing renewable energy on public lands. The BLM has instead used the FLPMA Title V rights-of-way authority to permit wind and solar on public land.[168] In 2002, BLM issued its first wind permitting policy[169] and completed a Wind Energy Programmatic Impact Statement and Record of Decision ("Wind PEIS") to amend 52 RMPs to provide for wind facilities

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166 Press Release, U.S. Department of the Interior, *Secretary Jewell Offers Vision for Balanced, Prosperous Energy Future* (March 17, 2015).

167 30 U.S.C. § 1001 *et seq.*

168 U.S.C. §§ 1761-1771; 43 C.F.R. 2800 *et seq.*

169 Instruction Memorandum No. 2003-020, *Interim Wind Energy Development Policy* (October 16, 2002).

subject to "best management practices."[170] A solar permitting policy was announced in late 2004.[171] Most significantly, EPAct addressed renewable energy in several provisions. The Act modernized the provisions of the Geothermal Steam Act[172] and called for the preparation of a Geothermal PEIS (completed in 2008). The Act included significant financial incentives (tax breaks) for all forms of renewable energy and set out an explicit goal to permit 10,000 MW of renewable energy on public lands by 2015.[173] As a result, EPAct created a "gold rush" mentality for public land renewables that BLM was ill-prepared to handle.[174]

[2] — Public Land Green Energy in Obama Administration.

[a] — Initial Actions at BLM.

In 2009, BLM saw a 78 percent increase in applications for solar energy — from 107 to 223. Without a statute or regulations creating a regulatory framework to permit renewable energy, BLM struggled to manage the deluge of applications. The tools BLM used were the PEIS, to better plan for siting and permitting of renewable energy, and the BLM Instruction Memorandum ("IM") to provide guidance to field offices and industry.[175]

Secretary Salazar underscored the focus of the Obama Administration on renewable energy by highlighting green energy in his January 15, 2009 confirmation hearing and by the issuance of his first Secretarial Order

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170 *BLM, Final Programmatic Impact Statement on Wind Energy Development on BLM Administered Lands in the Western United States*, 70 Fed. Reg. 36651 (June 24, 2005).

171 http://www.blm.gov/wo/st/en/info/newsroom/2004/October/nr/0212004.html.

172 EPAct § 221; 43 U.S.C. § 1701.

173 EPAct § 388; 43 U.S.C. § 1337(p).

174 U.S. Gov't Accountability Office, *Renewable Energy: Agencies Have Taken Steps Aimed at Improving the Permitting Process for Development on Federal Lands*, at 15, 21-22 (January 2013) ("GAO Renewable Energy"); *see also,* Rebecca W. Watson, *Renewable Power Projects on Federal Lands: Wind and Solar and the FLPMA Right-of-Way – Is it Working?*, Rocky Mtn. Min. L. Fnd., Special Institute Energy Development, Paper 10 (Sept. 2009).

175 *See, e.g., Solar Energy Development Policy*, IM-2007-097; *Wind Energy Development Policy*, IM-2009-043, www.blm.gov/wo/st/en/prog/energy/renewable-energy.html.

in January 2009,[176] followed by a second in March 11, 2009.[177] These Secretarial Orders established a Task Force on Energy and Climate Change and made the development, production and delivery of renewable energy one of the Interior Department's "highest priorities."[178] The American Recovery and Reinvestment Act of 2009 (ARRA) provided $41 million of stimulus monies to reduce the permitting backlog of BLM wind and solar projects. In May 2009 the Secretary directed the opening of four BLM Renewable Energy Coordination Offices to expedite green energy permitting.[179] In June 2009, the Secretary announced "fast-track initiatives for solar energy development" on BLM public lands in 24 solar energy zones to meet ARRA deadlines.[180]

The initial driver of this effort to expedite or "fast track" renewable energy projects — wind, solar, geothermal and green energy transmission — was to get the projects through permitting and under construction by December 31, 2010 in order for the developments to qualify for ARRA stimulus funding (grants for 30 percent of construction costs).[181] In October 2009, Interior and California entered into a Memorandum of Understanding to establish a Renewable Energy Action Team to work across jurisdictional boundaries to expedite permitting. In July 2010, the BLM identified 14 solar, seven wind, six geothermal and seven transmission "Fast-Track" projects. In the fall of 2010, nine "Fast Track" solar projects completed NEPA and Secretary Salazar issued Records of Decisions for these projects.

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176 Secretary of the Interior Order No. 3283, *Enhancing Renewable Energy Development on Public Lands* (January 2009).

177 Secretary of the Interior Order No. 3285, *Renewable Energy Development by the Department of Interior* (March 11, 2009).

178 *Id*.

179 Press Release, U.S. Dept. of the Interior, *Secretary Salazar Pledges to Open Four Renewable Energy Permitting Offices, Create Renewable Energy Team*, (May 5, 2009).

180 Press Release, U.S. Dept. of the Interior, *Secretary Salazar, Senator Reid Announce, "Fast Track" Initiatives for Solar Energy Development on Western Lands* (June 29, 2009).

181 American Recovery and Reinvestment Act § 1603, 123 Stat. 115 [hereinafter *ARRA*].

[b] — 2011 BLM Renewable Energy Guidance.

Secretary Salazar took several important policy steps to improve the BLM's basic tools for permitting renewable energy — the PEIS and the Instruction Memorandum.

[i] — Solar PEIS (Programmatic Environmental Impact Statement).

The Solar PEIS was underway when the Obama Administration began, but in December 2010, Secretary Salazar refocused the Solar PEIS in a unique way in what he described as a "Smart from the Start" approach.[182] That policy was designed to change an applicant-driven siting process to one where BLM directed the location of solar projects to "low conflict" areas.[183] The Solar PEIS and Western Solar Plan finalized in 2012 identified 17 solar energy zones (SEZs) (285,000 acres) where applicants would receive expedited processing and other incentives to locate projects in a SEZ.[184] The Solar PEIS closed other areas (79 million acres) to development and amended 89 RMPs in six western states. To address the concerns of the solar industry over the loss of some good sites, the PEIS established variance areas outside a SEZ (19 million acres), where processing would be on a less accelerated path. On-going processes have designated new SEZs. In Arizona, the Arizona Restoration Design Energy Project, and in California, the West Chocolate Mountains.[185] An ambitious process in California, the Desert Renewable

182 Press Release, U.S. Department of the Interior, *Salazar Launches 'Smart from the Start' Initiative to Speed Offshore Wind Energy Development off the Atlantic Coast* (Nov. 11, 2010).

183 BLM Instruction Memorandum 2011-181 (February 2011).

184 BLM, *Approved Resource Management Plan Amendments/Recording Decision for Solar Energy Development in Six Southwestern States* (October 2012), http://solareis.anl.gov/documents/docs/Solar_PEIS_ROD.pdf.

185 Arizona Restoration Design Project, www.blm.gov/az/st/en/prog/energy/arra_solar.html and West Chocolate Mountains SEZ, www.blmsolar.anl.gov/sez/ca/west_chocolate_mountains/.

Energy Conservation Plan, plans to identify SEZs and mitigation areas in 22 million acres in a series of BLM RMPs amendments by the end of 2015.[186]

[ii] — 2011 Renewable Energy Instruction Memoranda and Rulemaking.

By 2011, BLM had five years of experience in permitting renewable energy projects. In January 2011, Interior held a "lessons-learned" workshop and on February 7, 2011 issued three significant IMs to address several challenging permitting issues. The first IM, "National Environmental Policy Compliance for Utility-Scale Renewable Energy Right-of-Way Authorizations,"[187] addressed NEPA compliance, in particular, how to draft a "Purpose and Need" statement and how to address different technologies in the alternatives analysis. The second, "Solar and Wind Energy Applications — Due Diligence,"[188] was designed to weed out speculative applications by requiring a detailed Plan of Development early in the process. The third IM, "Solar and Wind Applications — Pre-Application and Screening,"[189] provided guidance on how to "screen out" infeasible or environmentally problematic projects. This IM requires a more robust pre-application process, provided direction on what projects had a low, medium or high potential for conflict and allowed BLM to move away from the "first-come, first-served" approach to a siting process that gave BLM more control. BLM also issued two other IM's to address conflicting land uses from grazing and mining.[190]

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[186] *See* Desert Renewable Energy Conservation Plan, Bureau of Land Management (June 19, 2015), www.blm.gov/ca/st/en/prog/energy/DRECP.html.

[187] BLM Instruction Memorandum 2011-059, *National Environmental Policy Act Compliance for Utility-Scale Renewable Energy Right-of-Way Authorizations* (February 8, 2011).

[188] *Id.; see also* BLM Instruction Memorandum 2011-060, *Solar and Wind Energy Applications — Due Diligence* (February 8, 2011).

[189] BLM Instruction Memorandum 2011-061, *Solar and Wind Energy Applications - Pre-Application and Screening* (February 8, 2011).

[190] BLM Instruction Memorandum 2011-181, *Involvement of Grazing Permittee/Lessee with Solar and Wind Energy Right-of-Way Application Process* (February 8, 2011); BLM Instruction Memorandum 2011-183, *Implementation Procedures – Interim Temporary Final Rule for Segregating Renewable Energy Right-of-Way Application* (February 8, 2011).

Later in 2011, BLM sought to more permanently address conflicts between mining claims and wind and solar projects to discourage speculative mining claims for the purpose of financial payments from renewable energy developers.[191] BLM issued a temporary rule withdrawing 303,900 acres of public land to mining claims to protect solar energy zones.[192] The rule was finalized in 2013[193] and allows BLM to temporarily segregate lands from competing land uses during the pendency of renewable energy permitting.

[3] — BLM Renewable Energy Results and Regulatory Next Steps.

[a] — Results.

In 2012, operations began at the first solar power plant on public lands – a photovoltaic ("PV") facility in Nevada. Several wind projects in Oregon, Nevada and California were operational in 2011-2012, as were several geothermal plants in Nevada.[194] The GAO found that during the time period of 2009-2013, BLM had significantly improved its permitting time frames, in the case of wind and solar, from 4 years to 1.5 years.[195]

Nationwide, the BLM has approved 52 utility-scale renewable energy projects since 2009, including 29 solar projects with a total capacity of over 14,000 (enough to power 4.8 million homes) of which six are operating.[196] In 2015, the two largest solar power plants in the world — Desert Sunlight and Topaz Solar Farm were permitted by BLM in central California. Each plant will produce over 500 MW of energy (in 2005, the largest solar plant in the world was 10 MW). On June 1, 2015, the Department announced the approval of the first competitively sold solar permits under the Western

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191 GAO, Renewable Energy at 27.

192 77 Fed. Reg. 74, 690 (December 17, 2012).

193 77 Fed. Reg. 25, 205 (April 30, 2013).

194 Renewable Energy Projects Approved Since the Beginning of Calendar Year 2009, Bureau of Land Management, (June 17, 2015) http://www.blm.gov/wo/st/en/prog/energy/renewable_energy/Renewable_Energy_Projects_Approved_to_Date.html.

195 GAO Renewable Energy at 1.

196 BLM, New Energy for America, (April 28, 2015), http://www.blm.gov/wo/st/en/prog/energy/renewable_energy.html.

Solar Plan. These Nevada solar permits were approved ten months from the date the parcels were auctioned in June, 2014 demonstrating the permitting efficiencies of the Western Solar Plan. In May 2015, BLM issued the FEIS for the TransWest Express Transmission Line project, a high priority transmission project, to deliver wind energy from what would be the world's largest wind farm in Wyoming to Las Vegas.[197] BLM, having already met the EPAct goal (in 2012) to have 10,000 MW of renewables permitted on public lands by 2015, is now working to meet President Obama's new goal of 20,000 MW by 2020.[198]

Although there have been over 31 lawsuits filed against 20 BLM-approved renewable energy projects, including most of the 2010 "Fast Track" authorizations, the Administration's renewable energy policies have not met serious legal setbacks.[199] In part, this is due to a cooperative working relationship between Interior and "the big green groups," The Wilderness Society, Natural Resources Defense Council, Defenders of Wildlife, and the Sierra Club, in the development and implementation of the Administration's renewable energy policy. That said, BLM's June 5, 2015 approval of the Soda Mountain Solar Project in California was met with strong disapproval by the Sierra Club's Beyond Coal Campaign, despite BLM's significant reduction in the size of the solar plant. Litigation is anticipated.[200]

[b] — BLM Renewable Energy Proposed Regulations.

In December 2011, BLM solicited public comments to be used in preparing a proposed rule to establish a competitive process for leasing public

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197 BLM, TransWest Express Transmission Line Project, (June 4, 2015), www.blm.gov/wy/st/en/info/NEPA/documents/hdd/transwest.html.

198 BLM, Authorized and First-in-Line Pending Solar Applications in the Six-State Study Area, as of April 1, 2015, http://blmsolar.anl.gov/maps/data/Pending-Applications-Map.pdf.

199 *See*, E. Boling and B. Birdsong, *Moving Forward: Solar and Wind Development on Public and Indian Lands*, Rocky Mountain Mineral Law Foundation Special Institute Renewable Electric Energy, Paper 4 at 4-5 - 4-12, November 2013, for thorough discussion of legal challenges and largely (23) positive decisions.

200 Press Release, *BLM Approves Massive Energy Project at Expense of Environment*, Defenders of Wildlife (June 5, 2015).

lands for solar and wind development.[201] The need to improve its renewable permitting processes was highlighted in a critical 2012 Inspector General report that found BLM could add millions of dollars to the federal treasury if it used a competitive process.[202] BLM "previewed" the competition concept in the Solar PEIS for use in a SEZ where competitive interest was anticipated. In August, 2013, BLM used this PEIS authority to conduct a competitive lease sale in two Colorado SEZs.[203] Unfortunately for BLM, there was no interest in the two Colorado SEZs.[204] But, on June 30, 2014, BLM hosted a successful solar auction in Nevada earning the federal treasury $5.8 million for leases in the Dry Lake SEZ.[205] With that success, BLM moved to issue a proposed rule for a competitive process for wind and solar on September 30, 2014.[206]

The proposed rule does more than flesh out a competitive process; the rule will also formalize the 2011 renewable energy policies into regulation. The rule, when final, will complete BLM's move away from "first come, first served" renewable energy permitting system to one where BLM directs where renewable energy is to be sited. First, the proposed rule creates a leasing process for wind and solar in "designated leasing areas" (DLAs) and provides incentives (reduction in rental fees, predictable bonds) for leases in DLAs.[207] The proposed rule provides an incentive in the form of a "variable offset" for bidders who pre-qualify in a DLA.[208] Pre-qualified bidders would

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201 *Announcement of Proposed Rulemaking, Competitive Processes, Terms and Conditions, Bureau of Land Management,* 79 Fed. Reg. 81906 (December 29, 2011).

202 Department of the Interior Office of Inspector General, *Bureau of Land Management's Renewable Energy Program: A Critical Point in Renewable Energy Development*, CR-EV-BLM-0004-2010 (June 12, 2012).

203 78 Fed. Reg. 50086 (August 16, 2013).

204 Mark Jaffe, "1st Auction of Solar Rights on Public Lands in Colorado Draws No Bids," *Denver Post*, October 24, 2013.

205 Press Release, *BLM Director Highlights Agency Accomplishments in 2014,* U.S. Department of the Interior (January 9, 2015).

206 BLM, *Competitive Processes, Terms and Conditions for Leasing Public Lands for Solar and Wind Energy Development and Technical Changes and Corrections*, 79 Fed. Reg. 59022 (September 30, 2014).

207 43 C.F.R. subpart 2809.

208 43 C.F.R. § 2809.16.

be eligible for offsets limited to no more than 20 percent of the high bid. If competitive interest is shown in an area outside a DLA, BLM can also use the competitive process.[209]

The proposed rule incorporates many of the important components of the 2011 guidance documents (BLM IM-2011 59, 60 and 61). In the rule, the BLM describes the screening process as a means to "prioritize processing applications with lesser resource conflicts over applications with greater resource conflicts."[210] The BLM provides specific terms for wind and solar grants — three years for wind test sites and 30 years for wind and solar development grants.[211] BLM requires an extensive list of terms and conditions for all wind and solar grants that incorporate the due diligence requirements.[212] The BLM also clarifies the bonding requirements for wind and solar facilities and requires, in most cases, the preparation of a "reclamation cost estimate" (RCE). Perhaps the most novel component of the rule is the rental provision.[213] The rentals for wind and solar deviate from BLM's typical land grant rentals by charging a rent that includes a component reflecting the amount of electricity generated.[214] The rental calculation for solar[215] and wind[216] are separately addressed, but contain similar elements:

- Calculation of acreage in the authorized area;
- Application of the per-acre county rate from the BLM linear rent schedule (*see* 43 C.F.R. § 2806.20(c)) with an encumbrance factor applied. Solar pays 200 percent of the per acre value, while wind pays 20 percent of the per acre value in recognition that other uses may occur at a wind farm, but not at a utility solar facility;

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209 43 C.F.R. § 2809.19.

210 BLM Instruction Memorandum 2011-061, *Solar and Wind Energy Application – Pre-Application and Screening* (February 8, 2011).43 C.F.R. § 2804.25.

211 43 C.F.R. § 2805.11.

212 43 C.F.R. § 2805.12.

213 43 C.F.R. § 2805.20.

214 43 C.F.R. § 2806.

215 43 C.F.R. § 2806.50.

216 43 C.F.R. § 2806.60.

- MW capacity fee; and
- MW capacity fee phase-in.

The rental fees also reflect certain incentives for projects in DLAs.[217] The comment period closed on December 16, 2014 and BLM expects to finalize this rulemaking by October 2015.

[4] — The U.S. Forest Service and Renewable Energy.

The U.S. Forest Service authorizes renewable energy projects under special use authorization regulations at 36 C.F.R. pt. 251, subpart B. The U.S. Forest Service declined to participate in BLM's 2005 Wind PEIS and, instead, undertook to develop its own regulations in the form of directives. After beginning the process in 2007,[218] the Forest Service was unable to complete the process until 2011.[219] The new Chapter 70 provides direction on screening proposals for projects, siting proposed projects, processing proposals and applications and issuing special use permits for wind energy. These requirements are similar to BLM's procedures, but with some important differences around competition at the application phase, and the need for an appraisal to assess the rental fee. In addition, new chapter 80 requires extensive wildlife monitoring at wind energy sites before, during and after construction.[220]

Unlike BLM, the Forest Service has been a reluctant participant in siting renewable energy on public lands.[221] The first and only Forest Service wind project, Deerfield Wind in Vermont, was submitted in 2004 and not approved until 2012. The approval of Deerfield Wind was litigated and the project has not yet been built. The first project submitted under the Forest Service 2011 directives did not go well. The Cleghorn Ridge Wind Project

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217 *See e.g.* 43 C.F.R. § 2806.64.

218 USFS, *Wind Energy Proposed Forest Service Directives*, 72 Fed. Reg. 54,233 (Sept. 24, 2007).

219 Final Directives for Forest Service Wind Energy Special Use Authorizations, Forest Service Manual 2720, Forest Service Handbooks 2609.13 and 2709.11, 76 Fed. Reg. 47,354 (August 4, 2011).

220 *Id.*

221 U.S. Gov't Accountability Office Renewable Energy at n. 30.

in the San Bernardino National Forest was submitted to the Forest Service in September 2011, identified by Agriculture Secretary Vilsack and the White House as one of 14 "high priority" federal energy infrastructure projects in October 2011. Less than two months later, the Forest Service "screened out" the project and did not allow it to proceed to permitting.[222]

§ 5.05. Evolution of Land Use Planning.

[1] — A Shift in Land Use Planning Philosophy.

President Obama's Secretaries of the Interior have implemented a number of initiatives aimed at fundamentally changing the way public land planning decisions are made. These changes have included not only the oil and gas and renewable energy-specific policy and rule changes discussed in the preceding sections, but have also been accompanied by a major, top-down shift in the philosophy of land management, dubbed "Planning 2.0" by the Administration. Planning 2.0 adopts a less-localized focus on land use, and emphasizes dynamic, landscape-level management as the best way to respond to climate change. The new approach is aimed at managing lands on an ecosystem or "landscape" level, without reference to BLM boundaries, while simultaneously adding additional layers of environmental analysis and new mitigation requirements.

According to BLM, current regulations governing RMP development which dictate that RMPs be prepared and maintained at the field office level have led to a patchwork of some 160 RMPs, potentially leading to inconsistent management of the same resource by different field offices.[223] The BLM's new planning philosophy recognizes that land use issues and resources, particularly in the context of energy development and climate change, often do not correspond with administrative boundaries and seeks to "tackle problems and issues at their natural scales, looking beyond geopolitical boundaries and working across jurisdictions . . . ."[224] Under this approach,

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222 Federal Infrastructure Projects, Cleghorn Ridge Wind Project, Performance.GOV, http://www.permits.performance.gov/projects/cleghorn-ridge-wind-project.

223 BLM, *Winning the Challenges of the Future: A Roadmap for Success in 2016,* p. 10 (October 2010).

224 *Id*. at 7.

land managers will aim to "identify important ecological values and patterns of environmental change that may not be evident when managing smaller, local land areas."[225]

The Obama Administration's oil and gas and renewable energy reforms, discussed *supra*, illustrate this shift in management philosophy. The oil and gas leasing reforms contained in Instruction Memorandum 2010-117, which introduced master leasing plans and additional lease parcel review prior to lease issuance, are prime examples of a move toward landscape-level management decisions. Instead of relying solely on the RMP as written, IM 2010-117 "reminded" land managers that they should periodically consider whether the RMP "adequately protects important resource values in light of changing circumstances, updated policies and new information," and exercise their discretionary oil and gas leasing authority based on both the RMP and their conclusions about the plan's efficacy.[226] Similarly, the concept of the master leasing plans encourages long-range planning for single resources (oil and gas) in the context of the larger landscape and competing resources (such as recreation, scenery, wildlife, *etc*.), but as an added process to RMP. The Administration's Western Solar Plan and proposed renewable energy rules have also sought to make sweeping, resource-specific changes to the way permitting decisions are made, driving a landscape approach — all while attempting to incent development in areas identified in advance by the federal government as preferable because of low resource conflict.

The Forest Service has followed a similar path as Interior with the Secretary of Agriculture laying out a restoration agenda across "landscapes" and the 2012 introduction of a new Forest Planning Rule, which is aimed at "ensur[ing] an adaptive land management planning process that is inclusive, efficient, collaborative and science-based to promote healthy, resilient, diverse and productive National Forests and Grasslands."[227]

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225 BLM, *The BLM's Approach for Managing Public Lands* (Jan. 31, 2014), http://www.blm.gov/wo/st/en/prog/more/Landscape_Approach.html.

226 IM 2010-117.

227 USFS, The Forest Planning Rule, http://www.fs.usda.gov/planningrule.

The new planning processes, although in the early stages at Interior and only slightly more mature at U.S. Forest Service, indicate a move away from localized planning to a process, in the case of BLM, more driven at the Washington Office level, and in the case of the Forest Service, more inclusive of many publics and less controlled by agency professionals. These changes represent a marked departure from the way land management and permitting decisions for proposed actions on public lands have been made over the last several decades. Whether they are an improvement will be borne out over time.

[2] — Interior Landscape-Level Planning.

[a] — Rapid Ecoregional Assessments.

In 2009, Secretary Salazar issued Secretarial Order 3289A1, which stated "[g]iven the broad impacts of climate change, management responses to such impacts must be coordinated on a landscape-level basis."[228] In response to this policy direction, BLM launched its Rapid Ecoregional Assessments (REA) program, which seeks to synthesize existing data to increase understanding of "ecological values, conditions and trends within ecoregions, which are large, connected areas that have similar environmental characteristics."[229]

The REAs are BLM analyses that examine ecological values, conditions, and trends within "ecoregions," which are defined as large, connected areas that have similar environmental characteristics. Each REA analyzes these trends within an EPA Level III Ecoregions. Examples of ecoregions include the Sonoran Desert, Seward Peninsula, and the Colorado Plateau. Preparation of REAs does not require research or collection of new data, but instead synthesize existing information, hence the name's reference to "rapid." The REA's will provide the data for landscape-level planning and mitigation.

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228 U.S. Department of the Interior Secretarial Order No. 3289A1, *Addressing the Impacts of Climate Change on America's Water, Land, and Other Natural and Cultural Resources* (September 14, 2009, as amended February 22, 2010).

229 BLM, Rapid Ecoregional Assessments (REAs) (June 5, 2015), http://www.blm.gov/wo/st/en/prog/more/Landscape_Approach/reas.html.

To date, BLM has undertaken 14 REAs, ranging in size from 11 million to 91 million acres. These REAs cover the following ecoregions, all located in the western United States and Alaska: Central Basin and Range (California, Nevada and Utah), Central Yukon (Alaska); Chihuahuan Desert (Arizona, New Mexico and Texas); Colorado Plateau (Utah and Colorado); Mandrean Archipelago (Arizona and New Mexico); Middle Rockies (Idaho, Montana and Wyoming); Mojave Basin and Range (Arizona, Nevada and California); North Slope (Alaska); Northern Great Basin (California, Oregon, Idaho and Utah); Northwestern Plains (North Dakota, South Dakota, Nebraska, Montana and Wyoming); Seward Peninsula (Alaska), Sonoran Desert (California and Arizona); Southern Great Plains (Kansas, Oklahoma, Texas, Colorado and New Mexico); Wyoming Basin (Wyoming, Idaho, Utah and Colorado); and Yukon Kuskokwin (Alaska). To date, eight REAs have been completed.[230]

BLM intends to use REAs, along with input from partner agencies, stakeholders, and tribes, to develop broad-level management strategies. BLM has stated that REAs will not make management decisions, but will instead be used to provide science-based tools for managers and stakeholders to consider during the planning process.[231] The purpose of the ecoregional direction is to identify priority areas for conservation, mitigation and development, including focal areas for conserving wildlife habitats and migration corridors, and focal areas for potential energy development and urban growth, and share that information with land managers throughout the ecoregion. BLM's goal is that the REAs will provide direction and a blueprint for coordinating and implementing consistent policies within the numerous BLM state and field offices that may be located within a single ecoregion.

In practice, it remains to be seen how valuable a tool the REAs will be in the actual planning process. They have been heralded by environmental groups as a necessary tool for analyzing land management decisions in the face of a changing climate,[232] and BLM is currently relying on several

230 *Id*.

231 *Id*.

232 The Wilderness Society, *Rapid Ecoregional Assessments*, http://wilderness.org/article/rapid-ecoregional-assessments.

REAs in preparing RMP revisions and amendments and NEPA documents analyzing wildlife management practices (such as the Greater sage-grouse RMP amendments discussed i*nfra*). On their face, they appear to be a mechanism to strip planning authority from field offices and state offices and put it in the Washington office of BLM.

[b] — Landscape Mitigation Secretarial Order.

Continuing the Administration's push for landscape-level land management, on October 31, 2013, Secretary Jewell issued Secretarial Order No. 3330, establishing a department-wide strategy to mitigate the impacts of infrastructure development projects.[233] Central to this strategy [is] "the use of a landscape-scale approach to identify and facilitate investment in key conservation priorities in a region."[234] The Order directs Interior's Energy and Climate Change Task Force to develop a "coordinated Department-wide, science-based strategy to strengthen mitigation practices so as to effectively offset impacts of large development projects of all types through the use of landscape-level planning, banking, in lieu fee arrangements, or other possible measures."[235]

In response to Order No. 3330, Interior's Energy and Climate Change Task Force issued a report to the Secretary outlining "the key principles and actions necessary to successfully shift from project-by-project management to consistent, landscape-scale, science-based management of the lands and resources for which the Department is responsible."[236] Among the key principles identified is the need to incorporate landscape-scale approaches into "all facets of development and conservation planning and mitigation."[237]

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233 U.S. Department of the Interior Secretarial Order No. 3330, *Improving Mitigation Policies and Practices of the Department of the Interior* (October 31, 2013).

234 *Id*.

235 *Id*.

236 J.P. Clement, *et al., A strategy for improving the mitigation policies and practices of the Department of the Interior; a report to the Secretary of the Interior from the Energy and Climate Change Task Force, Washington, D.C*. (April 4, 2014).

237 *Id*.

BLM is in the process of putting this policy into action by developing its Regional Mitigation framework, currently in draft form as IM No. 2013-142, *Interim Policy, Draft — Regional Mitigation Manual Section 1794*, which will help identify and facilitate mitigation opportunities on a landscape level.[238] The purpose of the Regional Mitigation policy is to provide a uniform basis to outline consistent mitigation measures within regions that do not necessarily correspond to state or field office boundaries. The purpose of the policy is to provide guidance on (1) how to develop regional mitigation strategies; (2) how to incorporate regional mitigation into the land use planning process; and (3) how to identify and implement appropriate mitigation measures for particular land use authorizations.[239] It does not, however, provide any specific guidance on particular mitigation measures that should be imposed, but instead provides general guidance on factors that should be evaluated when developing mitigation requirements for specific proposals. It is notable that neither the Report to the Secretary nor BLM's Draft Regional Mitigation guidance went out for public comment.

[c] — Wildlands, National Monuments and Arctic Drilling.

[i] — Wilderness and the BLM's "Wildlands Policy."

When Congress passed the Wilderness Act in 1964,[240] it applied only to lands managed by the Forest Service, the National Park Service and the Fish and Wildlife Service. The statutory authority for BLM to manage lands for wilderness values lies in FLPMA Section 603. Section 603 of FLPMA required BLM, by 1991, to create an inventory of lands under its management that possess "wilderness characteristics" spanning over 5,000 acres, and then to recommend to the President areas suitable and non-suitable for wilderness preservation. BLM completed this inventory in 1980, identifying wilderness characteristics on 23,000,000 acres of land, or 13 percent of the surface acres

238 BLM, Draft MS-1794 - Regional Mitigation Plan (June 13, 2013).

239 *Id*. at 1-1.

240 16 U.S.C. §§ 1131–1136.

managed by the agency, which were divided into 191 wilderness study areas ("WSAs").[241] As dictated by Section 603, these initially identified WSAs were to be managed "so as not to impair their suitability" for later designation by Congress as wilderness areas, which Section 603 reiterates can only be accomplished through Congressional action.[242]

Following completion of the Section 603 inventory, submission of the inventory to President George H. W. Bush and the President's submission of recommended wilderness to Congress for action, BLM continued to identify lands with wilderness characteristics pursuant to Section 201 of FLPMA, which requires BLM to maintain a current inventory of lands and resource values.[243] BLM also interpreted Section 202 of FLPMA, which governs RMP development, to authorize the designation of additional WSAs.[244] When these new Section 202 WSAs were identified in an RMP, BLM would manage them under a "modified" version of the Section 603 non-impairment standard.[245] The Clinton Administration, in 2001, attempted to formalize this policy with the issuance of a "Wilderness Handbook," which explicitly instructed land managers to use the land use planning process to identify wilderness values and determine whether these areas could be managed as WSAs.[246]

Also during the Clinton Administration, BLM undertook a re-inventory of millions of acres of land in Utah that had been evaluated during the initial Section 603 inventory, but found to lack wilderness characteristics. This re-inventory resulted in the identification of an additional 3.1 million acres of land in the state with wilderness characteristics. The State of Utah filed suit, arguing that the re-inventory and post-1991 identification of new WSAs

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241 Olivia Brumfield, "The Birth, Death, and Afterlife of the Wild Lands Policy: The Evolution of the Bureau of Land Management's Authority to Protect Wilderness Values," 44 *Lewis and Clark Environmental Law Review*, Issue 1, 250 (2014) [hereinafter cited as *Brumfield*].

242 *Interim Management Policy and Guidelines for Land Under Wilderness Review*, 44 Fed. Reg. 72,014 (Dec. 12, 1979); see also 43 U.S.C. § 1782(c).

243 43 U.S.C. § 1711(a).

244 *Brumfield* at 252. These "Section 202 WSAs" were less than 5,000 acres in size, under the 5,000-acre size of WSAs that were to be included in the Section 603 inventories.

245 *Id.*; Sierra Club v. Watt, 608 F. Supp. 305, 311 (E.D. Cal. 1985).

246 BLM, H-6310-1, Wilderness Inventory and Study Procedures (2001).

were not allowed under FLPMA.[247] This litigation was ultimately settled by the Bush Administration, ending BLM's practice of using Section 202 to designate new WSAs. Under the settlement, BLM conceded that its authority to conduct wilderness reviews and establish WSAs expired with Section 603's 1991 deadline and that it lacked authority to create new WSAs under Sections 603 or 202 after that date.[248] "In effect, the settlement created a finite universe of WSAs designated under Sections 603 or 202, leaving the agency no post-settlement means to afford "nonimpairment protection" to subsequently identified lands with wilderness characteristics.[249] However, the settlement did not affect BLM's authority to include lands with wilderness characteristics in its Section 201 inventories, or its authority to apply stringent surface protection or no-occupancy requirements to such areas in RMPs.[250]

In December of 2010, Secretary Salazar announced a new BLM policy governing management of non-WSA lands with wilderness characteristics. The new policy, contained in Secretarial Order No. 3310,[251] and referred to as the "Wildlands Policy," "constituted BLM's first comprehensive national wilderness policy since the 2003 settlement agreement."[252] The Policy contained three primary components:

- It contained a statement affirming that BLM should consider wilderness values as an "integral component" of its multiple-use mandate and required field offices to identify lands with wilderness characteristics in FLMPA Section 201 Inventories.
- In preparing RMPs and amendments under FLPMA Section 202, field offices were directed to "consider" designating lands

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247 Utah v. Norton, No. 2:96-CV-0870 (D. Utah Sept. 20, 1998).

248 *Brumfield* at 267.

249 *Id*.

250 *Id*. (citing *Norton*, No. 2:96-CV-0870, noting that the settlement had no binding effect on BLM's duty and authority under sections 201 and 202, and that consequently BLM "remains free to inventory land for wilderness characteristics pursuant to § 201 and to protect land so as to leave wilderness character unimpaired under § 202[,]" but without applying section 603'snonimpairment standard).

251 United States Department of the Interior Secretarial Order No. 3310, *Protecting Wilderness Characteristics on Lands Managed by the Bureau of Land Management* (2010).

252 *Brumfield* at 273.

with wilderness characteristics as "Wildlands" that would be managed under the RMP to "avoid impairment" to the wilderness characteristics.

- For project-level proposals in areas that had not yet been inventoried under the new Wildlands Policy, it required BLM to undertake an inventory of lands with wilderness characteristics in the project area and discuss the proposed project's effects on them in the NEPA analysis.

Immediately after rollout, the Wildlands Policy sparked considerable protest, with several oil and gas trade associations arguing that it was prohibited by the 2003 settlement.[253] Western Republicans also criticized the new policy, arguing that it created "de facto wilderness" and usurped Congress's sole authority to designate wilderness under FLMPA and the Wilderness Act.[254] In the face of legal challenges and a 2011 Congressional rider that prohibited BLM from using appropriated funds to implement the Order, Secretary Salazar rescinded the policy.[255] Nonetheless, the rescission memorandum made clear that the BLM was to continue to include lands with wilderness characteristics in FLPMA Section 201 inventories and that consideration of preservation of wilderness characteristics would still be a factor included in preparing RMPs and making project level decisions. These instructions were formalized in a BLM Manual amendment that emphasized BLM's discretion to manage wilderness values under the multiple-use umbrella.[256] Notably, the Manual was careful not to require that these lands be managed so as not to impair wilderness characteristics.

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253 Phil Taylor, "House Chairman to Target BLM 'Wild Lands' Policy," *Env't & Energy Daily*, Jan. 5, 2011.

254 *Id*.

255 Memorandum from Ken Salazar, Sec'y of Interior to BLM Director, U.S. Department of the Interior (June 1, 2011), http://www.doi.gov/sites/doi.gov/files/migrated/news/pressreleases/upload/Salazar.

256 Conducting Wilderness Characteristics Inventory on BLM Lands, Bureau of Land Management, 1 (2012), http://www.blm.gov/pgdata/etc/medialib/blm/wo/Information_Resources_Management/policy/blm_manual.Par.38337.File .dat/6310.pdf.

The Department has continued to press for designation of new areas as wilderness, notably the Arctic National Wildlife Refuge in Alaska, under the management of the Fish and Wildlife Service (FWS). On January 25, 2015, President Obama released a conservation plan for the refuge that recommends the implementation of additional protections and makes an official recommendation to Congress to designate large areas of the refuge as wilderness.[257] The recommendation follows the release of FWS's Comprehensive Conservation Plan for the area and accompanying EIS, which will guide the FWS's management decisions in the area for the next 15 years. Under the Plan, a large majority of the refuge — 12.2 million acres — will be managed as wilderness, pending any formal designation by Congress.[258]

This proposal, and the FWS's decision to manage the refuge as wilderness without any Congressional action, has sparked intense criticism from Alaska state and federal lawmakers[259] Alaska Governor Bill Walker has stated that he is "very, very angry" and has significant fears about funding basic services to citizens. Alaska's Senator Lisa Murkowski, chair of the Senate's Energy and Natural Resources Committee, echoed these concerns stating "what's coming is a stunning attack on our sovereignty and our ability to develop a strong economy that allows us, our children and our grandchildren to thrive."[260] Senator Murkowski also noted that the decision was made without any discussion with — or even notification to — elected officials from Alaska.[261]

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257 Press Release, U.S. Department of the Interior, Obama Moves to Protect Arctic National Wildlife Refuge (January 25, 2015), https:// www.doi.gov/news/pressreleases/ obama-administration-moves-to-protect-arctic-national-wildlife-refuge.

258 *Id*.

259 Chris Klint, *Walker "angry, very angry" over planned ANWR Wilderness Designation*, KTUU, January 25, 2015, http://www.ktuu.com/news/news/walker-angry-very-angry-over-planned-anwr-wilderness-designation/30914922.

260 Juliet Eilperin, "Obama Administration to Propose New Wilderness Protections in Arctic Refuge — Alaska Republicans Declare War," *The Washington Post*, January 26, 2015.

261 *Id*.

[ii] — National Monuments.

The Obama Administration has also not been shy about using the Antiquities Act[262] to set aside public lands as National Monuments, wherein commodity production is prohibited. While President Obama has designated more National Monuments than any other president at similar points in their presidencies, President Obama, to date, has been careful to designate monuments in locations where there is broad political support.[263] Nonetheless, these actions have prompted strong responses from Congressional Republicans, with House Natural Resources Committee Chairman Rob Bishop (R. Utah) stating, "This White House has shown once again its utter and complete disdain for the public process, Congress and the communities most impacted by these unilateral, unchecked land designations."[264]

President Obama's apparent growing willingness to designate National Monuments is of particular concern to Utah, where, in the waning days of the Clinton Administration, President Clinton used the Antiquities Act to designate the 1.7 million acre Grand Staircase-Escalante National Monument, "blocking development of a massive coal deposit and enraging lawmakers in the Beehive State."[265] Utah is currently the focus of several conservation efforts aimed at urging President Obama to designate additional National Monuments in Utah, including the two million acre Greater Canyonlands and the 1.7 million Grand Canyon Watershed proposed.[266] Groups are also pushing for protection of more than one million acres in the Southern California desert, 350,000 acres in Northern California and 350,000 acres of Southern Nevada's Gold Butte.[267]

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262 16 U.S.C. §§ 431-433.

263 Phil Taylor, "Obama Flexes Muscles on Resources with Eye on Legacy," *Greenwire*, February 23, 2015.

264 *Id*.

265 *Id*.

266 *See e.g*. Amy Joi O'Donoghue, "Enviro Groups Push National Monuments for Arizona Strip, Utah Cries Foul," *Deseret News*, April 16, 2012.

267 *Id*.; Phil Taylor, "Obama Flexes Muscles on Resources with Eye on Legacy," *Greenwire*, February 23, 2015.

Whether President Obama will follow President Clinton's lead and designate additional, more controversial monuments at the end of his term is unknown, but it is clear that President Obama is willing to use executive powers to accomplish conservation goals, even when those actions are in conflict with the policy goals of elected officials in the affected regions.

[d] — Greater Sage-Grouse RMP Amendments.

The BLM is in the final push of what has been a five-year effort to develop RMP amendments aimed at conserving Greater Sage-Grouse (GrSG) habitat in an effort to head off a potential listing of the bird under the Endangered Species Act (ESA).[268]

[i] — Background.

Over the last decade, wildlife advocates have flooded the Fish and Wildlife Service (FWS) with petitions requesting that numerous animal species be listed under the ESA. Under Section 4 of the ESA, any party can file a listing petition, to which the Fish and Wildlife Service must respond within 90 days.[269] When a species is proposed for listing, the ESA requires that the FWS study the candidate species and then issue a determination finding that the listing of the species as "threatened" or "endangered" is either "warranted," "not warranted," or "warranted, but precluded by other priorities."[270] Under the crush of the hundreds of petitions, FWS began finding that the listing of more and more species was "warranted, but precluded by other priorities."

This is precisely what happened to numerous petitions to list the sage-grouse. In 2005, in response to various listing petitions, the FWS issued a finding that the sage-grouse did not warrant listing under the ESA as it was neither threatened nor endangered.[271] As a result of subsequent litigation, a federal district court overturned the finding, sending the FWS back to the

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[268] 16 U.S.C. §§ 1531-1544.

[269] 16 U.S.C. § 1534.

[270] 16 U.S.C. § 1533(b)(3)(B); 50 C.F.R. § 424.14(b).

[271] *U.S. Fish and Wildlife Service, 12-Month Finding for Petitions to List the Greater Sage-Grouse as Threatened or Endangered*, 70 Fed Reg. 2244 (Jan. 12, 2005).

drawing board.[272] In 2010, the FWS announced its finding that the listing of the sage-grouse was "warranted but precluded."[273] Along with numerous other similar FWS findings, the FWS's decision not to list the sage-grouse was challenged in court.[274] This litigation gave rise to a settlement agreement wherein the FWS agreed to make a final listing decision on the sage-grouse by September 30, 2015.

[ii] — BLM's Sage-Grouse RMP Amendments.

In response to the impending listing decision date, western states and federal land managers — particularly at the BLM, where over fifty percent GrSG habitat is found — have scrambled to put protection measures in place that will serve to keep the bird off of the endangered species list. BLM has elected to undertake a suite of RMP amendments that cover 50 million acres and focus on conservation of habitat. Prior to finalization of the RMP amendments, BLM has been operating under interim guidance contained in an internal Instruction Memorandum, No. 2012-043, ("IM") outlining interim conservation policies and procedures to be applied to ongoing and proposed authorizations and activities affecting GrSG habitat.[275] The 11 western states with GrSG populations also developed their own GrSG conservation plans, which focus on identifying and implementing conservation measures. Under the IM, BLM field offices were instructed to defer to the state GrSG conservation plans when those plans had been adopted and approved by the BLM.

After four years of preparation, on May 29, 2015, the BLM unveiled 14 Land Use Plan Amendments and Final Environmental Impact Statements that would modify 88 existing RMPs in 10 western states to put significant

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272 W. Watersheds Project v. Fish & Wildlife Serv., 535 F. Supp. 2d 1173 (D. Idaho 2007).

273 U.S. Fish and Wildlife Service, *Twelve-Month Findings for Petitions to List the Greater Sage-Grouse*, 75 Fed. Reg. 13,910 (Mar. 23, 2010).

274 W. Watersheds Project v. Fish & Wildlife Serv., Case No. 06-cv-277 (D. Idaho).

275 U.S. Department of the Interior, *Greater Sage-Grouse Interim Management Policies and Procedures*, Instruction Memorandum No. 2012-043 (December 27, 2011).

new habitat protection measures in place.[276] Specifically, the Land Use Plan Amendments would put 28 million acres off limits to surface development through the imposition of "no surface occupancy" restrictions and an additional 35 million acres will have disturbance caps that limit surface disturbance.[277]

The Plan Amendments have come under fire from a variety of industry groups and states, which argue that the Plans fail to adequately consider and adopt state GrSG plans and impose a national, one-size-fits-all approach that does not take other land uses into consideration. Much criticism has been focused on the failure of the Plan Amendments to analyze in depth the economic ramifications of the plans, particularly as to revenue that may be lost to states and local economies if oil and gas development is constrained.[278]

At a May 28, 2015 speech held at the historic Wyoming Hereford Ranch announcing the release of the proposed Plan Amendments, Secretary Jewell emphasized they were an "amazing milestone" that demonstrated unprecedented cooperation between Interior and western states.[279] The release of the proposed Plan amendments kicked-off a 30-day public protest period, as well as a 60-day governor's consistency review. When the protest period concluded in early July, over 250 protests had been filed, including those of six states — Colorado, Utah, Idaho, Montana, Nevada and Wyoming. BLM intends to resolve the protests in August so it can reach a final decision in advance of the FWS September 2015 listing decision deadline.

The RMP amendments call for establishing a multi-tiered landscape-level management approach concentrating the highest level of protections in "sage-grouse focal areas." The amendments break habitat areas into three primary categories: priority habitat, general habitat, and focal areas, which

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276 U.S. Department of the Interior, Notice of Availability of Greater Sage-Grouse Proposed Land Use Plan Amendments and Final Environmental Impact Statements, 80 Fed. Reg. 30703 (May 29, 2015).

277 Phil Taylor, "Tale of the Tape—Interior's Grouse Protection Plans," *E&E News*, June 5, 2015.

278 *Id*.

279 Scott Streater, *Endangered Species: Interior Unveils Final Federal Grouse Protection Plans,* Greenwire, May 28, 2015, http://www.eenews.net/stories/1060019264.

are contained within priority habitat areas. According to BLM, priority habitat consists of areas that have been identified as having the highest value to maintaining the species and its habitat. Priority habitat focal areas are "important landscape blocks with high breeding population densities of sage-grouse and existing high quality sagebrush."[280] Land use measures in priority habitat are designed to minimize or avoid habitat disturbance.

The plans recognize existing grazing allotments, as well as valid, existing oil and gas leases and renewable energy right-of-way grants. But, no new surface disturbing activity would be allowed within priority habitat unless significant mitigation measures are implemented. The Plan Amendments also call for directing large wind and solar power projects "to areas outside of priority sage-grouse habitat."[281] The primary commonality in management practices across all of the proposed RMP amendments is that surface disturbance in priority habitat areas is limited to thee percent of the total surface of the habitat area, except Wyoming where the total surface cap is five percent.[282] Additional federal oil and gas leasing will be prohibited within priority habitat areas if infrastructure such as roads or power lines disturbs more than the specified percentage of the area, regardless of whether the disturbance occurs on public or private lands within the area.[283] Additionally, each plan calls for specific setbacks from active **leks,** with most setbacks ranging from three to five miles, and calls for robust use of habitat mitigation, both onsite and offsite, to account for surface disturbance within general habitat areas.[284]

The states on the receiving end of BLM's landscape management scheme for the sage-grouse have protested and made their displeasure plain. For example, in Utah, the state's two senators were blunt, with Senator Orrin Hatch stating:

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280 *Id.*
281 *Id.*
282 *Id.*
283 *Id.*
284 *Id.*

> I am deeply disappointed by the federal government's Final Environmental Impact Statement. Our state has spent years coordinating with key stakeholders to forge a plan that accommodates the need to protect the bird's habitat with Utahns' desire to develop our resources in a responsible manner. Utah deserves the opportunity to implement our effective, locally driven solution.[285]

Senator Mike Lee similarly echoed disappointment that local interests were not considered in the Plan Amendments and highlighted the concern that the BLM plan did not consider impacts to local economies:

> The state of Utah has invested millions of dollars and coordinated across numerous state agencies to put forth a plan that will protect the sage-grouse and Utahns' access to public lands. This balance — between conservation, economic development and recreational use of lands — is one that is best struck by the people living in affected communities, not federal bureaucrats.[286]

The Utah-elected official comments are interesting in that they highlight a common sentiment in much of the rural West, and discussed in more detail *infra*, that the federal government has been overreaching in its management of federal lands and placing less significance on the concerns of local, directly affected communities and more weight on the concerns of the larger public which may be located far from the affected regions.

On the broader stage, there are currently several bills before Congress that propose to delay the sage-grouse ESA listing decision for between five and ten years,[287] but, even if these bills pass, it is very likely that the RMP amendments will remain in place unless struck down through litigation, which has been promised by various industry groups (who argue that the

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285 *Id*.

286 *Id*. These types of critiques are not limited to Republicans. When the Administration elected to list the Gunnison sage-grouse as threatened, despite the plans Colorado had put in place to conserve the bird, Democratic Governor Hickenlooper sharply criticized the Administration and filed a lawsuit, *See Colorado Challenges Decision on Gunnison Sage-Grouse*, AP, February 10, 2015.

287 S. 1036, 114th Cong., Sage-Grouse Protection and Conservation Act.

amendments go to far) and environmental groups (who argue the RMP amendments do not go far enough).[288]

[3] — U.S. Forest Service 2012 Planning Rule.

The Forest Service has also been focused on developing a new planning rule that emphasizes conservation and consistent management across forest regions, even when those regions cross Forest boundaries. Although finally accomplished by the Obama Administration, efforts to modernize the 1982 Forest Planning Rule span almost 15 years, beginning with changes proposed by the Clinton and Bush Administrations.

In late 2000, the Clinton Administration released a final planning rule[289] "establishing ecological sustainability as the key objective guiding planning for the national forests."[290] In 2001, the Bush Administration set aside the 2000 Planning Rule and, in 2005, issued a new planning rule ("2005 Planning Rule")[291] that "emphasize[d] the interconnection between the ecological, social, and economic components of sustainability, and requires consideration of each in the planning process,"[292] but placed more emphasis on multiple-use and extractive resource development within Forests. Significantly, it also included a categorical exclusion from NEPA for Forest Plans and included a streamlined appeals process for challenges to Forest Plans.[293] The 2005 Planning Rule was challenged by a number of environmental groups and was ultimately set aside by the Northern District of California as being adopted without appropriate NEPA analysis and notice and comment.[294] The 2005

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288 Phil Taylor, "Tale of the Tape—Interior's Grouse Protection Plans," *E&E News*, June 5, 2015, http://www.eenews.net/greenwire/stories/1060019744.

289 USFS, *National Forest Land and Resource Planning,* 65 Fed. Reg. 67,521 (Nov. 9. 2000).

290 George Hoberg, *Science, Politics and U.S. Law: The Battle Over the Forest Service Planning Rule*, p. 2, Resources for the Future, Discussion Paper 03-19 (June 2003).

291 *See* Katrina M. Kayden, "Will Paradise Become a Parking Lot?: The Debate Over the Bush Administration's Overhaul of Forest Management Regulations,"17 *Vill. Envtl. L.J.* 285, 291 (2006).

292 *Id*.

293 *Id*.

294 *See* Citizens for Better Forestry v. U.S. Dep't of Agric., 481 F. Supp. 2d 1059, 1067 (N.D. Cal. 2007).

Rule was re-issued in 2008 with an accompanying EIS,[295] but the rule was again struck down with the court finding that the Biological Assessment did not meet the Endangered Species Act's consultation requirements,[296] effectively reinstating the 1982 Planning Rule.

With this background in mind, when Secretary Vilsack took office at the beginning of the Obama Administration, he announced a "new vision" for the Forest Service, focusing on "restoration," forest conservation," "protection" and "preservation" of forests for future generations.[297] In this speech, Secretary Vilsack stated:

> Our shared vision begins with restoration. Restoration means managing forest lands first and foremost to protect our water resources, while making our forests more resilient to climate change. . . Importantly, this vision holds that the Forest Service must not be viewed as an agency concerned only with the fate of our National Forests, but must instead be acknowledged for its work in protecting and maintaining all American forests, including state and private lands. . . The threats facing our forests don't recognize property boundaries. So, in developing a shared vision around forests, we must also be willing to look across property boundaries. In other words, we must operate at a landscape-scale by taking an "all-lands approach."

[a] — The Rule.

The Forest Service's 2012 Planning Rule[298] ("Rule") and the Final Planning Directives, which provide agency guidance on implementation of the Rule, follow through on the "new vision" announced by Secretary Vilsack. The Rule guides the development, amendment, and revision of land

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295 USFS, *National Forest System Land Management Planning, Final Rule and Record of Decision*, 73 Fed. Reg. 21,468 (Apr. 21, 2008).

296 *Citizens for Better Forestry,* 632 F. Supp. 2d at 973.

297 U.S. Department of Agriculture, Agriculture Secretary Tom Vilsack: Remarks as Prepared for Delivery, Seattle, Washington, (August 14, 2009), http://www.fs.fed.us/video/tidwell/vilsack.pdf.

298 36 C.F.R. 219; 77 Fed. Reg. 21162 (April 9, 2012).

management plans (called "Forest Plans") for all units of the National Forest System, which consists of 155 national forests, 20 grasslands, and 1 prairie.[299]

According to Rule's preamble, the Rule is "designed to ensure that [National Forest Plans] provide for the sustainability of ecosystems and resources; meet the need for forest restoration and conservation, watershed protection, and species diversity and conservation."[300] The planning process framework in Rule consists of a three-part cycle:

- assessment;
- plan revision or amendment; and
- monitoring

The Rule requires that all Forest Plans include plan components to maintain and restore ecosystem and watershed health and resilience (ecological integrity), protect key resources on the unit, including water, air, and soil, and address water quality and riparian area protection and restoration. The preamble to the rule states that Forest Plans must provide for broad multiple uses of Forests, including outdoor recreation, grazing, timber, watershed, wildlife and fish, wilderness, and ecosystem services.

[b] — Mineral Development Under the Rule.

Notably absent from the Rule's list of broad resource considerations is any reference to mineral development, in spite of the fact that the Forest Service's Minerals Policy[301] specifically states that the Forest Service should seek to "foster and encourage" development of federal mineral resources located on public lands. The Mineral Policy Act of 1970 applies to both the Forest Service and the BLM and states that "it is the continuing policy of the Federal Government in the national interest to foster and encourage private enterprise" in the development of domestic minerals.[302] When

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299 United States Congress, House of Representatives, *House Reports, Issues 756*-772, pp. 89-90 (2004).

300 36 C.F.R. 219; 77 Fed. Reg. 21162 (April 9, 2012).

301 Jack Ward Thomas, Forest Service Minerals Program Policy, U.S. Forest Service, http://www.fs.fed.us/geology/FOREST%20SERVICE%20MINERALS%20PROGRAM%20POLICY.pdf.

302 30 U.S.C. § 21a.

developing or amending Forest Plans, the Forest Service is responsible for making designations as to which areas of Forests will be open to mineral development, and which areas will be closed.

Under the Energy Policy Act of 2005 the Secretary of Agriculture was directed to improve the administration of federal onshore oil and gas leasing programs through, among other things, entering into a Memorandum of Understanding with the Secretary of the Interior outlining coordination and consultation on oil and gas leasing activities.[303] In April of 2006, BLM and the Forest Service entered into BLM MOU WO300-2006-07, establishing joint BLM and Forest Service policies and procedures for managing oil and gas leasing and operational activities on National Forest system lands. Under the MOU, BLM and the Forest Service will coordinate leasing and resource management decisions to "be consistent across administrative boundaries" and, as to lease stipulations, shall be "only as restrictive as necessary to protect the resource(s) for which they are applied." However, in spite of this clear guidance that the Forest Service should encourage mineral development on Forest System lands, the 2012 Planning Rule makes no reference to mineral development on Forest Service-managed lands.

The 2012 Rule has already impacted plans for oil and gas development on National Forest System land. In 2011, a draft Forest Plan amendment was released that would have opened much of the 1.1 million acre George Washington National Forest in Virginia, West Virginia, and Kentucky to oil and gas leasing.[304] The Plan specifically banned horizontal drilling and hydraulic fracturing while allowing for only vertical well development.[305] Following the receipt of over 50,000 public comments regarding the draft, a final Plan released in 2014 scaled back the leasing significantly.[306] The new Plan closes most of the Forest to oil and gas development, but allows for the leasing of 10,000 acres of public land and for oil and gas development

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303 42 U.S.C. § 15922.

304 Trip Gabriel, "In Compromise Plan, Limited Fracking is Approved for National Forest in Virginia," *N.Y. Times*, November 18, 2014.

305 *Id.*

306 *Id.*

to go forward on 167,000 of the acres of the Forest that overlay privately owned minerals.[307] In what has been described as a "compromise" between industry and environmental groups, the final Forest Plan moved away from the proposal to ban horizontal drilling and hydraulic fracturing,[308] instead allowing operators to apply for federal permits to hydraulically fracture the federal minerals, and providing for reliance on state permits allowing horizontal drilling and hydraulic fracturing on the private minerals.[309]

As the 2012 Forest Rule was being prepared and implemented, another major forest plan involving oil and gas resources was being prepared for the White River National Forest, located in western Colorado ("WRNF Oil and Gas Plan").[310] The White River National Forest is comprised of 2,277,670 acres of land, covering Summit, Eagle, Gunnison, Moffat, Rio Blanco, Routt, Pitkin, Mesa, and Garfield Counties. It is the most visited National Forest in the nation, largely due to the number of ski resorts located on forest lands.[311] It is also located in close proximity to areas that have experienced a boom in natural gas production over the last decade and overlies the largely unexplored, although potentially prolific, Mancos shale formation.[312]

> The WRNF Oil and Gas Plan evaluated and determined which areas of the Forest will be open to oil and gas leasing, and which areas will be closed. Development of the Plan has been politically charged, with Pitkin County (home to Aspen, Colorado) playing an active role in seeking the closure to oil and gas development of the Thompson Divide, in Pitkin, Garfield and Mesa Counties. This is an area that has long been home to oil and gas development and in

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307 *Id*.

308 Jenna Portnoy, "Forest Service Praised for Drilling Restrictions in G.W. National Forest," *The Washington Post*, November 18, 2014.

309 *Id*.

310 *Notice of Availability of White River National Forest Oil and Gas Leasing Plan*, 77 Fed. Reg. 53198 (August 31, 2012).

311 White River National Forest Oil and Gas Leasing Final Environmental Impact Statement, U.S. Forest Service § 3.3.3.13 (December 9, 2014).

312 U.S. Department of Energy *Review of Emerging Resources: U.S. Shale Gas and Oil Plays,* U.S. Energy Information Administration, July 2011.

which several operators have valid, although undeveloped, oil and gas leases.

Ultimately, when the Draft Record of Decision and Final EIS for the WRNF Oil and Gas Plan were announced, Forest Supervisor Scott Fitzwilliams decided to close, through management direction, all portions of the Thompson Divide to new leasing, along with a total of 1,281,726 acres of the Forest.[313] Under the proposed Plan, 194,123 acres are administratively available for leasing, located primarily in the far western and northern portions of the Forest.[314] In announcing this decision, Supervisor Fitzwilliams stated:

> My draft decision places an emphasis on conserving the roadless character, wildlife habitat and recreation opportunities of the White River National Forest while providing oil and gas development opportunities with a focus on lands that have proven productive in the past 10-15 years.
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> …
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> One of the major factors in my decision was the public input and comments received over the past four years . . . . Throughout the process of arriving at this decision, public comment from scoping, meetings, conversations and workshops held over a four-year period confirmed to me that the White River National Forest is strongly valued local, regionally, and nationally for the existing natural character including wildlife, fish, ranching, recreation, air quality and sense of place.[315]

Several parties filed formal objections under the Rule's new objection process;[316] the Forest Service rejected the Objections, but, as of the date

313 White River National Forest Oil and Gas Leasing Final Environmental Impact Statement, U.S. Forest Service § 3.3.3.13 (December 9, 2014).

314 USFS, Draft Record of Decision Oil and Gas Leasing on Lands Administered by the White River National Forest, (December 9, 2014), http://www.fs.usda.gov/Internet/FSE_DOCUMENTS/stelprd3824509.pdf.

315 *Id.*

316 36 C.F.R. § 219, subpart B.

of this writing, no Final Record of Decision has been issued.[317] The final outcome of the Plan is unknown, but, from Forest Supervisor Fitzwilliams' draft record of decision and the results of the objection process, it seems clear that the 2012 Forest Service Planning Rule, which places importance on maintenance and restoration of ecosystem and watershed health above resource extraction, heavily influenced the outcome of the WRNF Oil and Gas Plan.

§ 5.06. Sagebrush Rebellion 3.0.

While land use planning practices have changed under the Obama Administration to reflect the Administration's goal of landscape and ecosystem preservation to better address the challenge of climate change, this shift has been accompanied by an increase in anti-BLM and Forest Service sentiment across the West. Many of the objections to current federal land management policies are rooted in sentiments that have existed since the beginning of the nation's westward expansion. In many ways, the genesis and evolution of these anti-federal land management viewpoints have been informed and shaped by changing philosophies of land management.

Early public land statutes were used to encourage the "taming" of the West by providing settlers fee title to land and preferential access to federal lands for grazing and mineral extraction. Many families in the West, particularly in rural areas, trace their lineage to settlers who came West during the so-called "disposition" era of land management. Many of these people understandably have very strong feelings about the importance of local control and management of the lands that have been home to small, tight-knit communities for generations. There has always been a western resentment toward the presence of so much federal land and federal control in the 12 public land states starting with the early challenges to the establishment of the Forest reserves in *Light and Canfield*, *supra,* to the 1970's challenge to

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317 *See e.g.*, Encana Oil and Gas, Inc., Western Energy Alliance, West Slope Colorado Oil and Gas Association, and Public Lands Advocacy, Mesa County, Pitkin County, SG Interests I, Ltd., Wilderness Workshop and WillSource Enterprise LLC have all filed objections. http://www.fs.usda.gov/detail/whiteriver/home/?cid=STELPRD3824477

the Wild and Free Roaming Horses and Burros Act of 1971.[318] Recently, there has been an increase in tension between those who feel that federal public land management decisions should be made on a local level and the increasing tendency of federal land managers to make planning decisions on a regional, or even national, level. Examples of these more recent conflicts are Cliven Bundy's standoff with BLM officials and federal marshals over BLM grazing fees in Nevada and the growing interest of numerous western state governments in somehow acquiring control of federally managed public lands.

[1] — State "Take Back" of Public Lands.

The idea of western states "taking back" public lands has been around for over one hundred years, peaking during the Sagebrush Rebellion of the 1970s and the Wise Use and County Supremacist movements of the 1990s. In the 1970s, with numerous new environmental and public land statutes being enacted, segments of the western population began to challenge what they saw as increasing federal meddling in rural communities.[319] FLPMA faced particular scorn because, for the first time, the federal government made clear that it "intended to retain" and manage federal lands in consideration of a variety of interests, including conservation.[320] Additionally, "environmentalists objected to many aspects of the federal role in the West. They began to challenge federal support for water projects, cheap transportation, and other means of promoting western economic development."[321] During the height of the 1970's Sagebrush Rebellion, led by Nevada, the states of Utah, Arizona, New Mexico and Wyoming passed bills seeking the "return" of federally managed public lands to the states.

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318 Kleppe v. New Mexico, 426 U.S. 529 (1976) ("the Property Clause also gives Congress the power to protect wildlife on public lands, state law notwithstanding.").

319 Robert H. Nelson, "Why the Sagebrush Revolt Burned Out," *American Enterprise Institute Journal on Government and Society*, p. 28, May/June 1984.

320 *Id*. at 30.

321 *Id*. at 28

"Sagebrush legislation gained strong support and active consideration — if not final passage-in virtually every other western legislature as well."[322]

Individual members of the public also took matters into their own hands, staging numerous rallies, including armed standoffs between so called "posses" and federal officials in North Dakota, Nevada and Idaho. However, beginning in the mid-1980s, for a variety of reasons, such as lack of clear leadership and economic backing, the movement began to lose momentum.[323] In the era of the Clinton Administration, those sentiments came roaring back.

> [I]n Catron County, N.M., [elected] officials passed 21 ordinances attempt[ing] to supersede federal authority on public lands.[324] The ordinances asserted that all Forest Service roads in the county were 'public property,' made it a felony for citizens to alter the terms of grazing permits, and gave the county the right to condemn and manage public property for County use, among other things.[325] The county's 1992 land use plan declared that 'federal agents threaten the life, liberty and happiness' of county residents and promised to defend "private property rights and protectable interests held by individuals in federal and state lands."[326]

Despite the fact that these earlier efforts did not fare well in the courts,[327] in recent years, similar efforts have once again been gaining traction with western states. In the last five years, eight states, including Utah, Wyoming, Montana, Idaho and Nevada have "studied" the feasibility of "taking back"

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322 *Id* at 32.

323 *Id*.

324 *Backgrounding Bundy: The Movement*, Southern Poverty Law Center (July 2014), https://www.splcenter.org/20140709war-west-bundy-ranch-standoff-and-american-radical-right//background/six-months-after-standoff-in-nevada-the-federal-government-has-not-yet-responded/.

325 *Id*.

326 *Id*.

327 Robert B. Keiter and John Ruple, *A Legal Analysis of the Transfer of Public Lands Movement,* Wallace Stegner Center for Land, Resources and the Environment, Stegner Center White Paper No. 2014-2,October 27, 2014 [cited as "Keiter and Ruple"].

or somehow acquiring title to the millions of acres of federally managed public lands that were reserved to the Union at the time of statehood.[328]

While the idea of states taking title to federally managed public lands (whether through voluntary transfer or litigation) has been widely viewed as, at best, an unlikely and costly proposition, the idea has gained considerable traction. Utah has taken the idea the farthest, passing House Bill 148 in 2012 demanding the transfer of approximately 20 million acres of federally managed public land.[329] In each fiscal year since 2012, the Utah legislature has allocated taxpayer money to study the issue and devise legal strategies. Most recently, in the 2015 Utah legislative session, the state passed a law allocating considerable funds to pay outside legal counsel to help devise a legal strategy and, potentially, bring litigation against the federal government.[330]

The issue has raised considerable debate in Utah and across the West, with most casual observers wondering about the legality and feasibility of the proposal. While the State of Utah staunchly defends the basic legality of its law authorizing the "take-back" of federal lands,[331] most legal scholars disagree. A recent legal analysis published by the Stegner Center at the University of Utah S.J. Quinney College of Law roundly criticized the State's plan as lacking any legal foundation and ignoring over two centuries of case law making clear that the United States Constitution's Property Clause gives the federal government the authority to retain and manage federal lands.[332] "The Supreme Court has made clear that the Property Clause grants Congress an "absolute right" to decide upon the disposition of federal land and '[n]o

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328 Brian Calvert, "The Push is on to "Take Back" Public Lands," *High Country News*, October 30, 2014, https://www.hcn.org/articles/the-push-is-on-to-take-back-public-lands.

329 *Transfer of Public Land Act and Related Study,* Utah H.B. 148 (enacted March 23, 2012).

330 *Id*.

331 *See, e.g.*, State of Utah Public Land Coordinating Office, *A Case Statement for the H.B. 148, Toward a Balanced Public Land Policy*, Constitutional Defense Council (November 2012).

332 *Supra* note 327.

State legislation can interfere with this right or embarrass its exercise.'"[333] Further, in the seminal case of *Light v. United States,* the Supreme Court made clear that the federal government could indefinitely retain public lands for a broad range of uses.[334]

Although the precise legal theories upon which proponents of "taking back" federal lands rely are somewhat unclear, they argue that state enabling acts require federal transfer of public lands to the states. However, as the Stegner Center paper points out, enabling acts do not create an obligation to "return" lands to state management; instead, in the enabling acts, "the state is disclaiming any future claims to federal lands."[335]

Environmental supporters of federal land management argue that the transfer of public lands is to allow the State to sell its public lands to the highest bidder. The debate recently took an interesting turn when a Washington, D.C.-based environmental group filed a complaint with the Utah Attorney General's office against a key proponent of Utah's bill alleging fraud.[336] Utah State Representative Ken Ivory has been a vocal supporter of the "take back our lands" movement, and founded the non-profit American Lands Council to champion the idea of transferring western lands to states. Representative Ivory often travels the West, promoting the idea of land transfers to county commissioners and members of the public, often seeking donations to the American Lands Council.[337] The complaint alleges that Representative Ivory "is soliciting on the promise that if you give us money, we can get public land returned to your state." It goes on to state that "reliable legal and economic

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[333] *Id*. (quoting Gibson v. Chouteau, 80 U.S. 92, 99 (1872) (upholding claim to land by a federal patent holder against a competing claim reliant on state law)).

[334] Light v. United States, 220 U.S. 523 (1911); *see also* Utah Power & Light Co. v. United States, 243 U.S. 389, 405 (1917) (holding that the Enclave Clause does not require cession of state jurisdiction over federal lands and that the United States retains authority under the Property Clause).

[335] Keiter and Ruple at 8.

[336] Brian Maffly, "Utah 'snake oil salesman' Representative Ken Ivory accused of fraud for hitting up counties in three states for public lands fight donations," *Salt Lake Tribune*, June 2, 2015.

[337] *Id*.

analyses of transferring public land to the states concluded the idea has no legal foundation and could prove costly to the receiving states."[338] It is unlikely that the fraud complaint will gain traction, particularly within the Utah Attorney General's office, which is charged with implementing Utah H.B. 148. Nonetheless, it shows the intensity of feelings many people on both sides of the debate have on issues involving management of public lands.

Recently, the United States Senate passed a largely symbolic budget amendment sponsored by Alaska Senator Lisa Murkowski (chair of the Senate Energy and Natural Resources Committee) that "supports" the idea of selling, transferring or trading federally managed public lands to the states.[339] The amendment, S. A. 838 to Senate Resolution 11, is described as "establish[ing] a spending-neutral reserve fund relating to the disposal of certain Federal land," and conveys no actual authority to transfer lands. Instead, the purpose of the amendment is to demonstrate that "considering such bills is a priority of the Congress" says Robert Dillon, communications director for the Senate Energy and Natural Resource Committee.[340] Under the Senate authorization, the chamber's "support" applies generally to "initiatives to sell or transfer to, or exchange with, a State or local government any Federal land that is not within the boundaries of a National Park, National Preserve, or National Monument." Voting on the measure was largely split down party lines, with Senator Cory Gardner of Colorado as the lone western Republican to vote no, joining all of the western Democrats.

[2] — The Cliven Bundy Standoff.

The standoff between Cliven Bundy and his supporters is a more extreme example of the growing tension in the West over management, and, indeed ownership, of public lands. The standoff began after Mr. Bundy, a 68-year-old cattle rancher from Southern Nevada, refused to pay $1.2 million in

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338 *Id*.

339 Cally Carswell, "Federal Public Land Transfers Get a Congressional Boost," *High Country News*, March 31, 2015, https://www.hcn.org/articles/western-states-trying-to-take-back-federal-lands-get-a-boost-from-the-u-s-senate.

340 *Id*.

grazing fees to the BLM, arguing that the land belongs to the state, not the federal government.

The standoff is the most recent event in an almost 20-year dispute with BLM over the Bundy family's grazing operations. From 1954 to 1993, Mr. Bundy grazed cattle legally under permits on an area of BLM-managed land called the Bunkerville Allotment. However, in 1993, in protest against Clinton-era changes to grazing rules, Mr. Bundy declined to pay to renew his permit, which was cancelled for non-payment by BLM in 1994. In spite of this cancellation, Mr. Bundy continued to graze cattle in the Bunkerville Allotment. In 1998, a federal court issued a ruling prohibiting Mr. Bundy from grazing cattle on the lands. In July 2013, at the BLM's request, the federal court ordered that Bundy refrain from trespassing on all BLM-managed lands in the area.[341]

The situation escalated on March 27, 2014, when 145,604 acres of federal land in Clark County, Nevada were temporarily closed to "capture, impound, and remove trespassing cattle," so that BLM officials could roundup and impound Mr. Bundy's cattle, which were considered to be trespassing on BLM lands. Mr. Bundy responded by sending letters entitled "Range War Emergency Notice and Demand for Protection" to county, state, and federal officials and asking for citizen assistance in preventing the seizure of his cattle. Hundreds of protestors (including members of a self-styled citizen militia called the "Oath Keepers") came to Mr. Bundy's ranch, blocking the access road to the federal lands. The standoff lasted for approximately two weeks, and ended when the BLM announced that it would suspend the cattle roundup and that previously seized cattle would be returned.[342]

While the situation at the Bunkerville Allotment has largely cooled for the time being, on June 5, 2015 BLM surveyors reported that gunshots were fired in their direction when they were in the vicinity of the Bunkerville Allotment.[343] Mr. Bundy has admitted that he did speak with the surveyors,

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341 Adam Nagourney, "A Defiant Rancher Savors the Audience that Rallied to His Side," *N.Y. Times*, April 23, 2014.

342 *Id*.

343 Henry Brean, "Cliven Bundy Says He Met Gold Butte Surveyors but Didn't Menace Them," *Las Vegas Review Journal*, June 5, 2015.

but contends that he had nothing to do with any gunfire.[344] The BLM maintains that it will still attempt to collect the outstanding $1.2 million in grazing fees. Mr. Bundy remains a popular face in the anti-BLM movement and, apparently, still grazes his cattle on the Bunkerville Allotment.[345]

Similar protests have occurred in Nevada[346] and other states in the last year. In April 2015, a large group of protesters, including numerous members of the Oath Keepers, descended on the small Sugar Pine Mine in Southern Oregon, after BLM threatened to prevent mining operations on an un-patented mining claim pending the operator's filing of a mine plan.[347] The protestors blocked access to the mine, effectively preventing any access to the area.

§ 5.07. Conclusion.

The history of our public lands has been and remains colorful. The legacy of these lands is one in which each American can take pride. But for those who live in the public land states, the evolution of public land policy and law can be an everyday challenge. How the federal lands are managed has a direct impact on the health and well-being of the citizens of the West. Justice Scalia well-described the challenge of "multiple-use" management, "a deceptively simple term that describes the enormously complicated task of striking a balance among the many competing uses to which land can be put . . . ."[348] Finding a public land "balance" that meets the needs of a national constituency and the needs of the citizens of the West will continue to be the challenge for the management of these lands.

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344 *Id.*

345 Kirk Seigler, *A Year After Denying Federal Control, Bundy Still Runs His Bit of Nevada,* National Public Radio, April 14, 2015, http://www.npr.org/2015/04/14/399397139/year-after-denying-federal-control-bundy-still-runs-his-bit-of-nevada.

346 Julie Turkewitz, "Nevada Ranchers Pick a Fight with Washington," *New York Times*, July 3, 2015, http://www.nytimes.com/2015/07/03/us/drought-forces-nevada-ranchers-to-take-on-washington.html?_r=0 .

347 Jim Urquhart, *Oregon Mine that Summoned Armed Guards in Land Dispute Files Appeal,* Reuters, April 23, 2015, http://www.reuters.com/article/2015/04/24/us-usa-miners-oregon-idUSKBN0NE16020150424.

348 Norton v. So. Utah Wilderness Alliance, 542 U.S. 55 (2004).

Chapter 6

Cooperative Federalism and Environmental Laws: Coping with Two Masters

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§ 6.01. Introduction.

The concept of federalism is relatively straightforward. Both the state and federal government are independent sovereigns with power to directly govern the people. According to the Constitution, the powers of the federal government are limited (enumerated) and all powers not expressly delegated

to the federal government "are reserved to the States respectively, or to the people."[1] As Chief Justice John Marshall once remarked, demarcating the reach the federal government's power is not an easy task. "This government is acknowledged by all to be one of enumerated powers. The principle, that it can exercise only the powers granted to it . . . is now universally admitted. But the question respecting the extent of the powers actually granted, is perpetually arising, and will probably continue to arise, as long as our system shall exist."[2]

Much has been written about the inherent constitutional design of federalism. This chapter barely scratches the surface of the volumes of scholarly materials that delve into the purpose, history, evolution, and meaning of federalism. The goal of this chapter is to contribute to that scholarship by addressing how "cooperative federalism" — state government administration and implementation of initially federal law — has evolved in recent years, particularly in the area of environmental regulation. Section 6.02 briefly addresses the basics of federalism — what it is and how it works — and the cooperative federalism model. Section 6.03 traces the evolution of the United States Supreme Court's federalism jurisprudence from the early years of the republic through the present. Section 6.04 provides an overview of the cooperative federalism approach to environmental regulation that began in the 1970s. Lastly, Section 6.05 describes a series of recent efforts by both the national government and non-governmental organizations to diminish the role and authority of the states in environmental regulation.

§ 6.02. What Is Federalism?

As noted above, federalism is a model of governance that has two separate and independent layers of government: (1) a national government that, at least in theory, has limited authority as spelled out in a Federal constitution; and (2) separate state and local governments for each of the sovereign states, each of which has more general powers as limited by each state's constitution.

1 U.S. Const. Amend. X.

2 McCulloch v. Maryland, 17 U.S. 316, 405 (1819) (as quoted in Erin Ryan, *Federalism and the Tug of War Within* 71 (2011)).

But federalism is more than just having national and state governments. Fundamentally, federalism is a question of how power, resources, and responsibility should be divided between the federal and state governments.[3] In other words, which government gets to call the proverbial shots on any given issue? To paraphrase Chief Justice Roberts, federalism essentially boils down to who calls the balls and strikes in the governmental game.

The federalism question, however, is really two questions. First, there is the question of who gets to decide an issue — the federal or state governments. The second question is who gets to decide who decides? Stated another way, which government has the power to bestow or assume the authority to have the final say on a particular issue? The United States Constitution does not squarely address these questions. As addressed in Section 6.03, the United States Supreme Court has been feeling its way through this issue since the birth of the republic.

Cooperative federalism is a relatively new phenomenon when viewed against the entire history of the nation. Several authors have attempted to define what cooperative federalism entails. Under one definition, cooperative federalism amounts to circumstances where "state and federal actors . . . take responsibility for separate but interlocking components of a unified regulatory program"[.][4] Cooperative federalism has also been described as "shared government responsibilities for regulating private activity"[,][5] and circumstances where "states take primary responsibility for implementing federal standards, while retaining freedom to apply their own, more stringent standards[.]"[6] Under cooperative federalism programs, federal law remains in place and is separately enforceable by the federal government even though the states have enacted their own version of the applicable federal law. An example of cooperative federalism is the Medicaid program where the

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3 Robert V. Percival, "Symposium: Environmental Federalism: Historical Roots and Contemporary Models," 54 *Md. L. Rev.* 1141, 1143 (1995).

4 Erin Ryan, *Federalism and the Tug of War Within* 92 (2011).

5 George Cameron Coggins and Robert L. Glicksman, *Public Natural Resources Law* 3:14 (1992).

6 Adam Babich, "Our Federalism, Our Hazardous Waste, Our Good Fortune," 54 *Md. L. Rev.* 1516, 1532 – 33 (1995).

states are the primary administrators according to a framework established by federal law that sets minimum standards that must be followed. Other examples include environmental regulation under the Clean Air Act and Clean Water Act, which are discussed in Section 6.04, below.

§ 6.03. Evolution of Federalism Jurisprudence.

This section attempts to divide the evolution of federalism jurisprudence into six general eras. Each of these time periods is not cleanly delineated by specific cases, but represents periods during which the Supreme Court tended to take a certain view of what was considered to be the proper spheres of power between the state and federal governments.

[1] — Dual Federalism in the Formative Years (18th Century Through the Civil War).

During the early years of the republic, according to one author, the respective roles of the federal and state governments were viewed as having distinctively separate roles and spheres of power that did not generally overlap.[7] However, as noted above, the power of each vis-à-vis the other was not clearly addressed in the United States Constitution, so many of the early federalism decisions by the United States Supreme Court attempted to flesh out that issue. In *Chisolm v. Georgia*,[8] the Court ruled that it had the power to award relief in a suit against a state government to collect a debt incurred during the Revolutionary War. The notion that a sovereign state could be subjected to suit in the court of the national government was apparently so antithetical to the general understanding of the federalism system that Congress swiftly passed the 11th Amendment in March, 1794, which was quickly ratified by the states in February, 1795, to clarify that states cannot be sued in federal court.

The Court extended its power of judicial review to state court decisions interpreting a federal treaty in *Martin v. Hunter's Lessee*,[9] 14 U.S. 304

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7 Erin Ryan, *Federalism and the Tug of War Within* 73 (2011).

8 Chisolm v. Georgia, 2 U.S. 419 (1793).

9 Martin v. Hunter's Lessee, 14 U.S. 304 (1816).

(1816). *Martin* also held that the United States Supreme Court had the power to command a state court to adhere to an order issued by the United States Supreme Court. In addition to recognizing extensions of federal power, the Court also limited the power of state governments over the national government. In *McCulloch v. Maryland*,[10] the Court invalidated as unconstitutional a state law tax by Maryland on the National Bank established by the federal government. The Court also acted to preserve the supremacy of federal law in the face of conflicting state laws. *Gibbons v. Ogden*[11] invalidated a state law granting exclusive right to use steam powered boats in New York waters, which was in conflict with Federal Navigation Act. The Court did continue to recognize the sovereignty of the states and the limitation application of the federal Constitution to them. For example, in *Barron v. Balt*,[12] the Supreme Court ruled that the Fifth Amendment prohibition against taking of private property for public use without just compensation did not apply to state of Maryland. Rather, the Fifth Amendment only restrained the power of the federal government — not the state governments.

Slavery was another issue with strong federalism implications. As the nation crept closer and closer to the Civil War and the tensions between liberty and slavery grew, legislative efforts by abolitionists in both Congress and the northern states faced legal challenges by slave-holding citizens. *Prigg v. Pennsylvania*[13] deemed unconstitutional a Pennsylvania statute that criminalized recovery of slaves who escaped into Pennsylvania from slave-holding states. A few years later, the Court ruled that a state court lacks authority to enforce writs of habeas corpus issued to the federal government by a state court to release a prisoner held for aiding and abetting escape of slave in violation of federal Fugitive Slave Act.[14] The infamous *Dred Scott v. Sandford*[15] decision also had a federalism angle. In addition to ruling that

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10 McCulloch v. Maryland, 17 U.S. 316 (1819).

11 Gibbons v. Ogden, 22 U.S. 1 (1824).

12 Barron v. Balt, 32 U.S. 243 (1833).

13 Prigg v. Pennsylvania, 41 U.S. 539 (1842).

14 Ableman v. Booth, 62 U.S. 506 (1859).

15 Dred Scott v. Sandford, 60 U.S. 393 (1857).

slaves were not citizens, for which the opinion is largely known, the Court also held that Congress lacked authority to prohibit citizens from owning slaves in territories acquired by the federal government. The Court observed that the right to own slaves was reserved to the people and the states in the Constitution, and therefore Congress lacked authority to interfere with that right.

[2] — Postbellum Through the Early 20th Century.

The result of the Civil War and associated amendments to the Constitution drastically changed the nature of the relationship between the federal and state governments.[16] Passage of the 13th Amendment outlawed slavery everywhere in the United States and granted Congress the power to enforce the amendment "by appropriate legislation." The 14th Amendment expressly prohibits the *states* from engaging in three categories of conduct: (1) making or enforcing "any law which shall abridge the privileges and immunities of citizens of the United States"; (2) depriving any person of "life, liberty, or property, without due process of law"; and (3) denying any person "equal protection of the laws." The 15th Amendment states that neither the federal government nor the state governments may deny any citizen the right to vote "on account of race, color, or previous condition of servitude."

The post-Civil War amendments vested more power in the national government over the states to address racial discrimination and other vestiges of slavery, but the Supreme Court did not interpret these amendments to give Congress plenary power to do so. In an early challenge to federal legislation aimed at prohibiting racial discrimination by private individuals, the Court invalidated the law based on the conclusion that the 14th Amendment applies only to state governments — not individual citizens.[17] The Court also upheld state segregation laws that established the purportedly "separate but equal" public schools.[18]

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16 Erin Ryan, *Federalism and the Tug of War Within 76* (2011).

17 United States v. Stanley, 109 U.S. 3 (1883).

18 Plessy v. Ferguson, 163 U.S. 537 (1896).

The Civil War amendments did not alter the Court's view of federalism outside of slavery and discrimination. The Court continued to recognize the distinct governmental spheres occupied by the national and state governments:

> The general government, and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former in its appropriate sphere is supreme; but the States within the limits of their powers not granted, or, in the language of the tenth amendment, 'reserved,' are as independent of the general government as that government within its sphere is independent of the States.[19]

As the industrial revolution came into full swing and interstate commerce continued to grow, both the federal and state governments took action to regulate the burgeoning new industries. The Court initially took a rather dim view of these efforts. The Court struck down a state statute banning the importation of liquor because only Congress can regulate interstate commerce.[20] However, the Court also narrowly construed the Congressional power to regulate commerce. In *United States v. E.C. Knight Co.*,[21] the Court concluded that federal authority to regulate interstate commerce did not extend to regulation of manufacturing. Similarly, in *Hammer v. Dagenhart*,[22] the Court struck down a federal law prohibiting interstate shipment of goods produced using child labor. "In interpreting the Constitution it must never be forgotten that the Nation is made up of States to which are entrusted the powers of local government. And to them and to the people the powers not expressly delegated to the National Government are reserved."[23]

Also in apparent disfavor were state government attempts to regulate employment conditions. The Court invalidated a state labor law setting

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19 Collector v. Day, 78 U.S. 113, 124 (1870).

20 Leisy v. Hardin, 135 U.S. 100 (1890).

21 United States v. E.C. Knight Co., 156 U.S. 1 (1895).

22 Hammer v. Dagenhart, 247 U.S. 251, 275 (1918).

23 *Id*.

maximum hours for bakery employees in *Lochner v. New York*.[24] The Court found such as statute to be an "unreasonable, unnecessary and arbitrary interference with the right and liberty of the individual to contract" in violation of the 14th Amendment.[25]

[3] — The Great Depression and the New Deal.

When the second man named Roosevelt stepped into the presidency in 1933, the nation was in the throes of the possibly the worst economic conditions the nation had yet experienced. Roosevelt had campaigned on a platform of federal intervention (part of the "New Deal") to address the problems that President Hoover's policy of local and private solutions had failed to cure — at least in the short term. Several of Roosevelt's New Deal laws failed to pass constitutional muster in the early years of his presidency. In *Schechter Poultry v. United States*,[26] the Supreme Court struck down provisions enacted under the National Industrial Recovery Act that authorized the President to establish "codes of fair competition," as beyond the congressional power to regulate commerce. According to the Court, "[e] xtraordinary conditions do not create or enlarge constitutional power. The Constitution established a national government with powers deemed to be adequate, as they have proved to be both in war and peace, but these powers of the national government are limited by the constitutional grants."

The following year, two more of Roosevelt's legislative initiatives fell to the constitutional axe wielded by the Supreme Court. First, the Court rejected federal legislation aimed at taxing agriculture in *United States v. Butler*.[27] Since the Constitution did not expressly grant the national government power to regulate agriculture, the Court concluded that such power was reserved to the states, and Congress may not tax what it cannot regulate. Later the same year, federal legislation aimed at regulating coal mining activities failed to survive a constitutional challenge because, according to the Court's view at

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24 Lochner v. New York, 198 U.S. 45 (1905).

25 *Id*.

26 Schechter Poultry v. United States, 295 U.S. 495 (1935).

27 United States v. Butler, 297 U.S. 1 (1936).

the time, intrastate mining activities did not constitute interstate commerce that Congress may regulate.[28]

The Supreme Court's hostility to Roosevelt's agenda would not last. From 1937 through 1943, FDR appointed eight new justices to the Supreme Court. As those justices took their seats, the constitutionality of New Deal legislation began to change. The Supreme Court performed a proverbial "about face" in two areas. First, the Court rejected precedent and ruled that the commerce power did give Congress authority to regulate employment conditions.[29] Second, the Court overruled *United States v. Butler* by holding that not only may Congress regulate agriculture under the commerce power, but Congress may even regulate purely intrastate production of wheat grown for private consumption.[30]

Although federal power was increasing on the civil rights front, the Court also limited the reach of the national government by recognizing circumstances under which the federal courts should abstain from addressing issues arising under state law. *Railroad Commission of Texas v. Pullman*[31] held that federal courts should abstain from interpreting ambiguous state laws. A few years later, the Court also recognized that federal courts should abstain from hearing cases while state administrative procedures were underway.[32]

[4] — Civil Rights, the Great Society, and Birth of Cooperative Federalism

The civil rights decisions of the 1950s and 1960s greatly expanded the scope of federal power to legislate in the area of racial discrimination. Probably the most famous decision of this era was *Brown v. Board of Education*,[33] in which a unanimous court overturned the "separate but equal" doctrine recognized in *Plessy v. Ferguson*.[34] The Court also overruled

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28 Carter v. Carter Coal Co., 298 U.S. 238 (1936).
29 United States v. Darby, 312 U.S. 119 (1941).
30 Wickard v. Fillburn, 317 U.S. 111 (1942).
31 Railroad Commission of Texas v. Pullman, 312 U.S. 496 (1941).
32 Burford v. Sun Oil Co., 319 U.S. 315 (1943).
33 Brown v. Board of Education, 347 U.S. 483 (1954).
34 Plessy v. Ferguson, 163 U.S. 537 (1896).

earlier decisions and upheld federal bans on private discrimination in motels and restaurants as within the Congressional power to regulate commerce.[35]

This expansive interpretation of the commerce power extended beyond civil rights issues in the 1970s and 1980s. In *Perez v. United States*, the Court upheld a federal prohibition against "extortionate credit transactions" (*i.e*. loan sharking) even though the conduct at issue was "purely intrastate."[36] The Court also sanctioned a federal ban on possession of firearms by felons so long as the firearm had traveled in interstate commerce at some time in the past.[37] The commerce power arguably reached the pinnacle of its breadth in *Garcia v. San Antonio Metropolitan Transit Authority*, where the Court affirmed federal legislation regulating minimum wage and overtime for employees of a city government.[38]

In addition to efforts by the national government to expand its regulatory reach, Congress expanded social programs pushed as a part of President Johnson's "Great Society" campaign. During this time, Medicare and Medicaid came to be and cooperative federalism was the vehicle through which these programs would be implemented. Environmental regulation on a national scale was also a legislative priority, out of which the Clean Air Act and Clean Water Act were born (more on those in Section 6.04).

[5] — "New Federalism" — the Rehnquist Revival of Dual Federalism and Limits on the Power of the National Government.

The expansion of federal authority began to reach its limits in the 1990s when Justice Rehnquist began to command a majority of the Supreme Court. Federal programs implemented in cooperation with the states had become less of a voluntary partnership and more of a master-servant relationship. In *New York v. United States*,[39] the Court ruled that Congress may not compel

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35 Heart of Atlanta Motel v. United States, 379 U.S. 241 (1964); Katzenbach v. McClung, 379 U.S. 294 (1964).

36 Perez v. United States, 402 U.S. 146 (1977).

37 Scarborough v. United States, 431 U.S. 563 (1977).

38 Garcia v. San Antonio Metro. Transit Authority, 469 U.S. 528 (1985).

39 New York v. United States, 505 U.S. 144 (1992).

the participation of state legislatures in a federal regulatory program for the disposal of hazardous waste. Similarly, the Court struck down federal legislation that required state governments to enact or enforce a federal regulatory program imposing mandatory background checks for handgun purchases.[40]

The Rehnquist Court established limits on the ability of Congress to subject the states to suits in federal court. In 1989, the Court ruled that the Congress had the power to abrogate state immunity from suit when legislating pursuant to a power granted by the Constitution, such as the power to regulate interstate commerce, notwithstanding the 11th Amendment.[41] The Rehnquist Court rejected that reasoning in *Seminole Tribe v. Florida*,[42] and limited the federal power to abrogate state sovereign immunity to the scope of 14th Amendment. Building on that reasoning a few years later, the Court recognized the immunity of states from citizen suits brought under federal law in federal courts.[43]

The Rehnquist Court also identified some limits to what seemed like a virtually limitless Congressional power to regulate in the name of interstate commerce. *United States v. Lopez*[44] ruled that the regulation of guns in school zones was not sufficiently related to interstate commerce. The Court also deemed the regulation of violence against women to be outside the bounds of interstate commerce.[45]

[6] — Federalism Under the Roberts Court.

In recent years, the Roberts Court has issued a mixed bag of decisions involving federalism concerns. In *Bond v. United States*,[46] the Court took a more pro-state federalism stance by holding that the a criminal defendant may challenge the constitutionality of a federal criminal statute under the

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40 Printz v. United States, 521 U.S. 898 (1997).
41 Pennsylvania v. Union Gas, 491 U.S. 1 (1989).
42 Seminole Tribe v. Florida, 517 U.S. 44 (1996).
43 Alden v. Maine, 527 U.S. 706 (1999).
44 United States v. Lopez, 514 U.S. 549 (1995).
45 United States v. Morrison, 529 U.S. 598 (2000).
46 Bond v. United States, 131 S. Ct. 2355 (2011).

10th Amendment, which reserves to the States or the people all powers not delegated to the national government, even without the involvement of a state government in the proceeding. In other words, an individual can challenge a federal law on the grounds that it infringes on the powers reserved to the States by the 10th Amendment.

The controversial decision that initially upheld the Patient Protection and Affordable Care Act (also known as Obamacare) as a valid exercise of Congress's taxing authority had a lesser known federalism component that protected the States from the federal coercion.[47] The Court struck down the portion of Obamacare that would allow Congress to withhold all Medicaid funds from states who do not participate in the expansion of the Medicaid program. "Congress may use its spending power to create incentives for States to act in accordance with federal policies. But when "pressure turns into compulsion," . . . the legislation runs contrary to our system of federalism." (citations omitted).

The Roberts Court curtailed the power of the states to deal with illegal immigrants in *Arizona v. United States*,[48] in which the Court struck down a state law making it unlawful for unauthorized alien to (1) fail to apply for or carry federally issued registration documents and (2) solicit, apply for, or perform work. Writing for the majority in a 5-3 decision,[49] Justice Kennedy reasoned that most of the Arizona law at issue was preempted by federal law because the Arizona law established a policy that undermines federal immigration policy.

§ 6.04. Cooperative Federalism Approach to Environmental Regulation.

The national and state governments have combined efforts to address the effects of industrial activity on air and water resources. The Clean Air Act and Clean Water Act are probably the best examples of a cooperative federalism approach to environmental regulation. As described in more

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47 Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2602 (2012).
48 Arizona v. United States, 132 S. Ct. 2492 (2012).
49 Justice Kagan did not participate in the decision.

detail below, both programs were designed on the federal level and primarily administered by the state governments (at least initially). The environmental program for regulation of surface coal mining, the Surface Mining Control and Reclamation Act[50] (SMCRA), was originally created by Congress and is administered by the states, but SMCRA does not perfectly fit the cooperative federalism mold. Rather than being implemented cooperatively by both the national and state governments, SMCRA allows state law to essentially displace federal law once a state receives approval for its regulatory program. At that point, federal oversight is (or should be) minimal.

A detailed review of each of these statutory schemes would require a chapter unto itself — or even an entire book in the case of the air and water programs.[51] The summary below is intended only to provide a high level overview of these provisions pointing to the cooperative nature of the regulatory framework, and to set the stage for a discussion of efforts to alter that paradigm.

[1] — Clean Air Act.

Congress enacted the Clean Air Act in 1970 in recognition of the problem of air pollution (including specifically "the increasing use of motor vehicles") caused by "rapidly expanding metropolitan and other urban areas, which generally cross the boundary lines of local jurisdictions and often extend into two or more States."[52] Congress recognized that "federal financial assistance and leadership" was essential for the development of "cooperative" air pollution control programs.[53] While federal involvement was necessary, the Act acknowledges that air pollution prevention "is the primary responsibility of States and local governments . . . ."[54] Similar to other environmental statutes that followed it, the Clean Air Act establishes a

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50 30 U.S.C. §1201, *et seq.*

51 Ryan, Mark A., *The Clean Water Act Handbook* (3rd ed. 2011); Domike, Julie R. and Zacaroli, Alec C., *The Clean Air Act Handbook* (3rd ed. 2011).

52 42 U.S.C. § 7401(a)(b).

53 42 U.S.C. § 7401(a)(4).

54 42 U.S.C. § 7401(a)(3).

"floor," or minimum standards, that must be achieved by all States in order to achieve the goal of clean air.

To achieve that goal, EPA promulgates national ambient air quality standards (NAAQS) for all "criteria" or "conventional" air pollutants (lead, ozone, nitrogen dioxide, carbon monoxide, sulfur dioxide, and particulates (now, PM10 and PM 2.5).[55] Primary NAAQS are set at levels needed to protect public health (including sensitive populations).[56] Secondary NAAQS are set at levels needed to protect public welfare (visibility, harm to animals, crops, etc.).[57] The Act mandates periodic review of the science upon which NAAQS are based, and of the need for NAAQS for additional pollutants.[58] NAAQS are achieved through State implementation plans (SIPs) that implement "new source review" permitting program for all major stationery sources of air pollution (including "Prevention of Significant Deterioration" and Nonattainment Area provisions) with federal oversight and approval.[59]

In addition to NAAQS, the Act also imposes separate source-directed emissions limits. For stationary sources, new source performance standards (NSPS) apply to specific industrial categories and establish minimum "best available control technology" (BACT) that must be in place for such sources.[60] Hazardous (or "toxic") air pollutants (currently 187) are governed by technology-based emissions limits known as "maximum achievable control technology" (MACT) that must be incorporated into State-issued permits for stationary sources.[61] These requirements are imposed through comprehensive operating permits program for all "major (stationary) sources" (a.k.a, "Title V" permits), which incorporate all applicable air pollution control requirements, and stringent monitoring, measuring and reporting protocols.[62] Title V permits are issued by state regulatory agencies. If EPA

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55 42 U.S.C. § 7409.
56 42 U.S.C. § 7409(b)(1).
57 42 U.S.C. § 7409(b)(2).
58 42 U.S.C. § 7409(d).
59 42 U.S.C. § 7410.
60 42 U.S.C. § 7411.
61 42 U.S.C. § 7412.
62 42 U.S.C. § 7661a.

objects to a state permit, EPA has the power to ultimately issue a federal permit that would supersede the state permit.[63]

Mobile sources of air pollution (*e.g.* vehicles and non-stationary sources) are treated differently. EPA must make a finding that a particular category of mobile sources cause or contribute to air pollution which endangers public health or welfare before EPA may promulgate regulations limiting pollution from those sources.[64] For example, in December, 2009, EPA determined that the combined emissions of six greenhouse gases (including carbon monoxide and methane) threaten the public health and welfare.[65] Based on this finding, EPA issued a New Source Review regulation for greenhouse gases (discussed further below).

The Clean Air Act was originally designed to afford the states discretion in identifying which sources to regulate and how stringent emission limits should be. The scope of state discretion has been narrowed and eroded over the years through Congressional amendments, EPA policies and regulations, and judicial interpretations. On the enforcement side, a broad citizen suit provision authorizes suits against EPA and operators of sources alleged to be in violation (or to have incurred a pattern of violations) of air emission standards, limits or permits, or anyone who constructs or modifies a major new source without undergoing New Source Review.[66]

[2] — Clean Water Act.

The Clean Water Act[67] is legislation established a state option to administer a program for water discharge permits (National Pollution Discharge Elimination System — NPDES) for "point sources," which has been called the "center piece" of the Clean Water Act.[68] Upon approval of

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63 42 U.S.C. § 7661b.

64 42 U.S.C. § 7521(a)(1).

65 Endangerment and Cause or Contribute Findings for Greenhouse Gases Under Section 202(a) of the Clean Air Act, 74 Fed. Reg. 66496 (December 15, 2009).

66 42 U.S.C. § 7604.

67 33 U.S.C. § 1251 *et seq*.

68 Friends of the Everglades v. S. Fla. Water Mgmt. Dist., 570 F.3d 1210, 1225 (11th Cir. 2009).

regulatory program, states become the primary, but not exclusive, enforcement authority. EPA maintains discretion to take independent enforcement action in the absence of, or (sometimes) even in the presence of, state enforcement action.[69]

NPDES permits are designed to implement technology-based standards and recommended water-quality based standards promulgated by EPA and used to calculate "end of pipe" effluent limits.[70] States have primary responsibility for adoption and enforcement of water quality standards with EPA oversight and approval.[71] The Act establishes two basic types of effluent limits. The first type is technology-based limits, meaning that the limit is based on the availability and cost of pollution control technology.[72] EPA publishes guidelines that establish these limits for various types of industrial activities. The second type is water-quality based effluent limits, which are designed to achieve compliance with water quality standards without regard to technological or economic feasibility.[73] Water-quality based effluent limits are required whenever a permitting authority determines that pollutants "are or may be discharged at a level that will cause, have the reasonable potential to cause, or contribute to an excursion above any applicable water quality standard, including state narrative criteria for water quality" and technology-based limits are insufficient to ensure compliance.[74]

Water quality standards (also referred to as "criteria") establish allowable concentrations of pollutants while still protecting the uses of water bodies (*e.g.* aquatic life, recreation, drinking water source). Both the states and EPA can promulgate water quality standards, but EPA must approve any standards before they become effective.[75] The criteria are normally expressed as numeric value of the concentration of a particular pollutant that may be

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69 33 U.S.C. § 1342(i).
70 33 U.S.C. § 1311(b).
71 33 U.S.C. § 1313.
72 Ryan, Mark A., *The Clean Water Act Handbook*, 33 (3rd ed. 2011).
73 33 U.S.C. § 1311(b)(1)(C).
74 40 C.F.R. 122.44(d)(1)(i); Ryan, Mark A., *The Clean Water Act Handbook*, 33 (3rd ed. 2011).
75 33 U.S.C § 1313(c).

present in a water body without impairing one or more uses (average/chronic value and acute/maximum value). The criteria can also be expressed in a "narrative form" that express water quality goals, such as keeping water free from debris, scum, other nuisance-type substances, odors, films, and sheen.[76] For example, West Virginia's narrative water quality standards prohibit (1) materials in concentrations which are harmful, hazardous or toxic to man, animal or aquatic life; and (2) conditions that cause any "significant adverse impact" to the "chemical, physical, hydrologic, or biological components of aquatic ecosystems."[77] To ensure that narrative standards are attained, EPA may require development of implementation procedures, including (unless shown to be unnecessary due to other controls) use of whole effluent toxicity (WET) testing to regulate discharges.[78]

To further the overall goal of achieving compliance with water quality standards, the states that administer an approved Clean Water Act program compile a list every three years of waters that that do not meet one or more water quality standards — known as the "§ 303(d) list" or the "impaired waters" list.[79] The state regulatory agency then prepares a "total maximum daily load" (TMDL) plan to reduce the pollutant load by imposing more stringent effluent limits for the relevant pollutants in permits that authorize discharges into impaired streams.[80] One must obtain a "waste load allocation" in order to be permitted to discharge a TMDL-limited pollutant. Like water quality standards, TMDLs must be approved by EPA before a state may implement them.[81]

[3] — Surface Mining Control and Reclamation Act of 1977 (SMCRA).

SMCRA is similar to the Clean Air Act and Clean Water Act in that SMCRA was a Congressional initiative in the 1970s to establish national

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76 Ryan, Mark A., *The Clean Water Act Handbook*, 43 (3rd ed. 2011).
77 W. Va. C.S.R. § 47-2-3.2.i.
78 40 C.F.R. 122.44(d).
79 33 U.S.C. § 1313(d).
80 33 U.S.C. § 1313(d)(1)(C).
81 33 U.S.C. § 1313(d)(4).

environmental standards for certain industrial activities, but SMCRA is very different in several ways. SCMRA is not limited to a particular media (air or water). Rather, SMCRA establishes standards governing air quality, water quality, and to some degree land use associated with coal mining activities. SMCRA focuses on a single industry while the Clean Air Act and Clean Water Act apply across many industries.

Unlike the Clean Air Act and Clean Water Act, the role of the states in enforcing the SMCRA program is primary, and to some extent exclusive of the federal government. Once a state has received approval for a state-law based regulatory program that is "in accord with" and "no less effective than" the federal standards, the state has "primacy" for administering the program.[82] State programs are subject to limited federal oversight through the Secretary of Interior Office of Surface Mining Reclamation and Enforcement (OSM). That oversight includes regular and special (complaint driven) inspections of mine sites, an annual evaluation of how the state program is performing, and authority to issue cessation orders to address conditions that present an imminent danger to the health or safety of the public or conditions presenting significant, imminent environmental harm.[83] If OSM identifies perceived violations that do not present imminent danger, OSM issues a "10-day notice" to the primacy state to address the condition.[84] The state then has 10 days to take "appropriate action" to correct the violation or show "good cause" why action is not warranted (no violation, lack of jurisdiction, etc.).[85] Unless harm is imminent, or a state agency fails to take appropriate action to address a mining-related condition, OSM cannot take independent enforcement action.

82 30 U.S.C. § 1253.
83 30 U.S.C. § 1271(a).
84 30 U.S.C. § 1271(a).
85 30 U.S.C. § 1271(b).

§ 6.05. Federal Agency Efforts to Diminish State Authority in Environmental Regulation.

[1] — Federal Mandates Under the Guise of Federalism — the Clean Air Act Example.

As discussed above, the Clear Air Act was enacted in 1970 with the purpose of establishing federal leadership in controlling air pollution associated with urban areas that crosses state lines.[86] One of the primary means of achieving that goal is through the establishment by EPA of National Ambient Air Quality Standards (NAAQS) for all "criteria" or "conventional" air pollutants. At the time the statute was enacted, such pollutants were deemed to be lead, ozone, nitrogen dioxide, carbon monoxide, sulfur dioxide and particulates. Since then, the form of particulates that is subject to a NAAQS has been refined (to encompass so-called "$PM_{2.5}$"), but the list of conventional air pollutants has not been otherwise amended.

Nevertheless, as a part of its charge under other provisions in the Clear Air Act, EPA has proceeded aggressively to develop regulatory programs aimed at controlling emissions of all Greenhouse Gases ("GHGs"), and in the case of electric generating units, carbon dioxide in particular. These efforts reflect President Obama's determination that climate change represents "an urgent and growing threat to our national security."[87] EPA's development of these programs and its attempts to force their implementation through state agencies have sorely tested the boundaries of cooperative federalism under the Clean Air Act.

[a] — Regulation of Mix of Greenhouse Gases.

[i] — *Massachusetts v. EPA*.

EPA's first such effort to impose regulations on GHG emissions began with a challenge to EPA's refusal to do so. In particular, *Massachusetts v. EPA*[88] arose out of EPA's rejection of a petition filed under Clean Air Act Section 202(a)(1). That provision requires that EPA develop regulations to

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86 *See* 42 U.S.C. § 7401(a), (b).

87 White House, *National Security Strategy*, February, 2015.

88 Massachusetts v. EPA, 549 U.S. 497 (2007).

set standards on emissions from new motor vehicles as to any air pollutant that EPA determines "causes or contributes to air pollution . . . reasonably . . . anticipated to endanger public health or welfare."[89] For purposes of this part of the Act addressing new vehicle emissions control, the statute defines "air pollutant" to include "any air pollution agent . . . including any physical [or] chemical . . . substance . . . emitted into . . . the ambient air."[90]

Various private groups, as well as state and local governments, challenged EPA's refusal to grant their request that EPA develop regulations to control vehicle emissions of carbon dioxide and three other GHGs, for reasons that they considered to be invalid under the statutory scheme. In denying the petitions, EPA argued that it had no authority to issue mandatory standards intended to address global climate change, and even if it did, because of the uncertainty of the science with respect to the causal link between GHGs and the increase in global surface air temperatures, it would be unwise to do so. EPA also observed that the Clean Air Act was designed to address local air pollutants, rather than a substance "that is fairly consistent in its concentration throughout the *world's* atmosphere."[91]

In reversing the D.C. Circuit Court of Appeals and ordering that EPA make an "endangerment finding" under CAA Section 202(a), the United States Supreme Court (Stevens, J. writing for the majority) determined that the policy issues and other political considerations cited by EPA in refusing the petition could not override the plain statutory language. Addressing the issue of standing, the Court held that even though an increase in GHG emissions inflicts "widespread harm," the doctrine of standing only requires that *one* plaintiff demonstrate that the action complained of "injures him in a concrete and personal way." Further, in making that inquiry in a case involving a state as a plaintiff, the Court observed that it has long recognized that "states are not normal litigants for purposes of invoking federal jurisdiction."[92]

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89 42 U.S. § 7521(a)(1).
90 42 U.S.C. § 7602(g).
91 *Massachusetts*, 549 U.S. at 512.
92 *Id*. at 518.

Citing *Georgia v. Tennessee Copper Co.,*[93] the Court found it to be important that this was a suit by a state "for an injury to it in its capacity of *quasi*-sovereign." In that capacity any state has an interest "independent of and behind the titles of its citizens, in all of the earth and air within its domain."[94]

Nevertheless, the Court explained that when a state enters the Union, it surrenders "certain sovereign prerogatives," including the right to force emissions reductions in neighboring states, the right to negotiate treaties with foreign nations, and "in some circumstances the exercise of its police powers to reduce in-state motor vehicle emissions might well be pre-empted."[95] Those sovereign prerogatives "are now lodged in the federal government," and through the Clean Air Act "Congress has ordered EPA to protect Massachusetts (among others) by prescribing [motor vehicle emissions] standards. . . ."[96]

In other words, under this sovereignty exchange, the states have a right to *expect* effective, federally-driven regulation of air pollutant emissions with interstate implications, and EPA would be failing in that mission if it declined to follow the plain language of the statute by enacting rules limiting emissions of harmful pollutants. Given the unchallenged assertions that global warming causes sea levels to rise, and that these "rising seas have already begun to swallow Massachusetts' coastal land," the Court had no difficulty in finding that Massachusetts had established standing to bring the lawsuit.[97]

[ii] —EPA Responses to *Massachusetts.* The Endangerment Finding and the Tailpipe Rule.

In response to *Massachusetts*, in 2009 EPA issued its determination that GHG emissions from new motor vehicles contribute to elevated atmospheric GHG concentrations, endangering public health and welfare by causing

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93 Georgia v. Tennessee Copper Co., 206 US 230 (1907).

94 *Massachusetts*, 549 US at 518-519.

95 *Id*. at 519.

96 *Id*.

97 *Id*. at 522-523.

global climate change (the "Endangerment Finding").[98] The agency noted that GHG emissions from mobile sources in the United States exceed the total GHG emissions of all other nations except China, India and Russia, and comprise 23 percent of total U.S. GHG emissions.[99] This, in turn, led to the issuance of light-duty vehicle GHG emission standards and other regulations designed to improve vehicle fuel efficiency and thereby reduce aggregate GHG emissions from the transportation sector (the so-called "Tailpipe Rule"). Those regulations, which took effect January 2, 2011, are expected to result in approximately 960 million metric tons of reductions in carbon dioxide equivalent emissions over the life of such vehicles produced for model years 2012 through 2016.[100]

The Tailoring Rule.

As a result of the Endangerment Finding, EPA concluded that it was required under the Clean Air Act to apply its *stationary* source permitting requirements to all major sources with the potential to emit GHGs in excess of specified statutory thresholds. In particular, under the New Source Review program, EPA would be forced to require permitting of sources with the potential to emit 100 tons per year or 250 tons per year of GHGs (depending on the type of source), as such a source is typically subject to the Act's "Prevention of Significant Deterioration" (or PSD) requirements. Since the amounts of GHGs emitted by various sources are typically orders of magnitude greater than the emissions of other, conventional pollutants, this would result in an "unprecedented expansion of EPA authority that [would] have a profound effect on virtually every sector of the economy and touch every household in the land . . . ."[101]

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98 74 Fed. Reg. 66496 (Dec. 15, 2009). Specifically, EPA identified a mix of 6 GHGs that would be regulated as a single air pollutant, with a source's emissions measured in terms of "carbon dioxide equivalent units" or "CO_2e." 74 Fed. Reg. at 66499.

99 74 Fed. Reg. at 66499. From a global perspective, GHG emissions from U.S. mobile sources comprise approximately four percent of worldwide GHG emissions. *Id*.

100 75 Fed. Reg. 25324, 25328 (May 7, 2010).

101 73 Fed. Reg. 44420, 44355 (2008).

Likewise, under EPA's Title V operating permit program, all stationary sources with the potential to emit GHGs in excess of 100 tons per year would be required to obtain operating permits from delegated state agencies (or EPA itself). This too would bring so many sources within coverage of the program that state agencies could not be expected to have the resources to competently administer such a permit program.[102]

In response, EPA issued the so-called "Tailoring Rule." The Tailoring Rule set New Source Review and Title V threshold limits for GHG emissions *different* from those found in the Clean Air Act, on the basis that to do otherwise would lead to "absurd results," creating a regulatory program that would impose impossible burdens on state agencies.[103]

In general, the Tailoring Rule created a three-step, phased approach to New Source Review and Title V permitting for GHGs:

(a) Step One: threshold for imposing BACT emissions controls for GHGs, for sources that were *already subject to* PSD permitting due to emissions of conventional pollutants, set at 75,000 tons per year CO2e.

(b) Step Two: for new sources, threshold for triggering PSD permitting set at 100,000 tons per year CO2e, and for modifications of existing sources, at 75,000 tons per year CO2e, beginning on July 1, 2011.

(c) Step Three: expressed intent to consider further reducing threshold levels for permitting, and/or to consider promulgating exemptions for PSD and Title V permitting for certain sources of GHGs, after July 1, 2013.[104]

Although these adjustments admittedly found no specific sanction in the Clean Air Act, EPA believed they were appropriate because even if Congress intended the New Source Review program to apply to GHG emission

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102 73 Fed. Reg. at 44512.

103 75 Fed. Reg. 31514, 31516 (2010).

104 75 Fed. Reg. at 31516.

sources, it could not have intended to impose statutory requirements that are impossible to administer.[105]

Utility Air Regulatory Group v. EPA.

In *Utility Air Regulatory Group v. EPA (UARG),*[106] the Supreme Court was presented with the somewhat odd circumstance of the regulated industry petitioning the Court for relief from an EPA regulation that was intended to moderate the adverse effects of its own regulations. Arguing that EPA had no authority to simply dismiss the plain statutory language dealing with emissions thresholds for permitting of stationary sources, industry plaintiffs in *UARG* asked that the Court strike down the Tailoring Rule and require that EPA go back to square one in considering whether limits on the emissions of GHGs from stationary sources were truly mandated by the Clean Air Act.[107]

By its ruling issued on June 23, 2014, the Court agreed in large measure with the plaintiffs. It rejected EPA's premise that because it was required to regulate GHG emissions from motor vehicles under CAA Section 202, it was required to apply the same definition of "air pollutant" under the New Source Review and Title V permit programs. Though the Court in *Massachusetts* had upheld the application of the CAA's "Act-wide" definition of "air pollutant" to CAA Section 202, the Court held that its earlier decision in that case did not prohibit EPA from applying a "narrower, context-appropriate" definition of "air pollutant" when administering the Act's "operative provisions."[108]

Indeed, the Court observed that EPA has been applying different definitions of that term under various parts of the CAA for years. In the words of Justice Scalia writing for the majority, "[i]t takes some cheek for EPA to insist that it cannot possibly give 'air pollutant' a reasonable, context-

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105 75 Fed. Reg. at 31517.

106 Utility Air Regulatory Group v. EPA, 134 S. Ct. 2427 (2014).

107 *See* Coal. for Responsible Regulation, Inc. v. EPA, 684 F.3d 102, 146 (D.C. Cir. 2012). State plaintiffs in UARG alternatively sought to have the statutory permitting thresholds for stationary sources take effect immediately as to GHGs, because they believed this would "result in astronomical costs and unleash chaos on permitting authorities," forcing Congress to act to rectify the situation. *Coal. for Responsible Regulation, Inc.,* 684 F.3d at 146-147.

108 *UARG*, 134 S. Ct. at 2439.

appropriate meaning in the PSD and Title V contexts when it has been doing precisely that for decades."[109]

As a result, the Court rejected the rule's "Step Two," that was based upon EPA's decision to "rewrite" the statutory thresholds for PSD and Title V permitting. As the Court explained, "[w]hen an agency claims to discover in a long-extant statute an unheralded power to regulate 'a significant portion of the American economy,' we typically greet its announcement with a measure of skepticism."[110] Thus, *UARG* established that an agency "has no power to 'tailor' legislation to bureaucratic policy goals by rewriting unambiguous statutory terms."[111]

On the other hand, the Court in *UARG* upheld EPA's "Step One" approach to GHG stationary source permitting, affirming EPA's authority to impose BACT controls on so-called "anyway" sources (*i.e.*, sources that are independently subject to PSD permitting due to potential emissions of criteria pollutants). This was a legitimate exercise of EPA's authority because the text of the Act's definition of "best achievable control technology" or "BACT" makes it clear that it is applicable to "each pollutant subject to regulation under this chapter."[112]

However, the ruling was a narrow one: in essence, the Court held that nothing in the statute compels EPA to impose BACT limits on GHG emissions at "anyway" sources, but nothing "categorically prohibits" EPA from doing so. In passing on this aspect of EPA's regulations, the Court was also careful to point out that it was not approving of any particular *approach* to the BACT determination for such sources, and acknowledged that there were "legitimate concerns" that EPA might try to apply BACT in such a way as to regulate every aspect of a facility's design and operation, in the name of "energy efficiency."[113]

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109 *Id*. at 2440.

110 *Id*. at 2444 (*citing FDA v. Brown & Williamson Tobacco Corp*., 529 U.S. 120, 159 (2000)).

111 *Id*. at 2445.

112 *Id*. at 2447.

113 *Id*. at 2448-2449. On August 14, 2015, EPA published a final rule amending its GHG regulations to specify that only those sources that were already required to obtain permits

[b] — Regulation of Carbon Dioxide Emissions from Electric Generating Units.

Beyond the light-vehicle GHG emissions regulations and EPA's continuing efforts to implement a legally authorized strategy for applying GHG emission thresholds to Title I (New Source Review) permitting of stationary sources of all GHGs, EPA has also started the development of standards of performance under CAA Section 111(b) and Section 111(d) aimed at substantially limiting and reducing the emissions of one particular GHG (carbon dioxide) from one particular industrial category: electric generating units (EGUs). The purpose of these rules is to force states to curtail the use of fossil fuels (especially coal) in the generation of electricity, and to require the use of greater amounts of renewable energy. All of these changes are being implemented as a part of President Obama's "Climate Action Plan," which the EPA describes as, in part, adopting a "commonsense approach to cut carbon pollution from power plants."[114]

[i] — New Source Performance Standards — CAA § 111(b).

President Obama's June 25, 2013 Memorandum on Power Sector Carbon Pollution Standards directed EPA to issue NSPS for the control of carbon dioxide emissions under CAA section 111(b), to be applied to new, modified, and reconstructed EGUs (constructed or modified after publication date of proposal).[115] The proposed NSPS for new EGUs were published on January 8, 2014, and the proposed NSPS for modified and reconstructed EGUs were published on June 18, 2014. The final version of all of these NSPS was issued on August 3, 2015.[116]

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for emissions of conventional pollutants will be required to permit their GHG emissions. __ F.R.____ (Aug. 14, 2015).

114 EPA Fact Sheet: Clean Power Plan and Carbon Pollution Standards (available at www2.epa.gov/cleanpowerplan/fact-sheet-clean-power-plan) ("EPA Clean Power Fact Sheet").

115 Available at www.whitehouse.gov/the-press-office/2013.

116 79 Fed. Reg. 1430 (January 8, 2014); 79 Fed. Reg. 34960 (June 18, 2014); ___ Fed. Reg. _(August __, 2015).

Under the rules, the emission limit for new fossil fuel-fired EGUs is based on emissions reductions associated with a highly efficient supercritical pulverized coal (SCPC) unit, with partial carbon capture and storage (CCS) — a technology that has seen at best limited commercial application. The limit has been set at 1,400 lb CO_2/MWh, which reflects the rate EPA believes is achievable by such a plant that captures "about 20 percent" of its carbon emissions.e (CCS).[117] For modified plants, EPA decided not to impose a NSPS unless the modification would result in an increase of hourly CO_2 emissions at least 10 percent greater than the most recent five-year average emission rate. For those that do trigger NSPS, the emission limit will be set based upon the individual plant's best historical performance since 2002. For reconstructed plants with a heat input of more than 2,000 MMBtu/h, the emission limit is 1,800 lb CO_2/MWh.[118]

[ii] — Clean Power Plan — State Guidelines — CAA § 111(d).

Pursuant to Clean Air Act Section 111(d), whenever EPA has promulgated NSPS for an industrial category, it is generally required to also publish guidelines for individual states to follow, in developing programs to limit emissions from *existing* sources within that same category. That obligation does not arise, however, whenever sources within that industry have already been subject to emissions limits issued under Clean Air Act Section 112 (authorizing emission limitations on hazardous air pollutants).[119]

In 2012, EPA published emission standards for EGUs under CAA Section 112, imposing limits on emissions of mercury and other toxic air pollutants (the so-called "Mercury and Air Toxics," or "MATS" rule).[120] Disregarding

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117 __ Fed. Reg. __ (August _, 2015).

118 __ Fed. Reg. __ (August _, 2015).

119 42 U.S.C. 7411(d).

120 77 Fed. Reg. 9363 (Feb. 16, 2012). On June 29, 2015, the United States Supreme Court vacated the MATS rule due to EPA's admitted failure to consider the costs of compliance. Michigan v. EPA, 129 S. Ct. 2699 (2015). The MATS rule was remanded to the D.C. Circuit Court of Appeals, in order to require that EPA take some action to consider the costs of compliance — be that through formal cost-benefit analysis or otherwise. *Michigan*, at 2702.

those regulations, on June 18, 2014 EPA published proposed "Carbon Dioxide Emission Guidelines for Existing Plants" under Section 111(d) Section 111(d) (a.k.a., the "Clean Power Plan"). In seeking to justify issuance of the Clean Power Plan, EPA asserted (through a 104-page legal memorandum) that a drafting error during the legislative process created an ambiguity as to how Section 111(d) should be interpreted. Because the courts must defer to EPA on any ambiguity in the statute or corresponding regulations, EPA believes that its reasonable, good faith opinion that the MATS rule does not preclude issuance of Section 111(d) guidelines for carbon dioxide limits at existing plants is entitled to deference.[121] The Clean Power Plan was published in final form on August 3, 2015.[122]

The substance of the Clean Power Plan is unprecedented, both in scope and in the ways that EPA plans to achieve its stated goal of reducing nationwide carbon dioxide emissions from EGUs by 32 percent (compared to 2005 levels) by 2030. To do so, EPA's proposal include two main elements: (1) state-specific emission rate-based carbon dioxide emission reduction goals (based on the percentage of current coal-fired EGUs in each state), and (2) Guidelines ("Building Blocks") for the development, submission and implementation of state plans, incorporating a mix of fuel-switching at EGUs, improved power plant efficiency and increased use of renewable and zero-emitting sources — all of which together will be deemed to satisfy the Section 111(d) requirement that such sources meet limits based on the "best system of emission reduction . . . adequately demonstrated" (or "BSER").[123]

EPA's Three Building Blocks to achieve BSER emission rates have been summarized as follows:

(1) Reducing the carbon intensity of generation at individual affected EGUs through heat rate improvements (improved coal-fired EGU efficiency).

(2) Reducing emissions from the most carbon-intensive affected EGUs in the amount that results from substituting generation at

121 79 Fed. Reg. 34830, 34853 (June 18, 2014).

122 __ Fed. Reg. ____ (August __, 2015).

123 79 Fed. Reg. at 34858-34859.

those EGUs with generation from less carbon-intensive affected EGUs (i.e., switch from coal-fired to natural gas-fired EGUs).

(3) Reducing emissions from affected EGUs in the amount that results from substituting generation at those EGUs with expanded low- or zero-carbon dioxide generation (*i.e*., renewable energy).[124]

Most significantly, these requirements encompass a number of steps that will require states to fundamentally alter the regulation of their electric supply systems, relying to a great extent on making changes to the types of energy sources used (and as to EGUs, the type of fuel used in those sources), and encouraging (if not effectively requiring) the use of emissions trading on a state-wide or regional basis.[125] All of these measures go far beyond the traditional tool of direct emissions limits on EGUs, that until now has been EPA's only method of reducing power plant emissions of various pollutants.

[iii] — Legal Challenges to the Clean Power Plan.

Although early challenges to the proposed version of the rule were dismissed as premature,[126] it is easy to see that there are several grounds upon which EPA's Clean Power Plan may be subject to legal challenge. Whether any attempts to derail the regulation will have any practical effect in the end is yet to be seen.[127]

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124 "Does EPA's Clean Power Plan Proposal Violate the States' Sovereign Rights," Rivkin, Grossman, DeLaquil, *Engage*, Volume 16, Issue 1, at 37 (The Federalist Society, February, 2015) (available at www.fed-soc.org) ("*Engage*"). In the final rule, EPA dropped a proposed 4th Building Block, which was based on efforts to improve demand-side energy efficiency.

125 *See* Fact Sheet, "Overview of the Clean Power Plan," available at http://www2.epa.gov/cleanpowerplan/carbon-pollution-standards-new-modified-and-reconstructed-power-plants; Application for Administrative Stay of Final Rule [Clean Power Plan], August 5, 2015, filed by 16 States, available at www.ago.wv.gov/Documents.

126 *See* Order on Petition for Review of an Order of the EPA, *In Re:* Murray Energy Corporation, Petitioner, D.C. Cir., No. 14-1112, June 9, 2015.

127 For example, it is widely believed that the Supreme Court's decision in *Michigan* is unlikely to have a substantial effect on EGU plans to comply with the MATS rule, as most utilities long ago made plans to incorporate necessary equipment to control mercury and other emissions in order to comply with the challenged EPA regulations. As the D.C.

To begin with, the regulation was proposed based upon a debatable interpretation of the legislative history leading to the amendment of Clean Air Act Section 111(d) in 1990 and the effect of certain legislative procedural errors. In particular, EPA's legal memorandum accompanying the proposal suggested that such lack of clarity regarding the validity of a statutory provision based upon alleged *drafting* errors somehow creates the type of statutory ambiguity that an administrative agency such as EPA has special expertise to resolve. That these types of arguments serve as the key bases upon which such a significant rule was promulgated raises serious questions.

More significant, however, are the considerable questions that have been posed regarding EPA's authority to promulgate the Clean Power Plan even assuming that Section 111(d) does not preclude it. Those questions arise because Section 111(d) requires that states impose a "standard of performance" on existing sources. A "standard of performance" is defined as "a standard for emissions of air pollutants" that reflects the degree of emissions limitation achievable through application of the "best system of emission reduction . . . ."[128] There is nothing in this statutory provisions that authorizes EPA to require that states change the types of sources used for power generation, or the types of EGUs that may be employed, or mandate the use of emissions trading in order to achieve an overall national emissions reductions goal as to one type of energy source.

One commentary on the proposed Clean Power Plan has described it as "forc[ing] the states to carry out federal policy. It is a gun to the head of the states: 'Your sovereignty or your economy' is EPA's ultimate demand."[129] Former EPA General Counsel Roger Martella has written that ". . . the [Clean Power Plan] *would forever redefine the system of cooperative federalism upon which the nation's environmental laws are built* and challenge Constitutional limits on the federal government's ability to commandeer states to pursue

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Circuit Court noted in *In Re: Murray Energy Corporation*, ". . . prudent organizations and individuals may alter their behavior (and thereby incur costs) based on what they think is likely to come in the form of new regulations." *In Re: Murray Energy Corporation*, at 9.

128 42 U.S.C. §§ 7411(d), 7411(a).

129 *Engage*, at 36.

federal policies."[130] Harvard Law Professor Laurence H. Tribe, noting that many states "will need to enact new legislation and develop completely new regulatory schemes" to comply with it, described the Clean Power Plan (in its proposed form) as raising "grave constitutional questions" as EPA seeks to "commandeer state agencies in violation of core structural principles of federalism and the Tenth Amendment.[131] Although various changes were made to make the regulations more palatable to some states and more legally defensible, nothing that EPA did in finalizing the plan was enough to erase these concerns.[132]

[2] — Regulating at the Margins of the Clean Water Act: EPA Enforcement of State Narrative Water Quality Standards.

[a] — Implementation of West Virginia Narrative Water Quality Standards.

WVDEP regulations include two "narrative" water quality standards (the "Narrative Standards") that are intended to protect the biological health of streams against harm from unregulated pollutants, and against harms that may not otherwise be prevented through compliance by sources with applicable numeric standards for various parameters. Specifically, the Narrative Standards specify that the following conditions are not allowed in State waters:

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[130] Testimony of Roger Martella before Subcommittee on Clean Air and Nuclear Safety, Committee on Environment and Public Works, United States Senate (presented on May 5, 2015).

[131] Comments of Laurence H. Tribe and Peabody Energy Corporation, Docket ID No. EPA-HQ-OAR-2013-0602; available at http://www.politico.com/story/2015/03/epa-power-plant-rule-laurence-tribe-116258.html.

[132] On August 13, 2015, after EPA declined to issue an Administrative Stay, a group of 15 states filed an emergency petition with the D.C. Circuit Court of Appeals, seeking a stay of the Clean Power Plan while their (and others') substantive legal challenges are heard. Those states sought such relief because absent a stay, they will have to immediately "spend significant and irrecoverable sovereign resources to begin preparing their State plans" as required under the new federal regulations. *Emergency Petition for Extraordinary Writ*, State of West Virginia, by Attorney General Patrick Morrisey, *et al.*, No. 15-277, D.C. Circuit Court of Appeals (August 13, 2015), at 2.

- Materials in concentrations which are harmful, hazardous, or toxic to man, animal or aquatic life;
- Any other condition . . . which adversely alters the integrity of the waters of the State . . .; no significant adverse impact to the chemical, physical, hydrologic, or biological components of aquatic ecosystems shall be allowed . . . [133]

Until recently, the WVDEP did not have any written regulations or policies specifically describing how it would determine whether a stream complies with its Narrative Standards. However, for purposes of complying with its obligations under Clean Water Act Section 303(d) (to report to EPA those streams that do not meet water quality standards), the WVDEP has informally used a tool known as the "West Virginia Stream Condition Index" (or WVSCI). The WVSCI is an index of benthic macroinvertebrate metrics that was developed for the purpose of assessing the biological health of West Virginia streams. Based on an evaluation of the types and conditions of macroinvertebrates (small aquatic insects) found within a designated stream segment, the stream is given a WVSCI score which is used to determine compliance with the biologic component of the Narrative Standards.[134]

The WVDEP used the WVSCI for purposes of determining compliance with the Narrative Standards for many years. A WVSCI score of 68 or higher indicates that the narrative standard is satisfied; a score of 60.6 or below indicates that the stream is "impaired." The "gray zone" between 60.6 and 68 represents a precision estimate that takes into account sampling error. To avoid misclassifying streams, any stream that falls within this "gray zone" interval is considered to be in compliance.[135]

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133 W. Va. C.S.R. §§ 47-2-3.2.e – 3.2.i (2014).

134 See "Permitting Guidance for Surface Coal Mining Operations to Protect West Virginia's Narrative Water Quality Standards" ("WVDEP Guidance"), at 4, discussing *A Stream Condition Index for West Virginia Wadable Streams*, March 28, 2000 (Rev. July 21, 2000); available at http://www.dep.wv.gov/WWE/watershed/bio_fish/Documents/WVSCI.pdf.

135 WVDEP Division of Water and Waste Management, 2010 West Virginia Integrated Water Quality Monitoring and Assessment Report (2010), at 14; available at http://www.dep.wv.gov/WWE/watershed/IR.

[b] — EPA "Guidance" on Improving Oversight of Appalachian Coal Mining Operations Under the Clean Water Act.

On April 1, 2010, EPA issued a draft guidance document indicating that henceforth, in Appalachian coal mining states only, it was recommending the use of a single indicator — stream conductivity (or "specific conductance") — to measure and regulate the adverse affects of coal mining-related discharges on aquatic life. The primary basis for EPA's draft guidance was a 2008 study by Mr. Gregory Pond and other scientists at EPA that had concluded that the WVSCI was ineffective at detecting harm to macroinvertebrates in Appalachian streams, because the WVSCI only identifies those organisms to the "family" classification rather than the genus level.

As a comprehensive measure of all ionic strength, Pond suggested that Appalachian streams were likely harmed by levels of conductivity at 500 microSiemens or more. EPA's 2010 draft Guidance therefore suggested that environmental agencies in Appalachian states place conductivity limits of 500 micro Siemens/cm on all coal mining NPDES permits, and to consider placing limits as low as 300 microSiemens/cm.[136] As discussed below, based on data compiled by the WVDEP on the levels of conductivity routinely associated with coal mining operations, imposition of such standards would make it virtually impossible to issue future permits, as the treatment that would be necessary to achieve and maintain such levels at every surface mining discharge point would be prohibitively expensive.[137]

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[136] EPA, "Improving EPA's Review of Appalachian Surface Coal Mining Operations under the Clean Water Act, National Environmental Policy Act, and the Environmental Justice Executive Order" (April 1, 2010) (on file with authors). This guidance was issued in final form on July 21, 2011. It was upheld against an industry challenge based on EPA's representations that it had "no legal impact," and the WVDEP and other state agencies were "free to ignore it." National Mining Association v. McCarthy, 758 F.3d 243, 253 (D.C. Cir. 2014). The final guidance document was preceded by EPA's release of "A Field-Based Aquatic Life Benchmark for Conductivity in Appalachian Streams" (March 2011) (based, in part, on the work of 16 members of EPA's Science Advisory Board) (the "Benchmark").

[137] Through at least 2010, the WVDEP's "stressor identification protocols" used in its Total Maximum Daily Loads (TMDL) program, as approved by EPA, specified that conductivity would not even be recognized as a "likely stressor" of aquatic life until it reached levels of

[c] — W. Va. House of Delegates, Concurrent Resolution No. 111.

Beginning at least with the 2008 Pond study and continuing throughout 2009, EPA routinely cited the need for consideration of conductivity levels in evaluating WVDEP's application of its Narrative Standards, and in reviewing individual NPDES permits issued by the WVDEP for mining operations. In response, in March 2010 the West Virginia Legislature approved House Concurrent Resolution No. 111 ("HCR 111"). By it, among other things, the Legislature resolved that: (i) any interpretation of the Narrative Standards is the responsibility of the WVDEP, not other agencies; (ii) the requirement of the Narrative Standards are satisfied when a stream "supports a balanced aquatic community that is diverse in species"; and (iii) in interpreting the Narrative Standards, the WVDEP must balance the protection of the environment with the need to maintain and expand opportunities for employment, agriculture and industry (as expressed in the statement of legislative purpose set forth in the WVWPCA, at W. Va. Code § 22-11-2).[138]

HCR 111 was explicitly a federalism statement — affirming the State's role in implementing the Clean Water Act, and citing the federal statute itself. In support of this, it explicitly encouraged the EPA to "change [its] current interpretation of [the WVWPCA]" to reflect the sense of the Legislature as expressed in the resolution.[139]

[d] — WVDEP Guidance on Narrative Water Quality Standards Implementation.

In August 20, 2010, WVDEP released its "Permitting Guidance for Surface Coal Mining Operations to Protect West Virginian's Narrative Water Quality Standards" ("Narrative Guidance") along with a "Justification and Background" document explaining the purpose, factual basis, and scientific

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1075 to 1500 microSiemens/cm. WVDEP, "Permitting Guidance for Surface Coal Mining Operations to Protect West Virginian's Narrative Water Quality Standards" (August 20, 2010). EPA offered no explanation for this inconsistency.

138 H.C.R. 111 (2010 Regular Session); available at http://www.legis.state.wv.us.

139 *Id.*

studies that were considered in developing it. Essentially, WVDEP's Narrative Guidance measures compliance with the Narrative Standards through a combination of WVSCI scores, WET tests,[140] and "aquatic ecosystem protection plans."

WVDEP's Justification Document demonstrated that, based on data obtained by the agency over the years, there is no correlation between conductivity scores and Narrative Standards impairment as measured by the WVSCI. The WVDEP also rejected the assertion set forth in the Pond (2008) study that a finding of a diminished number of certain mayflies, without more, constituted a violation of the Narrative Standards.[141]

[e] — Codification of Biologic Water Quality Standard Implementation: W.Va. Code § 22-11-7b(f).

Building upon House Concurrent Resolution 111 and WVDEP's Narrative Guidance, in 2012 the West Virginia Legislature amended the West Virginia Water Pollution Control Act by including a specific provision directing the WVDEP to develop new legislative rules for assuring compliance with the biologic component of the Narrative Standards. That provision (W.Va. Code § 22-11-7b(f)) requires that the agency develop a new protocol under which a stream will be deemed to meet the biologic component of the Narrative Standards if it:

(i) supports "a balanced aquatic community that is diverse in species composition;"

(ii) "contains appropriate trophic levels of fish, in streams that have flows sufficient to support fish populations;" and

(iii) has an aquatic community that is composed of "benthic invertebrate assemblages sufficient to perform the biologic functions necessary to support fish communities within the

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140 The referenced "WET" or "Whole Effluent Toxicity" tests measure the toxicity of water to aquatic organisms by exposing test species to stream water and/or samples of discharge water from a particular source.

141 WVDEP Narrative Guidance, at 6.

> assessed reach, or, if the assessed reach has insufficient flows to support a fish community, in those downstream reaches where fish are present."[142]

As the WVDEP Secretary made clear in a letter to EPA, the WVDEP has engaged West Virginia University in a project to "develop a more robust protocol" for determining compliance with the Narrative Standards, in accord with this legislative mandate.[143]

[f] — EPA Usurpation of West Virginia's Role in Determining Impaired Streams.

In the meantime, in submitting its list of impaired streams for 2012 to the EPA pursuant to Clean Water Act Section 303(d), the WVDEP declined to apply the WVSCI, or any other measure, to evaluate whether there are any new streams that were biologically impaired. In the WVDEP's view, enactment of the amendments to the WVWPCA prohibited the agency from adding new biologically impaired streams to the 303(d) list, until the agency had developed and obtained legislative approval of new rules for interpreting and applying the Narrative Standards.[144]

In response, EPA rejected that portion of the WVDEP 303(d) list that pertained to biologically impaired streams. According to EPA, "even assuming that [the new legislation] *as a matter of state law* precludes WVDEP from assessing state waters against West Virginia's narrative water quality criteria as applied to the aquatic life uses, [the new legislation] is a state law that does not override federal requirements."[145] Although EPA indicated that it would review any proposed new method of measuring compliance with the Narrative Standards that might be developed, in the meantime EPA

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142 *Id*.

143 April 6, 2012 letter from WVDEP Secretary Randy Huffman to Jon Capacasa, Director, EPA Region III Water Protection Division (on file with authors).

144 *See* WVDEP Division of Water and Waste Management, 2012 West Virginia Integrated Water Quality Monitoring and Assessment Report (2012) ("2012 303(d) List Report"), at 15; available at http://www.dep.wv.gov/WWE/watershed/IR.

145 March 25, 2013 letter, from Jon Capacasa, Director, EPA Region III Water Protection Division to WVDEP Secretary Randy Huffman (enclosure, at 14) (on file with authors).

added 255 streams to West Virginia's 303 (d) list for biological impairment, based on EPA's determination that these streams *would* have been listed had WVDEP applied WVSCI scores. Further, EPA also stated that it believes the "gray zone" that was recognized when the WVSCI was developed (and was used with EPA's implicit approval for many years) is "statistically unproven." Therefore EPA refused to follow the WVDEP's former policy that established a score of 60.6 as the impairment threshold, and instead classified any stream with a score below *68* as impaired.[146]

[g] — CWA Citizens Suits Based upon the EPA Benchmark.

Based in large part on EPA's actions in disapproving WVDEP's Narrative Standards implementation in favor of imposing a conductivity measure (as proposed in the Benchmark Report and other EPA publications), and no doubt encouraged by EPA's refusal to allow WVDEP time to develop a new protocol for assessing compliance with the Narrative Standards (as required by W.Va. Code § 22-11-7b(f)), several Clean Water Act citizen suits have been filed against West Virginia coal companies on the theory that high conductivity values in their discharges constitute violations of the federal Clean Water Act. Given proof that such discharges caused or contributed to stream conductivity values higher than recommended in the Benchmark Report, these civil actions have imposed on the defendants the costs of treating for a condition that was never made an express part of their NPDES permits during the permitting process, in order to reduce the value of a parameter that does not in itself constitute a pollutant. Thus, the federal oversight agency has both displaced the WVDEP in its role as the evaluator of compliance with the Narrative Standards (through EPA's own interpretation and application of the WVSCI) and provided a basis for third parties to sue companies that

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146 *Id*., at Enclosure 2 ("EPA's List Development Process"); 2012 303(d) List Report, EPA List Pages 1-9; EPA Gray List Pages 1-4. Since then, various environmental groups have sued EPA for wrongly approving of TMDLs submitted by WVDEP (dating back to 2009) for several watersheds that did not include TMDLs for "ionic stress" as to streams that were listed as biologically impaired using the WVSCI. *See* Ohio Valley Envtl. Coalition, Inc. v. McCarthy, Civil Action No. 3:15-cv-00271 (S.D. W. Va.; Complaint filed Jan. 7, 2015).

hold NPDES permits issued by the WVDEP, for failing to comply with EPA's new proposed compliance test (conductivity).[147]

[3] — Expanding the Federal Role under the Surface Mining Control and Reclamation Act of 1977.

[a] — Evolution of OSM Oversight Policies.

As summarized above, SMCRA is structured differently than other federal environmental statutes that allow for the submission of state regulatory programs intended to achieve minimum federal environmental protection goals. Under SMCRA, once a state agency has been approved as the sole issuer of coal mining permits and primary regulatory authority over mining operations within its borders (known as "primacy"), the federal statute and regulations "drop out" of the picture — meaning they have no direct application to coal mine operators.[148]

Moreover, SMCRA encourages states to achieve primacy. According to the Act, it is the states, not the federal government, that are to "develop and implement a program to achieve the purposes of this chapter."[149] To make this point absolutely clear, SMCRA provides explicitly that when states regulate, they do so exclusively,[150] and when the federal government regulates, it does so exclusively.

Likewise, the federal Office of Surface Mining Reclamation and Enforcement (OSM) within the Department of Interior has only limited oversight authority with respect to the activities of an approved state regulatory authority (SRA) under SMCRA, and limited involvement in direct inspection and enforcement carried out under a state's SMCRA program. In

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147 The most recent decision granting judgment against a coal company defendant on these grounds is Ohio Valley Envtl. Coalition v. Fola Coal Co., LLC, No. 2:13-cv-21588 (S.D. W.Va. August 12, 2015). Other cases proceeding on the same grounds include Ohio Valley Envtl. Coalition v. Elk Run Coal Co., No. 3:12-cv-0785 (S.D. W. Va. June 4, 2014) (order finding that defendants have caused or materially contributed to violation of Narrative Standards in the form of high conductivity) and West Virginia Highlands Conservancy v. Pocahontas Land Corp., No. 3:14-cv-11333 (S.D. W. Va.) (pending).

148 Bragg v. W. Va. Coal Ass'n. 248 F.3d 275, 289 (4th Cir. 2001).

149 *Id*. citing 30 U.S.C. § 1202(g).

150 30 U.S.C. § 1203(a).

particular, SMCRA allows OSM to conduct oversight inspections at "surface coal mining and reclamation operations" based upon either citizen complaints identifying alleged violations of the state program, or on a random basis, to evaluate state implementation of its program (which inspections should be made jointly with the SRA, upon request).[151] There is no provision in SMCRA or OSM regulations that describes the review of SRA permit files as a form of authorized oversight, separate and apart from inspections of mine sites.

[i] — The Mettiki "E Mine" Decision.

Consistent with this limited and ordered oversight prescribed by SMCRA, on October 21, 2005, Assistant Interior Secretary Rebecca Watson issued a letter overturning a "Ten Day Notice" that had been issued by OSM's Charleston Field Office to the West Virginia Department of Environmental Protection (WVDEP) pertaining to the WVDEP's decision to issue a mining permit to Mettiki Coal Company for its proposed "E Mine."[152] As noted in that decision, once a permit has been issued, administrative and judicial appeals of permit decisions "[in a primacy state] are matters of state jurisdiction in which the Secretary plays no role."[153] Therefore, OSM had no jurisdiction in its oversight role to entertain a citizen's complaint based upon a challenge to an administrative appeal board's affirmance of the state-issued permit (a decision that could have been appealed to a state circuit court). In the words of Assistant Secretary Watson, to find otherwise "would conflict with the federalism established under [SMCRA] by allowing OSM to commandeer the state permit review and appeal process . . . ."[154]

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151 30 U.S.C. § 1267(h)(1); 30 U.S.C. § 1271(a)(1); 30 C.F.R. § 842.11(a).

152 Oct. 21, 2005 letter, Interior Dept. Assistant Secretary Rebecca W. Watson to attorney Joseph M. Lovett, Appalachian Center for the Economy and the Environment (on file with author) ("Watson Letter").

153 *Id.*, *citing In re:* Permanent Surface Mining Regulations Lit., 653 F.2d 514, 519 (D.C. Cir. 1981).

154 Watson Letter at 3.

[ii] — INE-35 and Other OSM Permit Review Activities.

Soon after his appointment early in President Obama's first term, OSM Director Joseph Pizarchik issued a Memorandum to all OSM Regional Directors, notifying them that henceforth OSM policy would be to "reject the rationale set forth in the *Mettiki* [E Mine] decision."[155] Instead, OSM will apply its oversight authority to "***all*** types of violations, including . . .violations of permitting requirements" found in state programs.[156] No further explanation for this change in policy was provided, other than that "the Solicitor's Office has . . . determined that this analysis represents a better reading of SMCRA . . . ."[157]

About two months later, OSM issued a new policy directive, No. INE-35, governing "Ten-Day Notices." In it, OSM set forth detailed procedures for issuance of Ten-Day Notices ("TDNs") to SRAs, evaluation of responses to TDNs, and actions that should be taken when a SRA does not take appropriate action to address a TDN and fails to show good cause for not doing so.[158] INE-35 also specifically authorized the issuance of TDNs for "permit defects," and defined that term broadly, to encompass "any procedural or substantive deficiency in a permit-related action taken by a [SRA] (including permit issuance, permit revision, permit renewal, or transfer, assignment or sale of permit rights)."[159] At least one primacy state complained that this directive "eviscerate[d] the concept of state primacy in relation to SMCRA . . . ."[160]

Since the issuance of INE-35, OSM has engaged in a number of permit-related oversight actions. One such effort is an ongoing, detailed review of various aspects of the WVDEP permitting system being conducted by a joint federal-state task force in order to prepare a response to a petition for

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155 November 15, 2010 letter, OSM Director Pizarchik to Regional Directors (on file with author).

156 *Id*. at 1 (emphasis in original).

157 *Id*. at 1.

158 INE-35, January 31, 2011 ("INE 35"); available at www.osmre.gov/lrg/directives.shtm.

159 *Id*. at 3.

160 April 28, 2011 letter, Kenneth T. Cuccinelli, Attorney General, Commonwealth of Virginia, to OSM Director Pizarchik (on file with author).

federal takeover of the WVDEP mine regulatory program that was filed on June 23, 2013.[161]

[b] — OSM Oversight of Clean Water Act Issues.

[i] — OSM Position on Oversight Authority over Water Discharges.

Consistent with federal law, WVDEP mining regulations specify that discharges from a mine site cannot cause a violation of effluent limits set forth in a NPDES permit or cause a violation of state water quality standards that apply to the receiving streams for such discharges.[162] At the same time, SMCRA recognizes that the Clean Water Act and delegated state programs under that statute are the *primary* means of ensuring against pollution of surface waters. Accordingly, Congress specified that no provision in SMCRA may be interpreted or applied as superseding or modifying any Clean Water Act requirement or any state law enacted thereunder.[163] As explained below, it is OSM's current position that because of the cross-reference to NPDES permits and water quality standards in WVDEP mining regulations, it is forced to interpret the requirements of *both* those regulations *and* WVDEP's water pollution control regulations in order to determine whether the WVDEP is adequately implementing its approved SMCRA program.

[ii] — Citizen Complaints Regarding Selenium Discharges.

In December, 2012, representatives of several non-governmental organizations filed complaints with the WVDEP under its mining program, claiming that five active mines were in violation of W.Va. C.S.R. § 38-2-14.5 because those mines were discharging selenium at levels in excess of water quality standards.[164] These citizen representatives asked that WVDEP

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161 *See* "OSM Analysis and Determination of the June 2013 West Virginia 733 Petition," available at www.arcc.osmre.gov.

162 W. Va. C.S.R. § 38-2-14.5.c.

163 30 U.S.C. § 1292(a)(3).

164 *See* 733 Petition," available at www.arcc.osmre.gov. The complainants also raised concerns about a sixth mine, at which mining had been mostly completed but the bond

inspect the mines, and that they be allowed to accompany the WVDEP inspection teams.

After initially indicating that inspections would be allowed, the WVDEP declined to entertain the citizen complaints once it became clear that the corresponding NPDES permits for the five mines in question did not have selenium effluent limits. Since the mines were not subject to selenium limits, and water quality standards are not self-implementing (*e.g.*, they must be translated to permit-specific limits to be enforced), the WVDEP determined that it did not have "reason to believe" that there were ongoing violations of any mining regulation.[165] In response, OSM's Charleston Field Office found that the actions of the WVDEP *under the West Virginia Water Pollution Control Act*,[166] *(WV WPCA)* requiring the companies to evaluate their discharges and potentially apply to amend their NPDES permits to include selenium limits, constituted "appropriate action" under SMCRA to cause any mining-related violations to be addressed.[167]

At the same time, the OSM July 2, 2013 Letter conditioned its determination of "appropriate action" on "WVDEP following through on its [WV WPCA Orders] in a timely fashion." In addition, OSM questioned WVDEP's position on application of the West Virginia permit shield statute, rejected the notion that the complaints could not be recognized because the

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was forfeited and the permit had been revoked. OSM found that WVDEP's response to the citizens' complaint as to that site was inappropriate for reasons related to the regulations pertaining to reclamation of forfeiture sites. July 23, 2013 letter, OSM Charleston Field Office Director Roger Calhoun to WVDEP Division of Mining and Reclamation Director Thomas L. Clarke, re: Forfeited Keenan Trucking site ("OSM Keenan Trucking Letter") (on file with author).

165 April 22, 2013 letter, WVDEP Division of Mining and Reclamation Director Thomas L. Clarke to OSM Charleston Field Office Director Roger Calhoun ("Clarke April 22, 2013 Letter") (on file with author). Director Clarke also noted that this result was made more certain by the recent passage of W. Va. Code § 22-11-6, which provides a "permit shield" for NPDES permittees against allegations of water quality standard violations when those standards have not been expressed in an NPDES permit.

166 W. Va. Code § 22-11-1, *et seq*.

167 July 2, 2013 letter, OSM Charleston Field Office Director Roger Calhoun to WVDEP Division of Mining and Reclamation Director Thomas L. Clarke ("OSM July 2, 2013 Letter") (on file with author).

sampling that had been done was not sufficient to actually determine a water quality standard violation, and rejected the WVDEP's position that it was entitled to substantial deference because OSM has no authority to interpret the Clean Water Act or the WV WPCA.[168]

Recognizing this as a serious challenge to its authority under both the WV WPCA and its approved SMCRA program, WVDEP took the unusual step of informally appealing OSM's "appropriate action" determination on the five citizen complaints, to the Regional Director of OSM's Appalachian Region.[169] In addition to asserting that conditions that do not violation clean water laws cannot constitute violations of the mining laws, the WVDEP reasserted that the citizen complainants should have been required to seek redress through approved state administrative appeal channels rather than using the OSM citizen complaint mechanism. Perhaps in recognition of the difficulty of addressing these issues, OSM has yet to issue a decision on this appeal.

§ 6.06. Conclusion.

In dissenting from the Court's decision in *Sebelius*, Supreme Court Justices Scalia, Kennedy, Thomas and Alito commented on the nature of federalism today:

> The principal practical obstacle that prevents Congress from using the tax-and-spend power to assume all the general-welfare responsibilities traditionally exercised by the States is the sheer impossibility of managing a Federal Government large enough to administer such a system. That obstacle can be overcome by

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168 OSM July 2, 2013 letter at 3-4. Significantly, OSM also noted that the duties of the WVDEP NPDES permit reviewers were so intertwined with the WVDEP staff responsible for preparing "cumulative hydrologic impact" analyses under the mining program that OSM had "fund[ed] some of West Virginia's NPDES employees under SMCRA." In OSM's view, this funding confirmed that OSM "must consider [WV WPCA] compliance as it relates to our SMCRA oversight responsibilities." *Id*.

169 July 15, 2013 letter and July 24, 2013 letter, WVDEP Division of Mining and Reclamation Director Thomas L. Clarke to OSM Regional Office Director Thomas Shope ("Shope Letters") (on file with author).

> granting funds to the States, allowing them to administer the program. That is fair and constitutional enough when the States freely agree to have their powers employed and their employees enlisted in the federal scheme. But it is a blatant violation of the constitutional structure when the States have no choice.[170]

As has become evident in the continuing evolution of the federal government's implementation policy for environmental statutes, in most cases the states truly "have no choice," both as to the question of what precisely should be the goal of any particular regulatory program, and as to the manner in which private activity will be regulated. Administrative petitions for relief are rarely granted, and judicial challenges of apparent federal overreach are more often than not effectively decided through delayed resolutions that force the states and regulated community to comply with a regulation they view as illegal, lest they face severe sanctions for failing to toe the line in the meantime. Hence, in small, day-to-day decisions and through large policy announcements, federal bureaucrats impose their will both on the state agencies administering these delegated programs, and on large segments of the business community that are forced to maneuver through the maze of federal and state requirements. It is difficult to imagine a federalism that is less "cooperative."

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[170] Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. at 2695 (Justices Scalia, Kennedy, Thomas and Alito, dissenting).

Chapter 7

A Study in the Abuse of Power: The United States Forest Service's Illegal Efforts to Seize Control of Private Mineral Estates Underlying Pennsylvania's Allegheny National Forest

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1 Mr. Mayer is the chairman of the Pennsylvania Independent Oil and Gas Association (PIOGA) Standing Committee on the Allegheny National Forest. He has held this position since the spring of 2008 when the Committee was established within the predecessor Pennsylvania Oil and Gas Association (POGAM). As committee chairman, Mr. Mayer was actively involved in the planning and execution of the POGAM/PIOGA *Minard Run* litigation.

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§ 7.01. Introduction.

In a decision published on December 15, 2009, after extensive briefing and a three-day evidentiary hearing in the case of *Minard Run Oil Co. and Pennsylvania Oil and Gas Association v. U.S. Forest Service* (*Minard Run II*),[2] federal district court Judge Sean McLaughlin stopped the U.S Forest

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2 *See* Minard Run Oil Co. v. U.S. Forest Service, No. 09-125, 2009 WL 4937785 (W.D. Pa. Dec. 15, 2009) (*Minard Run II*). In April 2010 the Pennsylvania Oil and Gas Association (POGAM) merged with the Independent Oil and Gas Association of Pennsylvania to form the Pennsylvania Independent Oil and Gas Association (PIOGA). Hereafter, for accuracy, the industry plaintiff trade association will be referred to as PIOGA for events occurring after April 2010 and POGAM for events occurring before that date. Warren County, Pennsylvania

Service (Forest Service) and the U. S. Department of Justice (DOJ) from further implementation of an illegal settlement agreement with the Sierra Club and two other anti-development activist organizations. The settlement was designed to effectively seize and wrest control of 483,000 acres of privately owned mineral estates from their rightful owners. The agreement's immediate purposes were to obstruct and prevent oil and gas drilling on the Allegheny National Forest (ANF) and to aid the Forest Service in implementing *de facto* oil and gas drilling bans on private oil and gas estates throughout the National Forest System. On appeal to the United States Third Circuit Court of Appeals the district court decision was upheld on September 26, 2011 (*Minard Run III*).[3]

The *Minard Run II* and *III* decisions represented an "unqualified" defeat for the Forest Service[4] in a war that was initiated by it on the ANF beginning in 2006. While a truce of sorts is now in place on the ANF it is by no means a settled peace. Regrettably, the war, which has been waged for eight years, continues. Its intensity has changed and Forest Service objectives may have been reevaluated but, notwithstanding its judicial defeats, the Forest Service's overt and covert efforts to impose federal control and de facto drilling bans over reserved and outstanding private mineral estates on the ANF and across the National Forest system persist.

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and the Allegheny Forest Alliance (AFA), a regional economic development organization comprised of 7 school districts, 33 municipalities and numerous businesses, participated as co-plaintiffs in *Minard Run II* until dismissed for lack of standing.

3 *See* Minard Run Oil Co. v. U.S. Forest Service, 670 F.3d 236 (3rd Cir. 2011) (*Minard Run III*).

4 *See* Thorpe, Minard Run Oil Co. v. United States Forest Service, 36 *Harv. Envt. L. Rev.* 567, 579 (2012). The Law Review article author characterized the defeat as unqualified. Additionally and notably, in April 2014 the Department of Justice awarded PIOGA $530,000 in attorney fees and expenses under the Equal Access to Justice Act, 28 U.S.C. § 2412 (d) (1) (A) *et. seq.* (EAJA). The EAJA authorizes recovery of attorney fees by an aggrieved party in the absence of a showing by the government that its position in litigation was substantially justified. *Also see* Note 110 *infra*.

[1] — Purpose of the Chapter.

This chapter explains the *Minard Run II* litigation and discusses important milestones in the history of the ANF legal engagements with private mineral owners. Its purpose is to cast light on how a federal agency abused its powers and for legal practitioners and other readers to gain a better appreciation and understanding of what occurred and the threat it and similar undertakings pose to the rule of law. Hopefully, with the advantage of hindsight and the experience that eight years of legal contest provide, future disputes can be avoided. However, what should not be lost in the academic discourse is an appreciation for the real battle that has been waged around this litigation.

That battle is about people, their private property, their communities, and their livelihoods. Easily, well over 1,500 workers from northwest Pennsylvania and southern New York derive a living, as they have for almost 150 years, through the companies and individuals that produce oil and gas on the private mineral estates underlying the ANF.[5] Oil and gas business owners, their workers, and supporting businesses want to protect century-old property rights, their jobs, their families, and their communities from the forces that would destroy them. At the same time the opponents of the industry, active both inside and outside the Forest Service, would doubtless take little pause in bringing about their destruction.[6]

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5 Of the 483,000 acres of privately owned oil, gas, and mineral ("OGM") estates in the ANF, roughly 60 percent of the acreage, or an estimated 290,000 acres, is currently owned and controlled by five (5) companies. The remaining private acreage is controlled by 80 or so smaller companies and family or individually operated businesses. The 513,000-acre ANF is divided for Forest Service administrative purposes into two Ranger Districts — Marienville and Bradford — of roughly equal size.

6 The issues in the litigation center on land use preferences and principles of federalism. Decidedly, the case did not focus on environmental concerns. Judge McLaughlin at Finding of Fact No. 65 in his *Minard Run II* decision noted: "*The Forest Service concedes that . . . the cooperative interaction approach of Minard Run I adequately protected the environmental interests of the Forest Service* (emphasis added). Additionally, of the 2,126 miles of mapped streams within the ANF proclamation boundary, an area of 720,000 acres, fully 72 percent are rated as high quality or exceptional value for water quality. Moreover, the Forest Service in 2007 characterized the water quality in the ANF as "among the highest in the state." Further, the Forest Service estimated in the 2007 ANF Land and Resource Management Plan ("2007 ANF Forest Plan) ". . . that oil and gas clearing (including associated oil and

No one should applaud or take comfort in what the Forest Service, the Department of Justice (DOJ), and the anti-development activists have done. The Forest Service and the DOJ engaged in illegal activity. In concert with environmental activists they trampled due process rights and attempted to extinguish vested and valuable private property rights protected under state law. Moreover, these unlawful actions were knowingly and callously perpetrated when the people and businesses in the ANF region could least afford it. It came when our nation and the northwest Pennsylvania region were caught in the grip of the most severe impacts of the worst economic recession since the Great Depression. Besides the human toll in disrupted lives and businesses, easily tens of millions of dollars in economic benefit

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gas access roads) currently occupy 1.4% of the ANF land base." That percentage amounts to approximately 7,000 acres of converted land from a 513,000-acre land base. These facts can be verified at the Final Environmental Impact Statement (FEIS) for the 2007 ANF Forest Plan at pages 3-26 to 3-28 and at page 3-163. This small amount of surface disturbance resulted from over 150 years of commercial oil and gas development that has occurred on the lands that comprise the ANF. During this time tens of thousands of oil and gas wells have been drilled with an estimated 12,000 wells currently in production on the ANF. Similarly, the Pennsylvania Department of Conservation and Natural Resources (DCNR) Shale Gas Monitoring Report of April 2014, reported that after five years of intensive unconventional shale development only 1,486 acres of the 673,000 acres currently available for such development on Pennsylvania's state forest lands has been converted from prior uses or condition to facilitate gas development. This amounts to approximately half of one percent of the total acreage currently available for development. The DCNR report also noted in its section on water monitoring that "initial water monitoring results have not identified any significant impacts due to shale development." In November 2014, the US Forest released its five-year Monitoring and Evaluation Report for the ANF for the period from 2008 through 2013. It focuses on oil and gas development during that period. The 2014 ANF Monitoring Report concludes that "The majority of streams on the ANF are meeting state water quality standards. Impairments are most frequently related to acid deposition or acidity from natural sources." Of particular note is the Clarion University study undertaken to compare the results of oil and gas development on benthic macroinvertebrate communities in a high development watershed as compared to a very low to no-development watershed. The study reviewed detailed data from a 2010 survey as well as results of studies conducted in the early 1980s, 1990s, and 2008. The report concluded that these macroinvertebrate studies " . . . *did not detect a negative impact to water quality* from this development" (emphasis added).

were delayed or lost entirely because of the Forest Service's actions,[7] not to mention the approximately $4,000,000 to date that was expended in litigation costs by oil and gas producers.[8]

[2] — The Pursuit of Federal Supremacy and Agency Control.

Oddly, the identity and motives of at least some of the United States government's intellectual perpetrators, perhaps even the key players in this engagement, are revealed in an unlikely place — namely, in supplements to a series of annual Congressional budget requests. The first mention of the ANF situation occurs in the supplement titled "2010 Explanatory Notes Office of the General Counsel" (hereafter "Notes") prepared by the U.S. Department of Agriculture (USDA) Office of General Counsel (OGC). The Notes are penned in the summer or fall of the calendar year, which precedes the next federal fiscal year for which the budget is being requested. For example, the Notes or explanatory supplement for the 2010 budget year, which begins in July 2009, would be penned in the late summer or fall of 2008 and they would describe the activities of the preceding fiscal year (*i.e.,* July 2007 to July 2008) in justification of the budget request. In the section of the 2010 Notes describing the activities of their lawyers in the Eastern Region Office in Milwaukee — the lawyers that advise the Forest Service's ANF and Regional (Region 9) officials — the OGC stated:

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7 In the March 2009 Warren County Chamber of Business and Industry "Chamber Corner" newsletter, an article was published titled "Economic impact Oil and Gas production on the Allegheny National Forest." It was authored by the Chamber president and addressed the moratorium and what he termed the "seizure of production" and it explained many of the negative economic impacts of the ban. Additionally, Findings of Fact Nos. 66 thru No. 111 of the *Minard Run II* decision describe, in detail, the damaging and severe economic consequences of the drilling ban. *Supra* note 2 at pages 22-30 of the decision.

8 Forty-Seven (47) companies by way of individual company contributions as well as the PIOGA organization itself, which is comprised of over 900 member companies and individuals, have financed the legal fees and expenses associated with the *Minard Run* litigation. The $4,000,000 figure represents the total of actual and estimated fees and expenses incurred in all seven of the *Minard Run* cases by energy companies.

> In addition, Eastern Region attorneys advised and assisted the Forest Service with significant decisions involving the granting or denying of permits to drill for oil and gas on National Forest System Lands. For example, in *Durhing et al. v. USFS* OGC attorneys are defending a challenge to the Forest Service authority to regulate oil and gas activities on national forest lands in Pennsylvania *which has the potential to result in a landmark ruling in the area of Federal Supremacy and agency authority under the Property Clause of the Constitution*. (emphasis added)[9]

This heralding remark was followed a year later by the 2011 "Explanatory Notes" and after which all seven of what would become the set of ANF cases had been filed[10] with:

> Oil and Gas and Energy Issues. In FY 2009, Eastern Region attorneys continued to advise and assist the Forest Service with significant decisions involving the ownership of oil, gas, and mineral estates. In *Pennsylvania Oil and Gas Assoc. et al. v. Forest Service. PAPCO v. US Forest Service. Minard Run v. Forest Service, Duhring Resource. Co. v. US Forest Service* and *FSEEE v. Forest Service*, OGC attorneys are assisting in defending a challenge to the Forest Service authority to regulate oil and gas activities on national forest lands in Pennsylvania which has the potential to result in a landmark ruling in the area of Federal Supremacy and agency authority under the Property Clause of the Constitution.[11]

A year later, and after the 2009 *Minard Run II* decision was reported, the 2012 "Explanatory Notes" under what is now the National Office activities section of the Note report:

> The Litigation Division also assisted DOJ in preparing an interlocutory appeal to the Third Circuit in Minard Run Oil Co.

9 On file with author.

10 *See* Note 107 *infra* for identification and citation to all seven of the related cases.

11 On file with author.

> v. USFS. The issue on interlocutory appeal is whether the Forest Service, in order to protect surface resources in the National Forest System, has the authority to delay approval of drilling proposals submitted by owners of subsurface mineral rights until after the Service has conducted environmental analysis under the NEPA. Holders of private oil, gas, and mineral rights on the Allegheny National Forest persuaded a district court judge in Pennsylvania to enter a preliminary injunction requiring the Service, without preparing any environmental analysis, to issue Notices to Proceed. Briefing before the Third Circuit is complete and oral argument is scheduled.[12]

It is readily apparent from the three quoted passages that OGC attorneys at the USDA Regional and National offices had assigned both great promise and significance to the ANF cases. It is also clear that whoever authored or approved the passages was quite disappointed with the *Minard Run II* decision, as evidenced by the offhanded manner in which the author referred to Judge McLaughlin and the mischaracterization of what the Judge directed.

For example, the OGC statement asserting that the injunction required the Forest Service to issue notices to proceed "without preparing *any* environmental analysis" is simply false. To this day, throughout the pendency of the litigation, and since at least 1980 under the *Minard Run I* construct and in accordance with standard ANF procedure, an environmental analysis and review is conducted for every drilling proposal before surface disturbing activities commence and notice to proceed letters are completed. Judge McLaughlin did nothing to prevent the USFS from conducting legitimate environmental analysis. What he did do was to prevent the Forest Service and the anti-development activists from proceeding with their plan to use National Environmental Policy Act (NEPA) processes as the means and pretext for stopping and then strangling oil and gas drilling on the ANF.

The description of Regional Office activity in the 2012 Note, like those of 2010 and 2011, parade the potential for a landmark ruling in the area

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12 On file with author.

of federal supremacy and agency authority. It would not be until the 2013 Notes and after the circuit court's *Minard Run III* decision was published that the promise of landmark rulings is dropped from the narrative. By the time of the 2014 Notes mention of the ANF cases has been omitted from the National Litigation section of the Notes and is found only in the Regional Office section. There the *Minard Run* case alone is referenced as simply one of a few cases in the Region where the OGC is assisting DOJ in defending oil and gas leasing issues.[13]

To those in the least bit conversant in the law and facts involved in the ANF litigation, statements about landmark rulings and challenges to authority should be at once recognized as both misleading and presumptuous. They mislead a reader, not to mention a client, into thinking that a complete change in Forest Service policy and the application of new binding rules was not taking place; that the law supported the government's positions; and that the OGC role in the ANF controversy was comprised of only being asked to help rescue the Forest Service from unfounded challenges to its established authority.[14] These impressions, like the OGC's mischaracterization of Judge

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13 Additional insights into the possible identity and motives of the intellectual perpetrators of the supremacy and regulatory control initiatives were provided in the Spring/Fall 2011 Issue of *Forest History Today* (published in December 2011) which was a special issue honoring the 100 year anniversary of the Weeks Act. At page 70 an article under the title "Implementing the Weeks Act — a Lawyer's Perspective" discusses, among other things, private rights on Weeks Act lands and the circuit court decision in *Minard Run III*. What is striking about this article are its uninformed and misleading representations of what led to the Minard Run litigation. The author, an attorney identified as a retired special counsel for real property for the U.S. Department of Agriculture, mischaracterized the case arising as a result of "inevitable conflict with the Forest Service" and demonized mineral owners by portraying them as asserting an "uninhibited right to build roads and place drilling pads wherever they please, notwithstanding conflicts with wildlife habitats and waterways…." This description of the case strongly suggests some special involvement in it.

14 The 1990 Forest Service Manual (FSM) — unchanged to this day — states that "Secretary's rules and regulations *do not apply* to the administration of outstanding rights." FSM § 2832(2) (emphasis added). With regard to reserved rights the FSM states that they are managed in accordance with "applicable Secretary's rules and regulations *as stated in the deed*." FSM § 2831 (emphasis added). Moreover, the National Forest Reservation Commission (NFRC) meeting minutes from the 1920s and 1930s are replete with unambiguous references to the Secretary's rules and regulations not applying to mineral estates outstanding in third

McLaughlin's ruling, stray very, very far from the truth. It appears that the OGC was fully invested from the outset in the initiatives to establish federal control and quite possibly led and continues to lead the agency's efforts.

[3] — The Nature of the Dispute: Territorial Aggression.

Wars typically start when an aggressor invades territorial possessions of others. And so it is here. Without troop movements or weapons, the United States government invaded, and continues to invade, private property of its citizens located in the ANF region.[15]

The lands that comprise the ANF and other eastern national forests were once privately owned. In 1911, Congress passed the Weeks Act (primarily codified at 16 U.S.C §§ 511-531 ("Weeks Act")), thereby allowing the federal government to buy land in the eastern United States for the establishment of National Forests.[16] The ANF was established in September 1923 under the Weeks Act.[17]

To address constitutional concerns, along with concerns about productive mineral lands lying fallow if acquired by the federal government, Section 9 of the Weeks Act provides:

> That such acquisition may in any case be conditioned upon the exception and reservation to the owner from whom title passes to the United States of the minerals and of the merchantable timber, or either or any part of them within or upon such lands at the date of the conveyance, but in every case such exception and reservation and the time within which the cutting and removal of such timber and the mining and removal of such minerals shall be done shall be expressed in the written instrument of conveyance, and thereafter the mining, cutting, and removal of the minerals and timber so

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parties. The NFRC was responsible for final approval of all Weeks Act acquisitions from the passage of the Act in 1911 until disestablishment of the NFRC in 1976.

15 *See* the discussion below under the headings: "The National Rulemaking Front after *Minard Run II*," and "The Administrative Front after *Minard Run II*."

16 DEIS, preface, ix (AR0012092).

17 ROD-5 (AR0012805); DEIS, Preface, ix (AR0012092).

excepted and reserved shall be done only under and in obedience to the rules and regulations so expressed.[18]

As a result of the above provision and the federal government's desire to acquire large amounts of surface lands at discounted prices, a large number of the deeds of acquisition for the lands comprising the ANF contained oil, gas, and mineral ("OGM") reservations. At first, deed reservations created "Reserved" OGM rights, meaning that the rights were reserved by the grantor of the full fee interest at the time the surface estate was conveyed to the United States.[19] The Weeks Act was amended in 1913 to allow federal acquisition of surface estates subject to "Outstanding" OGM rights, which refers to rights that were severed while the lands were in private ownership, prior to the transaction in which the surface estate was conveyed to the United States. In this situation, the grantor of the surface estate in the transaction with the United States could neither sell nor reserve the OGM rights because these rights had already been severed by a prior owner.[20]

The arrangement where one party (here the federal government) owns the surface estate and another party (here private individuals or entities) own the mineral estate is commonly referred to as a "split estate." Nearly all of the ANF was acquired as "split estate" lands.[21]

Under Pennsylvania law both surface owners and mineral owners are holders of a fee simple estate.[22] The deed for a mineral interest gives to the purchaser a "conveyance in fee simple for his particular deposit or stratum,

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18 36 Stat. 961 § 9, codified at 16 U.S.C. § 518 (2015).

19 As provided for in the Weeks Act, use of "Reserved" private mineral rights are subject to Forest Service regulation only to the extent "such rules and regulations shall be expressed in and made part of the written instrument conveying title to the lands of the United States." 16 U.S.C. § 518.

20 37 Stat. 828, 855 (1913); *see* United States v. Southern Power Co., 31 F.2d 852, 856 (C.A.4 1929); United States v. Nebo Oil Co., 90 F.Supp. 73, 85 and 90 (W.D.La. 1950).

21 As of 2007, the percentage had been reduced (by federal acquisition of OGM rights) to approximately 93 percent of the ANF.

22 Snyder Brothers, Inc. v. Peoples Natural Gas Co., 676 A.2d 1226, 1230 (Pa. Super. 1996).

while [the grantor] retains the surface for settlement and cultivation. . . ."[23] Consequently, the mineral owner's fee estate includes the right to enter upon and reasonably use the surface.[24] Moreover, as between the surface estate and the mineral estate, the mineral interest is dominant.[25] In other words, the mineral owner does not need to obtain the surface owner's permission or consent to enter the property to explore for or extract minerals.[26] Instead, the surface owner and mineral owner must exercise their respective property rights with "due regard" for each other.[27]

In 1980 the United States District Court for the Western District of Pennsylvania applied Pennsylvania law concerning "split estates" in a dispute that arose in the ANF between the federal government as surface owner and Minard Run Oil Company, private mineral owner.[28] To give effect to the property law principle that mineral rights are dominant, but must be exercised reasonably to avoid unnecessary disturbance of the surface estate, the court adopted some "minor restrictions which . . . should not seriously hamper the extraction of oil or gas.[29] The court determined that the Forest Service is entitled to receive "reasonable advance notice in writing" on five specific matters, after which oil and gas development can commence.[30] This reasonable advance notice to provide time for accommodations between the Forest Service and OGM owners was defined to be "no less than 60

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23 Chartiers Block Coal Co. v. Mellon, 25 A. 597, 598 (Pa. 1893). *See also*, Babcock Lumber Co. v. Faust, 39 A.2d 298, 303 (Pa. Super. 1944).

24 *Chartiers*, 25 A. at 598. *See also*, Belden & Blake Corp. v. Commonwealth, Department of Conservation and Natural Resources, 969 A.2d 528, 532 (Pa. 2009) (characterizing Chartiers as "seminal" (at n. 6)); and Dewey v. Great Lakes Coal Company, 84 A. 913 (Pa. 1912) (citing Chartiers).

25 *Babcock*, 39 A.2d at 303; United States v. Minard Run Oil Co., Civil Action No. 80-129, 1980 U.S. Dist. LEXIS 9570, *13 (W.D. Pa. 1980).

26 Clearfield Bank & Trust v. Shaffer, 553 A.2d 455, 457 (Pa. Super. 1989).

27 *Chartiers*, 25 A. at 598; Gillespie v. American Zinc & Chemical Co., 93 A. 272 (Pa. 1915), at 273, 279.

28 United States v. Minard Run Oil Co., Civil Action No. 80-129, 1980 U.S. Dist. LEXIS 9570, *13 (W.D. Pa. 1980) ("*Minard Run I*").

29 *Id*. at *16.

30 *Id*. at *18-22.

days in advance" of forest clearing for roads and drill sites.[31] As a result of *Minard Run I*, the Forest Service established a 60-day notice and cooperative consultation procedure that applies to both Reserved and Outstanding OGM rights as part of its Standards and Guidelines in the 1986 Land and Resource Management Plan for the ANF ("1986 ANF Forest Plan").[32] Consequently, the 60-day notice and cooperative consultation procedure and its accompanying recognition of very limited federal regulatory authority adopted as a result of *Minard Run I* (commonly referred to as the *Minard Run* framework) became longstanding practice and policy of the Forest Service in the ANF.

Beginning in about 2006, the Forest Service decided that it no longer liked the "split estate" arrangement, and no longer desired to be constrained by State law in the ANF (and other forests). Instead, it shifted from the *Minard Run* framework to a "reasonable regulatory authority" paradigm based on the United States' status as sovereign.[33] Using its new-found regulatory authority, the Forest Service began interfering with the lawful exercise of private mineral rights in a variety of ways. Most notably, the Forest Service began treating a document known as a "Notice to Proceed" (NTP) — which the Forest Service originally created as a form letter to acknowledge completion of the 60-day notice and cooperative consultation procedure under the *Minard Run* framework — as having permit status. Of course, the regulatory authority to issue permits carries with it the authority to condition or deny permits; and the withholding of NTPs ultimately became the weapon of choice in the Forest Service's war on private oil and gas developers in the ANF.

§ 7.02. The Conspiracy to Establish Federal Control over Private Property.

The initial efforts to initiate management changes, and the imposition of regulatory authority began in early 2006. They coincided with the arrival on

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31 *Id*. at *22.

32 *See* 1986 ANF Forest Plan, at 4-42 - 4-47 (AR0009637 - AR0009642).

33 A similar approach was being tested by the Pennsylvania Department of Conservation and Natural Resource, which the Pennsylvania Supreme Court squarely rejected in *Belden & Blake Corp. v. Commonwealth, Department of Conservation and Natural Resources*, 969 A.2d 528, 532 (Pa. 2009).

the ANF of both a new Forest Supervisor and one of its two District Rangers, along with the preparation of a required but delayed periodic revision of the 1986 ANF Forest Plan.[34] As subsequent inquiries revealed, the ANF accorded great significance to the subject of private OGM development in the Plan revision as evidenced by its having organized an ANF Oil and Gas Task Force in February 2006 to address the subject.

Through FOIA requests POGAM obtained ANF documents demonstrating that the Forest Service formally created an Oil and Gas Task Force ("Task Force') for the ANF that first met on February 24, 2006. Documents show that various Region 9 officials in the Milwaukee office were aware of the Task Force effort and offered assistance to the undertaking. The February meeting was followed with a series of meetings conducted in March and April 2006 designed to arrive at an April 2006 action plan. It appears that the effort was one of thoroughly assessing the state of the OGM program and management activities with a view to finding ways to improve program administration.

One of the documents obtained by POGAM was a PowerPoint© presentation, which included a slide entitled "Managing the Reluctant OGM Operator." The text of this slide was heavily redacted with only about a third of the information being viewable. Given that the slide show was intended to be instructional, the fact that the Forest Service redacted information about how it was instructing ANF personnel is both remarkable and telling. The Task Force operated throughout 2006. One of its activities included a lengthy slide-show presentation to the Pennsylvania Department of Environmental Protection (DEP) and Department of Conservation and Natural Resources (DCNR) Secretaries on May 31, 2006 detailing perceived problems with oil and gas development activities in the ANF and exploring steps that could be taken by the State agencies and ANF officials to address certain issues. Clear

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34 For the nine-year period between January 2006 and December2014, there have been eight (8) ANF Forest Supervisors or Acting Supervisors, four (4) Eastern Region #9 Regional Foresters and three (3) Chiefs of the US Forest Service. The eighth ANF Forest Supervisor since January 2006 was named the week of October 13, 2014 and replaces an Acting Supervisor.

from the text of the slides is the fact that the concept of "shared enforcement" with the DEP was advanced by the ANF Task Force in that presentation.

When the Task Force was created, oil and gas producers were not informed of its existence, and, certainly, no one from the oil and gas industry was invited to join or participate in any Task Force activities. The summary to the Proposed or draft 2007 Land and Resource Management Plan (LRMP) revision, published in May 2006, signaled the work of the Task Force and the Forest Plan planners' focus on oil and gas issues, stating that the draft preferred Plan includes ". . . new standards and guidelines for OGM development."

While the Task Force and planners were working behind the scenes changes were already taking place in the field. By May of 2006 unexpected delays in the delivery of NTPs, along with the attendant interruption of oil and gas construction activities, were being experienced. These developments were reported at a May 10, 2006 POGAM Board of Director's meeting, at which it was reported that a District Ranger said in response to being reminded about the 60-day *Minard Run* process that "the Forest Service would do all of its studies and would take as long as it liked and if an operator tried to cut a single tree before USFS approvals were granted, they'd be arrested by USFS law enforcement and charged with timber theft."

While the Forest Service's relationship toward local producers was turning from one of cooperation and respect to one of confrontation and threats, the draft OGM "design criteria" standards and guidelines in the May 2006 draft LRMP nonetheless remained consistent with the *Minard Run* framework. As a result, OGM owners did not perceive a need to comment on the draft LRMP revision.[35] However, additional and substantial changes were being made to the draft LRMP design criteria (standards and guidelines) that

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35 There was no apparent need to be concerned with the May 2006 Plan revision given decades of cooperative practices and state law guarantees. In this regard, at Finding of Fact # 59 Judge McLaughlin notes that the "Forest Service concedes that state property law is not preempted by the new regulatory scheme and acknowledges that it may not unreasonably interfere with a mineral owner's right to access his minerals." *See* Minard Run Oil Co. v. U.S. Forest Service, No. 09-125, 2009 WL 4937785 (W.D. Pa. Dec. 15, 2009) ("*Minard Run II*") at page 20.

the Forest Service decided to shield from public view and comment before formally adopting the 2007 Forest Plan.

Memoranda found in the Administrative Record (AR) assembled by the Forest Service in conjunction with the *Minard Run II* litigation confirm the covert changes and the strategy of using design criteria in this manner. For example, in a memorandum dated November 2, 2006, the author reports that an ANF Interdisciplinary Team (IDT) meeting, included a discussion about ". . . decisions made at an internal meeting on OGM effects," and that it was concluded at the meeting that ". . . All S & G's apply unless deny the right to drill. . . ."[36] S & Gs is an abbreviation for standards and guidelines.

Similarly, a memorandum of an October 19, 2006 IDT meeting reported a meeting between ANF personnel and the Regional Office (RO) that occurred on 17 and 18 October about "decisions made with the RO." This memorandum noted that as a result of that meeting it was decided that "The OGM section will change — the preamble will disappear and forest-wide S & Gs will apply to OGM."[37] An earlier memorandum penned by ANF personnel sheds light on the changes that were apparently agreed to and directed on 17 and 18 October. This memo is entitled "Oil and Gas Management 10/13/06 — Concerns, Vulnerabilities, and Questions," and lists seven questions or items of concern to the Forest Service. Three of the questions were: Number 1: "Can we require OGM developers to comply with our standards and guidelines?"; Number 3: "Is it reasonable to require OGM operators to comply with our water requirements?"; and Number 4: "Can we require NEPA documentation to be completed prior to OGM development being started? This would involve more than 60 days for processing OGM proposals."[38]

As revealed in the quoted memoranda, by early November 2006 a final decision to dramatically depart from existing law and policy had been made by the Forest Service Region 9 Regional Office and ANF leadership.

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36 AR0011224.

37 AR0011222.

38 AR0005395-96.

[1] — The 2007 Forest Plan Sneak Attack — Deliberate Misuse of Planning Authority.

Between November of 2006 and the publication of the 2007 Forest Plan and its accompanying Record of Decision (ROD) in March 2007, the Forest Service made the substantial changes to the draft Plan. Consistent with the Forest Service's new *modus operandi,* this was accomplished in secret without the knowledge of affected OGM property owners and without any opportunity for objection or public comment.

Due to the additions and deletions to the draft Plan's OGM section(s) that were detrimental to private OGM owners, numerous POGAM members filed administrative appeals to the 2007 Forest Plan. During the appeal process, the specific and substantive changes that were made were documented by both private operators and by the Forest Service itself.[39] The appeal review identified the "Preamble to 2800 Design Criteria" and various "Standards" and "Guidelines" as having been changed. It noted the the adoption of 11 new "Standards." Foremost among the 11 new "Standards" was one prescribing a new permit requirement: namely that, "Surface disturbing OGM development activities shall not commence until the ANF has issued a notice to proceed to the OGM operator" (hereinafter referred to as the "NTP Permit Rule").

A close second to the NTP Permit Rule in the way of granting itself new regulatory authority was the addition of a sentence to the first paragraph of the original draft design criteria standards (hereinafter the "Evaluation Rule"). This addition dictates that the Forest Service would henceforth be determining what constitutes the "reasonable use of the surface" in relationship to subsurface rights. It also operated to apply design criteria (increasingly a euphemism for regulations) to private OGM estates. The

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39 *See* AR0005059-0005061. The Forest Service memo prepared in the appeal review is an analysis of the changes is dated January 9, 2008 and is titled "Allegheny (Change from Draft LRMP to Final LRMP)." Additionally, the February 15, 2008 Appeal Decision of the 2007 revised Forest Plan itself identified offending provisions by reference to blocks of page numbers in the revised Forest Plan. Paragraph 1 of the Decision which addressed changes states: "The FEIS states that a number of design criteria of OGD have changed to reflect new knowledge and public comments (FEIS pp. 2-3 to 2-4; FEIS Appendix A, PI#74 to PI#116, pp. A-47 to A-68)."

drafters phrased the new assertion of authority obtusely, attempting to disguise it in the following language: "Reasonable surface use for the development and operation of subsurface rights will be evaluated based on the design criteria and other direction of this plan."[40]

As a matter of administrative law, administrative appeals of the 2007 ANF Forest Plan do not Stay or suspend the imposition of the Plan, and in this matter, the imposition of the new NTP Permit Rule, the Evaluation Rule, or any other new "regulatory" design criteria. Written requests to the Chief of the Forest Service (the official to whom the appeals are addressed and who acts on the appeals) to have the objectionable provisions stayed pending disposition of the appeals were summarily rejected. The new rules were in effect from March 2007 until February 2008 when the Appeals decision was announced. Consequently, with the adoption of the 2007 Forest Plan and no Stay of its challenged provisions allowed, the processing of drilling plan notifications under the *Minard Run* framework ballooned from an average of less than 60 days to an average of about 180 days. Along with this, the length and content of what was a courteous two-page NTP exploded into 11 pages of notices, demands, and conditions.[41]

Despite the new Forest Service attitude toward OGM owners that manifested itself in the spring of 2006 the industry attempted to work with the Forest Service. In June 2006 POGAM initiated a proposal for a set of meetings to address ANF concerns. As a result, a POGAM-Forest Service

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40 *See* AR0012938-0012941.

41 Notice to Proceed letters remain with us on the ANF. While they serve to memorialize agreements as the courts describe their purpose, the letters are actually signed only by the Forest Service and do not include counter signatures by operators. The letters are now six pages in length and have undergone some welcomed and constructive changes in substance and style from 2012 to 2013. The 2013 version of the NTP refers to "Operational Considerations" rather than conditions or requirements. It is organized into two parts, namely: "Case Specific Mitigations and Agreements," and "Standard Operating Considerations." The "Mitigation and Agreements" section, generally, records and addresses specific understandings and agreements that have been negotiated. In the absence of joint preparation it would be advisable for operators to notify the Forest Service of any errors or misstatements that might appear in the NTP once delivered.

working group process was established and commenced with its first meeting held on July 21, 2006. The last of a total of five meetings was held on March 2, 2007, when the single Forest Service attendee announced that the long-serving Forest Service OGM program administrator for the ANF was being replaced and had "voluntarily" elected to move to another position on the ANF. This program administrator was an experienced and highly respected geologist who was known to POGAM attendees at the meeting as having expressed concerns about the legality of changes being made or contemplated by the Forest Service, The single ANF attendee also stated at the meeting that additional work group meetings were not likely to be productive and the Forest Service would no longer participate.

In light of what ensued after this March 2, 2007 meeting, there is little surprise — looking back — with the disappointing news reported at the meeting and why the work group meetings, overall, were unproductive. By at least November of 2006, the Forest Service at the Regional and ANF levels had already chosen to embark on a coercive regulatory approach to managing private oil and gas development in the ANF. By March 2nd of 2007 the new regulatory approach was taking effect, the dramatically revised OGM design criteria Standards and Guidelines had been drafted, and the Regional Forester was about to approve and issue the revised 2007 ANF Forest Plan. Coercion, not cooperation, would soon emerge as the official management style of the Forest Service. Publication of the ANF's 2007 Forest Plan occurred on March 11, 2007 and the Plan became fully effective 30 days later.

[2] — In Any War the First Casualty Is the Truth.

March 2007 was an eventful month — the final POGAM-ANF work group meeting was held, and the revised 2007 ANF Forest Plan was published with the inclusion of new and illegal OGM design criteria. Additionally, on March 20, 2007 the Forest Service's mineral staff in the Region 9 Office requested a legal opinion from the Associate Regional Counsel, Office of the General Counsel to support the new "reasonable regulatory authority" scheme. The stated purpose for this request to Regional OGC Counsel was ". . . to help determine if NEPA applies to surface use for exploration and development of private mineral estates underlying National Forest System

(NFS) lands within our region.'[42] However, this issue had been previously addressed in a legal opinion memorandum dated October 11, 1991 from the same office, which concluded that NEPA does not apply to such activity or to any Outstanding mineral estates underlying ANF lands in Pennsylvania.[43] The OGC responded to the March 20, 2007 "request" with a 13-page legal opinion on May 24, 2007 ("2007 OGC Opinion"), concluding that NEPA requirements apply, without exception, to all private OGM activity and thereby reversed its earlier opinion.

There are several troubling aspects of the 2007 OGC Opinion. First, available evidence indicates that the legal opinion expressed therein was a foregone conclusion, and that the request of March 20, 2007 was made to tidy up the administrative record. As discussed above, for example, a memorandum of meetings held in October 2006 includes references to what became the NTP Permit Rule, demonstrating that months before the request for the Opinion, the Regional Office and ANF personnel were actively redrafting the ANF Forest Plan to support the application of NEPA to private oil and gas development. In addition, a memorandum of a Forest Service meeting held on January 11, 2007 to discuss a private oil and gas project in the ANF shows that Forest Service personnel and the Regional OGC had already decided that NEPA applies to private OGM activities in the ANF. The memorandum reflects a total of 14 participants at the meeting, including five Forest Service Regional Office staff, two representatives of OGC Regional Counsel, and seven Forest Service officials from the ANF, including the Forest Supervisor. The memorandum clearly states, without qualification, that "It was decided that NEPA applies to the entire project as a result of the OGM development falling under the 1911 rules and regulations.'[44]

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42 *See* AR010298.

43 The full text of the 1991 memorandum, which the Forest Service objected to disclosing, was entered as an exhibit in the August 2009 evidentiary hearing in *Minard Run II*. It was also discussed in the *Harvard Law Review* article, *supra* Note 4 at 573, and was relied upon at a 1991 Congressional hearing and in crafting the ANF-specific provisions of the 1992 Energy Policy Act.

44 The "1911 rules and regulations" refers to language included in the deed creating Reserved OGM rights, discussed *infra*.

Another troubling aspect of the 2007 OGC Opinion is the deceptive manner in which OGC portrays the 1911 Rules and Regulations. Recall that there are two types of private OGM rights in the ANF "split estate" context: Reserved rights and Outstanding rights. Reserved rights refer to private OGM rights that were reserved by the grantor of the full fee interest at the time the surface estate was conveyed to the United States. As provided for in the Weeks Act, use of Reserved rights are subject to Forest Service regulation only to the extent "such rules and regulations shall be expressed in and made part of the written instrument conveying title to the lands of the United States."[45] Pursuant to this authority, the Secretary of Agriculture created "rules and regulations" ("Secretary's Rules") to include in deeds that created Reserved rights. There are a now a total of eleven stock versions of the Secretary's Rules, identified by year: 1911 (of which there are four versions), 1937, 1938, 1939, 1947, 1950, 1963, and 1963 revised or 2013.

As demonstrated by POGAM in *Minard Run II*, the provision most commonly used in acquiring surface lands in the ANF, by far, was a seven-paragraph version of the 1911 Secretary's Rules.[46] Other versions of the 1911 Secretary's Rules include a 10-paragraph version and two variants of an 11-paragraph version. Two provisions in the 10-paragraph version, commonly referred to as "clauses 4 and 7," provide federal approval authority for facility locations and some environmental protection measures in relation to "miners, "mining operators," and "mining operations." The significance of these two clauses is that they purport to give Forest Service officers some degree of "approval" authority over development activity on Reserved estates. Despite the relative rarity of deeds containing the 10-paragraph version (and,

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45 16 U.S.C. § 518.

46 *See* Finding of Fact No. 16 of *Minard Run II*, which was supported by two, unchallenged, sworn statements. One of the sworn statements reported the results of a case study of a group of circa 1920 and 1930 real estate acquisition transactions from the ANF deed files showing that 76 percent of the deeds reviewed that involved Reserved rights contained the seven-paragraph version of the 1911 Secretary's Rules. The deeds reviewed were all from alphabetically organized grantor files maintained by the Forest Service at its ANF Headquarters in Warren, PA. They represented a random compilation of about 37,000 acres of the ANF from Grantor's deeds whose names began with A or B.

in turn, clauses 4 and 7), the 2007 OGC Opinion expressly refers to them in support of its "reasonable regulatory authority" scheme. At the same time, the Opinion fails to note that clauses 4 and 7 do not appear in very many deeds, or that the ubiquitous seven-paragraph version of the 1911 Secretary's Rules do not contain these clauses, or that there may be hybrid versions of the Secretary's Rules such that deed language differs from the stock provisions, or that OGC's analysis relying on clauses 4 and 7 would not apply at all to Outstanding OGM rights, or that the ANF sometimes consists of "blended" estates, where a single OGM land tract has both Outstanding and Reserved rights. In short, the 2007 OGC Opinion emphasizes language that was rarely used in deeds while conveniently overlooking the absence of support in most deeds or the myriad of circumstances that pose complex legal issues. This is clearly misleading.[47]

Equally troubling is that two years later in *Minard Run II*, the Forest Service/DOJ attempted to mislead the district court into adopting the "clause 4 and 7" version of the 1911 Secretary's Rules as applicable to all ANF deeds. More specifically, in its 2010 Motion for Reconsideration of the *Minard Run II* decision, the government argued that the 10-paragraph version of the 1911 Secretary's Rules was the "official" version and the one the court should have used in the 2009 *Minard Run II* decision — regardless of what appears in actual deeds. The court rejected this argument, noting that uncontradicted evidence was presented during the preliminary injunction proceeding proving that the seven-paragraph version of the 1911 Secretary's Rules was the most typically used version in ANF deeds. The court correctly observed that what actually appears in the deeds is what matters, and that the Forest Service's attempt to offer the 10-paragraph version as the "official" version was a "Johnny-come-lately to the party. . . ."[48]

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47 In addition to the incomplete treatment of 1911 Secretary's Rule, the 2007 OGC Opinion fails to directly address contradictory statements in the Forest Service Manual, the *Minard Run I* precedent, the ANF Handbook, and — most notably — the former and conflicting 1991 OGC legal opinion and corresponding Congressional testimony.

48 *See* pages 5 to 7 of the March 19, 2012 hearing transcript. Not surprisingly, the Third Circuit in the *Minard Run III* decision found that the 2007 OGC opinion was entitled to no deference whatsoever.

Another troubling aspect of the 2007 OGC Opinion is its argument (at p. 3) that there is "No provision of law or regulation that exempts outstanding minerals from . . . permit requirements. . . ." The notion that a federal agency has authority to act because it has not been prohibited from acting is wrong-headed, legally incorrect, and dangerous. Simply put, federal agencies may not exercise power in the absence of delegated authority. This flawed thinking is in line with the discredited notion that somehow the Forest Service possesses regulatory authority directly by virtue of a self-executing Property Clause of the U.S. Constitution, without any need for Congress actually to delegate such authority.

With the 2007 OGC Memorandum in place, the Forest Service began, apparently, to use it in a propaganda-like manner. For example, in a PowerPoint© presentation prepared for an OGM issues update meeting of ANF and Region 9 personnel held in June 2007,[49] several slides promote the private OGM takeover strategy. One slide, specifically number 34 (entitled "Courageous Conservation") asserts with stilted bullet point phrases that the ANF/Forest Service will "Implement Secretary's Rules and Regulations," and "Require and Enforce Forest Officer Approval for all Operations." (The underline emphasis under "Enforce" appears on the slide.) It also states that this action "Assumes Forest Service Has Regulatory Authority Over OGM Private Actions."[50] Slide number 36 is entitled "1911 Rules and Regulations" and quotes only from clauses 4 and 7, suggesting that these provisions are common to all of the 1911 Secretary's Rules. Moreover, the slide misleadingly conveys the impression that there is only one version of 1911 Secretary's Rules and that the two quoted provisions apply to all ANF lands. The slide does not mention that the two provisions appear in a relatively uncommon version of four versions of the 1911 Secretary's Rules or that there are 10 stock set versions of Secretary's Rules and Regulations. Notably, in addition

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49 The 36-slide presentation was obtained by POGAM as part of the AR in *Minard Run II*.

50 *See* AR 010313 - The slides appear after AR page 010313 and are noted as "Item1.1.41 June 2007, ANF OGM Presentation to RO."

to the slide's misleading characterizations, is the fact that it mirrors the 2007 OGC opinion's equally misleading discussion of the 1911 Secretary's Rules.

Individuals pushing for the imposition of regulatory control over private oil and gas development in the ANF and elsewhere needed legal cover to pursue their agenda. To obtain it they had to first overturn the contrary 1991 OGC legal opinion. Given the OGC's involvement in the January 11, 2007 ANF meeting and NEPA decision, its willingness to reverse its previous legal opinion, and the 2007 OGC Opinion's responsiveness to the questions posed by ANF personnel in the 10/13/06 memo, it would be naïve to think that attorneys in the Milwaukee OGC office and Forest Service officials in the Regional Office were not coordinating the effort to implement an ANF regulatory scheme during the redrafting phase of the 2007 ANF Forest Plan.[51] Further, it would be difficult to imagine that the Regional OGC staff and Regional Forest Service staff were not aware that last-minute adoption of the substantial changes being made in the ANF Forest Plan, in the absence of an opportunity for public comment, would constitute a violation of the due process mandates of NEPA and the National Forest Management Act (NFMA).[52]

[3] — Appealing the 2007 Forest Plan.

The 2007 ANF Forest Plan was approved in March 2007. Within a short time thereafter a total of 86 separate administrative appeals were filed. Seventy-seven (77) of them were filed by OGM producers or supporters on the basis that unauthorized regulatory "Standards" or new rules had been adopted and imposed. In hindsight it comes as no surprise, given the June 2007 briefing in Milwaukee, that efforts initiated by POGAM and individual companies to reach an informal resolution of the industry appeals were initially spurned and ultimately proved fruitless.

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51 OGC lawyers in the Washington office may also have been involved at this stage, but only a review of internal OGC communications is likely to confirm this. Recent events at the national level have demonstrated, however, a lack of transparency of federal agencies.

52 The National Forest Management Act of 1976; 16 U.S.C. § 1600 *et seq.*

Informal resolution meetings were requested in September of 2007 in accordance with administrative appeal rules. The Forest Service responded by agreeing to conduct a "meeting" by telephone, which was undermined by an unguarded remark from the Region 9 Plan Appeal Coordinator that meetings were pointless as nothing was going to change in the Forest Plan in any event. Written objections by POGAM and others to this inhospitable reaction resulted eventually in a seemingly "real" meeting held on December 12, 2007 in Erie, Pennsylvania. That meeting, originally scheduled for two days, was cut short by the Regional Office Forest Service participants on the morning of the second day. This unexpected conclusion to the meeting was accompanied with positive representations by Forest Service officials that an informal resolution might be accomplished. However, after weeks of unexplained silence, each industry participant received a letter dated January 28, 2008, stating that nothing would be resolved. It was clear then that the meeting itself and the positive representations about a resolution were never genuine.

[4] — The Decision on the Plan Appeals and the *Forest Plan* Case.

Even the then Chief of the Forest Service could not ignore the actions of Forest Service officials in concealing their Forest Plan redrafting activities. Responding to the industry appeals, the Chief, in a February 15, 2008 decision signed by a Deputy Chief ("2008 Appeals Decision"),[53] conceded that these agency officials had violated the law. Among other things, the 2008 Appeals Decision directed that application of the changes in the 2007 ANF Forest Plan as they pertained to the administration of private OGM development be suspended until they were subjected to public notice and comment. At the same time, however, she approved the entire 2007 Forest Plan, thereby recognizing and adopting the Forest Service's newly discovered authority to regulate private mineral estates.

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53 Allegheny National Forest 2007 Revised Land and Resource Management Plan Appeal Decision, File Code 1570-1, February 15, 2008.

In a set of three "Instructions" that accompanied the 2008 Appeals Decision, the Chief explained three separate violations of NEPA: 1) the Forest Service's inclusion of new design criteria Standards and Guidelines applicable to private OGM rights without undergoing public notice and comment; 2) the Forest Service's failure to explain the legal framework and authority supporting the imposition of the new Standards and Guidelines; and 3) in response to an environmental activist group appeal, the Forest Service's failure to evaluate cumulative air quality effects of the Alternative selected in accordance with the NEPA process. With respect to the first violation, the Chief treated the notice and comment due process violations as merely procedural in nature and did not question whether it was lawful for the Forest Service to adopt and apply the new regulatory scheme in the first place. Similarly, the second violation focused on the Forest Service's failure to adequately *explain* its new-found regulatory authority, not the more basic issue of whether or not such authority exists (which was apparently presumed).

In terms of curative actions, with respect to the first violation the Chief instructed the Regional Forester "to provide the public the opportunity to comment on [the substantial changes to the design criteria] in accordance with FSH 1909.15, Chapter 18.2."[54] "Until that time, applying the use of the Revised Plan design criteria to specific OGD is suspended. During that time . . . I expect you to follow the site specific authority in the 1986 ANF Plan to administer private OGD."[55] With respect to the second violation, the Chief instructed the Regional Forester to "incorporate language in the . . . Revised Plan . . . to clarify the Allegheny NF's authority to manage oil and gas activities." Neither instruction directs the Forest Service to determine if its newly asserted authority exists.[56] It was clear that the question left for further

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54 *See* the 2008 Appeals Decision at page 3.

55 *Id*.

56 The clearly understood import of this agency double speak was not lost on the drafters of the "curative" document, referred to as the Draft Supplemental Environmental Impact Statement ("DSEIS"). In Chapter 1 of the DSEIS at Paragraph "1.3.1 Background" the drafters promise that: "*Appendix C will disclose the ANF's legal authority*" to determine reasonable surface use (emphasis added). In turn, the introduction of Appendix C states that: "*The ANF's legal authority to determine the reasonable and necessary use of surface*

examination was not if the new design criteria were going to be applied, but rather how. Significantly, as a result of these curative "instructions," the Chief then declared all industry appeals moot, thereby wholly circumventing the need to address the principal and key objections raised by oil and gas producers. An appreciation for the circular reasoning and use of non-specific language needed to accomplish this maneuver can be seen in how he justified the mooting of these questions. He states as follows: "Appellants primarily raised concerns regarding legal and regulatory authorities and responsibilities relating to the rights of oil and gas development (OGD) held in private ownership; especially in regard to design criteria. As a result of my decision (Item 1, page 2) I determined a number of these issues to be moot. They are displayed as Attachment 3 to this decision letter." Attachment 3 identified five pages of questions and stated in its preamble that these "will not be responded to."

As would be demonstrated by the litigation that ensued,[57] the Chief's curative instructions were used, if not originally crafted to be part of an overall legal strategy to delay or prevent judicial review of the Forest Service's assertion of regulatory authority. For example, even though the Chief took "final action" in approving the 2007 ANF Forest Plan — which included all of the objectionable new OGM design criteria Standards and Guidelines (albeit temporarily "suspended," at least officially) — the Forest Service would advance the argument that it had not yet taken a "final action" because it had not yet satisfied the curative instructions by completing the DSEIS process.

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resources when reserved and outstanding oil and gas rights are exercised will be disclosed, thus serving as the basis for development of [Standards and Guidelines] included in the Forest Plan" (emphasis added).

[57] *See* Pennsylvania Oil and Gas Ass'n v. U.S. Forest Service, No. 1:08-cv-00162-SJM (W.D. Pa. filed May 27, 2008), which was stayed pending the Circuit Court decision in *Minard Run III*. The case was reassigned to district court Judge Harnak upon Judge McLaughlin's stepping down from the federal bench in August 2013. In a decision dated February 21, 2014, 2014 U.S. Dist. LEXIS 21601 (W.D. Pa., Feb. 21, 2014), Judge Hornak dismissed the case, *without prejudice*, on case or controversy grounds. This allows for PIOGA to reopen the case should the Forest Service continue its activity of trying to impose illegal regulations on oil and gas operators.

Of course, it was clear to the oil and gas community which had been engaged with these issues since 2006 that the Forest Service had no intention of legitimately addressing, let alone revisiting, the pivotal and threshold question of its authority to impose rules on private mineral estates in the first instance. By approving the issuance of the 2007 ANF Forest Plan "with Instructions" the Chief approved the new regulatory scheme without addressing its legality or considering public comments about the lack of Forest Service authority. This "With Instructions" maneuver then served as the basis for asserting that POGAM would have to wait to challenge the new rules because the Forest Service action was not "final" because the new rules had been suspended.[58] This rendered the remedy of curing the public notice and comment violation nothing more than a charade, making it a mockery of due process.[59]

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[58] *See* note 60 below for a discussion of a sanctions motion advanced by POGAM in the *Forest Plan* case based on evidence that the Forest Service had not in fact suspended the use or application of the 2007 Forest Plan OGM design criteria.

[59] The Forest Service's deliberate and similar effort to escape accountability and avoid oversight by the courts on the same issue in the context of the April 2009 illegal settlement agreement was addressed in the *Minard Run III* decision. Judge Roth explained:

> First, the Marten Statement represents the consummation of the Service's decision making process on the specific question of whether to issue NTPs while the Service is conducting a lengthy EIS. The Service argues that this decision is "interlocutory," *TSG Inc.*, 538 F.3d at 267, or a "preliminary, procedural, or intermediate agency action," 5 U.S.C. § 704, which will not be final until the EIS is complete and NTPs are issued. We agree with the Service that the completion of the EIS or issuance of an NTP would constitute final agency action, but that does not mean that any determinations made by the Service prior to these actions are not final. An agency determination of a particular issue that will not be reconsidered in subsequent agency proceedings may represent the consummation of the agency's decisionmaking process on that issue. *Compare Fairbanks North Star Borough v. U.S. Army Corps of Engineers*, 543 F.3d 586, 591 -592 (9th Cir. 2008) (finding of Clean Water Act jurisdiction was consummation of decisionmaking process on jurisdiction because subsequent regulatory proceedings would not revisit this determination) *with In re Sac & Fox Tribe of Miss. in Iowa/Meskwaki Casino Litig.*, 340 F.3d 749, 756 (8th Cir. 2003) (temporary closure order not final because order was preliminary and subject to further administrative review). The Service does not claim that it will revisit the propriety of imposing a moratorium on new drilling in the ANF during the forest-wide EIS, and by the time the EIS is completed, the propriety of the moratorium will be moot. Accordingly, the Marten

While the ordered suspension of the new OGM design criteria was welcomed by producers it only operated, at best, to delay the imposition of new rules.[60] At the same time, there is no doubt that the 2008 Appeals Decision was not welcomed by the perpetrators of the federal control scheme. The papering-over fix would require more time-consuming administrative processes that would cause undesired delay and potentially frustrate their goals.

In response to the 2008 Appeals Decision and the resultant approval of the 2007 ANF Forest Plan, PIOGA filed an action in district court seeking to have the offending OGM provisions of the 2007 ANF Forest Plan set aside. *See Pennsylvania Oil and Gas Ass'n v. U.S. Forest Service*, No. 1:08-cv-00162-SJM (W.D. Pa. filed May 27, 2008). Because the case primarily concerned violations of NEPA and the Administrative Procedures Act (APA),[61] it necessarily focused on the process by which the Forest Plan and offending provisions were approved, not the underlying unlawfulness of both adopting or applying them in the first instance.

[5] — Response of the Pennsylvania State Legislature.

While the Forest Service Chief was playing legal shell games in Washington, Pennsylvania State Representatives and Senators became aware of developments in the ANF and did not sit idly by. Both chambers of the Legislature, acting in April 2008, condemned the adoption of the new OGM

> Statement represents the consummation of the Service's decision making process with respect to the moratorium on new drilling.

See 670 F.3d. 236 at 247-248.

60 *See Pennsylvania Oil and Gas*, No. 1:08-cv-00162-SJM (filed May 27, 2008), Pennsylvania Oil and Gas Ass'n v. U.S. Forest Serv., 2014 U.S. Dist. LEXIS 21601 (W.D. Pa., Feb. 21, 2014) (hereafter the *Forest Plan* case). On January 15, 2010 POGAM filed a Motion for Sanctions against the Forest Service for representing to the court in both the *Minard Run II* case and the *Forest Plan* case that the suspended design criteria had not been applied to private oil and gas development. In an affidavit dated January 11, 2010 that accompanied the Forest Service's motion for Reconsideration of the *Minard Run II* decision (*see supra* note 99), the ANF Forest Supervisor stated that well package reviews include application of Draft SEIS Preferred Alternative design criteria which design criteria include "suspended" 2007 Forest Plan design criteria.

61 5 U.S.C. § 501, *et seq*.

design criteria Standards and Guidelines in the 2007 ANF Forest Plan. More specifically, the House and the Senate of the Pennsylvania General Assembly unanimously adopted separate but identical Resolutions declaring that the acquisition of the ANF under the Weeks Act, ". . . did not and does not confer power on the United States to manage or regulate or extinguish, diminish, or disparage any State or privately owned easements, rights-of-way, mineral estates and surface rights appurtenant thereto …that were in existence but not purchased or condemned by the United States at the time of acquisition." The General Assembly then further resolved that the imposition of any ". . . rules, regulations, or policies. . ." that would purport to manage or regulate Reserved or Outstanding rights, "unless expressed in the deeds," would ". . . exceed the consent of the Commonwealth. . . ."[62] The sponsors of these Resolutions were Representative Kathy Rapp of Pennsylvania's 165th House District and Former Senator Mary Jo White of Pennsylvania's 21st Senatorial District.

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62 *See* General Assembly of Pennsylvania House Resolution No. 693 (April 8, 2008) and Senate Resolution No. 294 (April 29, 2008). This sentiment of not recognizing federal jurisdiction over property rights the federal government never acquired when purchasing the ANF was carried forward by the Legislature three years later when it passed Act 13 of 2012, H.B. 1950 (Feb. 14, 2012), 58 Pa. C.S. §§ 2301-3504. The Act comprehensively updated the laws pertaining to oil and gas development and included a provision in Section 3504 reaffirming that Pennsylvania statutes and regulations were the "exclusive" means and method by which any requirements could be imposed on oil and gas operations involving Reserved or Outstanding oil and gas estates on the ANF. The provision precludes Forest Service regulation of these privately owned estates as the attempted imposition of any rule, to include rules regarding notifications of drilling proposals, would "affect" State authority. Section 17 (o) of the 1992 Energy and Policy Act (30 U.S.C. § 226 (o)), which was drafted for only the ANF, in deference to state authority, prohibits the creation or imposition of any regulation that would "affect' "any" state authority over private oil and gas operations conducted on the ANF. Effectively, this section acknowledges State primacy and pre-emption of federal regulatory efforts aimed at un-acquired ANF property rights that are being regulated by the States. Also, in the *Minard Run IV* decision, Judge Mclaughlin dismissed, on the merits, the anti-development activists' argument that the Forest Service possessed broad regulatory authority as a result of Pennsylvania's 1911 consent statute, which authorized the federal government to acquire forest lands in the state. *See* 32 P.S. § 101 *et seq*. In doing so he noted that the "Pennsylvania Act contains no language authorizing the federal government to pass regulatory laws concerning unacquired mineral estates." *See* Minard Run Oil Co. v. U.S. Forest Serv., 894 F. Supp. 2d 642, at 659 (W.D. Pa. 2012).

§ 7.03. Implementing Controls and Making War Plans — 2008.

While the 2008 Appeals Decision was being prepared the agency actors at the local, regional, and national levels were apparently busy devising new plans to effect control over oil and gas development. Undaunted by the setback of having to acknowledge the procedural wrongdoing in adopting the new ANF design criteria or perhaps because of it, the Forest Service was preparing to implement what would prove to be an unscrupulous, ambitious, and carefully planned campaign designed to comprehensively establish Forest Service control over all oil and gas development activities of privately owned mineral estates in the ANF and throughout the National Forest System.

The campaign was organized to proceed on three fronts simultaneously: Administrative, Judicial, and Regulatory. Among the many heavy-handed tactics used by the Forest Service in the campaign were those of seizing possession of so-called "common variety" hard rock minerals on the ANF, delegating itself regulatory authority through a sue-and-settle lawsuit, using and threatening use of Forest Service police and the criminal process to intimidate operators, imposing administrative drilling moratoriums, and initiating a national rulemaking proposal crafted to strangle and extinguish private oil and gas development.

[1] — Forest Service Seizure of Hard-Rock Minerals and The *PAPCO Stone* Case.

On the heels of the 2008 Appeals Decision, the initial engagement (or ambush) occurred in an administrative action that took the form of a March 28, 2008 broadcast letter ("2008 Stone Letter") from the ANF Forest Supervisor to all oil, gas, and mineral operators. In perfunctory language the 2008 Stone Letter announced through application of a regulation, whose terms assumed federal ownership of "common variety" hard-rock aggregate materials, that all such materials found on the ANF, such as sand and stone, were thereafter owned by the federal government.

This meant that private mineral estate owners who controlled 93 percent of the ANF mineral estates or subsurface, regardless of what their deeds stated and regardless of Pennsylvania property law, were simply dispossessed of

their property via administrative edict. Moreover, as ANF personnel were well aware, this new edict would have a harsh economic impact on oil and gas producers because they had been using "pit run" stone (or sandstone) deposits for decades as erosion and sedimentation control on access roads and well pads. Under the new edict, producers would be forced to pay for and transport stone from off-site sources at greatly increased costs.

In response to the 2008 Stone Letter, PAPCO, Inc., an OGM owner, filed a Quiet Title Action on September 9, 2008. The action asserted that the Forest Service was infringing on PAPCO's ownership and right to take stone that was derived through a mineral reservation in a 1930 deed where the United States had acquired the surface estate In an opinion published in August 2011,[63] the case was resolved in favor of PAPCO. Senior United States District Court Judge Cohill, construing the mineral reservation language under Pennsylvania law (which looks to the intention of the parties to the deed creating the reservation) found that ". . . sandstone located in the Allegheny National Forest has its own commercial value apart from the land" and "was regarded as a commercially valuable mineral at the time of the . . . Deed." Accordingly, the stone being used by PAPCO for oil and gas development falls within the scope of the deed.

Additionally, the district court commented on the goals of the Weeks Act and relied on various cases, including *Minard Run II*,[64] in holding that the seven-paragraph version of the Secretary's 1911 Rules does not preclude surface mining. And although the opinion did not comment on the 2008 Stone Letter, the decision impliedly vacated the federal government's unwarranted and summary assertion of federal stone ownership irrespective of deed provisions. The United States elected to not appeal the decision, which was undoubtedly a strategic choice to avoid adverse Third Circuit precedent on the stone issue. The PAPCO case marked another unexpected and significant defeat for the Forest Service.

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63 PAPCO v. U.S., 814 F. Supp. 2d 477 (W.D. Pa. Aug 30, 2011).

64 Although filed later, *Minard Run II* was decided before the *PAPCO* case.

[2] — The Calm Before the Storm — March to November 2008.

The relationship between oil and gas producers and the Forest Service remained uneasy and continued to be adversarial following the 2008 Appeals Decision. Delays imposed by the Forest Service in processing drilling notifications continued, and Forest Service personnel routinely confronted private oil and gas producers over a variety of issues, including the use of stone and tree clearing for well sites and access roads. Producers did not know what was occurring with respect to the implementation of the Appeal Decision instructions and the Forest Service's plan for apparently papering-over the substantive and procedural due process violations. The Washington Office Appeal decision provided little guidance in this regard, as it did not instruct the Regional Forester on how or when the Decision's instructions should be implemented.

Although the Forest Service was not forthcoming about how it intended to implement the 2008 Appeals Decision, POGAM subsequently learned, from an internal Forest Service e-mail exchange that occurred on October 9, 2008, that an ANF staff officer and an ANF staff legal advisor (not an OGC attorney) were discussing, if not contemplating, the use of a lawsuit "test case" to effect agency control over drilling. More specifically, they were discussing the prospect of "recreational stakeholders" suing the Forest Service based upon its failure to perform NEPA analyses for private oil and gas development.

As any Forest Service employee on the ANF was well aware, willing "stakeholders" were not in short supply. A few months earlier, in late May 2008, the Allegheny Defense Project (ADP), claiming that it had discovered NEPA being applied in other eastern region National Forests, sent a formal letter to Forest Service officials calling upon them to apply NEPA to private oil and gas development activities on the ANF.[65] POGAM also learned that on November 12 and 13, 2008 that the Forest Service Region 9 office convened

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65 "Turning up the Heat, the ADP cites drilling policies on other forest," *Warren Times Observer*, May 30, 2008.

and held a two-day workshop for Regional officials to address oil and gas exploration on Forest Service lands. Documents obtained from this workshop through a FOIA request revealed that private oil and gas development activity was negatively characterized and portrayed by the Forest Service as posing a major threat to Forest Service lands and its mission.[66]

§ 7.04. The Winter Offensive of 2009: An Assault on Three Fronts.

[1] — The Judicial Front — Rolling Out the NEPA Weapon.

The first Front in the execution of its War Plans — the Judicial Front — opened with a lawsuit of the type discussed in the internal Forest Service e-mail exchange that occurred in October 2008. A little over a month after that e-mail — on November 20, 2008 — a group of "recreational stakeholders" sued the Forest Service for failing to perform NEPA analyses in conjunction with private oil and gas development on the ANF. The group consisted of the Forest Service Employees for Environmental Ethics (FSEEE) — an organization that includes both active and retired Forest Service officials — the Sierra Club, and ADP. After learning of the FSEEE lawsuit, POGAM and AFA moved to intervene. Predictably, the intervention motion was vigorously opposed by the activist organizations. POGAM's request to participate in settlement discussions while the intervention motion was pending was likewise rebuffed.[67] As a result, and because of increasing hostility toward private oil and gas development in the ANF, POGAM filed a

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66 Statistics maintained by the Forest Service demonstrate that only a very modest amount of National Forest lands are devoted to oil and gas development. For example, in the ANF, which is the National Forest with the greatest amount of OGM development in the country, the reality is that less than two percent of its land following 150 years of OGM development activity have been converted to oil and gas leasing or production. *See supra* Note 6.

67 From entries in a Forest Service Privilege Log that accompanied the *Minard Run II* Administrative Record (compiled in June 2010), POGAM learned that a possible settlement of the FSEEE lawsuit was being proposed by the Forest Service Chief of Staff as early as December 17, 2008. Given the carefully planned, orchestrated, and comprehensive nature of the Forest Service campaign, it is not at all unlikely that "settlement" discussions preceded the filing of the lawsuit.

motion to expedite the decision on its intervention motion. POGAM's motion to intervene would not be decided until April 2009.

[2] — The Rulemaking Front — Self-Delegation of Rule-Making Authority.

In a matter of days after the *FSEEE* lawsuit was filed, the Second Front — the National Rulemaking Front — was opened. On November 6, 2008 the Forest Service published in the Federal Register a final rule effective on December 8, 2008 involving petty offense matters and, specifically, definitional changes to 36 C.F.R. § 261.2 so that the term "operating plan" as used in the context of mineral operations would clearly apply to a wide variety of documents used in the process of authorizing such operations. Ostensibly, this would allow the Forest Service to criminally cite mineral operators who violated any terms or conditions of approved operating plans.[68] The draft rule had been proposed in March 2007 and included the addition of six-words in a definitional addition which redefined or made the word "permit" as "provided for" in 36 C.F.R. § 251.15 to mean an "operating plan." Section 251.15 in its original form is the 1963 edition of the Secretary's Rules that are required to be expressly incorporated into and made part of any deeds or instruments of conveyance involving reserved mineral rights.[69]

Weeks later, on December 29, 2008, the Forest Service published an Advanced Notice of Proposed Rulemaking (ANPR).[70] By its terms, the ANPR applied to the ANF specifically, but also to National Forest System lands throughout the country. The ANPR, entitled "Management of National Forest System Surface Resources with Privately Held Mineral

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68 *See* 73 Fed. Reg. No 216, pages 65984-65999; RIN-0596-AC38 (November 6, 2008).

69 *See* 36 C.F.R. § 251.15 and the discussion *supra* at pages 12 through 14. It is important to note that this provision by its express terms must be incorporated into any deeds of acquisition to be applicable and effective at all and that it originally appeared or was adopted in 1963 – well after the deeds involved in acquisition of the ANF had been executed. Accordingly, 36 C.F.R. § 251.15 could only apply to deeds that were written after 1963. It is also notable that this definitional maneuver operated to retroactively modify the terms of the negotiated deed by revising the meaning of the word permit so that it could be used for the purpose of effecting control through the use of criminal sanctions.

70 *See* 73 Fed. Reg. 79,424 (December 29, 2008).

Estates," announced that the Forest Service was ". . . preparing to promulgate regulations to provide clarity and direction on the management of . . . surface resources when the mineral estate is privately held." It went on to declare that the Forest Service was fulfilling its "mandate" to publish regulations about ANF private oil and gas development notifications that were authorized in the 1992 Energy Policy Act.[71] Not surprisingly, the timing for fulfillment of this 1992 "mandate" coincided with the 2009 three-Front Forest Service Offensive.

[3] — The Administrative Front — Criminal Enforcement, Moratoriums and Make Believe.

The Administrative Front was perhaps the most effective of the three Avenues of Attack as the Forest Service, like any agency, has the upper hand in such initiatives unless and until a successful judicial challenge is mounted. This practical advantage allowed the Forest Service to implement unlawful measures in the short-term to the extreme hardship of the oil and gas industry.

[a] — Threats and Abuse of Criminal Process.

Only two days after the ANPR was published and about a month after the adoption of the new definitions and rules discussed above, Forest Service personnel working in the ANF cited a drilling company under the Forest Service's petty offense provisions for violating 36 C.F.R. § 261.10 pertaining to "Violation of Terms and Conditions of an Approved Operating Plan." The situation involved one of the 1911 Versions of the Secretary's Rules — not the 1963 Version. Accordingly, Forest Service law enforcement sought to have the new definition of "operating plan" applied and to treat the 1963 Version of the Secretary's Rules as a stand-alone regulation of general application to all reserved and outstanding mineral estates.

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71 *See* 30 U.S.C. § 226(o). The Forest Service was 17 years late in complying with its 90-day regulatory "mandate" in the Act.

The use of a criminal law enforcement action against this operator would appear to have been planned and coordinated by senior Forest Service leadership in concert with the planned Offensive.[72]

The Forest Service was now going out of its way to interpret and redefine terms in order to shoehorn lawful conduct into petty offenses. This appears to be particularly so with respect to the regulations appearing at 36 C.F.R. § 261.10 regarding "Occupancy and Use" of National Forest System lands. In addition to not requiring a *mens rea* element (unless specifically provided for), the occupancy and use offenses rely on very general terms or phrases to define prohibited conduct. These include phrases such as: ". . . conducting *any kind of work activity* . . . unless authorized;" violating *any term or condition of a special use authorization, contract or approved operating plan;*" and "failing to pay *any special use fee or other charge* as required" (emphases added). The prohibited conduct encompasses a vague, largely unspecified, and virtually limitless universe of activities, all of which are subject to becoming criminal in nature based on the broad discretion and biases of local Forest Service officials.

Moreover, the various legal relationships occasioned by the presence of private property, such as reserved mineral estates and private easements on acquired lands as in the ANF, are not addressed in the regulations. District Court Judge Kellison in the case of *United States v. McClure,*[73] identified part of the problem when he noted in dismissing a citation that the ". . . Forest Service oftentimes has difficulty in attempting to correspond an individual's alleged illegal activity with a specific Part 261 prohibition."[74]

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72 The revisions to 36 C.F.R. Part 261 in the November 6, 2008 Rule included the addition of a subsection (p) to 36 C.F.R. § 261.10 making "Use or occupancy of National Forest System land or facilities without an approved operating plan when such authorization is required" a criminal offense. There is ample evidence that the efforts were coordinated. For example, the Forest Service Privilege Log produced in *Minard Run II* revealed the existence of multiple e-mails between the Regional Office, the Washington Office, and legal counsel identified as "Discussion on rulemaking related to settlement options." In the author's opinion, absent a large-scale coordinated effort, national rulemaking has nothing to do with settling a particular case.

73 U.S. v. McClure, 364 F. Supp. 2d 1183 (E.D. Calif. 2005).

74 *Id*. at 1186.

Of even more concern, however, is the extent to which the Forest Service deliberately constructs and uses its petty offense provisions as it appears to have done in the 2008 rulemaking and on the ANF as a substitute for municipal jurisdiction over state lands. Essentially, and as it was attempted to be used in the ANF, it appears to be the Forest Service's means and method to effectuate a municipal police presence and extend its jurisdiction beyond permissible constitutional bounds.[75]

Another tactic that the Forest Service was employing was the threat of criminal prosecution for the offense of commencing private development activities before a proposed plan of operations was "approved." This differed from the offense of violating already "approved" terms and conditions. In the case of private oil and gas development where tree removal rights, among others, were reserved by deed, such approval took the form of one receiving a Notice to Proceed (NTP). Accordingly, if a private developer submitted written notice of a proposed development in accordance with the *Minard Run* framework, and then elected to proceed with the development after the 60-day period but without Forest Service "approval," this lawful exercise of private property rights would be viewed as a criminal offense by the Forest Service as soon as the first tree was cut.[76]

On January 16, 2009 — 16 days after the criminal citation was issued — the third Front was formally opened. In a hurriedly called meeting with oil and gas operators at the Forest Service ANF headquarters, the ANF Forest Supervisor distributed three letters, two of which were purportedly

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[75] On August 15, 2009 POGAM submitted a lengthy letter with supporting documentation to the U.S. Attorney's Office in Erie, PA, the U.S. Department of Justice, the U.S. Department of Agriculture Inspector General, and the Pennsylvania Office of Attorney General Public Corruption Unit explaining in detail the surface/subsurface ownership structure on the ANF and that a citation for failing to comply with a plan of operations is not an offense. Upon information and belief, neither the citation nor the threatened criminal sanctions have been pursued.

[76] In *Minard Run III,* the Third Circuit observed that the Forest Service had resorted to using threats of arrest and prosecution as a means of implementing its illegal regulatory scheme. *See Minard Run III,* 670 F.3d 236 at page 246.

prepared by the Regional Forester and one which the Supervisor evidently penned herself.

The first letter from the Regional Forester directed the initiation of a Supplemental Environmental Impact Statement (SEIS) process to satisfy the Instructions in the Chief's 2008 Appeals Decision from nearly a year earlier that had directed suspension of the 2007 OGM design criteria.[77] This letter, dated January 16, 2009, specifically directed the Supervisor to include the suspended design criteria as one of the alternatives to be included in the SEIS process.[78]

The second letter, also from the Regional Forester, directed that all private oil and gas development proposals pending as of January 1, 2009 and submitted thereafter were to be sent to the Regional Forester for "review" associated with pending litigation — although the exact litigation was not identified. Coupled with the new criminal enforcement regime, this letter effectively stopped all proposed oil and gas development pending legal "review."

The third letter of the trilogy, the ANF Forest Supervisor's letter, commenced a drilling ban. It informed operators that they would not be able to drill any new wells until the Regional Forester's "review" was "complete." As would be revealed, the Regional Forester's purported "review," with attendant drilling delays, was a subterfuge and tactic used on the Judicial Front in the overall campaign strategy. In addition to commencing the *de facto* drilling ban, the "review" was designed to facilitate settlement discussions in the *FSEEE* case while at the same time concealing from public scrutiny the primary purpose of the so-called "review."

As the terms of the illegal settlement agreement in the *FSEEE* case would soon demonstrate, the "review" was actually a selection process designed to pick a small number of drilling proposals that would be allowed to proceed

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77 The SEIS process was formally announced on February 27, 2009 (Federal Register, Vol. 4, No. 38, pages 8899-8900) with completion originally forecast for September 2009.

78 It came as no surprise to the oil and gas industry that this alternative – later dressed up and expanded to be more limiting, intrusive, and authoritarian – was the one proposed for implementation as the SEIS process unfolded in the fall of 2009.

while others would not.[79] To accomplish this, the agency actors, assisted now by attorneys from the DOJ, obviously decided to exclude oil and gas operators from taking part in the settlement discussions or any aspect of the *FSEEE* case. This exclusion, which would keep operators from learning that their property rights and livelihoods were being bargained away, was critical for Forest Service success on the Judicial Front and in the overall campaign to thwart private oil and gas development. After months of friendly negotiations between the Forest Service and the anti-development activists the district court predictably granted POGAM's intervention motion. Within one day of that, settlement negotiations promptly concluded and the settlement agreement was finalized and executed.

[b] — The Star Chamber.[80]

Particularly troubling were the "Star Chamber" proceedings conducted by the federal government. They occurred under the guise of the legal "review" announced on January 16. The "Star Chamber" here consisted of avowed opponents of oil and gas development activity, being both the Forest Service and the anti-development activists, selecting a small number of drilling projects that would be "permitted" to go forward. This selection process occurred through the application of secret criteria in secret meetings. Undertaking to make such decisions in a secret setting without any participation by the parties who are actually the object of the meetings is offense enough to the rule of law. It was compounded here by the disturbing fact that the decision makers knew full well their actions would likely cause

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79 For example, the *Minard Run II* Privilege Log records an e-mail entry from ANF Forest Service personnel to the OGC dated January 7, 2009 titled: ". . . Transmitting Oil, Gas, & Mineral (OGM) status summary regarding proposals that the ANF is currently reviewing and ones that are currently on-hold due to various reasons; responding to OGC request." The Privilege Log then identifies dozens of communications regarding the preparation and selection of "tables" of "pending" OGM projects to be used in settlement discussions.

80 The term "StarChamber" originated with the English court of Star Chamber created by King Henry VII in 1487 and refers to any secretive or arbitrary proceedings in opposition to personal rights and liberty.

businesses to fail, would seriously harm many individuals and families, and would result in significant hardship to local communities.

[c] — Deception and Double Speak.

We need not speculate whether Forest Service leaders believed their actions would cause considerable harm to the local community or oil and gas businesses. They told us that it would. On April 7, 2009, the district court granted POGAM's motion to intervene in the *FSEEE* case. Two days later, the DOJ filed a Stipulation of Dismissal, announcing that the parties had reached a settlement agreement. The very next day, ANF Supervisor Marten and the ANF's two District Rangers issued a joint public statement document that came to be known as the "Marten Statement."[81] Therein, the ANF leadership informed the public about the settlement agreement and a new and lengthy environmental study that would be conducted pursuant to NEPA, during which time all new oil and gas development proposals would be stayed (except certain already submitted projects that were "approved" in the agreement). In communicating this news, the three ANF leaders wrote:

> . . . we acknowledge the impact this will have on families and businesses, especially at a time when our nation is facing such a difficult economic downturn . . . . There is no easy explanation of why this is occurring. The honest answer from us is that we must follow our oath as public servants to uphold the laws, regulations, and policies that define our responsibilities as federal land managers . . . . For some this impact will be short-term and for others it may be a life time. For us it will undoubtedly last a life time to see and remember the consequences of these decisions (emphasis added).[82]

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81 As routinely referenced in the *Minard Run II-V* series of decisions, the April 10, 2009 Marten Statement consists of a three-page joint statement. In its first paragraph after stating that a stipulation of dismissal had been filed along with a settlement agreement, the statement asserts: "The settlement *resolves all matters related to the lawsuit* that was filed in November 2008. . . ." (emphasis added). However, as Judge McLaughlin's opinion of May 12, 2013 would later expressly note, the settlement resolved no substantive legal matters related to the *FSEEE* lawsuit. This assertion of the settlement having resolved all matters appears to be carefully drafted legal spin and propaganda.

82 On file with author.

After acknowledging that the Forest Service had for years operated through the use of environmental reviews for all proposals in the ANF and worked with operators to mitigate impacts, the authors go on to proclaim that: *"Recent litigation pushed this debate [regarding the possible application of NEPA to private oil and gas development proposals] to the forefront, and agency direction on how to go about meeting . . . key objectives has been clarified — we will not impede access to private property rights, we will fulfill our land management responsibilities, and we will do this via NEPA."*[83] They closed their introductory explanation with the following remark: "*Please know that we will continue to do what we believe is best for the land we manage, while trying to balance the various needs of the people and interests we serve locally, regionally, and nationally."*

No one from the Forest Service or DOJ asked about or had any idea whatsoever of the individual or business needs, plans, contract commitments, or expectations related to the drilling proposals over which they were passing judgment. As it happened, 54 proposals of a larger number of "pending" proposals (as unilaterally determined to be "pending" by the Forest Service) were chosen to survive the selection process. The de-selected proposals, which comprised some 440 wells located in certain recreational areas of concern to the Forest Service and their activist partners, were effectively banned for an indefinite period of time. In addition, all drilling projects that might be proposed were also subject to the ban. The 54 selected proposals represented operations of only 22 of the approximately 80 producers operating in the ANF.

To understand the legal tactics being employed, it is instructive to review the terms of the settlement agreement. Recall that the legal theory concocted by the Forest Service and the OGC was that the Forest Service possesses "reasonable regulatory authority" over privately owned minerals in the ANF. As a result, the Forest Service needed to "approve" oil and gas

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83 Giving the Forest Service officials the benefit of the doubt, the assurance that "we will not impede access to private property rights" serves as a classic example of what George Orwell coined "Doublethink," meaning that the authors held two contradictory beliefs simultaneously and accepted both of them.

development proposals, which approval was of course subject to NEPA processes. Because there was no legislation or legal precedent to support this theory, the settlement agreement served a quasi-legislative role by purporting to grant to the Forest Service the authority to regulate reserved and outstanding mineral estates acquired under the Weeks Act (or, for that matter, any land purchase enabling act involving separate ownership of the mineral estate) through an unusual, self-serving "recognizing" clause.[84] The clause stated: "RECOGNIZING that in the context of split estates the Forest Service has legal authority to establish reasonable conditions and mitigation measures to protect federal surface resources;" The agreement goes on to spell out the terms of the settlement, none of which would be lawful or even possible without the self-delegated regulatory authority

The practice of deception and hiding activity from the public and affected businesses is a recurring theme in the ANF story. Like the concealment of the last-minute changes to the draft 2007 ANF Forest Plan Revision (in which the Forest Service first asserted its new-found regulatory authority), and the concealment of the 2007 OGC Opinion (in which the Forest Service found legal authorization for its new found regulatory program) as a non-public "confidential" attorney work-product, the Forest Service — now aided by the DOJ — intentionally hid their illegal Recognizing Clause styled or brand of rulemaking. They hid it here under the cloak of attorney-client communications and confidential "settlement" negotiations.[85] This latter

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84 The *Minard Run II* Privilege Log reports extensive and close participation by the OGC with all policy and legal aspects of the settlement discussions and agreements. For example, an entry dated March 3, 2009 records an e-mail communication from the ANF Forest Supervisor to OGC, the Regional Office Legal Counsel, the Regional Forester and the Deputy Regional Forester titled "discussing strategy for moving forward with implementation of settlement, seeking OGC concurrence with strategy."

85 For example, the 300 document *Minard Run II* Privilege Log asserts a "Prepared for Settlement Discussion" privilege for many documents even though the privilege most closely resembling this is called the "settlement negotiation privilege" and it is, in any event, not recognized in the Third Circuit. The circumstances surrounding the settlement in the *FSEEE/Minard Run II* cases are ample cause by themselves for not recognizing such a privilege as it would provide a means by which government actors can conceal or mask their illegal case settlement activities of the type experienced with the ANF litigation. The Privilege Log provided on June 28, 2010 covered the period from November 17, 2008 to

concealment occurred under the guise of a judicial "dispute" where all of the parties conveniently had the same goal. Fortunately, while the settling parties expected a standard court order accompanying the dismissal of the lawsuit (so they could claim the court had tacitly approved the terms of the settlement agreement), POGAM's intervention prevented this from occurring.

[4] — The Offensive Begins to Meet Resistance.

Throughout the initial stages of the 2009 campaign, the government controlled nearly all aspects of the Offensive. On the Judicial Front, however, the strategic plan began to encounter obstacles. The first problem came in the form of the District Court's April 7, 2009 grant of POGAM's motion to intervene. The result was a hurried flurry of activity, including the immediate execution of the settlement agreement and the filing of the Stipulation of Dismissal. This was followed by the revealing ruminations in the Marten Statement. POGAM objected to the dismissal and, following briefing, a hearing, and a one-month delay, the court issued a memorandum opinion (on May 12, 2009) allowing the dismissal. In doing so, however, the court noted that the dismissal expressed no opinion on the underlying dispute and in "no way foreclosed" POGAM from bringing a subsequent lawsuit challenging the legality of the settlement agreement.[86] The stage was now set for *Minard Run II*.

May 12, 2008. It lists almost 300 separate communications regarding the FSEEE case to include implementation of the settlement agreement. Needless to say, the Forest Service and DOJ asserted multiple grounds for withholding the listed documents from public view in the Administrative Record.

86 Specifically, Judge McLaughlin stated: "There is no impediment . . . to challenge the settlement agreement as an allegedly unlawful exercise of Forest Service's discretion in a subsequent lawsuit. The legal claims or contentions of the Intervenor-Defendants are in no way foreclosed by allowing dismissal of this action." In the conclusion he added "the court expresses no opinion whatsoever on the merits of the underlying dispute." *See* Forest Service Employees for Environmental Ethics v. USFS ("FSEEE v. USFS"), No. 1:08-cv-00323-SJM (W.D. Pa. filed Nov. 20, 2008).

[5] — Illegal Maneuvers to Block Oil and Gas Development Outside the ANF.

Before turning to *Minard Run II*, It bears particular mention that the *FSEEE* settlement agreement was not, during this timeframe, the only example of the Forest Service employing illegal maneuvers, based on the application of NEPA, to block oil and gas development on National Forest lands. A similar situation, coincident in time with the agency's ANF control efforts, arose in Wyoming in *Western Energy Alliance v. Salazar*.[87] In that case both the Secretary of the Interior and the Chief of the Forest Service did what the court called a complete "about face" in their re-interpretation of their agencies' previous (2005) guidance documents regarding application of NEPA to Section 390 Categorical Exclusions (CXs) for oil and gas leasing on National Forest lands. Unlike the original guidance, which provided that certain small-scale oil and gas development projects on federal lands would not be subject to special screening and lengthy NEPA processing, the new agency guidance (*i.e.*, a June 9, 2010 Forest Service letter and a May 17, 2010 BLM instruction memorandum) stated that the agencies would apply NEPA to such projects going forward. The court vacated and enjoined implementation of the guidance documents.

The policy changes concerning Section 390 (CXs) in the May and June 2010 guidance documents at issue in *Western Energy Alliance*, and the April-May 2010 changes in NEPA policy in the ANF, do not appear to be merely coincidental. To the contrary, Forest Service management appears to have clearly decided to target oil and gas development, and further decided to use NEPA as the weapon of choice. Particularly disturbing about these illegal initiatives is how comprehensively they attack oil and gas development on National Forest lands and that policy changes and execution of the illegal means to accomplish them were obviously coordinated between federal agencies.

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87 Western Energy Alliance v. Salazar, No. 10-CV-237F, U.S. Dist. Ct., Wyoming (Aug. 12, 2011) (41 ELR 20264).

Specifically, all development of private estates under National Forest lands would be brought to heel under the *FSEEE* case and the December 28, 2008 rulemaking, and all small scale development projects of public oil and gas lands currently leased by the Department of the Interior would be blocked by applying NEPA to Section 390 projects. All other federal oil and gas leasing was already subject to NEPA requirements, so the result was that all oil and gas development on federal lands, whether the mineral rights were publicly or privately owned, would now be subject to application of full blown and debilitating or fatal NEPA treatment for any proposed projects.

[6] — Rolling Out the ANF Moratorium.

The orchestrated presentation of the *FSEEE* "settlement agreement" between April 10 and 15, 2009 speaks to the extensive planning behind the 2009 multi-front Offensive and the significance that was assigned to the settlement by the Forest Service. A dizzying blitz of press releases, public meeting announcements,[88] carefully crafted implementation letters,[89] and personal telephone calls to municipal and state political leaders by Forest Service officials heralded the arrival of the "settlement" and the conclusion of the Regional Forester's "review" process. Nothing like it had ever been seen before within the ANF region. Along with the ongoing SEIS process to remedy due process and NEPA violations of the 2007 ANF Forest Plan, replete with its own set of public meetings (three of which were held in late April 2009), the Forest Service embarked or folded-in a new Transition Environmental Impact Statement (TEIS) process. This was replete with its own bewildering set of public meetings and instructions. All of this was unveiled in conjunction with the announcement of the "settlement." The amount of planning and coordination required to implement these various actions again demonstrates that the "settlement" was merely part of a much

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88 The 10 April Marten Statement included meeting announcements for three public meetings (13, 14, and 15 April) pertaining to the drilling ban or TEIS process, and three public meetings (27, 28, and 29 April) pertaining to the SEIS process. At these meetings, which were not held on any federal or U.S. Forest Service property, uniformed Forest Service law enforcement personnel were in attendance.

89 *See* Note 84 *infra*.

larger agency initiative which was using the ANF as the launching pad or "ground zero."

[7] — The "Oil and Gas Strike Team" and a Militant Mindset.

Interlaced with all the meetings and announcements in the spring of 2009 was a telling piece of evidence that surfaced in the *Minard Run II* Administrative Record. In a letter dated May 6, 2009 written by the Region 9 Regional Forester, the Regional Forester referred to an agreement entered into on April 22, 2009 between the Regional Forester and the ANF Forest Supervisor. The agreement was to organize an *"Allegheny Oil and Gas Strike Team"("*Strike Team*")*.[90] The primary mission of the Strike Team was to assist ANF Forest Service personnel in preparing the Draft SEIS to support the stringent OGM provisions of the 2007 ANF Forest Plan (in light of Forest Service's newly found "reasonable regulatory authority"). Eight team members were identified in the letter. And as the term "Strike Team" connotes, there is no mistaking its purpose and the militaristic or authoritarian mindset of the Forest Service leadership. Alarmingly, this leadership team found the group name chosen and idea of forming it at all perfectly acceptable.[91]

[8] — The Transitional Environmental Impact Statement Blockade.

The so-called TEIS process was designed to impose a drilling moratorium for at least several years. Ostensibly, the process was initiated with a Forest Service information solicitation letter dated April 10, 2009 from the ANF Forest Supervisor to private oil and gas producers operating in the ANF.[92] The letter "requested" drilling proposal information from all

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90 AR012400; 2009_0506_RO_memo_oil_and_gas_team. Pdf; File Code 1920/2830.

91 In response to a written May 30, 2014 request by PIOGA that the "Strike Team" be dissolved the Deputy Chief of the National Forest System confirmed by letter dated August 12, 2014 that ". . . the Regional Office team identified to assist with the SEIS process no longer exists."

92 The TEIS was formally announced on June 22, 2009 by way of a Notice of Intent to prepare an environmental impact study published in the Federal Register (Vol. 74, No. 118,

operators for the next three-year period. If a producer failed to respond to the letter by the prescribed date (May 8, 2009), any of that producer's drilling proposals would be set aside and not considered until after the TEIS process was completed. In this fashion a penalty or "disadvantage" was inserted into the information solicitation.[93] The letter, which was dated the same day as the Marten Statement, was sent to all private oil and gas producers operating in the ANF. With the limited exception of the 54 proposals selected to go forward through the Star Chamber process, the TEIS was the administrative device designed to extend the forest-wide *de facto* drilling ban on any new drilling which began in January 2009 with the initiation of the "review" process. As it had done with other tactics, the Forest Service was again attempting to cloak its illegal activities with the appearance of legitimacy. The NEPA weapon, bootstrapped into existence by the Forest Service's self-delegation of regulatory authority in the 2007 ANF Forest Plan, the 2007 OGC legal opinion, and now the *FSEEE* settlement agreement, would prevent new private oil and gas development for years to come and likely destroy most of the oil and gas industry operating in the ANF.

Among the many meetings called by the Forest Service in April 2009 is an important one that requires mention. It was held on April 28, 2009 at the Warren, Pennsylvania Public Library and was the first non-public face-

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pages 29463-29464), with an "expected" completion date in April 2010. The announcement made it clear that the TEIS process was related to the SEIS process and the new, restrictive OGM design criteria in the 2007 ANF Forest Plan. The announcement stated: "For purposes of scoping, this proposed action will be consistent with standards and guidelines in the 2007 Forest Plan Supplement Environmental Impact Statement proposed action" (Notice of Intent, at 29464). In short, the new standards and guidelines allegedly "suspended" by the 2008 Forest Plan Appeals Decision were now being unsuspended and applied in the TEIS process.

93 A DOJ trial attorney would later acknowledge during oral argument in *Minard Run II* that the April 10 solicitation letter was unauthorized for failing to comply with the Paperwork Reduction Act, 44 U.S.C. § 3501, *et seq*. The Act requires federal agency information requests to be approved by the Office of Management and Budget (OMB). The failure of federal agencies to obtain approval renders all such requests illegal and allows the solicited parties to raise and assert all defenses and entitlements otherwise available in any judicial or administrative setting in objection to the imposition of any penalty or "disadvantage" posed or incurred because of the unlawful solicitation or demand.

to-face meeting of private oil and gas operators and ANF Forest Service personnel since the *FSEEE* settlement agreement was announced. It was a non-scripted meeting. The meeting was called by the ANF Forest Supervisor for the stated purpose of explaining the TEIS process and what was expected of operators. Thirteen operators attended the meeting, along with the two ANF District Rangers and two local ANF Forest Service staff officers. The Forest Supervisor did not attend.

The two main points of information presented by the Forest Service attendees were that: 1) a lengthy TEIS process was being put in place to evaluate the effects of private oil and gas development in the ANF, and 2) with the exception of the "selected" oil and gas development projects authorized in the settlement agreement, the Forest Service would not permit any new private oil and gas development to occur in the ANF until the TEIS process was completed. Despite the draconian effect that a *de facto* drilling ban would have on most operators, it was readily apparent that the TEIS process had not been thought out. No written materials were provided to the operators, and numerous questions about how the process would be managed and what exactly was being sought in the April 10 solicitation letter could not be answered by the Forest Service personnel in attendance. It was evident that the rules governing the TEIS process and exactly what was going to occur were going to be made up as the process unfolded.

It was also apparent at the April 28 meeting that the Forest Service participants had no real knowledge of the financial and operational aspects of the oil and gas business. If they did, they were, in any event, indifferent to the impact of their actions on the businesses. Several operators clearly expressed frustration with what was occurring and it was pointed out that the *FSEEE* case was not yet final. Two comments in response — one by a District Ranger and the other by a staff officer — captured the prevailing Forest Service attitude. The District Ranger, suggesting that resistance is futile, stated that the Forest Service "wins 93 percent of its cases." What is revealing about this remark is that the Forest Service *settled* the *FSEEE* case. On its face, a "win" in *FSEEE* would have meant defeating the plaintiff activists rather than agreeing to their demands (and paying their legal fees). The District Ranger viewed the *FSEEE* settlement as a "win," thereby confirming the sweetheart

nature of the settlement. The second comment, made by a staff officer, was that "there is a new administration now" (referring to the President Obama administration). This revealed that the Forest Service's anti-drilling behavior was if not expressly supported at the highest levels in Washington, certainly perceived to be, thereby emboldening ANF personnel. Due to confusion and uncertainty about the April 10 solicitation letter that was expressed at the meeting, and as a result of urging from the operators, the District Ranger in charge of the TEIS process agreed to a one-week delay for submission of future drilling plans (thereby postponing the submission deadline until May 15, 2009.

On May 1, 2009 the Pennsylvania House of Representatives Republican Policy Committee convened a hearing in Warren, Pennsylvania to take testimony related to the *FSEEE* case and the ensuing drilling ban. U. S. Congressman Glenn Thompson,[94] along with Pennsylvania State House Representative Kathy Rapp, Warren County Commissioner, John Bortz, business leaders, and POGAM representatives, offered testimony highly critical of the Forest Service and the "sweetheart" settlement agreement. The hearing helped to galvanize industry and community opposition to the drilling ban and to encourage operator resistance.[95]

Building on the momentum of the May 1st hearing, letters were sent on or about May 12th, 2009 by all of the large private oil and gas producers and nearly all of the smaller producers to the ANF Forest Supervisor. These letters, whose content had been coordinated among the participating

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94 Congressman Thompson, first elected in 2008, represents Pennsylvania's 5th Congressional District which includes all of the ANF. He also serves as a member of the House Committee on Natural Resources and the House Committee on Agriculture. Within the Agriculture Committee he serves as the Chairman of the Conservation, Energy, and Forestry Subcommittee. His Subcommittee oversees the U.S. Forest Service. Representative Rapp represents Pennsylvania's 38th District and, among other committee memberships, is a member of the Pennsylvania House Committee on Energy and Natural Resources.

95 In August 2009, a 4,000-signature petition circulated by POGAM and signed by citizens from Pennsylvania and southern New York protesting the Forest Service's moratorium was sent to President Obama and the Council on Environmental Quality. No response was received and receipt of the petition was never acknowledged by either the President or the Council.

operators, informed her that the operators declined to submit information in response to her April 10th solicitation letter. As explained in the producers' letters, the solicitation was unlawful in a variety of particulars. These response letters marked another set-back or obstacle — widespread and organized resistance — that the Forest Service likely did not expect to encounter at this stage in their Offensive.

As noted, the first set-back came in the form of the district court's grant of intervention in the *FSEEE* case. In reaction and in order to prevent POGAM from being able to influence such discussions, the Forest Service abruptly ended the case and commenced rolling out the Marten Statement and laying the groundwork for the TEIS Blockade. The "Strike Team" was formed to shore up the restrictive OGM design criteria in the 2007 ANF Forest Plan, and by June 2009 the SEIS maneuver designed to paper over due process violations was well underway. However, when the district court dismissed the *FSEEE* case over POGAM's objection on May 12, 2009 (due to the restricted nature of intervenor status), the accompanying opinion signaled the court's willingness to review the merits in a separate lawsuit challenging the *FSEEE* settlement agreement. Consequently, POGAM, joined by Minard Run Oil Company, Allegheny Forest Alliance, and the County of Warren, commenced the *Minard Run II* lawsuit on June 2, 2009 and promptly filed for a preliminary injunction to end the *de facto* drilling ban. A three-day hearing was held at the federal courthouse in Erie in August 2009, during which about a dozen witnesses provided essentially unchallenged testimony concerning the substantial and irreparable harm being caused by the Forest Service-activist agreed ban on drilling.

[9] — The SEIS Rubber-Stamp.

During the spring and summer of 2009, the Forest Service was busily working behind the scenes to shore up advances it had made. A draft SEIS document ("DSEIS") dated in July 2009, but not published until early August 2009, was comprised of over 300 pages of detailed text and supporting appendices. As expected, the DSEIS proposed the adoption of new and exacting design criteria that were basically the same (but in some cases even more restrictive) than the design criteria illegally inserted into the

2007 ANF Forest Plan. Appendix C of the DSEIS, entitled "Reserved and Outstanding Oil and Gas Development On the Allegheny National Forest," purported to provide "background" information but was simply another draft of the legal argument to support the existence of "reasonable regulatory authority" as first articulated in the 2007 OGC Opinion. It was intended to implement the Forest Service's new-found regulatory authority and replace the corresponding Appendix F in the 2007 ANF Forest Plan.

In the introductory paragraphs of Appendix C, the Forest Service asserts the purpose of the Appendix as "clarifying roles and responsibilities of operators and the Forest Service." In addition to presenting the 2007 Design Criteria as the "preferred alternative," meaning the alternative selected to be adopted, (surprise), the implementation section of the DSEIS contained an alarming statement. It stated that: "*If circumstances warrant, on a case-specific-basis, an authorization to the pvt OGD to operate may contain terms and conditions different from the standards set forth by the design criteria*"[96] (emphasis added). In other words, the Forest Service was now granting itself authority to make up any rules it wanted as long as "circumstances warrant." This included disregarding the very design criteria or Standards and Guidelines being established in the DSEIS document.

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[96] The section goes on to state: *"A formal authorization to operate will be issued by the appropriate Forest Service line officer and will contain terms and conditions enforceable against the pvt OGD.*" Basically, in this passage the Forest Service simply grants itself unrestrained authority and advises its functionaries that they may proceed as they like in disregard to established rules or design criteria. We were warned about this 70 years ago. "*To say that in a planned society the Rule of Law cannot hold is, therefore, not to say that the actions of the government will not be legal or that such a society will necessarily be lawless. It means only that the use of government's coercive powers will no longer be limited and determined by pre-established rules. . . . If the law says that such a board or authority may do what it pleases, anything that board or authority does is legal – but its actions are certainly not subject to the Rule of Law. By giving the government unlimited powers, the most arbitrary rule can be made legal; and in this way a democracy may set up the most complete despotism imaginable." See The Road to Serfdom, Text and Documents, The Definitive Edition (*The Collected Works of F.A. Hayek), The University of Chicago Press, copyright 1944 by University of Chicago Press, pages 119 and 120. This quote comes from Hayek's classic and timeless work warning against state control over the means of production as well as the consequences of government's instinct for central planning. It is based on his scholarly examination of the rise of the European totalitarian states in the 1920s and 1930s.

Again, we see another example of disregard for the law and institutional lawlessness concealed in an outwardly legitimate document. Moreover, such an authorization was completely contrary to the purpose of "clarifying" roles and responsibilities and exposed that word for the deceit that it represented. The make-it-up-as-you-go formula clarified nothing and would have served to undermine certainty about what Standards and Guidelines would actually apply in the ANF.

[10] — The Offensive Comes to a Halt.

The Forest Service's advance to seize the ANF oil fields of Northwest Pennsylvania met a fate similar, figuratively, to that of the German 6th Army when it was stopped at Stalingrad in December 1942 as part of the effort to seize the Soviet oil fields in the Caucasus. On December 15, 2009, the district court announced the much anticipated decision in *Minard Run II*. The court agreed with private oil and gas developers in every material respect. In substance, the court held that private drilling projects in the ANF were not "federal actions" triggering the application of the NEPA[97] and private drilling activity on private mineral estates therefore could not be delayed for the purpose of satisfying NEPA requirements. Further, the court held that the Forest Service had no authority under the Weeks Act[98] to regulate privately owned mineral estates with post-acquisition regulations. With respect to reserved rights, the Forest Service's regulatory authority is limited to the terms of the deeds under which the United States acquired the ANF in the 1920s and 1930s.[99] With respect to outstanding rights, the Forest Service possesses only the same common law rights as non-government surface owners. And despite the Forest Service's claim that there was no "final agency action" subject to being challenged, the court concluded that the *FSEEE* settlement agreement and its implementing directive represented

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97 The National Environmental Policy Act of 1970, 42 U.S.C. §4321, *et seq.*

98 Pub. L. No. 61-435, 36 Stat. 961 (codified as amended at 16 U.S.C. §§ 480, 500, 513-519, 521, 563 (2006).

99 On January 12, 2010 the Forest Service filed a Motion for Reconsideration or in the Alternative to Alter or Amend Judgment of the December 15, 2009 decision. A hearing was held on March 9, 2010, and the Motion was denied.

a "sea change" in Forest Service policies and the manner in which it had interacted with private operators. As a result, the Court enjoined the illegal *FSEEE* settlement agreement and lifted a year-long *de facto* drilling ban imposed by the Forest Service in January 2009.

The defeat suffered in *Minard Run II* stymied and disrupted the Forest Service's Offensive along all three Fronts and at every point of engagement with oil and gas owners. The district court's broad and clear declaration that *". . . the Forest Service does not possess the regulatory authority that it asserts relative to the processing of oil and gas drilling proposals"*[100] (emphasis added) arrived at a crucial time.

As the ANF Forest Supervisor would later disclose, the Regional Forester and the ANF Forest Supervisor were within days of approving and implementing the new ANF OGM design criteria that were being rubber-stamped through the corrupted SEIS process. Recall that this DSEIS action was directed in the February 15, 2008 Appeals Decision and put in motion on January 16, 2009 in a letter sent by the Regional Forester to operators and ANF personnel. Recall as well that the redrafting of the restrictive design criteria was accomplished with the help of the "Strike Team" formed in April 2009 and was presented as the "preferred alternative" in the DSEIS.

The development of the DSEIS had paralleled the development of the TEIS throughout the summer and fall of 2009 until the district court's grant of injunctive relief on December 15. At this time, POGAM promptly sent a letter, in the form of a supplemental DSEIS public comment, informing the ANF Forest Supervisor and Regional Forester that any efforts to proceed with the SEIS process, or implementation of the design criteria or further implementation of the TEIS would be viewed as being in contempt of the injunction. Work on these documents came to a halt, but it would not be until another four years had passed that their fate was finally resolved. That would occur in the spring of 2014.

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[100] *See* Minard Run Oil Co. v. U.S. Forest Serv., No. 09-125, 2009 WL 4937785 (W.D. Pa. Dec. 15, 2009) ("*Minard Run II*") at page 46.

In response to a written May 30, 2014 request by PIOGA the Deputy Chief of the Forest Service confirmed by letter dated August 12, 2014 that the ANF SEIS project was cancelled. That cancellation occurred in the spring of 2014. The TEIS project was not mentioned in the Deputy Chief's letter, but it too was noted as cancelled on the ANF Schedule of Proposed Actions (SOPA). Until these ANF SOPA cancellation notices appeared in July 2014, the projects were classified in the ANF SOPA as "On-Hold.[101]

§ 7.05. The Immediate Aftermath of *Minard Run II*.

The year 2010 began with a well-attended producer-Forest Service meeting on January 6 in North Warren, Pennsylvania. The Forest Service called the meeting to explain how, in light of the preliminary injunction, it was now going to unravel the mess it had created and deal with all of the backlogged drilling proposals. Promising to work diligently, the Forest Service dictated a six-step process that would be implemented through the coordinated efforts of four separate ANF teams.[102] The pending and backlogged proposals were broken into four groups: 1) small packages identifed in the former TEIS process — 97 wells; 2) large packages identified in the former TEIS process — 523 wells; 3) new proposals — 152 wells; and 4) on-hold proposals — 1,619 wells.[103] The priority as far as the Forest Service was concerned, and absent a producer informing them otherwise, was going to be given to the small TEIS packages, followed by the large TEIS packages, and then by new proposals. Again, the creation of the lists and their prioritization (which favored proposals "approved" by the Forest Service in the presumptively illegal *FSEEE* settlement agreement) was done

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101 Their status and the accompanying documentation can be viewed on the ANF website under the Projects heading.

102 The six-step process was: 1) *Minard Run* notice information is provided to the Forest Service; 2) Team A conducts an environmental review; 3) Team B works with producers to negotiate surface issues, such as the layout of wells; 4) Team C marks timber to be cut; 5) Team D appraises the marked timber and deals with road use permits; and 6) Notices to Proceed and other paperwork are finalized after timber payments are received.

103 "On-hold" proposals were proposals that were either being withdrawn or reconsidered by producers, or were being questioned by the Forest Service as not having been a genuine or valid submission in the first instance.

without any participation by aggrieved parties or any attempt by the Forest Service to consult them.

At the January 6 meeting the ANF Forest Supervisor also informed producers that the pending well packages would be reviewed by ANF personnel using the "Preferred Alternative" design criteria of the DSEIS that was published in July 2009. There were several problems with this. First, as noted above, the DSEIS design criteria were primarily comprised of the 2007 Design Criteria that were allegedly "suspended" by the February 2008 Plan Appeals decision. Second, the *Forest Plan* case had not been decided, so ANF personnel lacked the authority to "un-suspend" or act upon the 2007 Design Criteria. Third, the Forest Service had assured the court in *Minard Run II* that the 2007 Design Criteria were indeed "suspended," so the announcement that they would be used was contrary to this assurance. The clear import of the meeting was that, although the Forest Service lacked self-appointed "regulatory authority," it was going to process drilling proposals methodically and in a manner and pace of its own choosing. In short, the Forest Service either did not understand the *Minard Run II* legal rulings or intended to defy some of them.

On January 12, 2010 the Forest Service filed a Motion for Reconsideration of the *Minard Run II* decision, clearly indicating that it had by no means accepted the tenets of the decision. Three days later, based in part on what transpired at the January 6 meeting, POGAM filed a Motion for Sanctions against the Forest Service in the *Forest Plan* case based primarily on the ANF Forest Supervisor's report that the Forest Service had been applying supposedly "suspended" 2007 design criteria when reviewing drilling proposals.

On January 27, 2010 POGAM held a well-attended meeting at the Holiday Inn in Warren, Pennsylvania for oil and gas producers in order to discuss the *Minard Run II* decision and identify unresolved issues. Producers discussed the Forest Service response to the injunction as well as pending concerns. These included: 1) the Forest Service demanding Road Use permits and charging fees[104] and maintenance charges for road usage; 2) the Forest

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[104] Paragraph VI. B. of the standard Forest Service Road Use Permit (RUP) (Form # FS-7700-41(12/06) OMB 0596-0016, states that: "This permit is subject to all valid outstanding rights." In the context of the *Minard Run II* litigation as well as in general this provision

Service demanding that producers sign timber contracts as though they were commercial loggers; 3) the Forest Service demanding that producers attend pre-construction meetings in the ANF; and 4) the Forest Service demanding information in conjunction with well development notifications that exceeded the scope of the *Minard Run* framework.

[1] — Settling-in Under *Minard Run II*.

The initial reaction of the Forest Service personnel to the district court's 2009 decision in *Minard Run II* appeared to be that of disbelief. After all, the Forest Service wins 93 percent of its cases. After the district court denied the Forest Service's Motion for Reconsideration in *Minard Run II* on March 9, 2010, the Forest Service and the activist defendants filed separate appeals to the United States Third Circuit Court of Appeals. Apparently believing that the circuit court would reverse the district court, the Forest Service objective now appeared to be that of engaging in foot-dragging until the appeal was decided.

The Forest Service was processing drilling proposals, but doing so rather slowly (much longer than the historical 60-day practice under the *Minard Run* framework). This slow pace did not improve from the spring of 2010 through the summer of 2011. During this time, the Forest Service appeared to view its Offensive as being delayed, not defeated, and it appeared to be of a mind that it would bide its time until the district court decision was reversed and the full-fledged attack could recommence. It would not be until the late-fall of 2011, when the circuit court affirmed the district court decision "in all respects," that the Forest Service shifted to a defensive posture in managing what was left of the litigation.

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would also subject the permit to reserved rights. Rights of ingress and egress (easements) are either expressly or impliedly reserved in the acquisition deeds and Secretary's Rules do not condition the use of these easements. Under Pennsylvania law there is a common law duty to contribute to the maintenance of roads owned by a surface owner but used by a subsurface owner with rights of ingress and egress. A surface owner cannot unilaterally prescribe road maintenance charges.

[2] — The Current Status of the *Minard Run II* Litigation.

As noted above, separate appeals from the *Minard Run II* decision were filed by the Forest Service and the activist defendants. In July 2011, while the appeal decision was pending, PIOGA initiated a contempt action against the Forest Service. This was brought about in response to: 1) a June 2011 written directive by the ANF Forest Supervisor claiming federal ownership of private deeded groundwater rights;[105] and 2) growing and unexplained delays in processing drilling notifications. Although the motion was ultimately denied, it nonetheless forced the Forest Service to withdraw its unlawful water ownership letter/directive, and the district court made clear that the Forest Service was not entitled to delay the processing of drilling notifications and should ideally conclude accommodation discussions within the *Minard Run* 60-day notice period:

> We have previously cautioned that forbearance on the part of mineral owners beyond the initial 60 day period, while not legally required, may be practically advisable in order to exercise "due regard" for the Forest Service's estate. We also stress, however, that the Forest Service's processing of drilling proposals consistent with the *Minard Run* paradigm and our directive in *Minard Run II* should not be viewed by the Forest Service as merely an aspirational goal. It is required. Unreasonable delay by the Forest Service beyond the 60 day period increases the likelihood that mineral owners will simply choose, as would be their right, to commence drilling activities prior to completion of the interactive process. As a result, in the absence of filing its own lawsuit, the Forest Service could lose its ability, with respect to any given well package, to supply meaningful input

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105 *See* Minard Run Oil Co. v. U.S. Forest Service, No. 09-125-Erie, 2012 WL 994641 (W.D. Pa. March 23, 2012). The Supervisor's letter/directive to an operator explained that the Forest Service did not recognize the express reservation of water use rights contained in the mineral estate deed under which the operator was preparing to drill water wells in developing natural gas. The letter/directive effectively claimed federal ownership of all surface and groundwater on the ANF. In October 2011, and in anticipation of a scheduled two-day evidentiary hearing, the United States withdrew the letter/directive and argued that doing so had purged any contempt and rendered PIOGA's request for relief moot.

concerning issues it considers important to preserving the integrity of its servient estate. As has always been the case, the successful resolution of drilling-related disputes on an informal basis and the avoidance of future litigation depend on the good faith and cooperative efforts of both parties.[106]

On September 20, 2011 the United States Third Circuit Court of Appeals entered a "precedential" decision affirming *Minard Run II* "in all respects." The activist defendants' subsequent Motion for Rehearing *en banc* was summarily denied. The landmark Circuit Court decision, referred to as *Minard Run III*, became then the centerpiece decision for resolving several federal lawsuits that had been filed against the Forest Service between November of 2007 and July of 2009.[107]

Approximately one year after *Minard Run III* was decided, the district court entered a final judgment on remand. The decision, referred to as *Minard Run IV*,[108] addressed and dismissed some new and belated arguments by the activist defendants, and essentially mirrored the district court's decision in *Minard Run II* and the circuit court's decision in *Minard Run III*. More specifically, the district court reaffirmed that the Forest Service does not possess "reasonable regulatory authority" over private OGM rights in the

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106 *See* Minard Run Oil Co. v. U.S. Forest Service, No. 09-125-Erie, 2012 WL 994641 (W.D. Pa. March 23, 2012) at pages 13-14.

107 The seven related cases include Forest Service Employees for Environmental Ethics v. U.S. Forest Service (FSEEE), No. 1:08-cv-00323-SJM (W.D. Pa. filed Nov. 20, 2008) (settlement agreement enjoined and voided by Minard Run II and IV); Duhring Resource Co. v. U.S. Forest Service, No. 1:07-cv-314-GLL (W.D. Pa. filed Nov. 8, 2007) (stayed); Pennsylvania Oil and Gas Ass'n v. U.S. Forest Service, No. 1:08-cv-00162-SJM (W.D. Pa. filed May 27, 2008) (dismissed without prejudice on case or controversy grounds and subject to reopening by Plaintiffs, 2014 U.S. Dist. LEXIS 21601 (W.D. Pa., Feb. 21, 2014)); Catalyst Energy Inc. v. U.S. Forest Service, No. 1:09-cv-00070 (W.D. Pa. filed March 27, 2009) (dismissed on March 9, 2010 upon advisement that the parties reached a settlement); Seneca Resources Corp. v. U.S. Forest Service, No. 1:09-cv-00154-SJM (W.D. Pa. filed June 24, 2009) (summary judgment granted for Plaintiff by memorandum opinion on 3/19/2013 in Document 52 of the filings); PAPCO v. U.S. Forest Service, No. , (W.D. Pa. filed Sept. 8, 2008) (summary judgment granted for Plaintiff, 814 F.Supp.2d 477 (W.D. Pa. Aug 30, 2011)).

108 *See* Minard Run Oil Co. v. U.S. Forest Service, 894 F. Supp. 2d 642 (W.D. Pa. 2012) *("Minard Run IV")*.

ANF, and the Forest Service's insistence on issuance of a Notice to Proceed under the 60-day *Minard Run* framework does not constitute a "federal action" triggering NEPA. As a result, the *FSEEE* settlement agreement was voided. This decision was not appealed by the Forest Service, but was appealed by the Sierra Club and ADP (*FSEEE* did not participate).

A year later in 2013, the circuit court upheld the district court's *Minard Run IV* decision. In a 10-page unpublished opinion (*Minard Run V*),[109] a new circuit court panel expressly reaffirmed the circuit court's original interpretation of the Weeks Act in *Minard Run III*, noting that the court had reached the merits in *Minard Run III* and had "decisively resolved the legal claims. . . ." On December 27, 2013 the activist defendants' Motion for Rehearing *en banc* was denied in a unanimous order in which 12 circuit court judges joined. A request for *certiorari* to the U.S. Supreme Court was not filed, and *Minard Run II-V* became final.

Finally as the closing act in the litigation, and as a result of PIOGA's claim, which was presented in the form of a motion, in April 2014 the federal defendants/DOJ agreed to an out-of-court settlement for a $530,000 award of PIOGA attorney fees and expenses under the Equal Access to Justice Act.[110]

[3] — Activity and Interest within the U.S. House of Representatives.

The U.S. House of Representatives was paying attention to what was occurring on the ANF and within the Forest Service following the district court's decision in *Minard Run II*. The advent of the shale gas revolution and its transformative potential for the country had focused the nation's attention on

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109 *See* Minard Run Oil Co. v. U. S. Forest Service, No. 12-4160, 2013 U.S. App. LEXIS 19664 (3d Cir. Sept. 26, 2013) ("*Minard Run V*").

110 The Equal Access to Justice Act, 28 U.S.C. § 2412 (d) (1) (A) *et seq*. the Act authorizes (capped) payment of attorney fees and expenses to a prevailing party absent a showing by the government that its position was "substantially justified." The irony in this is the DOJ having also agreed in 2009 — in specific wording in the illegal settlement agreement itself to award the plaintiffs in the FSEEE case who were successful in obtaining the illegal settlement agreement — $19,000 in attorney fees pursuant to the EAJA. Interestingly, this raises the question of whether the FSEEE attorneys are required or in any event should return those public funds as they are the fruit of an illegal agreement.

the subject and government's role in promoting domestic energy production. On April 5, 2011 a joint oversight hearing was convened of the U.S. House of Representative's Natural Resources Committee's Subcommittee on Energy and Natural Resources, and the Agricultural Committee's Subcommittee on Conservation, Energy, and Forestry. During the joint hearing, Subcommittee Chairman Glenn Thompson[111] questioned the Director of the Forest Service Mineral Section Office (which oversees OGM policy) about the status of the December 28, 2008 ANPRM rulemaking and asked whether any rules had yet been drafted. The Director advised the Chairman that rules had not been drafted. This was not an accurate response. As will be explained in the discussion that follows draft rules had in fact been prepared by at least November of 2011 and had as well in February 2011 been made available to Indian tribes for comment.

Approximately three months later, on July 8, 2011, another joint hearing was convened of the same two subcommittees to examine initiatives by Forest Service officials in the George Washington National Forest to ban hydraulic fracturing through use of a Forest Plan revision. Additional to the testimony about the potential ban the sub-committees were also informed at the hearing about the apparent foot-dragging on the ANF. This observation was based upon the bi-weekly and monthly drilling proposal processing status reports being provided to POGAM (now PIOGA) by the Forest Service through repeated FOIA requests. Basically the testimony, provided by the author was that it was taking an average of more than seven months (not 60 days) to process drilling proposals on the ANF. This was up from average processing times of approximately four months that had been documented a year earlier.

Two weeks later, on July 20, 2011, at a U.S. House of Representatives Agricultural Committee's Subcommittee on Conservation, Energy, and Forestry hearing, the Forest Service Chief was questioned by Chairman Thompson about several issues, including the ANF drilling proposal processing delays and the Forest Service's effort to preclude use of

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111 Representative Glenn "GT" Thompson is from the 5th Congressional District, which covers the ANF, and he chairs the Agricultural Committee's Subcommittee that oversees the Forest Service.

groundwater on the ANF (which prompted the filing of the contempt petition by PIOGA). The Chief testified that the Forest Service was not processing notifications as quickly as he would like. In this regard, he also reported that a year earlier (*i.e.*, July 2010) average processing time was over five months, and that he understood processing time had been reduced to four months. In light of the information in the Forest Service FOIA responses, it would appear that the Chief was not being given accurate information about processing times.

§ 7.06. The National Rulemaking Front After *Minard Run II*.

Back on the Rulemaking Front, the actions of the Forest Service following the decision in *Minard Run II* were telling. By the fall 2010, the *de facto* drilling ban had been enjoined for nearly a year and the parties had submitted briefs and were preparing for oral argument in Philadelphia before the circuit court. Given the district court's clear ruling that the Forest Service lacked regulatory authority over private OGM rights, one might expect the Forest Service to stand down, at least temporarily, to see whether the circuit court agreed. Instead, PIOGA learned that the Forest Service was moving forward with the rulemaking initiative that was announced in the December 28, 2008 ANPRM. The ceasefire on the National Rulemaking Front — no doubt caused by *Minard Run II* — had apparently ended.

Through a FOIA request PIOGA obtained a copy of the U.S. Department of Agriculture (USDA) Work-plan prepared for the 2008 ANPRM, as well as USDA's regulation that prescribes the internal process and standards for completing regulatory work-plans within the USDA.[112] Generally speaking, a work-plan is required to be completed to justify regulatory classification of a proposed regulation as "non-significant." This is the classification that had been assigned to the 2008 ANPRM. When legitimate, this classification enables the agency to avoid various legal requirements (*i.e.*, analysis, studies, approvals, and certifications) that are required for actions classified as "significant" or higher because they implicate important constitutional,

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112 *See* USDA Department Regulation 1512-1.

national security, and economic considerations. Although most of these important considerations were implicated in the 2008 ANPRM, the USDA nonetheless treated the proposed rulemaking as "non-significant."[113]

FOIA requests in early 2011 led to the discovery of draft regulations that the Forest Service intended to propose in conjunction with the 2008 ANPRM. Slated as an amendment to 36 C.F.R. Part 251, the proposed regulations are entitled: "Exercise of Non-Federal Mineral Rights." The Forest Service sent the proposed regulations to American Indian Tribes in February 2011 to solicit interest and comment. And, not surprisingly, the proposed regulations presumed the existence of "reasonable regulatory authority" even though the court in *Minard Run II* had ruled otherwise.[114]

The draft regulations, noted as "Version — 11/16/10," consist of 16 pages with four different statutes cited as providing regulatory authority for their implementation. They completely ignore the *Minard Run II* decision and impose, among many rules, an approval requirement for operating plans and permitting requirements for the exercise of state-protected outstanding and reserved OGM rights in the National Forest System generally and on the ANF specifically.

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[113] For this reason, and also because the 2008 ANPRM Work-plan contained false, misleading, and unsupported representations, by letter dated January 5, 2011, POGAM requested the USDA Inspector General ("IG") to investigate whether official wrongdoing occurred in the initiation and processing of the 2008 proposal and highlighted the apparently disregarded requirements in USDA's own internal directive for processing rulemaking proposals. POGAM was contacted by an investigative counsel in the IG office a few months later confirming receipt of POGAM's request. Despite being advised that the matter was "under consideration" in 2011, PIOGA has not received any follow-up information regarding whether an investigation was conducted or any results of an investigation. As an aside, similar IG inquiries into violations of internal agency directives may be appropriate and necessary for many other and more recent agency initiatives discussed below and associated with similar federal agency efforts to restrict oil and gas development activity.

[114] In June 2011, when informed of the rulemaking development, the Governor of Pennsylvania, United States Senator Pat Toomey, and other prominent Congressional and State legislators sent inquiries to both the Secretary of Agriculture and Chief of the Forest Service expressing concerns about the rulemaking's potential economic impact and the lack of transparency in its preparation.

Subsequently, in an internal Forest Service action published in "2012," the 2008 ANPRM was merged with a new rulemaking initiative identified as "RIN: 0596-AD03,"[115] and the 2008 ANPRM was classified as a "completed action." The Fall 2014 Unified Agenda of Federal Regulatory Actions (UAFRA) published on December 22, 2014 reports and the Spring 2014 UAFRA published on May 23, 2014 reported the new rulemaking initiative entitled "Management of Surface Activities Associated with Outstanding Mineral Rights on National Forest System Lands" as scheduled, respectively, for a Notice of Proposed Rulemaking (NPRM) in March 2015 and August 2014.[116] The merged rulemaking is now classified as "Other Significant"

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[115] A RIN is a Regulation Identifier Number assigned by the Regulatory Information Service Center to identify each regulatory action listed in the Unified Agenda and the Regulatory Plan, as directed by Executive Order 12866 (Section 4(b)). Additionally OMB has asked agencies to include RIN's in the headings of their Rule and Proposed Rule documents when publishing them in the Federal Register to make it easier for the public and agency officials to track the publication history of regulatory actions through their development.

[116] The description of the rulemaking is as follows: "Abstract: Close to 11,000,000 acres (approximately 6 percent) of National Forest System lands overlie severed (split) mineral estates owned by a party other than the Federal Government. Over 75 percent of these lands are in the Eastern Region (Forest Service Regions 8 and 9). There are two kinds of severed mineral estates, generally known as "private rights": reserved and outstanding. Reserved mineral rights are those retained by a grantor in a deed conveying land to the United States. Outstanding mineral rights are those owned by a party other than the surface owner at the time the surface was conveyed to the United States. Because these are non-federal mineral interests, the USDI Bureau of Land Management has no authority for or role in managing development activities associated with such interests. States have the authority and responsibility for regulating development of the private mineral estate. Various Secretary's Rules and Regulations (years of 1911, 1937, 1938, 1939, 1947, 1950, and 1963) and Forest Service regulations at 36 C.F.R. 251.15 provide direction for the use of NFS lands for mineral development activities associated with the exercise of reserved mineral rights. These existing rules for reserved minerals development activities also include requirements for protection of NFS resources. Currently there are no formal regulations governing the use of NFS lands for activities associated with the exercise of outstanding mineral rights underlying those lands. The Energy Policy Act of 1992, section 2508, directed the Secretary of Agriculture to: apply specified terms and conditions to surface-disturbing activities related to development of oil and gas on certain lands with outstanding mineral rights on the Allegheny National Forest, and promulgate regulations implementing that section. The Forest Service initiated rulemaking for the use of NFS lands for development activities associated with both reserved and outstanding minerals rights with an Advance Notice of Proposed Rulemaking (ANPRM) in the Federal Register on December 29, 2008. Comments from the public in response to the

and as requiring a Regulatory Flexibility Analysis. However, it continues the deception of classifying the rulemaking as not involving federalism. This rulemaking matter must be watched very closely given the Forest Service's demonstrated willingness to violate private property rights and to disregard substantive and procedural legal requirements.

Another example of the Forest Service's covert behavior, in spite of the circuit court decision in *Minard Run III* and the representation in the NPRM 0569-AD03 rulemaking abstract republished on May 23, 2014 that there are *"no formal regulations governing the use of NFS lands for activities associated with the exercise of outstanding mineral rights"* (emphasis added) concerns an amendment to 36 C.F.R. Part 214.[117]

More specifically, on June 5, 2013, the Forest Service published a final regulation entitled: "Postdecisional Administrative Review for Occupancy or Use of National Forest System Lands and Resources"[118] that, *inter alia*, makes "determinations of the *acceptability of an initial or amended operating plan for exercise of outstanding mineral rights* located on NFS lands" (emphasis added) appealable decisions subject to all the processes and procedures specified in the revised administrative review rules. The regulation prescribes the same administrative review procedures for determinations "of the *acceptability of an initial or amended operating plan*

ANPRM conveyed a high level of concern about the broad scope of the rule, along with a high level of concern about effects of a broad rule on small businesses and local economies." *See* 79 FR 76673, Item 183.

117 The purpose of the § 214 regulations is to prescribe a process for "certain written decisions issued by Responsible Officials involving written instruments authorizing the occupancy or use" of Forest Service lands or resources. *Id*., § 214.1 The regulation also includes a definition of what constitutes a "Written authorization." These are defined as: "A term grazing permit, plan of operations, special use authorization, mineral material contract or permit, or other type of written instrument issued by the Forest Service or a lease or permit for leasable minerals issued by the U.S. Department of the Interior that authorizes the occupancy or use of National Forest System lands or resources and specifies the terms and conditions under which the occupancy or use may occur." *Id*., § 214.2 It would appear that terms "other type of written instrument" and "operating plan" being presented as the equivalent of a "written authorization" sets the stage for ANF notice to proceed letters to be included in the definition of "written authorization."

118 *See* Federal Register, 78 Fed. Reg. 33,705 June 5, 2013.

for exercise of reserved mineral rights located on National Forest System lands." (emphasis added).[119] The problem, of course, is that the Forest Service lacks authority to make such "acceptability determinations." This is what *Minard Run II* and *III* were all about.

Notably, the original NPRM and request for comment was published on October 11, 2011[120] approximately one month after *Minard Run III* was decided by the Third Circuit.[121] Promulgation of the final rule post-dates the district court ruling in *Minard Run IV*, in which the court entered final judgment against the Forest Service, FSEEE, and the other defendants. The apparent sleight-of- hand in trying to re-establish "reasonable regulatory authority" under the guise of addressing administrative procedure requirements again illustrates cause for concern with the ethical practices within the Forest Service and its integrity as an institution.[122]

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119 *See* 36 C.F.R. § 214.4 (8) and (9).

120 *See* Federal Register, 76 Fed. Reg. 62, 692 October 11, 2011.

121 Additionally, in the above referenced June 5, 2013 rulemaking the Forest Service has, modified the 1963 version of the Secretary Rules and Regulations for reserved mineral estates. Specifically, the Forest Service has revised two paragraphs of 36 C.F.R. 251.15 – namely, paragraphs (2) (iv) and (3). These paragraphs deal with revocation of permits and removal of structures following revocation of permits. Accordingly, we now have 11 versions of the Secretary's Rules and Regulations with the most recent being the "2013 Version" or "2013 modified Version of the 1963 Rules." The 2013 Version can only apply to conveyances entered into after the effective date of the rulemaking or June 5, 2013. Public lands and OGM legal practitioners should be alert to Forest Service attempts to apply it to conveyances that pre-date the rulemaking.

122 In the Federal Government's 2013 Best Places to Work Survey the Forest Service Index Score was quite low, being 260th overall out of 300 ranked offices or agencies. The number 300 represents the bottom of the rankings. With respect to the category of "Effective Leadership: Senior Leaders" the Forest Service ranked 286th out of 300. With respect to the category of "Strategic Management," the Forest Service ranked 290th out of 300. The trend graph for the annual surveys shows a marked and steady decline between 2003 and 2013 in the Forest Service Index Score. The Partnership for Public Service uses data from the Office of Personnel Management's (OPM) annual Federal Employee Viewpoint Survey to rank agencies and their subcomponents according to a Best Places to Work index score. Agencies and subcomponents are measured on overall employee satisfaction and scored on 10 workplace categories, such as effective leadership, integrity, employee skills–mission match, pay, teamwork and work–life balance.

The most recent example of illegal rulemaking and continued covert or deceptive behavior by the Forest Service, designed, if not principally, certainly in part, to block development of non-federally owned oil and gas resources within and adjacent to National Forest lands, is found in its "Proposed Directive on Groundwater Resource Management, Forest Service Manual 2560." This was announced at 79 Fed. Reg. 25815 on May 6, 2014. The proposed Directive, in the form or the guise of a policy statement reverses established law and self-delegates to the Forest Service the right to "manage" all groundwater resources that lie under and even adjacent to any National Forest land. The Directive asserts the right to review or act upon any actions that might affect groundwater. It is a sweeping and unprecedented attempt to summarily impose federal control over traditional state functions and state protected property rights and appears to be part of a recent coordinated and deliberate effort at the federal level to achieve a de-facto nationalization of our country's privately held oil and gas resources.[123]

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123 Nationalization or centralized control of a nation's mineral resources can be effected de facto or as a practical matter through agency edicts that dictate permitting and study processes that effectively place the economic decisions to explore for or produce gas and oil in the hands of an array of federal government overseers. federal agency undertakings to both impose and extend federal control over various aspects of oil and gas permitting activities that will serve to block and frustrate development on both private and public lands can be seen, among others, in the following recent initiatives: 1) The Federal Emergency Management Agency (FEMA) policy of May 5, 2014 titled "FEMA Mitigation Policy FP 302-405-146-1: Limits on Subsurface Uses of Hazard Mitigation Assistance (HMA) on Acquired Lands." The new policy, which completely reverses prior practices, relies on the excuse of flood-plain management and decrees that no HMA funds may be used to acquire lands where any right to engage in mineral extraction activities involving hydraulic fracturing or horizontal drilling in relation to the lands has not been extinguished or surrendered to FEMA. Moreover, it illegally interferes with the exercise of property rights by forbidding current owners of previously acquired HMA lands from leasing or selling mineral rights that "may allow" hydraulic fracturing or horizontal drilling on the property. 2) The Environmental Protection Agency (EPA) and Army Corps of Engineers (ACOE) Proposed Rulemaking of April 21, 2014 regarding the definition of "Waters of the United States" under the Clean Water Act (79 FR 22188, April 21, 2014). The Rule, by expanding the definition of waters extends federal permitting requirements to virtually any land feature that can channel water, and appears purposed to obfuscate, delay, or prevent the permitting of any drilling activity or infrastructure construction related to oil and gas development, and, 3) The May 12, 2014 U.S. Fish and Wildlife Service (USFWS) and National Marine Fisheries Service (NMFS)

PIOGA joining with many other economic users and stakeholders of National Forest lands, to include the National Mining Association and the Western Governor's Association, filed strong objections to the proposed Directive seeking to see it withdrawn. The 16-page PIOGA comment was dated July 7, 2014.

On September 10, 2014 Congressman Thompson, Chairman of the House Agriculture's Committee's Subcommittee on Conservation, Energy, and Forestry, as a result of many concerns surrounding the Directive, held a public hearing to review it. During the hearing the Chief of the Forest Service, who was the sole witness for the Forest Service, was informed by Congressman Thompson, who expressed strong opposition to the Directive, that his constituents in the ANF area feared that the Directive was a renewed effort to thwart or regulate oil and gas development on the ANF. The Forest Service Chief was asked by the Chairman if the Forest Service was going to continue to abide the *Minard Run* framework. In response the Chief represented that the Forest Service would comply with the *Minard Run* decision, but in his response stated "A good example on the Allegheny is, suppose the oil and gas developer wants to use water. We (the Forest Service) have our decision to make." This response is both troubling and instructive. It appears to signal the reemergence of the unfounded Forest Service claim to groundwater ownership and the right to deny groundwater use on the ANF irrespective of state law and implied/express deeded rights to use water.[124]

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rulemaking proposals regarding the Endangered Species Act (ESA) revising the definition of adverse modification to critical habitat, changing how critical habitat is designated, and adopting a policy on excluding lands from being designated as critical habitat (79 Fed Reg. 27053, 27063, and 27066, May 12, 2014). In the author's opinion, it would not be at all surprising, should investigators inquire, to find newly minted and confidential government legal memoranda supporting the recent 180 degrees changes in policy or rules exemplified by the items noted above. It would not be surprising either, to find that the new memoranda fail to mention former memoranda or opinions, which contain opposite conclusions.

124 *See* the discussion above under the heading "Current Status of the Minard Run II litigation" involving the contempt action brought by PIOGA in regard to the ANF Forest Supervisor claiming the right to deny use of groundwater expressly reserved to the private mineral estate in the deed of conveyance to the United States.

§ 7.07. The Administrative Front after *Minard Run II.*

The Forest Service's effort to impose regulations and permit requirements by way of the planning process in revising the ANF Forest Plan came to an abrupt halt with the *Minard Run II* decision. Recall that until April or May 2014, the SEIS process, which was intended to add legitimacy to the inclusion of the "reasonable regulatory authority" provisions and related design criteria requirements into the 2007 ANF Forest Plan and to supplement the illegal *FSEEE* settlement agreement, had been administratively "on-hold." However, that posture is changing.

In a decision announced on February 21, 2014[125] the district court dismissed, *without prejudice*, the PIOGA lawsuit filed in 2008 challenging the adoption of the illegal 2007 design criteria Standards and Guidelines. The dismissal was based on "case or controversy" grounds because the court concluded that: a) the Forest Service effort to correct admitted NEPA violations was apparently abandoned; b) the Forest Service represented to the court (through legal counsel) that the effort was no longer being pursued; and c) in light of the intervening and controlling *Minard Run III and V* cases, the Forest Service was unlikely to discontinue its self-imposed adherence to the 1986 ANF Forest Plan protocols and procedures for processing drilling notifications. In ordering the dismissal, however, the court recognized that the Forest Service might "unexpectedly" "revive its attempt to revise the oil and gas procedures in the 2007 Plan or otherwise move away from adherence to the relevant provisions of the 1986 Plan." To address these possibilities, the court expressly noted that the *"form of dismissal will preserve the ability of the Plaintiffs to petition to reopen this case and pick up where they left off, should the Forest Service resume the challenged activity by discontinuance of its adherence to the 1986 Plan"* (emphasis added). The district court, too, is catching on.

A recently surfaced letter dated February 7, 2014[126] from the Forest Service Chief to the ADP provides insight into the Forest Service's next

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125 Pennsylvania Oil and Gas Ass'n v. U.S. Forest Serv., 2014 U.S. Dist. LEXIS 21601 (W.D. Pa., Feb. 21, 2014).

126 Letter of February 7, 2014 from Leslie A. C. Weldon, Deputy Chief, National Forest System to Mr. Ryan Talbott, Executive Director, Allegheny Defense Project, File Code 1920.

possible move on the Administrative Front. The letter states that the ANF Forest Supervisor has been instructed to publish a Forest Plan monitoring report by July 15, 2014 that will cover the years from 2008 through 2013. Although the National Forest Management Act requires a Forest Plan update only once every 15 years, the Supervisor has also been instructed to begin a formal assessment process by September 2014 to determine if there is enough "new information" to warrant an update of the 2007 ANF Forest Plan.

The "FY 2008 — FY 2013 Monitoring and Evaluation Report — Allegheny National Forest" is dated October 2014 and was published to the ANF website in early November 2014. The report recommends that "the ANF should change the 2007 Forest Plan in a manner that is consistent with the legal cases that have been decided since the Plan was affirmed with instructions." It is not clear whether this Monitoring Report process is intended to replace the formal assessment process. Given that *Minard Run II and III* were decided since the 2007 update and the attempted SEIS curative process was cancelled it appears likely that the Supervisor's assessment will result in a premature Forest Plan revision. In this way, the Forest Service, cognizant that the only issue involving the ANF that could reasonably lead to a formal Plan update is oil and gas development, may be preparing to argue that a renewed attempt to inject "reasonable regulatory authority" into the ANF Forest Plan by way of the update does not trigger the re-opener in the *Forest Plan* case.[127]

The letter responded to a 31-page December 17, 2013 letter from the ADP to the Chief of the Forest Service.

127 Some indication that such an effort may not be contemplated is the recent adoption of a series of Forest-Wide (FW) Design Criteria by the George Washington National Forest (GWNF) in its November 2014 Revised Forest Plan (Plan) that address the management of reserved and outstanding mineral rights. Refreshingly, Design Criteria FW-224 includes the statement that: "The Forest Plan, including management prescriptions and forestwide direction, is subject to the outstanding and reserved mineral rights." Moreover, Design Criteria FW-223 requires that where private rights could be affected by a Forest project, that comment will be sought from current owners of private mineral rights and the potential effects on those rights assessed. The GWNF is a Weeks Act acquired Forest and is underlain by 167,000 acres of private mineral rights. *See* WNF Revised Land and Resource Management Plan, Chapter 4 – Design Criteria, Reserved and Outstanding Minerals, at page 4-22.

§ 7.08. What the Future Holds.

On the Judicial Front, PIOGA awaits the reopening and conclusion of the *Duhring* case. On the Rulemaking Front, PIOGA and individual producers are monitoring efforts by the ANF to issue decisions about the "acceptability" of operating plans as postured by the June 2013 rulemaking. Moreover, PIOGA will be monitoring the still-pending December 28, 2008 NPRM Forest Service initiative to impose federal rules on the exercise of privately held OGM rights. Activities in these areas, and on the Administrative Front involving the recommended ANF Plan update, will influence and inform decisions with respect to PIOGA possibly reopening the *Forest Plan* case.

A discussion or forecast of the effects of *Minard Run I, II, III, IV, and V* on the Forest Service and other federal land management agencies was provided in a recent *Harvard Environmental Law Review* article.[128] The article discusses the impact of the *Minard Run* cases on lands within the jurisdiction of the Forest Service based on the statutes under which the lands were acquired, as well as similar situations encountered by the U.S. Fish and Wildlife Service and the National Park Service. According to the article, the *Minard Run* decisions could impact over 60 million acres of federal lands held in split estate ownership. The Law Review author opines, and this author agrees, that the *Minard Run* decisions will not only influence future judicial cases, but also administrative interpretations of the Forest Service and federal land management agencies that will result in limitations on the assertion of federal control.[129]

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128 *Supra* note 4 at pages 582-596.

129 The author of the article posits an alternative interpretive approach regarding outstanding estates, arguing that Congress under the Weeks Act may have intended to grant the Forest Service more authority over outstanding mineral rights as compared to reserved mineral rights. The rationale, essentially, is that the Congress may have concluded that grantors of lands subject to outstanding mineral reservations at the time of sale to the United States, did not care how the federal government planned to regulate surface access or use as they were not parties to the sale. This alternative approach misunderstands the nature of severed estates, is not supported by the facts, the law, the Congressional history, and decidedly by the carefully designed conveyances by the business and property rights savvy landowners and lawyers who granted the ANF lands to the United States in the 1920s and 1930s. In any event the author's unsupported musing was rejected by the Third Circuit in *Minard Run III*.

At this point one substantive matter about the future is deserving of further mention and discussion. Namely, the efforts of anti-development activists and the Forest Service to convince the courts that the Weeks Act should be read to grant the federal government broad regulatory authority over the management of the lands acquired under the Weeks Act to include the use of groundwater and the exercise of private mineral rights, be they reserved or outstanding. In whatever manner, forum, or stage such efforts might continue to appear nothing could be more wrong than reading such a grant into the Weeks Act or its amendments.

The history of the Act is long and complicated and spans almost two decades of spirited legislative activity at the dawn of our nation's conservation movement. When all the atmospherics that can accompany such significant legislation — in this case many years' worth of studies, hearings, reports, and floor debates — is stripped away Congress's intent to restrict federal authority can be readily seen by carefully comparing the final draft of the Weeks Act with the various earlier drafts. With such an examination it will be appreciated that specific language purporting to grant regulatory authority to the United States that had appeared in earlier drafts was rejected and removed before the Act was adopted.

The precursor to the Weeks Act, S. 4825, 60th Cong. (April 2, 1908), had provisions purporting to allow somewhat broader federal regulatory authority than what was provided for in the final Section 9 of the Weeks Act. For example, Section 6 of the original bill empowered the Secretary of Agriculture to promulgate rules and regulations "authorizing the sale of any products of the lands acquired under this Act and the use of any such land or their resources thereof consistent with its reservation for forest purposes for the purpose of preserving the navigability of navigable streams."[130] That language was deleted in a later iteration of the bill,[131] which later became the Weeks Act.[132]

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130 S. 4825, 60th Cong. § 6 (Apr. 2, 1908).

131 *See* S. 4825, 60th Cong. § 11 (Feb. 3, 1909).

132 *See* H.R. 11798, 61st Cong. § 11 (July 23, 1909); 36 Stat. 962 (1911).

Also, Section 10 of the original bill authorized the Secretary to agree to administer and protect private forest lands, and would allow the Secretary to subject such private forest lands to the laws, rules, and regulations governing national forests.[133] The language allowing the Secretary to regulate the private forestlands as national forests was deleted in a later iteration.[134] The provision allowing the Secretary to enter into agreements for the administration of private lands was ultimately eliminated before the passage of the Weeks Act.[135]

The revisions to and deletion of these cited provisions support and establish that Congress did not intend the 1911 Weeks Act to delegate to the Forest Service any broad regulatory authority. In a conference of legislators that was held at Mr. Gifford Pinchot's[136] house on January 10, 1909 and recorded in a Memorandum of the meeting that PIOGA obtained from the National Archives the conferees discussed the means by which the Forest Reserve legislation (*i.e.,* the Weeks Act) might be advanced. It was decided at the meeting that the Senate Bill (*i.e.*, S. 4825) would be used for that purpose, but that all provisions after the enacting clause would be stricken and a substitute bill prepared. The new bill would then "embrace as much as possible of the Senate Bill" and would include the establishment of the National Forest Reservation Commission to oversee the examination and selection of lands to acquire. As noted above, the February 3, 1909 new version of S.4825, filed within a month after the January 10, 1909 meeting, omitted language that would allow the Secretary to promulgate regulations regarding the "use" of such acquired private forest lands or "their resources" or to subject private forest lands to rules and regulations governing the

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133 *See* S. 4825, 60th Cong. § 10 (Apr. 2, 1908).

134 *See* S. 4825, 60th Cong. § 3 (Feb. 3, 1909).

135 *See* H.R. 11798, 61st Cong. § 11 (July 23, 1909); 45 Cong. Rec. 9,025-26 (1910) 36 Stat. 962 (1911).

136 Mr. Clifford Pinchot was the Chief of the US. Forest Service at the time of the 1909 meeting and served as the First Chief from 1905 to 1910. From 1889 until 1905 he headed the Department of the Interior's Division of Forestry, the precursor to the US Forest Service. He also served two terms as Governor of Pennsylvania.

national forests. Put simply, the Congress rejected and the substitute Bill did not embrace any grant of broad regulatory authority to the Forest Service.

Moreover, with regard to understanding the Congressional intent surrounding the scope of federal authority, few principles of statutory construction are more compelling than the proposition that Congress does not intend sub silentio to enact statutory language that it has earlier discarded. . . ."[137] Further evidence of how the Congressional intent was clearly understood can be seen in the 160 page, 1915 Forest Service "Use Book" sub-titled the "Manual for Users of the National Forests." This was the 1915 edition of the comprehensive rules and regulations for governing the National Forests that was issued by the Secretary of Agriculture on March 15, 1915. Under Part 1 of the book, which covers the applicability and scope of the rules and is titled "Administration of the National Forests," it is prominently stated that "The regulations and instructions printed in this book do not apply to areas purchased under the Weeks law." The first "Use Book" for the Forest Service was published in 1905.

This refusal to extend authority is also fully consistent with the legislative history and the single most important Report that accompanied the passage of the Weeks Act. This was the House Judiciary Committee Report of April 20, 1908 titled: "Power of Federal Government to Acquire Land for National Forest Purposes."[138] After quoting from Supreme Court opinions holding that the United States has no constitutional capacity to exercise municipal jurisdiction or sovereignty over state territory except for that expressly granted in the Enclave Clause — Section 8, Article I of the Constitution — the Committee wrote:

> These authorities invite attention to two important matters bearing on the question, one the extent of ownership by the people and the States of the navigable waters and soils under them, and the riparian rights of the people and States: All of which are involved, when the United States seeks to acquire lands for forest purposes, and

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137 *See* INS v. Cardoza-Fonseca, 480 U.S. 421, 442-43 (1987).

138 House Judiciary Committee Report of April 20, 1908 (House Report 1514 reporting on HR 10456 and 10457 and declaring them unconstitutional).

> affected by the constitutional question. The other not constitutional but extremely important, as to whether the States or National Government shall exercise jurisdiction over lands so acquired. The United States can only exercise authority when lands are purchased by the consent of the legislatures of the States, in which the same shall be for the erection of forts, magazines, and arsenals, dock yards and other needful buildings: therefore, it seems plain that the United States cannot, even with the consent of the States, exercise jurisdiction, and if the United States, purchases lands as contemplated, the same shall forever remain subject to State power.[139]

§ 7.09. Conclusion.

The Weeks Act was passed for the purpose of acquiring substantial forest acreage at a time in our nation's history when the federal government was reluctant to expand its sovereign power in relationship to that of States and individuals. Indeed, Congress was not certain that the Act was even constitutional — there being no authority expressed in the Constitution concerning the federal government's right to purchase or condemn private land for national timber growing purposes. Accordingly, the Congress took precautions in crafting the provisions of the Act to protect private property rights, personal rights, and the sovereignty of the States.

Concerns about the exercise of federal power, and the intent of Congress to restrain the same in the passage of the Weeks Act, are by no means imagined or the product of literary license. To the contrary, they were specifically expressed, 100 years ago, in a prophetic observation by the House Committee on Agriculture. On April 15, 1910 in its review of the draft legislation that became the Weeks Act, the Committee described each of the 15 sections of the Act and noted:

> It will be observed from this review of the provisions of the bill that the interests of the people are carefully safe-guarded at every

139 *Id*. at pages 3 and 4 of HR 1514; *also quoted* at page 6392 Senate, May 16, 1908.

> point beyond any possibility of invasion, except by collusion of the Highest officials of the Legislature, Executive, and Administrative branches of the government.[140]

Unfortunately, our ever-expanding federal government does not recognize or respect private property rights as it did in the early Twentieth Century, and, disturbingly, successive generations of U.S. citizens have grown accustomed to less individual freedom. It should come as no surprise, then, that private oil and gas developers experienced the type of collusion-based invasion the House Committee on Agriculture envisioned as a possibility.

In the ANF litigation we have been witness to an agency leadership and culture that seem inclined to nurture and promote an unhealthy brand of authoritarianism. In what amounted to an unlawful taking in the ANF, the Forest Service used administrative and judicial processes to impose illegal rules, and then knowingly undertook to manipulate those same processes in an effort to deny property owners a meaningful, timely, and effective opportunity to contest the agency's wrongful actions.

One of the many lessons to be learned from the ANF litigation experience is the need for citizens to have available a more timely and effective means to challenge wrongful agency action in the courts. Put simply, an agency should not and cannot be permitted to deliberately game administrative and judicial systems to achieve unlawful goals. Moreover, agencies, agency employees, and federal lawyers (including prosecutors) who perpetrate or facilitate this type of unlawful activity should be subject to meaningful sanctions, including all costs of suit and criminal prosecution, for deliberate interference with the lawful exercise of private property rights. Furthermore, given the DOJ's obvious conflict of interest in pursuing such matters, Congress should, if applicable, waive federal sovereign immunity to allow such actions to proceed in State courts.[141]

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140 House Report #1036, Committee on Agriculture, April 15, 1910, to accompany HR 11798, at page 2.

141 In Pennsylvania, for example, it is a second-degree misdemeanor for a government official to intentionally interfere with the lawful exercise of property rights. "Official oppression," 18 P.S. § 5310, provides as follows:

What occurred in the ANF region is testament to the fears associated with the increasingly uncontrolled growth of the federal administrative state and its unwieldy exercise of authority. By the time the propriety of that exercise is able to be challenged, let alone resolved or even stayed pending its resolution, any remedy may be largely meaningless as the agency will have achieved its illegal goals.

This was nearly the case in the ANF and clearly the result intended by the agency perpetrators. A recent dissenting opinion by Supreme Court Justices Ginsburg and Stevens in *Wilkie v Robbins,*[142] is instructive — indeed prescient. As in the recent *Minard Run* litigation, *Wilkie* involved misconduct and overreaching by government officials calculated to deprive citizens of their property rights.[143] After pointing out that the Court had extended *Biven's* based constitutional tort protections to aggrieved parties and individuals in the spheres of freedom of speech, freedom of religion,

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> "A person acting or purporting to act in an official capacity or taking advantage of such actual or purported capacity commits a misdemeanor of the second degree if, knowing that his conduct is illegal, he:
> (1) subjects another to arrest, detention, search, seizure, mistreatment, dispossession, assessment, lien or other infringement of personal or property rights; or
> (2) denies or impedes another in the exercise or enjoyment of any right, privilege, power or immunity.

142 Wilkie v. Robbins, 551 U.S. 537 (2007).

143 This is becoming an alarmingly common issue. *See*, *e.g*., Marvin M. Brandt Revocable Trust v. United States of America, US Supreme Court: No 12-1173, March 10, 2014. CITE. The 8-1 Court in the *Brandt* case, not unlike the Circuit Court panels in *Minard Run III and V*, took the federal government to task for complete reversals of prior positions and advancing improbable and self-serving readings of settled property law concepts in order to obtain control of private lands. It is also revealing that the 2015 Explanatory Notes accompanying the 2015 USDA OGC budget request report that OGC counsel acting on behalf of the Forest Service assisted the DOJ in preparing the government's legal arguments in the appeal to the U.S. Supreme Court. *See also* the November 4, 2014 decision in People for the Ethical Treatment of Property Owners v. U.S. Fish and Wildlife Serv., Case No. 2:13-cv-00278 (U.S. Dist. Ct., Utah (Nov. 4, 2014). The court invalidated a revised special rule issued pursuant to the Endangered Species Act that extended USFW authority to regulate takes of a threatened intra-state species of prairie dogs to non-federal lands. The court noted in dismantling the government arguments that "if Congress could use the Commerce clause to regulate anything that might affect the eco-system . . . there would be no logical stopping point to congressional power under the Commerce Clause."

freedom of association, right to a jury trial, the right to travel, and the privilege against self-incrimination, Justice Ginsburg noted that the principle against government unnecessarily penalizing the exercise of constitutional rights:

> . . . should apply here too. The constitutional guarantee of just compensation would be worthless if federal agents were permitted to harass and punish landowners who refuse to give up property without it. The Fifth Amendment, therefore, must be read to forbid government action calculated to acquire private property coercively and cost free, and measures taken in retaliation for the owner's resistance to uncompensated taking.[144]

Harvard law professor Laurence Tribe, who represented the aggrieved landowner before the Supreme Court in *Wilkie*, pointed out many of the shortcomings in having to challenge wrongful agency actions affecting property interests through administrative channels or in federal court under the APA. Among his concerns were that reviews of the government's conduct is limited to the evidentiary record that the agency committing the wrong itself compiles, and under the APA courts are only authorized to set aside wrongful agency action in the form of *"equitable relief that is useless to a person who has already been injured."*[145]

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[144] *Id*., at 584, 585.

[145] *See* 2006-07 Cato Sup. Ct. Rev. 23, Laurence H. Tribe, "Constitutional Remedies: Death by a Thousand Cuts: Constitutional Wrongs Without Remedies After *Wilkie v. Robbins,*" at pages 45-46.

In the author's opinion, based upon the ANF experience and in the absence of a Biven's based constitutional tort protection an amendment to §10 (d) of the APA that would allow reviewing courts to more readily stay agency actions that adversely affect real property interests should be adopted. Specifically, §10 (d) could be amended to state: "Upon such conditions as may be required and to the extent necessary to *afford a meaningful opportunity for judicial review of questions of law, pertaining to the use, exercise, or enjoyment of real property rights or interests, to include questions of and sounding in standing or finality, cognizable under state or federal law* or to prevent irreparable injury, every reviewing court . . . is authorized to issue . . . appropriate process to . . . preserve status or rights pending conclusion of review proceedings." In effect this would allow for real property owners who are adversely affected by agency action or who will be during the pendency of such agency action to obtain a stay of the action without having to first establish irreparable harm. As a very real and practical matter by the time irreparable harm is able to be established for

When I began this chapter I noted that the battle of *Minard Run* these last eight years has been about real people, their livelihoods, and their communities. At its core, however, it is about a free people's right to remain free from government oppression. What seems to have been lost on those who plot for government control of private lands and de facto seizure of oil and gas rights is appreciation that in our democracy respect for private property and a citizen's right to make the decisions about how their property is to be used are cornerstones of freedom and essential to the prosperity of our nation.

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purposes of obtaining a stay or injunction the irreparable harm sought to be avoided has already occurred.

Chapter 8

Indemnity for Environmental Damage: Methods for Structuring an Enforceable Indemnification Agreement for Environmental Claims and Liabilities

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§ 8.01. Introduction.

Ownership and participation in the development of oil and gas, as well as other mineral interests, presents both environmental related risks and potential liability due to the nature of exploration and development operations. As risks associated with environmental liability have become more prevalent from increasing regulatory oversight and the availability of private rights of action for land and water damages, many companies engaged in mineral exploration and development have incorporated an indemnification requirement for environmental claims and liabilities into their contractual arrangements. The scope of indemnity provided under such an agreement will, however, be limited in many cases by the applicable environmental statute and state contract law.

This chapter examines the type of environmental liabilities companies intend to provide indemnification for, reviews the types of environmental indemnification agreements available, and analyzes the limitations of these indemnification agreements under certain federal and state laws. The chapter concludes by discussing practical ways companies can ensure the enforceability of a contractual agreement intending to provide indemnification for current and future environmental claims and liabilities.

§ 8.02. The Basics of Indemnification.

Indemnification, or indemnity, is essentially a form of risk-shifting or cost allocation that occurs through one party's compensation of another

party's loss, damage, or liability.[1] In most cases, indemnification results from one party's contractual obligation to reimburse another for specific losses and damages, but may also result from a common law obligation.[2] For example, a subcontractor may be required to reimburse a general contractor for property damage that occurs on the general contractor's site as a result of the subcontractor's work. The same contractor could also be required to indemnify the general contractor in the absence of a contractual agreement, if found at fault or legally responsible for the damage. Common law indemnification is therefore an indemnification obligation that arises from the nature of the relationship between the parties, the loss being indemnified, and the party's responsibility for the loss.[3] A contractual obligation to indemnify exists alternatively, when the parties' contractual agreement contains an express or implied indemnity obligation.[4] Unlike common law indemnification, contractual indemnification may require the full reimbursement of a specific loss or damage without a demonstration of fault, liability, or legal responsibility.[5]

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1 *Black's Law Definition*: (1) A duty to make good any loss, damage or liability another has incurred. (2) The right of an injured party to claim reimbursement for its loss, damage or liability from a person who has such a duty. (3) Reimbursement or compensation for loss, damage or liability. More Common Definition: An undertaking by which the indemnifying party ("indemnitor") agrees to make good any loss or damage that the indemnified party ("indemnitee") has incurred, or to safeguard the indemnitee against liability. *See generally*, George Chamberlain, "Cause of Action to Enforce Contractual Right to Indemnification Respecting Personal Injury Claim," 7 *Causes of Action* 2d 509 (1995), *updated* (May 2015).

2 *See* Chamberlain, *supra* n. 1.

3 *See id*.

4 *See generally,* William B. Johnson, "Indemnification or Release Agreement as Covering Liability Under § 107(e) of Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)" (42 U.S.C.A. § 9607(e)), 139 *A.L.R. Fed*. 123 (originally published 1997). This chapter focuses only on issues related to contractual indemnification of environmental claims and liabilities and does not discuss common law indemnification duties or obligations.

5 *See* Chamberlain, *supra* n. 1.

[1] — Defining an Indemnification Agreement's Function and Scope.

Although the exact function and scope of a contractual indemnification obligation will vary depending on the specific terms of the parties' indemnification agreement, the result is always some predefined allocation of risk or responsibility between the parties.[6] An indemnification agreement effectively safeguards one party from an existing or future loss, potential liability, or both, through the other party's guaranteed financial responsibility for the loss.[7] When executing the indemnification agreement, the parties intend that even if both parties are mutually culpable for a loss, only one of the parties is required to bear the risk of such culpability through either direct compensation or under an applicable insurance coverage.[8] The full scope of each party's indemnification obligation will however be confined to the parties' express or implied contractual terms and will be construed in accordance with applicable federal and state laws. To determine the scope and obligation of an indemnification provision, courts generally interpret the parties' agreement under the same rules governing any other contract and determine the resulting indemnification obligation from the plain meaning of the contract itself.[9]

[2] — Establishing a Contractual Indemnification Agreement.

Indemnification agreements can be established contractually in a variety of ways, including the execution of an explicit Indemnity and Risk Allocation Agreement, or through the inclusion of an indemnification or

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6 *See* Chamberlain, *supra* n. 1.

7 *See e.g.,* Dresser Indus., Inc. v. Page Petroleum, Inc., 853 S.W.2d 505, 508 (Tex. 1993).

8 *See generally,* Maurice T. Brunner, "Liability of subcontractor upon bond or other agreement indemnifying general contractor against liability for damage to person or property," 68 *A.L.R.*3d 7 (Originally published in 1976).

9 *See generally* Johnson, *supra* n. 4. It is important to note that due to differences in state contract laws, the same indemnification agreement may be interpreted in different ways according to the state's manner and method of interpreting contracts.

indemnity provision in an overarching contract.[10] In either case, each party's contractual obligation to pay or compensate another for certain incurred losses, damages, or liabilities, must be clearly expressed or implied in the parties' contractual agreement.[11] The party obligated to pay another under the contract is termed the indemnitor, while the party entitled to receive the payment is the indemnitee.[12]

Written indemnification agreements commonly include language such as "shall indemnify, hold harmless, and defend" along with a list of losses, damages, or liabilities for which indemnity is required, such as "claims, actions, suits, demands, damages, liabilities, obligations, losses, settlements, judgments, costs, and expenses."[13] When construing the parties' agreement to determine the scope of an indemnification obligation, the word "indemnify" is generally interpreted as the requirement to pay or compensate another for legal liabilities or losses.[14] The term "defend," alternatively provides an independent indemnity duty, to actively defend or fund the defense of any claim from its inception that falls under the scope of the indemnification

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10 *See e.g.*, David I. Albin, *et al.*, *A Whirlwind Tour Through an Acquisition Agreement,* 2009 Annual Meeting of the Bar Association, (Aug. 1, 2009) *available at* http://apps.americanbar.org/buslaw/newsletter/0083/materials/pp2.pdf.

11 *See, e.g.,* American Transtech, Inc. v. U.S. Trust Corp., 933 F. Supp. 1193, 1202 (S.D.N.Y. 1996) (indemnity may be found pursuant to an "implied in fact" theory when there is a special contractual relationship supporting such a finding, or pursuant to an "implied in law" theory of indemnity, when one is vicariously liable for the tort of another because one of the tortfeasors was primarily liable for the tort). In some jurisdictions however, indemnification will only be available where the parties' indemnification agreement is explicitly included or stated in the parties' contract.

12 *See* R. Steven Rawls and Rebecca C. Appelbaum, *The Future is Now: When Eventual Indemnity Obligations Become Present Defense Obligations,* IRMI (August 2008), *available at* http://www.irmi.com/expert/articles/2008/rawls08-liability-insurance-coverage-law.aspx?cmd=print.

13 *See e.g.*, Wells Fargo Bank, N.A. v. Smuck, 407 S.W.3d 830 (Tex. App. 2013), *opinion supplemented on denial of reh'g* (Aug. 15, 2013), review denied (Dec. 6, 2013) (discussing broad form indemnification agreements in general).

14 *See* e.g., Cousins v. Paxton & Gallagher Co., 98 N.W. 277 (Iowa, 1904); Walsh Const. Co. v. Mut. of Enumclaw, 104 P.3d 1146 (Or. 2005); N. v. N., 44 Va. Cir. 265 (Va. Cir. 1998).

provision.[15] The term "hold harmless," while not a per se indemnification provision, is viewed in some jurisdictions as an exculpatory provision that releases the indemnitee from liability to the indemnitor.[16] "Hold harmless" can also be interpreted as providing an implied indemnification in those jurisdictions that allow for implied indemnification agreements. Finally, terms such as "claims," and "damages," are often considered distinct from an indemnity for "liabilities," which is defined by some jurisdictions as a company's legal debts or obligations.[17] Accordingly, while there are a variety of ways for an indemnification agreement to be formed, the contract must clearly and unambiguously provide for indemnification and the specific scope of an indemnification obligation before it will be enforced.

[3] — Types of Indemnification Agreements.

Indemnification agreements can generally be broken down into three categories consisting of broad form, limited, and narrow or comparative form agreements. A broad form indemnification agreement provides indemnification for almost any problem or issue arising under a contractual agreement, regardless of the party's responsibility or conduct.[18] An example broad form indemnification agreement includes language such as "[Indemnitor] agrees to hold harmless and indemnify [Indemnitee] from any and all liabilities arising out of the performance of services rendered under this agreement."[19] Broad form agreements are most commonly found

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15 *See e.g.,* Ajax Paving Indus., Inc. v. Vanopdenbosch Const. Co., 797 N.W.2d 704, 710 (Mich. App. 2010); Britz Fertilizers, Inc. v. Bayer Corp., 665 F. Supp. 2d 1142 (E.D. Cal. 2009).

16 *See e.g.,* Pinney v. Tarpley, 686 S.W.2d 574 (Tenn. Ct. App. 1984); New York Cent. R. Co. v. Gen. Motors Corp., 182 F. Supp. 273, 291 (N.D. Ohio 1960).

17 *See generally,* Marie A. Moore, "Indemnification Provisions in Leases: What We Ask for and What Really Matters," *Probate & Property*, Vol. 22, No. 5 (September/October 2008) (discussing the general differences in language seeking indemnification for claims, damages, and liabilities in various jurisdictions).

18 *See e.g.,* James v. Burlington N. Santa Fe Ry. Co., 636 F. Supp. 2d 961 (D. Ariz. 2007) (discussing broad form indemnification agreements).

19 *See* Del Greco v. New York City Transit Auth., 45 Misc. 3d 1218(A) (N.Y. Sup. Ct. 2014) (evaluating broad form indemnification agreements).

in construction contracts where there is an assumption of liability associated with performance of the contract, but the potential liability is specifically left undefined to provide for a maximum assurance of a loss, liability, or damage. But, while a broad form indemnification agreement intends to cover all occurring liabilities, claims, or losses that occur under the contract, the language may ultimately be limited under the applicable jurisdiction's common law or anti-indemnification statute to prohibit the agreement from requiring indemnification of another party's negligence or intentional acts.[20]

A limited indemnification agreement, in contrast to a broad form agreement, provides indemnification for only certain liabilities, losses, or damages arising from the performance of a contractual agreement, and therefore in only specific circumstances.[21] An example limited form indemnification agreement includes language such as "[Indemnitor] agrees to hold harmless and indemnify [Indemnitee] from and against [certain claims, liabilities, and damages] arising out of the [Indemnitor's] negligent performance of services." Limited indemnification agreements, while also found in construction contracts, are usually used by an independent contractor or subcontractor to explicitly limit an indemnification obligation to a general contractor or property owner for only specific losses. Limited indemnification agreements, though construed strictly in accordance with the limitations embodied in the parties' agreement, are frequently preferred over broad form indemnification agreements because they concretely define the scope and terms of the parties' intended indemnification.[22]

Finally, a narrow or comparative form indemnification agreement provides indemnification for only those liabilities, losses, or damages for

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20 *See generally e.g.,* Gary Wickert, "You Break It, You Buy It: Understanding Anti-Indemnity Statutes," *Claims Journal*, (Apr. 3, 2014), *available at* http://www.claimsjournal.com/news/national/2014/04/03/246663.htm.

21 *See e.g.,* Vitiello v. Consol. Edison of New York, Inc., 51 A.D.2d 523 (N.Y. 1976); Zurich Ins. Co. v. Sunday River Skiway *Corp., No.* CIV. 08-325-P-H, 2010 WL 1511495, at *5 (D. Me. Apr. 15, 2010) (discussing limited indemnification agreements).

22 *See generally,* Mark M. Bell, *Indemnity and Additional Insured Requirements: Why Am I Demanding Them, Why Do Others Want Them, and What Does it All Mean?,* IRMI, (May 2013), *available at* http://www.irmi.com/expert/articles/2013/bell05-construction-liability.aspx.

which the indemnitor is directly responsible.[23] An example comparative form indemnification agreement includes language such as "[Indemnitor] agrees to hold harmless and indemnify [Indemnitee] from and against liabilities arising out of the [Indemnitor's] negligent performance of services."[24] Comparative form agreements, similar to limited agreements, are construed strictly in accordance with the limitations of the indemnification language in the parties' agreement.[25] Additionally, because a comparative form indemnification agreement requires a comparison of negligence before the indemnitor will be held responsible for a loss, the indemnitor cannot be held liable for the indemnitee's direct negligence.[26]

§ 8.03. Indemnification Trends.

Contractual indemnity clauses have become increasingly prevalent in a wide array of contracts, including Master Service Agreements (MSAs), Joint Venture Agreements ("JVs"), Work Orders, Purchase Agreements, and Real Estate Conveyances for purposes of allocating risks. In many cases, companies use the same indemnification clause or standard "boiler plate" indemnity provision in each work order, purchase agreement, or MSA that they execute.[27] The normality of such standard and broad clauses has facilitated the use of indemnification provisions to protect against an expanding scope of liability for environmental claims, personal injuries, property damage, regulatory compliance, and certain administrative penalties.[28] The

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23 *See e.g.*, Hernandez v. Badger Constr. Equip. Co., 28 Cal. App. 4th 1791 (4th Dist. Ct. App. 1994) (discussing the evolution of comparative indemnification agreements).

24 Stafford Matthews, *Indemnification Clauses,* SNR Denton, (Aug. 10, 2011), *available at* https://www.acc.com/chapters/midam/upload/SNR-Kansas-City-Indemnification-Clauses-101.pdf. Note: comparative indemnification clauses or agreements can also be referred to as narrow indemnification agreements, because they provide an extremely narrow scope of indemnification.

25 *See Hernandez, supra* n. 23.

26 *Id*.

27 *See generally* Austin W. Brister, "Legalese: Standard Interpretive Boilerplate," *Oil and Gas Law Digest*, (Jun. 19, 2014), *available at* http://www.oilandgaslawdigest.com/uncategorized/legalese-standard-interpretive-boilerplate/.

28 *See* Johnson, *supra* n. 4 (discussing the increasing use of indemnification agreements in property and business transactions for purposes of allocating responsibility for contamination claims and remediation expenses).

increasing use of such agreements has also led to the development of anti-indemnification statutes, complex litigation, and resounding confusion over when indemnification agreements will be enforceable, and more specifically enforceable for environmental claims and liabilities.

[1] — Enactment of Anti-Indemnification Statutes.

Anti-Indemnification statutes, or statues prohibiting or limiting the enforceability of parties' indemnification agreements, have been enacted in a majority of states.[29] While the state statutes differ dramatically in the limitations placed on how parties can indemnify one another, in most cases, states are limiting parties from entering into broad form indemnification agreements, agreements for the indemnification of one's own or sole negligence, and indemnification for intentional conduct or torts.[30] For example, in New York, a contractor cannot require a subcontractor to indemnify the contractor for its own negligence but may require the subcontractor to indemnify losses that "arise out of" the subcontractor's work.[31] Similarly, in Oregon, the state's anti-indemnification statute prohibits a subcontractor's surety or insurer from indemnifying another party's negligence.[32] To ensure that a parties' indemnification agreement will be enforceable, parties must therefore be aware of or control the specific law applied to the interpretation of their agreement and whether that state's indemnification law or anti-indemnification statute limits the scope of contractual indemnification available.[33]

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29 *See e.g.,* Kegler Brown Hill & Ritter, *Anti-Indemnity Statutes in the 50 States,* Foundation of the American Subcontractors Association, Inc., (2013), *available at* http://www.keglerbrown.com/content/uploads/2013/10/ASA-Anti-Indemnity-Chart-2013.pdf.

30 *See e.g.,* Ark. Code § 4-56-104, 22-9-214; Neb. Rev. Stat. § 25-21,187. *See also,* Matthiesen, Wickert & Lehrer, S.C., *Anti-Indemnity Statutes in All 50 States, available at* http://www.mwl-law.com/wp-content/uploads/2013/03/Anti-Indemnity-Statutes-In-All-50-States-00131938.pdf.

31 *See* N.Y. Gen. Oblig. Laws § 5-322.1.

32 *See* Or. Rev. Stat. § 30.140; *Walsh Construction,* 104 P.3d 1146 (Or. 2005).

33 In most cases, the parties can select the type of law to be applied to the interpretation of the indemnification agreement by including a choice of law provision in their contractual agreement.

[2] — Increasing Rates of Litigation Over Indemnification Agreements.

In many cases, even where a written indemnity agreement exists, parties will disagree about the duty or obligation to provide indemnification, leading to increasing rates of litigation over an indemnification's enforceability or scope. The most common indemnity disputes concern whether an indemnification obligation covers a specific claim or liability, another party's conduct or actions, or the enforceability of an indemnity provision under general contract principles.[34] An example of this type of litigation is evident in the case of a subcontractor's breach of action claim against a general contractor seeking to enforce the general contractor's indemnity obligations related to a personal injury claim pursued by the general contractor's employees for injuries arising under the parties' working agreement.[35] Another example is evident in a landowner's declaratory judgment action against an oil and gas company seeking to enforce a contractual indemnity obligation for water or soil contamination caused by oil and gas operations on the landowner's premises.[36]

[3] — Emerging Issues in Environmental Indemnification.

In recent years, the risks associated with environmental liability have increased due to an increasing federal and state environmental regulatory oversight and the availability of private rights of action for the release of

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34 *See e.g.,* Thompson v. The Budd Co., 199 F.3d 799 (6th Cir. 1999) (manufacturing plant owner could recover from construction corporation under indemnity provision as long as the plant owner was not defending claims arising out of its "sole negligence, or wanton and willful misconduct" and the plant owner was not 100 percent responsible for worker's injuries); Morton Thiokol, Inc. v. Metal Building Alteration Co., 193 Cal. App. 3d 1025 (1st Dist. 1987) (finding that in general a party is not permitted to be indemnified for its own active negligence under a general indemnity agreement, but can be when the parties' contract manifested a clear intent for the indemnification of its own negligence); Braye v. Archer-Daniels-Midland Co., 676 N.E.2d 1295 (Ill. 1997) (courts will not enforce promises to indemnify in construction contracts, as a matter of public policy, because their dominant aspect is disincentive for the indemnitee to exercise care).

35 *See e.g.,* Andresen v. Int'l Paper Co., 2014 U.S. Dist. LEXIS 112542 (Aug. 11. 2014).

36 *See e.g.,* Lodwick, L.L.C. v. Chevron U.S.A., Inc., 126 So. 3d 544 (La. App. 2 Cir. 2013).

hazardous chemicals, and land and water contamination.[37] This increasing risk of environmental liability has led to the explicit incorporation of indemnification requirements for environmental claims and liabilities into many contractual arrangements.[38] In fact many real estate transactions, such as lease agreements and asset purchases now contain both general indemnity and specific environmental indemnity provisions.[39] A large number of companies have also argued that a general or broad form indemnity provision providing indemnification for "claims, losses, damages, and liabilities" includes an intended indemnification for all environmental claims and liabilities.[40]

§ 8.04. Environmental Indemnification in Action.

Three recent environmental indemnification cases within the oil and gas industry demonstrate how indemnification for environmental claims have been asserted, the potential problems that can arise, and the necessity for drafting environmental indemnification agreements with care.

[1] — The Deepwater Horizon Explosion.

The Deepwater Horizon explosion, which occurred on April 20, 2010, resulted in the death of eleven people and a severe oil spill into the Gulf

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37 *See generally,* Alan Bressler, *Navigating the U.S. Environmental Liability Market (Part 1),* IRMI, (March 2002) (discussing generally increased awareness of environmental issues and necessity for environmental insurance); *Enforcement Basic Information,* EPA, (*last visited* May 9, 2015 at 5:50 p.m.) http://www2.epa.gov/enforcement/enforcement-basic-information (discussing the EPA's enhanced penalties for environmental violations).

38 *See e.g.,* Weston, Inc. v. Brush Wellman, Inc., 1994 WL 393685 (Ohio Ct. of App. 1994) (parties enacted specific environmental indemnification provision which was an essential and material term of the agreement to sell/purchase a particular piece of property); Channel Master Satellite Sys., Inc. v. JFD Elec. Corp., 702 F. Supp. 1229, 1232 (E.D.N.C. 1988) (providing explicit indemnification for the release or threat of release of hazardous substances).

39 James A. Vroman, "Structuring the Deal and Environmental Issues in the Real Estate Contract," *Jenner & Block*, (2007), *available at* https://jenner.com/system/assets/publications/2014/original/Ch3_forfinal.pdf?1319642205.

40 *See e.g.,* Trinity Indus., Inc. v. Chicago Bridge & Iron Co., 735 F.3d 131 (Pa. 2013); Goodyear Tire & Rubber Co. v. Lockheed Martin Corp., 2014 WL 4852129 (N.D. Ohio 2014).

of Mexico that lasted for nearly eighty-seven days.[41] At the conclusion of the spill, BP faced upwards of $40 billion in cleanup costs and resulting economic losses.[42] Transocean, the owner of the Deepwater Horizon oilrig, also sued BP under a contractual indemnification claim seeking to limit its liability for personal injury, wrongful death, economic loss, and property damage.[43] The basis of Transocean's indemnification allegations stemmed from Transocean and BP's reciprocal indemnification obligations, which were explicitly defined within a contractual agreement between Transocean and BP's predecessors.[44] The extent of BP's indemnification obligation was also at issue in a second suit by the United States for civil penalties arising under the Clean Water Act and the Oil Pollution Act of 1990, in which BP and Transocean each claimed that they were entitled to indemnification for accrued civil penalties.[45]

The contractual agreement at issue specifically provided that

> 24.1 CONTRACTOR [Transocean] RESPONSIBILITY
>
> [Transocean] SHALL ASSUME FULL RESPONSIBILITY FOR AND **SHALL PROTECT, RELEASE, DEFEND, INDEMNIFY, AND HOLD [BP] AND ITS JOINT OWNERS HARMLESS** FROM AND AGAINST ANY LOSS, DAMAGE, EXPENSE, CLAIM, FINE, PENALTY, DEMAND, OR LIABILITY **FOR POLLUTION OR CONTAMINATION,**

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41 *Deepwater Horizon Accident and Response,* BP, http://www.bp.com/en/global/corporate/gulf-of-mexico-restoration/deepwater-horizon-accident-and-response.html (last visited June 13, 2015).

42 *See In re* Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mexico on April 20, 2010, 808 F. Supp. 2d 943 (E.D. La. 2011); *In re* Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mexico on April 20, 2010, 841 F. Supp. 2d 988 (E.D. La. 2012); Iν ρε Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mexico on April 20, 2010, Case No. 10-2771, 2012 WL 2737726 (E.D. La. Jan. 31, 2012).

43 *In re* Triton Asset Leasing GmbH, No. 10-2771, 21 F. Supp. 3d 657 (E.D. La. 2014).

44 *Id*.

45 *In re* Oil Spill by the Oil Rig Deepwater Horizon in the Gulf of Mexico, 841 F. Supp. 2d 988 (E.D. La. 2012).

INCLUDING CONTROL AND REMOVAL THEREOF, **ORIGINATING ON OR ABOVE THE SURFACE OF THE LAND OR WATER,** FROM SPILLS, LEAKS, OR DISCHARGES OF FUELS, LUBRICANTS, MOTOR OILS, PIPE DOPE, PAINTS, SOLVENTS, BALLAST, AIR EMISSIONS, BILGE SLUDGE, GARBAGE, OR ANY OTHER LIQUID OR SOLID WHATSOEVER IN POSSESSION AND CONTROL OF [Transocean] AND WITHOUT REGARD TO NEGLIGENCE OF ANY PARTY OR PARTIES AND SPECIFICALLY WITHOUT REGARD TO WHETHER THE SPILL, LEAK, OR DISCHARGE IS CAUSED IN WHOLE OR IN PART BY THE NEGLIGENCE OR OTHER FAULT OF [BP], ITS CONTRACTORS, (OTHER THAN [Transocean]) PARTNERS, JOINT VENTURERS, EMPLOYEES, OR AGENTS. IN ADDITION TO THE ABOVE, [Transocean] TO A LIMIT OF FIFTEEN MILLION DOLLARES (US$ 15,000,000.00) PER OCCURANCE, SHALL RELEASE INDEMNIFY AND DEFEND [BP] FOR CLAIMS FOR LOSS OR DAMAGE TO THIRD PARTIES ARISING FROM POLLUTION IN ANY WAY CAUSED BY THE DRILLING UNIT WHILE IT IS OFF THE DRILLING LOCATION, WHILE UNDERWAY OR DURING DRIVE OFF OR DRIFT OFF FROM THE DRILLING LOCATION.

24.2 COMPANY [BP] RESPONSIBILITY

[BP] SHALL ASSUME FULL RESPONSIBILITY FOR AND **SHALL PROTECT, RELEASE, DEFEND, INDEMNIFY, AND HOLD [Transocean] HARMLESS** FROM AND AGAINST ANY LOSS, DAMAGE, EXPENSE, CLAIM, FINE, PENALTY, DEMAND, OR LIABILITY **FOR POLLUTION OR CONTAMINATION,** INCLUDING CONTROL AND REMOVAL THEREOF, ARISING OUT OF OR CONNECTED WITH OPERATIONS UNDER THIS CONTRACT HEREUNDER AND **NOT ASSUMED BY [Transocean]** IN ARTICLE 24.1 ABOVE, WITHOUT REGARD FOR NEGLIGENCE OF ANY PARTY OR

PARTIES AND **SPECIFICALLY WITHOUT REGARD FOR WHETHER THE POLLUTION OR CONTAMINATION IS CAUSED IN WHOLE OR IN PART BY THE NEGLIGENCE OR FAULT OF [Transocean].**

25.1 INDEMNITY OBLIGATION

EXCEPT TO THE EXTENT ANY SUCH OBLIGATION IS SPECIFICALLY LIMITED TO CERTAIN CAUSES ELSEWHERE IN THIS CONTRACT, THE PARTIES INTEND AND AGREE THAT **THE PHRASE "SHALL PROTECT, RELEASE, DEFEND, INDEMNIFY AND HOLD HARMLESS" MEANS** THAT THE INDEMNIFYING PARTY SHALL PROTECT, RELEASE, DEFEND, INDEMNIFY, AND HOLD HARMLESS THE INDEMNIFIED PARTY OR PARTIES FROM AND AGAINST ANY AND ALL CLAIMS, DEMANDS, CAUSES OF ACTION, DAMAGES, COSTS, EXPENSES (INCLUDING REASONABLE ATTORNEYS FEES), JUDGMENTS AND AWARDS OF ANY KIND OR CHARACTER, WITHOUT LIMIT AND WITHOUT REGARD TO THE CAUSE OR CAUSES THEREOF, INCLUDING PREEXISTING CONDITIONS, WHETHER SUCH CONDITIONS BE PATENT OR LATENT, THE **UNSEAWORTHINESS OF ANY VESSEL** OR VESSELS (INCLUDING THE DRILLING UNIT), BREACH OF REPRESENTATION OR WARRANTY, EXPRESSED OR IMPLIED, **BREACH OF CONTRACT, STRICT LIABILITY,** TORT, **OR THE NEGLIGENCE OF ANY PERSON OR PERSONS, INCLUDING THAT OF THE INDEMNIFIED PARTY, WHETHER SUCH NEGLIGENCE BE** SOLE, JOINT OR CONCURRENT, ACTIVE, PASSIVE OR **GROSS** OR ANY OTHER THEORY OF LEGAL LIABILITY AND WITHOUT REGARD TO WHETHER THE CLAIM AGAINST THE INDEMNITEE IS THE RESULT OF AN

INDEMNIFICATION AGREEMENT WITH A THIRD PARTY.[46]

In construing the indemnification agreement between BP and Transocean to require BP's indemnification of Transocean for gross negligence related to the oil spill and resulting environmental claims, the Federal Court found that because the reciprocal nature of the parties' agreement encouraged responsible conduct and avoidance of negligence, the agreement was enforceable.[47] The Federal Court also found however, that each party was responsible for payment of its own civil penalties under federal law.[48] Consequently, while BP could be required to compensate Transocean for environmental claims arising from the spill, BP could not be compelled to compensate Transocean for civil liabilities that were assessed against Transocean for violation of federal or state environmental regulations.[49]

The BP/Transocean indemnification dispute demonstrates that broad language such as "pollution" and "contamination" can be used to form the basis of a broad environmental indemnification agreement. Indemnification for environmental claims may therefore be required when the indemnification language is broad enough to cover an environmental contamination claim and the parties' agreement is otherwise fair and enforceable. The dispute further demonstrates that even when an applicable indemnification agreement could be construed to cover civil penalties for violations of federal environmental laws, federal courts are unlikely to require one party to indemnify another for assessed civil penalties.

[2] — Vermont Gas System's Proposed Pipeline Project.

In 2014, Vermont Gas System proposed a pipeline project that would span from Vermont to New York. In addition to raising significant public dialogue regarding pipeline construction, the proposed project hit a near

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46 *In re* Oil Spill by the Oil Rig Deepwater Horizon in the Gulf of Mexico, 841 F. Supp. 2d at 995.

47 *See In re* Triton Asset Leasing GmbH, *supra* n. 43; *In re* Oil Spill by the Oil Rig Deepwater Horizon in the Gulf of Mexico, *supra* n. 45.

48 *Id*.

49 *Id*.

fatal snag when Vermont residents demanded an extensive environmental indemnification agreement with the gas company in exchange for the town's agreement to the pipeline installation.[50] Vermont's residents specifically demanded that Vermont Gas System agree to indemnify the county and its residents for any physical damages, loss of use of its facilities, or "injury" caused by pipeline construction, operation, or maintenance.[51] By leaving the term "injury" as broad as possible, the town intended to force Vermont Gas System to provide indemnification for any environmental harm, not just personal injuries, that occurred from the pipeline's construction and use.[52] The residents further intended the agreement to require the gas company's correction of any perceived environmental damages without requiring any evidence of the pipeline project's connection to the alleged environmental damage.[53] Although Phase 2 of the pipeline project was ultimately abandoned and an environmental indemnification agreement was never reached, the project demonstrates the growing popularity and type of requests being made for extensive environmental indemnification agreements in contracts related to oil and gas operations.

[3] — TransCanada Keystone Pipeline Project.

The Keystone XL Pipeline is a proposed 1,179-mile (1,897 km), 36-inch-diameter crude oil pipeline beginning in Hardisty, Alberta, and extending south to Steele City, Nebraska, which has received significant public attention and scrutiny.[54] Before even initiating the project, TransCanada Keystone Pipeline LP, entered into a number of Pipeline Licenses, and Master Services Agreements that addressed TransCanada's indemnification obligations for

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50 John Flowers, "Updated: Vt. Gas, Cornwall eye agreement on Phase II pipeline," *Addison County Independent*, (Dec. 17, 2014), *available at* http://www.addisonindependent.com/201412vt-gas-cornwall-reach-agreement-phase-ii-pipeline.

51 *Id*.

52 *Id*.

53 *Id*.

54 Keystone XL Pipeline Project, Keystone XL, (last visited May 9, 2015) http://keystone-xl.com/.

environmental claims.[55] In its' 2008 Pipeline License with BNSF Railway Company, TransCanada Keystone Pipeline, LP agreed to the following:

> To the fullest extent permitted by law, [TransCanada] shall release, indemnify, defend and hold harmless [BNSF Railway Company] and its affiliated companies, partners, successors, assigns, legal representatives, officers, directors, shareholders, employees and agents ("collectively indemnitees" for, from, and against any and all claims, liabilities, fines, penalties, costs, damages, losses, liens, causes of action, suits, demands, judgments, and expenses (including without limitation, court costs, attorneys' fees and costs of investigation, **removal, and remediation and governmental oversight costs) environmental or otherwise (collectively "liabilities") of any nature, kind, or description of any person or entity director or indirectly arising out of, resulting from or related to**"[56]

Many companies involved in mineral resource exploration and development are now using language that is very similar to the language in the above agreement to contract for the indemnification of all claims, losses, damages, and liabilities arising out of a specific contract, including environmental claims and liabilities.

§ 8.05. Environmental Claims and Liabilities.

Environmental claims, liabilities, and penalties, can occur under numerous federal statutes, state laws, and local ordinances. Common environmental issues in the oil and gas industry can arise under the following:

[1] — Federal Environmental Laws.

[a] — Comprehensive Environmental Response Compensation and Liability Act

The Comprehensive Environmental Response Compensation and Liability Act (CERCLA) is an expansive environmental statute, which was enacted for purposes of requiring parties responsible for hazardous

55 *Id.*

56 TransCanada Keystone Pipeline LP Permits and Licenses, (Oct. 22, 2008), https://puc.sd.gov/commission/dockets/hydrocarbonpipeline/2007/hp07-001/103108trans1.pdf.

substances releases to clean up the environment or financially contribute to the cleanup or remediation effort.[57] CERCLA specifically requires generators and transporters of hazardous substances to remediate property where there has been a release[58] or threatened release of a hazardous substance.[59] A "release" under CERCLA is defined broadly to include any conceivable contact with the environment, such as a spill, leak, pump, pouring, emission, discharge, injection, escape, leach, dumping, or any other disposal into the environment.[60] A responsible party under CERCLA for a release or threatened release is financially responsible for remediation, testing, and other costs, which can include severe civil penalties and administrative fines.[61]

While a substantial number of oil and gas operations and activities are currently exempt under CERCLA, the EPA has intensified its focus on hydraulic fracturing operations and even proposed limiting the scope of CERCLA's current exploration exemption.[62] CERCLA further provides a private right of action against any potential responsible party under the legal doctrine of joint and several liability for costs incurred for responses to hazardous substances releases, which could therefore result in a civil action against an operator or driller not typically under CERCLA's purview.[63]

[b] — The Clean Water Act

The Clean Water Act (CWA) establishes regulations for the discharge of pollutants into U.S. controlled waters and regulates the overall quality

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57 *See generally*: Superfund Week, "Average Cost Per Site," June 3, 1994; Pipes, S., "Superfund Drains Economy," Policy Review, Heritage Foundation (Spring, 1994).

58 "Hazardous substances" under CERCLA include all substances that have been designated under CERCLA § 102, the Clean Water Act, the Resource Conservation and Recovery Act, Clean Air Act, or the Toxic Substance Control Act. *See* 40 C.F.R. § § 302.4.

59 42 U.S.C.A. § 9601 *et seq*. (1980).

60 42 U.S.C.A. § 9601(22).

61 *See generally*, 42 U.S.C.A. § 9607(a).

62 *See Exemption of Oil and Gas Exploration and Production Wastes from Federal Hazardous Waste Regulations*, EPA, http://www.epa.gov/osw/nonhaz/industrial/special/oil/oil-gas.pdf (last visited June 14, 2015).

63 42 U.S.C.A. § 9607(a)-(c).

standards for surface waters.[64] The CWA also provides the basis for a number of regulations on water pollution control programs and wastewater standards.[65] "Pollutants" are defined by the CWA as dredged soil, solid waste, incinerator residue, sewage, garbage, sewage sludge, munitions, chemical wastes, biological materials, radioactive materials, heat, rock, sand, industrial, municipal, and agricultural waste.[66] Before a pollutant can be legally discharged under the CWA, or added to a navigable surface water system, the entity seeking to discharge the pollutant must obtain a National Pollution Discharge Elimination System (NPDES) permit.[67] Until 2005, oil, gas, and mining operations were exempt from many CWA permitting requirements, but may require permits now, if there is a substantial risk of pollution to a water system from stormwater runoff or discharge.[68] Oil and gas operations are still however, substantially exempt from NPDES permitting requirements for stormwater discharges related to drilling and exploration activities.[69]

[c] — Resource Conservation and Recovery Act.

The Resource Conservation and Recovery Act, or RCRA, is a waste management system that was established for purposes of regulating disposal of "solid wastes."[70] RCRA regulations establish a "cradle to grave" system for hazardous waste substances, which effectively control the waste from the point of generation to its ultimate disposal.[71] RCRA hazardous wastes include the specific materials listed in the regulations (commercial chemical products, designated with the code "P" or "U"; hazardous wastes from specific industries/sources, designated with the code "K"; hazardous wastes from nonspecific sources, designated with the code "F") and materials, which exhibit a hazardous waste characteristic (ignitability, corrosivity, reactivity,

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64 33 U.S.C. § 1251 *et seq*. (1972).
65 *Id*.
66 33 U.S.C.A. § 1362(6).
67 33 U.S.C.A. § 1342.
68 33 U.S.C. § 1342(p)(3)(A).
69 33 U.S.C. § 1342.
70 42 U.S.C. § 6903(27).
71 *Id*.

or toxicity) designated with the code "D".[72] RCRA further requires that entities generating hazardous waste, that is not exempted under the standard, maintain accurate records of where the waste has accumulated and been transported, as well as ensure that all accumulated waste is properly stored, transported, and disposed.[73]

RCRA has an important exemption for wastes associated with certain oil and gas exploration and production activities, which include drilling fluids, produced waters, and other wastes associated with the production of crude oil, natural gas, and geothermal energy.[74] Not all wastes related to exploration and production activities are exempt however, and wastes exempted under RCRA may still be regulated under other state and federal waste management regulations.[75]

[d] — Safe Drinking Water Act.

The Safe Drinking Water Act (SDWA) was established to protect the quality of drinking water in the U.S. by protecting all waters actually or potentially designed for drinking use, whether contained in above ground or underground sources.[76] The SDWA authorizes the EPA to establish minimum standards for public water systems and enact specific standards for processes involving the underground injection of fluids.[77] The SDWA, like many other federal environmental laws, provides an exemption for certain oil and gas operations.[78] Most states have however, enacted additional groundwater and underground injection controls, which complement the SDWA and may apply to oil and gas operations in the state. State regulations working in conjunction with the SDWA are enforced by the state's environmental protection agency.

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72 *See* 40 C.F.R. § 261.31, § 261.32, § 261.33.

73 *Id*.

74 42 U.S.C.A. § 6935. *See also, Clarification of the Regulatory Determination for Wastes From the Exploration, Development and Production of Crude Oil, Natural Gas and Geothermal Energy,* 58 F.R. 15284-01 (1993).

75 42 U.S.C.A. § 6935.

76 42 U.S.C. § 300f *et seq*. (1974).

77 *Id*.

78 53 Fed. Reg. 25, 448.

[e] — The Clean Air Act.

The Clean Air Act (CAA) is a comprehensive federal law regulating air emissions from both stationary and mobile sources.[79] The CAA specifically authorizes the EPA to establish and enforce National Ambient Air Quality Standards (NAAQS) aimed at protecting public heath by reducing overall exposures to widespread air pollutants, such as volatile organic compounds, carcinogens, and toxins.[80] The CAA requires that any entity producing "hazardous air pollutants," such as benzene, toluene, xylene, methanol, mercury compounds, formaldehyde, and asbestos, above the established threshold quantity, obtain an operating permit from the EPA, monitor source emissions, and accurately report quantities of pollutant emissions on an annual basis.[81] In some cases, the CAA may always require that major sources of pollutants be managed by using the Maximum Achievable Control Technology for each source of pollution.[82]

While there is no explicit exemption for oil and gas operations under the CAA, the CAA allows oil and gas wells, and in some instances pipeline compressors and pump stations, to be assessed on a single source basis instead of being aggregated together for purposes of determining if a pollutant emission falls under National Emission Standards for Hazardous Pollutants (NESHAPs) and therefore requires a Maximum Achievable Control Technology.[83]

[f] — The Oil Pollution Act.

The Oil Pollution Act (OPA), which was signed into law in 1990, expanded the federal government's authority to respond to, control, and mitigate oil spills, by requiring regulated entities to establish spill prevention control measures, maintain adequate resources to respond to oil spills, and

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79 42 U.S.C.A. § 7401 *et seq*. (1970).

80 *Id*.

81 42 U.S.C.A. § 7412.

82 42 U.S.C.A. § 7412(n)(4).

83 *Id*.

compensate the federal government for any spills and or remediation costs.[84] Entities regulated under the OPA that fail to enact or maintain required spill prevention plans, notify the appropriate authority of an unauthorized spill, or engage in required clean up or remediation efforts can be issued both civil and criminal penalties.[85]

[g] — Toxic Substances Control Act.

The Toxic Substances Control Act, or TSCA, provides the EPA with authority to require reporting, record-keeping, testing requirements, and restrictions for specific chemical substances and/or mixtures.[86] TSCA specifically regulates production, importation, use, and disposal of hazardous chemicals such as polychlorinated biphenyls ("PCBs"), asbestos, radon and lead-based paint, by requiring certain notifications of the materials production, testing of chemicals for exposures, and maintaining extensive recordkeeping by persons who manufacture, import, process, and/or distribute chemical substances in commerce.[87]

Oil and gas exploration and production activities often meet TSCA's reporting requirements, such that operators and drillers may be required to report releases from point and fugitive on-site air, land, and water sources.[88] In some cases, TSCA reporting may even require reporting of substances used in hydraulic fracturing operations that are maintained on the site above a threshold quantity.[89]

[2] — Civil Penalties for Violation of Federal Environmental Laws.

Under each of the federal environmental laws discussed above, there is an extensive penalty structure for a violation of the federal statute, or

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84 33 U.S.C.A. § 2701 *et seq*. (1990).

85 33 U.S.C.A. § 4301.

86 15 U.S.C. § 2601 *et seq*. (1976).

87 40 C.F.R. § 704.1.

88 *Id*.

89 *Id*.

corresponding environmental regulation.[90] Many federal environmental statutes may also provide the basis for both a state based action or private right of action to address environmental contamination or harms.[91] Civil penalties can for example be issued at an amount of $25,000 per day, per violation, and be enhanced or limited based on the severity of the violation and discretion of the issuing administrative agency.[92] Criminal penalties may also be available for malicious and willful violations of a federal environmental law, which are assessed on a case-by-case basis.[93]

[3] — Environmental Claims and Liabilities in Pennsylvania, West Virginia and Ohio.

State laws establish the basis for many environmental claims and liabilities. For example, in the tristate area of Pennsylvania, West Virginia, and Ohio, the grounds for a number of environmental claims and liabilities in oil and gas operations can be found in the following state laws:

[a] — Pennsylvania.

In Pennsylvania, oil and gas exploration and development is heavily regulated under the state's Oil and Gas Act, Coal and Gas Resource Coordination Act, and Oil and Gas Conservation Law. Oil and gas activities are also regulated on an environmental level under Pennsylvania's Clean Streams Law, the Dam Safety and Encroachments Act, the Solid Waste Management Act, the Water Resources Planning Act and the Community Right to Know Act.[94] Under these laws, companies involved with oil and

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90 *See e.g., A Framework for Statute-Specific Approaches to Penalty Assessments: Implementing EPA's Policy on Civil Penalties,* EPA, http://www2.epa.gov/enforcement/framework-statute-specific-approaches-penalty-assessments-implementing-epas-policy-civil.

91 *See* U.S. v. Laughlin, 768 F. Supp. 957 (N.Y. 1991); U.S. v. Dee, 912 F.2d 741 (4th Cir. 1990); U.S. v. Int'l Minerals & Chem. Corp., 91 S. Ct. 1697 (1971); 42 U.S.C.A. § 7413(b); 33 U.S.C.A. § 309(d); 15 U.S.C.A. § 2615; 40 C.F.R. § 704.13.

92 *See generally,* 42 U.S.C.A. § 7413(b); 33 U.S.C.A. § 309(d); 15 U.S.C.A. § 2615; 40 C.F.R. § 704.13.

93 *See e.g.,* U.S. v. Hoflin, 880 F.2d 1033 (9th Cir. 1989); U.S. v. Hayes Int'l Corp., 786 F.2d 1499 (11th Cir. 1986); 42 U.S.C.A. § 7413(c).

94 *See* 58 Pa. C.S.A. § 3302; 25 Pa. Code § 79.1; 25 Pa. Code § 91.1; 25 Pa. Code § 105.88; 25 Pa. Code § 76.2; 25 Pa. Code § 110.2.

gas exploration in Pennsylvania must obtain a variety of permits related to air emissions, waste production and transportation, water use, and pollutant discharge from the Pennsylvania Department of Environmental Protection (DEP).[95]

A violation of a state environmental law can result in significant civil and criminal penalties.[96] In fact, under the majority of Pennsylvania's state environmental laws, the DEP is authorized to assess a civil penalty per day per violation, whether or not the violation was willful, and can apply a strict liability penalty assessment.[97] The DEP has even fined oil and gas companies operating in the state $2.5 million for environmental violations at well sites and pipeline routes over the past year.[98] The most commonly cited violations on oil and gas sites in Pennsylvania during 2013 and 2014 were for excess erosion, drilling mud spills into creeks, and failure to obtain appropriate permits.[99] Pennsylvania's environmental laws also provide grounds for private rights of action against entities in the oil and gas industry for damages to property, personal injury, and bodily harm under a number of legal theories including nuisance, trespass, negligence, and strict liability.[100]

[b] — West Virginia.

In West Virginia, oil and gas exploration is regulated under a variety of state laws, including the Oil and Gas Conservation Act, Coalbed Methane Wells and Units Act, Oil and Gas Wells Rule, and Oil and Gas Horizontal Well Rule.[101] West Virginia state law also imposes a number of waste and water pollution requirements on oil and gas operations through the state's oil

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95 *See generally,* 58 Pa. C.S.A. § 3302; 25 Pa. Code § 79.1; 25 Pa. Code § 91.1; 25 Pa. Code § 105.88; 25 Pa. Code § 76.2; 25 Pa. Code § 110.2.

96 *See e.g.,* 35 P.S. §§ 4001- 4106.

97 *See e.g.,* 35 P.S. § 4009.1(a).

98 *See* Laura Legere, "DEP Fined Oil and Gas Companies $2.5 Million Last Year," *StateImpact,* (Feb. 27, 2014 2:00 AM), http://stateimpact.npr.org/pennsylvania/2014/02/27/dep-fined-oil-and-gas-companies-2-5-million-last-year/.

99 *See* Legere, *supra* n. 98.

100 *See e.g.,* Lutz v. Chromatex, Inc., 718 F. Supp. 413 (M.D. Pa. 1989); DesJardien v. Strasburg Assoc., No. 85-02553 (Pa. Ct. C. P. Chester Cnty. March 18, 1986).

101 *See* WV ST § 22C-9-13; WV ST § 22-21-4; WV ST § 22-6B-7.

and gas program, which requires extensive air, waste, and water permitting as well as remediation of any environmental contamination.[102] A failure to comply with any regulation under the state's oil and gas program can result in both a civil and criminal penalty administered by West Virginia's Department of Environmental Protection's Office of Oil and Gas.[103]

In 2013, the West Virginia Department of Environmental Protection (WVDEP) issued a limited number of penalties to oil and gas companies in the state, but pursued significant fines and penalties for companies with operations that resulted in impounded streams, or significant discharge of debris.[104] For example, Chesapeake Appalachia, LLC, was required to spend an estimated $6.5 million and faced millions in civil penalties for the restoration of 27 sites that had been damaged by the unauthorized discharge of hydraulic fracturing materials into streams and wetlands.[105] West Virginia's environmental laws also provide grounds for private rights of action against entities in the oil and gas industry for damages to property, personal injury, and bodily harm under a number of legal theories including nuisance, trespass, negligence, and strict liability.[106]

[c] — Ohio.

The Ohio Department of Natural Resources, Division of Oil and Gas Resources Management, and the Ohio Environmental Protection Agency

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102 *See, e.g.,* W. Va. Code § 22-6-7 (1994) (providing for water pollution control permits issued by Chief); W. Va. Code § 22-6-35 (1994) (allowing civil action presumption of contamination or deprivation of a fresh water source or supply); W. Va. Code -12-1 to -4 (1996) (effective date 1993) (providing for solid waste permit issued by Chief by rule if there is compliance with W. Va. Code § 38-18). In cases where the operator does not obtain the requisite water pollution or waste permit from the Chief, it should be inferred that the operator is required by the pertinent water and waste regulatory requirements to obtain a permit under each respective program. *See* W. Va. Code § 22-11-8 (1994) (water); W. Va. Code § 22-15-10 (1994) (waste).

103 *See generally,* W. Va. Code, § 22-6-34

104 *See* Dale Kemery, *Energy Company to Pay $3.2 Million Penalty to Resolve Cleanup Water Violations in West Virginia,* EPA (Dec. 19, 2013), http://yosemite.epa.gov/opa/admpress.nsf/ bd4379a92ceceeac8525735900400c27/82ef516757fcd5dd85257c4600814c2b!opendocument.

105 *Id.*

106 *See e.g.,* Taylor v. Culloden Pub. Serv. Dist., 591 S.E.2d 197 (W. Va. 2003).

regulate oil and gas operations within the state of Ohio extensively.[107] The location, spacing, construction, design, and operation of wells are regulated specifically under the Ohio Revised Code, and Ohio Administrative Code.[108] Ohio's laws impose significant permitting requirements on all operations involving drilling, well deepening, well reopening, well conversion, Class II injection, and enhanced well recovery.[109] Ohio's laws also require certain notification and reporting requirements for cementing, well completion, stimulation, and production activities in urban and non-urban areas, and site restoration and remediation of all environmental contaminations.[110]

Ohio law authorizes the Ohio Environmental Protection Agency and Department of Natural Resources, Division of Oil and Gas Resources Management to pursue criminal and civil penalties against any person found to have violated a provision of Ohio's revised code, or oil and gas regulations.[111] Persons in violation of the act are also liable for any damage or injury caused by a violation of the act and responsible for the cost of rectifying the violation and conditions caused by the violation.[112] Recent legislation proposed in Ohio, if enacted, would give the Ohio Department of Natural Resources the authority to revoke the operating licenses of companies or persons found to have violated Ohio's environmental regulations pertaining to oil and gas operations.[113] Ohio's environmental laws also provide grounds for private rights of action against entities in the oil and gas industry for

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107 *See generally, Ohio's Regulations: A Guide for Operators Drilling in the Marcellus and Utica Shales,* Ohio Environmental Protection Agency, (March 2012), http://www.epa.state.oh.us/Portals/0/general%20pdfs/Ohio%20Regulations%20-%20A%20Guide%20for%20Operators%20Drilling%20in%20the%20Marcellus%20and%20Utica%20Shales.pdf.

108 *Id*.

109 *See generally,* R.C. § 1509.01.

110 *Id*.

111 *See* R.C. § 1509.33.

112 *Id*.

113 *See e.g.,* Ohio House Bill 490; Kathiann M. Kowalski, "Ohio Bill's Fracking Provisions Clash with Federal Law," *Midwest Energy News,* (Dec. 4, 2014), http://www.midwestenergynews.com/2014/12/04/ohio-bills-fracking-provisions-could-clash-with-federal-law/.

damages to property, personal injury, and bodily harm under a number of legal theories including nuisance, trespass, negligence, and strict liability.[114]

§ 8.06. Enforcement of Indemnification Agreements for Environmental Claims and Liabilities.

The enforceability of an indemnification agreement for an environmental claim or liability depends on the contract's validity, the indemnification scope, and whether the applicable jurisdiction's law authorizes indemnification for the environmental claim or liability at issue.

[1] — Federal Law.

The indemnification of environmental claims and liability arising under federal law is discussed extensively in federal case law analyzing the validity of indemnification and release agreements for CERCLA related liabilities and penalties.[115] When determining whether any particular agreement covers a CERCLA related claim or liability, federal courts first analyze the validity of the agreement under the applicable state's contract law.[116] When an indemnification agreement is valid under state law, federal courts will find that the an agreement properly allocates the risks of liability between the parties for CERCLA related claims and liabilities when either (1) general indemnity language can be strictly construed to cover CERCLA liability, or (2) the parties explicitly contracted for the indemnification of CERCLA or all environmental-type liabilities.[117] Federal courts will not however, find indemnification for CERCLA related penalties.[118]

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114 *See e.g.,* Skiles v. Bellevue Dev. Corp., 2008-Ohio-78, ¶ 3, 2008 WL 110628 (App. Ct. of Ohio 2008).

115 *See* Johnson, *supra* n. 4.

116 *See e.g.*, Beazer E. v. Mead Corp., 34 F.3d. 206 (3d. Cir. 1996). If however, the federal government is a party, federal law is applied to the interpretation of the contract. *See* Penn Cent. Corp. v. United States, 862 F. Supp. 437 (Reg'l Rail Reorg. Ct. 1994).

117 *See e.g.*, Mobay Corp. v. Allied-Signal, Inc., 761 F. Supp. 345 (D.N.J. 1991).

118 *See e.g.*, Hays v. Mobil Oil Corp., 736 F. Supp. 387, 393 (D. Mass.1990) (finding that indemnity clauses are permitted under CERCLA, but cannot shift the responsibility for CERCLA penalties).

The analysis applied by federal courts to determine the validity and enforceability of indemnification agreements for environmental claims is clearly demonstrated in the case of *Beazer East, Inc. v. Mead Corp.*[119] In *Beazer East,* the Third Circuit Court of Appeals began its analysis by considering whether parties could lawfully agree to a transfer liability under CERCLA in indemnification agreements and held that "agreements to indemnify or hold harmless are enforceable between the parties but not against the government."[120] The parties indemnification agreement at issue in *Beazer East,* could therefore lawfully shift liability for CERCLA related claims, if the agreement was valid and sufficiently specific, but could not shift liability for government issued penalties or fines.[121]

To determine whether the indemnification agreement was sufficiently specific to cover CERCLA related liabilities, the Third Circuit Court of Appeals turned to state contract law for interpretation of the agreement.[122] As the applicable state law lacked an analysis on environmental indemnification agreements, the court applied the majority rule that indemnification agreements would shift CERCLA liability if such agreements were "worded broadly enough to encompass any and all liabilities, or if environmental liability is clearly referred to in the agreement."[123] In finding that the indemnification agreement at issue was broad enough to cover CERCLA liability and was enforceable under the applicable state law, the federal court found that the indemnification agreement for CERCLA liabilities was valid and enforceable between the parties.[124]

Beazer East, and subsequent federal case law, demonstrates that indemnification agreements can be used to transfer liability for federal environmental claims and related liability, but must be sufficiently specific

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119 Beazer East, Inc. v. Mead Corp., 34 F.3d 206, 211 (3d Cir.1994). *Supra* n. 116.

120 *Beazer East, Inc., supra* n. 119 (*quoting* Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 89 (3d Cir.1988), *cert. denied*, 488 U.S. 1029, 109 S. Ct. 837, 102 L. Ed.2d 969 (1989)), *cert. denied*, 514 U.S. 1065, 115 S. Ct. 1696, 131 L. Ed.2d 559 (1995)).

121 *Id*.

122 *Id*.

123 *Id*. at 212 (*internal quotations omitted).*

124 *Id*. at 215.

under the applicable state's jurisdictions.[125] Parties are not permitted however, to transfer liability for claims and penalties pursued by the government.[126]

[2] — State Law.

The validity and enforceability of indemnification agreements under state law varies substantially. The analysis below provides a summary of Pennsylvania, West Virginia, and Ohio's treatment of indemnification agreements:

[a] — Pennsylvania.

Indemnification agreements are enforceable in Pennsylvania, but can be limited by Pennsylvania's indemnification jurisprudence or Pennsylvania's anti-indemnification statute.[127] Pennsylvania's anti-indemnification statute has a limited scope and invalidates only certain indemnification agreements related to architecture, engineering, and construction.[128] Although Pennsylvania does not require that specific language be included in an indemnification agreement before the agreement will be found valid, the agreement's language must provide sufficient evidence that the parties meant for one party to indemnify the other.[129] Pennsylvania courts therefore generally require that the parties' agreement contain language equivalent to the classic "save, keep harmless, and indemnify" clause before finding that the parties intended to create an indemnification agreement.[130] Indemnification agreements and clauses are further afforded strict construction and interpreted in a way that is consistent with the plain and ordinarily expressed meaning of the contract language.[131]

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125 *Id*. *See also,* Johnson, *supra* n. 4.

126 *Id*.

127 68 P.S. § 491.

128 *Id*.

129 *See e.g.,* Babjack v. Mount Lebanon Parking Auth., 518 A.2d 1311, 1313 (Pa. Commw. Ct. 1986).

130 *See e.g.,* Ersek v. Springfield Twp., 634 A.2d 707 (Pa. Commw. Ct. 1993) (finding that an exculpatory clause did not create an indemnity agreement, because there was no additional language referring to indemnification).

131 *See e.g.,* Fox Park Corp. v. James Leasing Corp., 641 A.2d 315 (Pa. Super. 1994).

When interpreting the scope of an indemnification agreement, Pennsylvania courts apply the longstanding rule that before a general indemnity agreement will be construed as requiring the indemnitor to indemnify the indemnitee for liability resulting from the indemnitee's own negligence; the agreement must expressly reference the negligence of the indemnitee.[132] Pennsylvania courts are also hesitant to construe the terms of an indemnification agreement to provide coverage for a party's active or sole negligence and intentional conduct or torts, and therefore require that the indemnification agreement unambiguously provide indemnification for such conduct before requiring a party to provide indemnification for another's sole negligence or intentional actions.[133] Accordingly, even though the general inclination may be to write a broad indemnification clause, Pennsylvania case law clearly demonstrates that specific provisions, rather than broad, general statements, are the basis of an effective indemnity agreement.

While Pennsylvania courts have yet to specifically analyze the enforceability of indemnification provisions for environmental claims and liabilities, these agreements will likely be enforceable when the agreements explicitly reference indemnification for environmental liabilities.

[b] — West Virginia.

Indemnification contracts are valid and enforceable under West Virginia law and are construed under ordinary rules for contract construction.[134] To be valid and enforceable, West Virginia courts generally require that "the indemnity language in question [must] be sufficiently plain, unambiguous, and broad to cover the losses incurred."[135] Although West Virginia courts

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132 *See* Greer v. City of Philadelphia, 795 A.2d 376, 381-82 (Pa. 2002) (applying the *Perry-Ruzzi* rule, which requires explicit reference to the indemnitee's own negligence). *See also* Perry v. Payne, 66 A. 553 (Pa. 1907) (holding that a contract of indemnity against personal injuries should not be construed to indemnify against the negligence of the indemnitee, unless it is so expressed in unequivocal language).

133 *See* Bethlehem Steel Corp. v. MATX, Inc., 703 A.2d 39, 43 (Pa. Super. Ct. 1997). *See also,* Ruzzi v. Butler Petroleum Co., 588 A.2d 1 (Pa. 1991); Hackman v. Moyer Packing, 621 A.2d 166 (Pa. 1993); Perry v. Payne, 217 Pa. 252, 66 A. 553 (1907).

134 Sellers v. Owens-Illinois Glass Co., 191 S.E.2d 166, 169 (W. Va. 1972).

135 VanKirk v. Green Const. Co., 466 S.E.2d 782, 788-89 (W. Va. 1995).

do not require any particular language to be enforceable, the agreement must fully define the parties' intended allocation of risk.[136] Each word contained in the indemnification agreement will therefore be treated as meaningful and given its full reasonable effect.[137]

West Virginia law places only limited restrictions on indemnification agreements and allows for contracts to provide indemnification for a party's own or sole negligence.[138] The state's anti-indemnification statute does however; limit the enforceability of broad form indemnification agreements covering the "sole negligence" of the indemnitee.[139] Under the statute, a broad indemnity agreement will be void only: (1) if the indemnitee is found by the trier-of-fact to be solely (100 percent) negligent in causing the accident; and (2) it cannot be inferred from the contract that there was a proper agreement to purchase insurance for the benefit of all concerned.[140]

To date, West Virginia courts have engaged in only a limited analysis of environmental indemnification agreements. In *Perrine v. E.I. Du Pont De Nemours and Co*. for example, the West Virginia trial court held that an indemnification clause embodied in the parties' real estate agreement, which indemnified "the past, current, or future environmental condition of the Real Property, *including, but not limited to... any liabilities* related to the off-site migration of soil, sediment, groundwater or surface water from the Real Property," was valid and enforceable.[141] In finding the agreement valid, the trial court further concluded that the risk of environmental contamination and claims under the agreement had been properly allocated through indemnification, but required an assessment of liability before the risk could be properly shifted.[142]

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136 *See* Dalton v. Childress Serv. Corp., 432 S.E.2d 428, 431 (W. Va. 1993).

137 *See* Diamond v. Parkersburger-Aetna Corp., 122 S.E.2d 436, 442 (W. Va. 1961) (*quoting* State v. Harden, 58 S.E. 715 (W. Va. 1912)).

138 Riggle v. Allied Chem. Corp., 378 S.E.2d 282, 288 (W. Va. 1989).

139 W.Va. Code § 55–8–14.

140 *Id*. *See also*, *Riggle*, 378 S.E.2d 282 (W. Va. 1989).

141 Perrine v. E.I. Du Pont De Nemours and Co., 694 S.E.2d 815 (W. Va. 2010).

142 *Id*.

West Virginia's current case law and contract jurisprudence demonstrate that agreements for the indemnification of environmental claims and liabilities will be valid and enforceable, but should be worded in a clear and unambiguous way to ensure proper interpretation and effect.

[c] — Ohio.

Ohio law generally allows for the execution and enforceability of indemnification agreements, but will invalidate indemnification agreements that provide for indemnity of one's own negligence, intentional conduct, or criminal activities.[143] Additionally, agreements providing for the indemnification of a party's own negligence will be invalidated, regardless of whether such negligence is sole or concurrent with another party's.[144] When determining the scope and extent of the parties' indemnification agreement, Ohio courts will apply the plain and ordinary meaning of the contracts language.[145] In the event that the indemnification agreement is ambiguous, Ohio courts will strictly construe the language to limit the scope of indemnification available to only what was intended by the parties, but will not construe the language strictly against the drafter.[146]

It is important to note that in Ohio, a contract of indemnity will not be construed to indemnify against the negligence of the indemnitee unless the contract clearly expresses the intention of the parties to indemnify for the indemnitee's own negligence "beyond doubt and by express stipulation."[147] Ohio courts also refuse to infer an indemnification agreement for the indemnitee's negligence or conduct from the contract as a whole and require explicit and direct language of such in the contract's language.[148]

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143 *See* Potti v. Duramed Pharm., Inc., 938 F.2d 641 (6th Cir.1991); Brown v. Gallagher, 902 N.E.2d 1037, 1040 (Oh. App. 2008); Ohio Rev. Code Ann. § 2305.31.

144 *See* Ohio Rev. Code Ann. § 4123.82(a); Ohio Rev. Code Ann. § 2305.31; Kendall v. U.S. Dismantling Co., 485 N.E.2d 1047 (Ohio 1985).

145 Cleveland Window Glass & Door Co. v. Nat'l Surety Co., 161 N.E. 280 (Ohio 1928).

146 Glaspell v. Ohio Edison Co., 505 N.E.2d 264, 266 (Ohio 1987) (*citing* 15 Williston on Contracts, § 1750, at 141 (1972)).

147 Kay v. The Pennsylvania R.R. Co. v. The Orr Felt & Blanket Co., 103 N.E.2d 751, 752 - 753 (Ohio 1952) (*quoting* George H. Drugledy Lumber Co. v. Erie R.R. Co., 102 Ohio St. 236, 131 N.E. 723 (1921)).

148 *Id*.

While Ohio courts have yet to specifically analyze the enforceability of indemnification provisions for environmental claims and liabilities, these agreements will likely be enforceable when the agreements explicitly reference indemnification for environmental liabilities or are broad enough to cover environmental claims, and specifically address the indemnitee's conduct intended to be covered by the agreement.

§ 8.07. Recommendations and Conclusions.

Parties can certainly enter into enforceable indemnification agreements for environmental claims and liabilities, but must ensure that appropriate language is included in the indemnity provision that explicitly identifies the applicable law interpreting the agreement, and the scope of environmental claims or liabilities that are intended to be indemnified. This can be accomplished best, by incorporating an explicit choice of law provision into the indemnification agreement that defines the specific law to be applied to the interpretation of the provision. Parties should also ensure that the provision provides an explicit statement of an intention for one party to indemnify another for environmental claims and liabilities and detail the types of environmental claims and liabilities requiring indemnification. If for example, the parties intend to provide indemnification for hazardous substance releases, emissions, or land and water contamination, this should be stated clearly in the indemnification language. While the parties are certainly permitted to enter into a broad form indemnification agreement and the agreement may ultimately be found enforceable for environmental claims and liabilities, indemnification agreements not providing for specific coverage of environmental claims may be substantially limited in scope under the applicable jurisdiction's contract and indemnity laws. Furthermore, even if parties intend to provide indemnification for regulatory compliance and assessed civil penalties, and state so explicitly in the indemnification language, these agreements will likely be invalidated in whole or in part under the applicable federal and state laws.

Chapter 9

Advancing Your Strategies for Managing Litigation Risk and Reputation Exposure from Health-Related Allegations

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There is a growing proliferation of unreliable scientific and medical articles being published attempting to link gas development activities to various medical conditions. Property owner claims of personal injury from natural gas development activities require expert testimony concerning the health risks and effects allegedly caused by the alleged exposures. It will be important for counsel defending these claims in litigation to be able to critically analyze the published articles through the use of reliable and well-qualified experts and preclude the admission of the unreliable science through the use of *Daubert* motions.[1]

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1 In *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1992), the United States Supreme Court held that the trial court must be a gatekeeper to assure that expert testimony is based on sufficient facts or data, is the product of reliable principles and methods, and that the expert has reliably applied the principles and methods to the facts of the case.

Plaintiffs may raise two types of personal injury claims: claims of present injury and claims for medical monitoring of anticipated future injury.

§ 9.01. Proof Required for Personal Injury Claims.

Claims for present injury require proof of causation through expert testimony. A plaintiff must prove general causation, that the exposure to the claimed constituents causes the condition; and specific causation, that the plaintiff's exposure in fact caused her condition.[2]

[1] — General Causation.

General causation is often established through the use of epidemiologic studies. Epidemiologic evidence identifies agents that are associated with an increased risk of disease in groups of individuals, quantifies the amount of excess disease that is associated with an agent, and provides a profile of the type of individual who is likely to contract a disease after being exposed to an agent. It is important to note that an association is not equivalent to causation. An association identified in an epidemiologic study may or may not be causal. "Assessing whether an association is causal requires an understanding of the strengths and weaknesses of the study's design and implementation, as well as a judgment about how the study findings fit with other scientific knowledge."[3]

Plaintiffs often attempt to rely on risk assessments which include "worst-case scenario" exposure and toxicity assumptions. In examining expert testimony relying on such risk assessments, courts have recognized that "risk assessments have largely been developed for regulatory purposes and thus serve a protection function in providing a level below which there is no appreciable risk to the general population. They do not provide information about actual risk or causation."[4] Similarly, case reports and case studies

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2 *See* Michael D. Green *et. al.*, *Reference Guide on Epidemiology, in Reference Manual on Scientific Evidence* 549, 552 (3d ed. 2011) ("This terminology and the distinction between general causation and specific causation is widely recognized in court opinions."); *see also* Soldo v. Sandoz Pharm. Corp., 244 F. Supp. 2d 434, 525 (W.D. Pa. 2003).

3 Green *et. al.*, *supra* note 2, at 553.

4 Rhodes v. E.I. DuPont de Nemours & Co., 253 F.R.D. 365, 377 (S.D. W. Va. 2008).

are universally regarded as an insufficient basis for a conclusion regarding causation because case reports lack controls.[5]

[2] — Specific Causation.

To prove specific causation, a plaintiff must prove through expert testimony that she was exposed to a dose of a constituent in sufficient quantity to cause the claimed injury.[6] Proof of dose is required because "all chemical agents are intrinsically hazardous — whether they cause harm is only a question of dose."[7] "The dose makes the poison."[8] Accordingly, establishing a dose-response relationship (*i.e.*, the amount of exposure to a dose above the safe level) is a necessary step in the causation analysis.[9] The "most widely-used method of demonstrating causation in toxic tort cases is to present scientifically-accepted information about the dose-response curve for the toxin which confirms that the toxin can cause the health effects experienced by the plaintiff at the dosage the plaintiff was exposed to."[10] "It is therefore not enough for a plaintiff to show that a certain chemical agent sometimes causes the kind of harm that he or she is complaining of. At a minimum, we think that there must be evidence from which the factfinder can conclude that the plaintiff was exposed to levels of that agent that are known to cause the kind of harm that the plaintiff claims to have suffered."[11]

Additionally, a plaintiff through expert testimony must rule out alternative causes for her condition. A "differential diagnosis" excluding

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5 Hall v. Baxter Healthcare Corp., 947 F. Supp. 1387, 1411 (D. Or. 1996).

6 *See* Allen v. Pa. Eng'g Corp., 102 F.3d 194, 199 (5th Cir. 1996) ("Scientific knowledge of the harmful level of exposure to a chemical, plus knowledge that the plaintiff was exposed to such quantities, are minimal facts necessary to sustain the plaintiffs' burden in a toxic tort case.").

7 Bernard D. Goldstein and Mary Sue Henifin, "Reference Guide on Toxicology," *Reference Manual on Scientific Evidence* 633, 636 (3d ed. 2011).

8 *Id*. (observing that one of the three central tenets of toxicology is that "the dose makes the poison").

9 McClain v. Metabolife Int'l, Inc., 401 F.3d 1233, 1241 (11th Cir. 2005) ("[T]he link between an expert's opinions and the dose-response relationship is a key element of reliability in toxic tort cases.").

10 Young v. Burton, 567 F. Supp. 2d 121, 128 (D.D.C. 2008).

11 Wright v. Willamette Indus., Inc., 91 F.3d 1105, 1108 (8th Cir. 1996).

alternative causes is a necessary element of specific causation, and the failure to perform a scientifically reliable differential diagnosis requires exclusion of a specific causation expert.[12] In order for an expert's proffered opinion to be admissible, a differential diagnosis should reliably rule out reasonable alternative causes of the alleged harm.[13] While an expert does not need to rule out *all* alternative possible causes, "[w]here a defendant points to a plausible alternative cause and the doctor offers no explanation for why he or she has concluded that was not the sole cause," the expert's methodology is unreliable.[14]

A plaintiff's causation expert may not rely exclusively on the temporal relationship between the claimed exposure and the onset of the condition. While temporality can support a specific causation opinion, it cannot be the primary support for a specific causation opinion.[15] It is well-settled that it is unreliable for an expert to show causation from a temporal relationship alone.[16]

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12 *In re* Paoli R.R. Yard PCB Lit., No. 86-2229, 2000 WL 1279922, at *5 (E.D. Pa. Sept. 6, 2000) ("[C]ourts have insisted time and again that an expert may not give opinion testimony to a jury regarding specific causation if the expert has not engaged in the process of differential diagnosis.").

13 Perry v. Novartis Pharm. Corp., 564 F. Supp. 2d 452, 469 (E.D. Pa. 2008).

14 Heller v. Shaw Indus., Inc., 167 F.3d 146, 156 (3d Cir. 1999); *see also Soldo*, 244 F. Supp. 2d at 551 ("[T]his Court must explore the alternative hypotheses posited by defendant's experts and plaintiff's experts' response thereto. If the alternative hypotheses are 'plausible,' then plaintiff's experts must show that they have been reliably ruled out."); Pritchard v. Dow Agro Scis., 705 F. Supp. 2d 471, 491-92 (W.D. Pa. 2010) (excluding expert who failed to reliably rule out potential alternative causes).

15 Roche v. Lincoln Prop. Co., 278 F. Supp. 2d 744, 764 (E.D. Va. 2003) ("An opinion based primarily, if not solely, on temporal proximity does not meet *Daubert* standards.").

16 *See* Moore v. Ashland Chem., 151 F.3d 269, 278 (5th Cir. 1998) ("In the absence of an established scientific connection between exposure and illness, … the temporal connection between exposure to chemicals and an onset of symptoms, standing alone, is entitled to little weight in determining causation."); *McClain*, 401 F.3d at 1244 ("simply because a person takes drugs and then suffers an injury does not show causation. Drawing such conclusions from temporal relationships leads to the blunder of the *post hoc ergo propter hoc* fallacy."); Buzzerd v. Flagship Carwash of Port St. Lucie, Inc., 669 F. Supp. 2d 514, 530 (M.D. Pa. 2009) (observing that temporal connection is entitled to little weight and that there must be evidence of exposure of such a degree and duration as to cause the injury); Moody v. Gen. Mills, Inc., No. 04-1942, 2006 WL 6872309, at *2 (D. N.J. Feb. 9, 2006) (observing various

§ 9.02. Proof Required for Medical Monitoring Claims.

A claim for medical monitoring of a potential future condition requires proof through expert testimony of seven factors:

1. exposure to greater than normal background levels;
2. of a proven hazardous substance;
3. caused by the defendant's negligence;
4. as a proximate result of the exposure, plaintiff has a significantly increased risk of contracting a serious latent disease;
5. a monitoring procedure exists that makes the early detection of the disease possible;
6. the prescribed monitoring regime is different from that normally recommended in the absence of the exposure; *and*
7. the prescribed monitoring regime is reasonably necessary according to contemporary scientific principles.[17]

Because of the difficulty in proving these seven factors, to date many of the medical monitoring claims are being abandoned by plaintiffs before trial or are dismissed by the court because plaintiffs cannot come forward with the required expert testimony to prove such claims.

§ 9.03. Standards for Admission of Expert Testimony.

The use of scientific and medical literature differs in law and in science.

> Beyond the meanings of certain key words, science and the law differ fundamentally in their objectives. The objective of the law is justice; that of science is truth. These are among the highest goals to which humans can aspire, but they are not the same thing. Justice, of course, also seeks truth, but it requires that clear decisions be

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courts have noted that "reliance on a temporal relationship in the absence of scientific studies, authoritative research or peer review is insufficient to constitute a reliable opinion"); *In re* Breast Implant Litig., 11 F. Supp. 2d 1217, 1232 (D. Colo. 1998) ("A temporal relationship by itself, provides no evidence of causation."); Sanderson v. Int'l Flavors, 950 F. Supp. 981, 1000 (C.D. Cal. 1996) ("Temporal coincidence does not support legal causation."); Schmaltz v. Norfolk & W. Ry. Co., 878 F. Supp. 1119, 1122 (N.D. Ill. 1995) ("It is well settled that a causation opinion based solely on a temporal relationship is not derived from the scientific method and is therefore insufficient to satisfy the requirements of [Rule] 702").

17 *In re* Paoli R.R. Yard PCB Litig., 113 F.3d 444, 461-62 (3d Cir. 1997).

> made in a reasonable and limited period of time. In the scientific search for truth there are no time limits and no point at which a final decision must be made.[18]

While public opinion may be swayed by unreliable science and by predictions of future impacts, a plaintiff's burden of proof in litigation requires more than a prediction about what science may prove. "Law lags science; it does not lead it."[19] Because of this, courts are required to be gatekeepers to assure that expert testimony conforms to the required legal and scientific standards.

It is the proponent of the expert testimony who has the burden of proof to establish all the requirements in Rule 702 "by a preponderance of proof."[20] The burden is "substantial" and requires more than just "taking the expert's word for it."[21] Courts interpreting Rule 702 have determined that it "embodies a trilogy of restrictions on [the admissibility of] expert testimony: qualification, reliability and fit."[22]

[1] — Qualification.

To meet the qualification requirement of Rule 702, the witness must "possess specialized expertise."[23] "We have interpreted this requirement liberally, holding that a broad range of knowledge, skills and training qualify an expert as such."[24] "An expert may be generally qualified but may lack qualifications to testify outside his area of expertise."[25]

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18 David Goodstein, "How Science Works," *Reference Manual on Scientific Evidence* 37, 52 (3d ed. 2011).

19 Rosen v. Ciba-Geigy Corp., 78 F.3d 316, 319 (7th Cir. 1996).

20 Oddi v. Ford Motor Co., 234 F.3d 136, 144 (3d Cir. 2000).

21 Cook ex rel. Tessier v. Sheriff of Monroe Cnty., Fla., 402 F.3d 1092, 1107 (11th Cir. 2005); Fed R. Evid. 702, advisory committee's note, 2000 amendment (internal quotation marks omitted); *see also McClain*, 401 F.3d at 1245 ("*[A]ny* step that renders the [expert's] analysis unreliable under the *Daubert factors renders the expert's testimony inadmissible*.") (emphasis in original).

22 Schneider v. Fried, 320 F.3d 396, 404 (3d Cir. 2003) (citations omitted).

23 *Id*. at 405.

24 Calhoun v. Yamaha Motor Corp., U.S.A., 350 F.3d 316, 321 (3d Cir. 2003) (quoting *In re Paoli,* 35 F.3d at 741).

25 *Id*. at 322.

[2] — Reliability.

To meet the reliability requirement of Rule 702, "the expert's opinion must be based on the methods of science rather than on subjective belief or unsupported speculation."[26] There are several factors a court must assess to determine whether a particular method is reliable, including: "(1) whether a method consists of a testable hypothesis; (2) whether the method has been subject to peer review; (3) the known or potential rate of error; (4) the existence and maintenance of standards controlling the technique's operation; (5) whether the method is generally accepted; (6) the relationship of the technique to methods which have been established to be reliable; (7) the qualifications of the expert witness testifying based on the methodology; and (8) the non-judicial uses to which the method has been put."[27] These factors "are neither exhaustive nor applicable in every case."[28]

In addition to these factors, and as described in the comments to the 2000 amendments to Rule 702, courts should consider whether the expert has unjustifiably extrapolated from an accepted premise to an unfounded conclusion.[29] Importantly, the trial court may also consider whether the expert has adequately accounted for obvious alternative explanations.[30] Additionally, courts may consider whether the experts are "proposing to testify about matters growing naturally and directly out of research they have conducted independent of the litigation, or whether they have developed their opinions expressly for purposes of testifying."[31] Finally, the court may consider whether the expert "is being as careful as he would be in his regular professional work outside his paid litigation consulting."[32] Thus, the

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26 *Id*. at 321.

27 *In re Paoli*, 35 F.3d 717, 742.

28 Kannankeril v. Terminix Int'l, Inc., 128 F.3d 802, 806-07 (3d Cir. 1997).

29 General Elec. Co. v. Joiner, 522 U.S. 136, 146 (1997) (observing that the trial court "may conclude that there is simply too great an analytical gap between the data and the opinion proffered"); *Heller*, 167 F.3d at 153 ("a district court must examine the expert's conclusions in order to determine whether they could reliably follow from the facts known to the expert and the methodology used.").

30 *See* Claar v. Burling N.R.R., 29 F.3d 499 (9th Cir. 1994).

31 *Daubert*, 43 F.3d at 1317.

32 Sheehan v. Daily Racing Form, Inc., 104 F.3d 940, 942 (7th Cir. 1997).

court must make certain that an expert "employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field."[33]

Because the existence of peer-reviewed literature supporting the expert's opinion is one of the reliability factors recognized by the courts, litigation experts and groups supporting litigation positions are actively pursuing the publication of articles in so-called peer review journals. However, all peer-reviewed journals are not created equally.

Myth: The institution of peer review assures that all published papers are sound and dependable.

Fact: Peer review generally will catch something that is completely out of step with majority thinking at the time, but it is practically useless for catching outright fraud, and it is not very good at dealing with truly novel ideas. Peer review mostly assures that all papers follow the current paradigm. It certainly does not ensure that the work has been fully vetted in terms of the data analysis and the proper application of research methods.[34]

The fallacy of the assumption that peer review assures good science was confirmed by a sting operation set up by *Science* which created a spoof paper which was accepted for publication in 157 of the "open-access" journals to which it was submitted.[35] Open-access scientific journals have mushroomed into a global industry, driven by author publication fees rather than traditional subscriptions. The identity and location of the journals' editors, as well as the financial workings of their publishers, are often purposefully obscured.[36]

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33 Kumho Tire Co. v. Carmichael, 526 U.S. 137, 158 (1999).

34 David Goodsetin, "How Science Works," *The Reference Manual on Scientific Evidence* 37, 48 (3d ed. 2011).

35 The spoof article contained numerous red flags, including a graph claiming that it shows a "dose-dependent" effect on cell growth, but the data clearly show the opposite. John Bohannon, "Who's Afraid of Peer Review?," 342 *Sci*. 6154 (Oct. 2013), http://www.sciencemag.org/content/342/6154/60.full.

36 *Id*.

[3] — Fit.

Rule 702 also mandates that an expert's opinion "help the trier of fact to understand the evidence or to determine a fact in issue." Usually referred to as "fit," this requirement asks whether there is a sufficient connection "between the expert's testimony and the facts that the jury is being asked to consider."[37]

§ 9.04. Proliferation of Unreliable Scientific and Medical Articles.

There is a growing proliferation of unreliable scientific and medical articles being published attempting to link gas development activities to various medical conditions, ranging from commonly occurring respiratory conditions and nosebleeds to birth defects. It will be important for counsel defending these claims in litigation to be able to critically analyze these articles through use of reliable and wellqualified experts and preclude the admission of the unreliable science through the use of *Daubert* motions.

[1] — Articles Based on Surveys/Case Studies.

Many of the published articles suggesting a link between gas development activities and health effects are based on surveys and/or case studies which do not prove causation. These articles which are based on self-reported symptoms then cite to each other for support.

[a] — Ferrar, *et al.*

An article published by Kyle Ferrar *et al*. entitled, "Assessment and longitudinal analysis of health impacts and stressors perceived to result from unconventional shale gas development in the Marcellus Shale region," is based on information about community members' health concerns related to shale gas extraction using a recorded one to two hours in-person interview, including open-ended questions about health and stressors.[38] The

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37 U.S. v. Schiff, 602 F.3d 152, 172-73 (3d Cir. 2010).

38 Kyle J. Ferrar *et al*., "Assessment and Longitudinal Analysis of Health Impacts and Stressors Perceived to Result from Unconventional Shale Gas Development in the Marcellus Shale Region," 19 *Int'l J. of Occupational & Envtl. Health* 104 (June 2013), http://www.ncbi.nlm.nih.gov/pubmed/23684268.

authors acknowledge that "our experimental design was not intended to determine whether or not there was a statistically valid causal relationship between health effects and Marcellus Shale activities; rather, our goal was to identify community concerns and reported symptoms to serve as input for the design of a follow-up study to address that question."[39] The authors further acknowledge that they interviewed only 33 individuals and that "these individuals came to CHEC with some type of concern about the development of unconventional natural gas resources in their communities."[40] A list of the symptoms reported by these 33 individuals includes: general illness, rashes, sores, itching, blisters, redness and warmth, swelling burning eyes, pain or soreness, muscle aches, weakness, headaches, change in vision, paralysis/ weakness, fainting, disorientation, tongue sensitivity, chest pain, irregular heartbeat, shortness of breath, high blood pressure, numbness in hands and feet, coldness, poor color, sore throat, nose irritation or runniness, fever, excessive sweating, chest congestion, nose bleeds, sinus congestion, burning nose, increased frequency of urination, incontinence, diarrhea, nausea, vomiting, stomach pain, constipation, hyperactivity, Vitamin D deficiency, cough, wheezing, stress, loss of sleep and memory loss.[41] The study made no attempt to identify any constituents to which these participants were exposed, let alone determine any doses of exposure.

Despite the acknowledged limitations of the study and the subjective common symptoms reported, the authors compare the self-reported symptoms of their participants to those reported in four other published studies and two unpublished studies and note that they are similar.[42] The four other published articles to which the authors point for reports of similar symptoms are not supportive. Two do not even discuss health effects.[43] At

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39 *Id*. at 105.

40 *Id*.

41 *Id*. at 108-09.

42 *Id*.

43 *See* Daniel J. Rozell and Sheldon J. Reaven, "Water Pollution Risk Associated with Natural Gas Extraction from the Marcellus Shale," 32 *Risk Analysis* 1382 (Dec. 2011), http://onlinelibrary.wiley.com/doi/10.1111/j.1539-6924.2011.01757.x/pdf; Bernard D. Goldstein *et al*., "Missing from the Table: Role of the Environmental Public Health Community in

most, the only conclusion that can be reached from a review of these articles is that every subjective symptom or target organ was identified by one or more of Ferrar's participants and is also included in one or more of the other cited articles.

The first article cited by Ferrar, "Natural Gas Operations from a Public Health Perspective," by Colburn *et al*., was commissioned by Earthworks, an organization established in 1999 to watchdog the oil and natural gas industry.[44] The authors compiled a list of chemicals used by the industry in the natural gas activities, and examined the information on the health effects associated with identified chemicals. From this compilation, the authors then created a profile of the possible health effects from one or more of these chemicals. The laundry list of possible health effects includes every symptom or target organ that could be identified and even includes an "other" category.[45]

The other article cited by Ferrar, "Human Health Risk Assessment of Air Emissions from Development of Unconventional Natural Gas Resources" by McKenzie *et al*., is based on a risk assessment of cancer and non-cancer risks from assumed hydrocarbon air exposures.[46] The assumed exposures were based on ambient air samples taken from a fixed monitoring station in a residential area during well development and production, as well as ambient air samples taken along four well pad perimeters during well completion activities. Samples included emissions from both uncontrolled flowback and diesel engines. For their exposure scenario the authors assumed 30 years of exposure (five years of well development and 2030 years of production with

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Governmental Advisory Commissions Related to Marcellus Shale Drilling," 120 *Envtl. Health Persp*. 483 (2012), http://ehp.niehs.nih.gov/1104594/.

44 Theo Colburn *et al*., "Natural Gas Operations from a Public Health Perspective," 17 *Hum. Ecol. Risk Assess*. 1039 (Sept. 2011), http://cce.cornell.edu/EnergyClimateChange/NaturalGasDev/Documents/PDFs/fracking%20chemicals%20from%20a%20public%20health%20perspective.pdf.

45 *Id*.

46 Lisa M. McKenzie *et al*., "Human Health Risk Assessment of Air Emissions from Development of Unconventional Natural Gas Resources," 424 *Sci. Total Env't*. 79 (May 2012), http://www.sciencedirect.com/science/article/pii/S0048969712001933.

the resident having exposure 24/hours day, 350 days/year). Two assumed exposure groups were analyzed; residents greater than half a mile from the well pads (using the results from the fixed monitoring station), and residents greater than half a mile from the well pads (using the well completion samples from the well pad perimeters and for the chronic exposure, also using the fixed monitor samples). The cut between exposures of less than half a mile and more than half a mile was based solely on the fact that residents at a distance of less than half a mile noted odors and those outside this radius did not. The only non-cancer risk (from assumed hydrocarbon exposures) that was reported to be increased for residents closer to the well pad was for undefined "neurological" effects.[47]

Ferrar also points to unpublished Earthworks-sponsored surveys in DISH/Clark, Texas and in Pavillion, Wyoming.[48] Both involved surveys of a limited number of individuals (31 in Texas and 16 in Wyoming). The laundry list of reported health conditions by the Texas participants (sinus problems, throat irritation, allergies, weakness and fatigue, eye irritation, joint pain, muscle aches and pains, breathing difficulties, vision impairment, severe headaches, sleep disturbances, swollen and painful joints, frequent irritation, skin irritation, wheezing, frequent nausea, ringing in ears, decreased motor skills, loss of sexual drive, bronchitis, easy bruising and difficulty concentrating) was compared to possible health impacts associated with the air emission chemicals detected in the ambient air. Not surprisingly, given the comprehensive list of reported subjective health conditions, they were also found on lists of symptoms that could be associated with one or more possible "toxins."[49] There was no attempt to determine exposures of the participants to any actual "toxin." The most prevalent health conditions

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47 *Id*.

48 *See* Wilma Subra, "Health Survey Results of Current and Former DISH/Clark, Texas Residents," *Earthworks* (Dec. 2009), http://www.earthworksaction.org/library/detail/health_survey_results_of_current_and_former_dish_clark_texas_residents/#.VZ_FZflVhBc [hereinafter *DISH/Clark Survey*]; Wilma Subra, "Community Health Results, Pavilion, Wyoming Residents," *Earthworks* (Aug. 2010), http://www.earthworksaction.org/files/publications/PavillionFINALhealthSurvey-201008.pdf [hereinafter *Pavilion Survey*].

49 DISH/Clark Survey.

reported by Wyoming participants were memory loss, feeling weak and tired, throat irritation, sinus problems, high blood pressure, muscle aches or pains, forgetfulness, recall problems, breathing difficulties, eyes burning, joint pain, decrease in vision, and sleep disorder. The authors point out that some of these symptoms are listed in the MDS for constituents found in some water wells.[50] There was no attempt to determine exposure of the participants to any well water constitutents.

[b] — Saberi, *et al.*

Similar to the Ferrar article, an article published by Poune Saberi, *et al.* entitled, "Field Survey of Health Perception and Complaints of Pennsylvania Residents in Marcellus Shale Region," is based on information obtained from questionnaires administered to adult volunteers with medical complaints in a primary-care medical office in a county where gas development was present. Participants were asked whether they were concerned about health effects from the gas development activities and whether they attributed current symptoms to the development or to some other environmental exposure.[51] Of the 158 people approached to take the survey, 72 (45 percent) completed it. Thirty of the 72 participants (41.7 percent) responded that one or more environmental reasons caused at least one of their health problems; however, only 16 (22.2 percent) cited natural gas activity as their perceived cause of their symptoms. Of these 16, only nine believed that they had any current symptoms related to gas development. The symptoms self-attributed to the gas development activities were sleeping difficulty (2), anxiety (1), ringing in ears (1), sinus problems/infection (2), headaches (1), balance difficulty (1), trembling of hands (1), tingling of hands and feet (1), dizziness (1), seizures (1), nausea (2), vomiting (1), diarrhea (1), stomach pain (1), and cardiac palpitations (1). A review of the medical records for six of the nine individuals attributing symptoms to gas development revealed that only one of the medical

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50 Pavilion Survey.

51 Poune Saberi *et al.*, "Field Survey of Health Perception and Complaints of Pennsylvania Residents in the Marcellus Shale Region," 11 *Int'l J. of Envtl. Res. & Pub. Health* 6517 (June 2014), http://www.mdpi.com/1660-4601/11/6/6517.

records included any mention by the patient of gas development activity and the records for three of the patients did not even include mention of the claimed symptoms.[52] The authors attempt to explain these inconsistencies by postulating that patients may not want to "bother" their health-care providers.[53] In addition, mapping of these individuals' addresses did not indicate a "clear pattern of clustering" around gas development activities.[54]

Like the Ferrar article, Saberi notes that many of these reported symptoms were also reported in other surveys.[55] A review of these referenced articles indicates that they do not support Saberi's statements.[56]

One of the cited articles, "Impacts of Gas Drilling on Human and Animal Health" by Bamberger *et al*., is based on interviews with referrals from environmental groups and individuals actively involved in influencing shale gas policy and studying its effects.[57] Twenty-four interviewed individuals described some effect to himself or his animals that he attributed to gas development; 16 of these described symptoms to himself. These symptoms included upper respiratory symptoms, burning of eyes, headache, gastrointestinal symptoms, neurological symptoms, immunological symptoms, dermatological symptoms, vascular symptoms, sensory symptoms, "bone marrow" symptoms, endocrine symptoms, and urological symptoms. There is no attempt to identify exposures.

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52 *Id*. at 6521.

53 *Id*. at 6523.

54 *Id*. at 6522.

55 *Id*. at 6522 (citing Rozanna Witter *et al*., "Health Impact Assessment for Battlement Mesa, Garfield County, Colorado," *Sch. of Pub. Health* (Sept. 2010), http://www.garfield-county.com/public-health/documents/1%20%20%20Complete%20HIA%20without%20Appendix%20D.pdf; Michelle Bamberger and Robert E. Oswald, "Impacts of Gas Drilling on Human and Animal Health," 22 *New Solut*. 51 (2012), http://psehealthyenergy.org/data/Bamberger_Oswald_NS22_in_press.pdf; Nadia Steinzor et al., "Investigating Links Between Shale Gas Development and Health Impacts Through a Community Survey Project in Pennsylvania," 23 *New Solut*. 55 (2013), http://new.sagepub.com/content/23/1/55.long).

56 One of the referenced articles is the Colburn article discussed at pages 9-10.

57 Bamberger & Oswald, *supra* note 34.

Another article cited by Saberi, "Health Impact Assessment for Battlement Mesa, Garfield County Colorado" by Witter *et al*., was conducted to help address community concerns regarding future land use decisions.[58] The article contains a broad description of potential "stressors" on community wellness from gas development activities.[59]

The final cited article, "Investigation Links Between Shale Gas Development and Health Impacts Through a Community Survey Project in Pennsylvania" by Steinzor *et al*., is based on an Earthworksbased survey of 108 individuals from chain referrals and wordofmouth.[60] The reported symptoms were then grouped based on frequency and proximity to gas well development activities. The top 20 symptoms reported (irrespective of proximity to gas drilling activities) were throat irritation, sinus problems, nasal irritation, eye burning, joint pain, severe headaches, sleep disturbances, skin rashes, shortness of breath, forgetfulness, sleep disorders, loss of sense of smell, persistent cough, feeling weak and tired, increased fatigue, frequent nose bleeds, swollen painful joints, lumbar pain, muscle aches or pain, and diarrhea.[61] The article indicated that for 18 of the 20 symptoms, a higher percentage of those living within 1500 feet of a facility experienced the symptom than of those living farther away.[62] There is no effort to identify exposures.

[c] — Rabinowitz, *et al.*

In yet another survey-based article, "Proximity to Natural Gas Wells and Reported Health Status: Results of a Household Survey in Washington County, Pennsylvania," Rabinowitz et al. conducted a "hypothesis generating health symptom survey of 492 persons in 180 randomly selected household

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58 Witter, *supra* note 34.

59 N. Steinzor *et al*., "Investigating links between shale gas development and health impacts through a community survey project in Pennsylvania," 23 *New Solut*. 55 (2013).

60 *Id*.

61 *Id*.

62 *Id*.

with groundfed wells in an area of active natural gas drilling."[63] Rabinowitz cites to the Witter, Steinzor, Bamberger, and Ferrar articles discussed above. Using a map of active natural gas wells in the study area, the authors calculated the distance between each household location and each natural gas well. They then classified households according to their distance from the nearest gas wells with distance categories of less than 1 km, 1-2 km, or greater than 2 km. One km was used as the initial cutpoint because of the reported association of higher methane levels in drinking water wells located less than 1 km from natural gas wells.[64] The authors concluded that the average number of reported symptoms of skin conditions and upper respiratory symptoms per person in households less than 1 km from a gas well was greater compared to those living more than 2 km from gas wells. Other groups of reported symptoms, including cardiac, neurological, or gastrointestinal, did not show a similar association with gas well proximity. It was noted that the higher the environmental awareness, the more symptoms of all types were reported.[65] Like the other authors, Rabinowitz made no attempt to identify, let alone quantify, exposures. Even though the study design appeared to assume that the exposure of interest was from water wells, there was no effort to evaluate the constituents in any of the participants' wells, let alone tie exposure to these constituents to the reported symptoms.

§ 9.05. Conclusion.

Whether attempting to prove a present injury claim or a medical monitoring claim, plaintiffs bear a heavy burden to come forward with reliable expert causation testimony from a qualified expert, which helps the trier of fact to understand the evidence or to determine a fact in issue. If such expert testimony does not meet these requirements, the court is required under its gatekeeper role to preclude the testimony, which will result in

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63 Peter M. Rabinowitz et al., "Proximity to Natural Gas Wells and Reported Health Status: Results of a Household Survey in Washington County, Pennsylvania," 123 *Envtl. Health Persp*. 21 (Jan. 2015), http://ehp.niehs.nih.gov/1307732/.

64 *Id*. at 23.

65 *Id*. at 24.

dismissal of the action. As a result, it is incumbent upon defendants and their counsel to develop reliance expert testimony based on accepted scientific principles to refute the unreliable science which is proliferating and which will undoubtedly be relied upon by plaintiffs attempting to prove causation.

Chapter 10

Reductions in Force: Factors to Consider in Order to Avoid Liability to Laid-Off Employees

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§ 10.01. Overview.

Employers are frequently faced with the necessity of downsizing operations to meet increased competition, to contain costs or to achieve greater efficiency of operations. In many cases, a significant reduction in an employer's workforce cannot be promptly achieved through relatively modest measures (*e.g.*, hiring freezes, job sharing, elimination of overtime) and the

employer may need to consider a voluntary or involuntary reduction-in-force (RIF). RIFs can pose significant legal hazards for the unwary — both in terms of selecting employees and in implementing RIF programs. This chapter discusses what an employer must consider in determining whether to conduct a RIF, how to conduct the RIF and what benefits issues to consider when conducting the RIF.[2]

§ 10.02. Potential Sources of Liability.

In conducting any RIF, the employer must be familiar with the legal theories, which can give rise to liability. Otherwise, the employer cannot do a proper risk analysis for a RIF and the employer will be effectively going into a RIF blindly. Not only is defending a wrongful discharge or discrimination case costly, jury verdicts for wrongful discharge or discrimination cases often reach over six figures and, sometimes, seven figures. Accordingly, each decision to discharge a specific employee must be thoroughly analyzed. This section reviews most of the legal theories to consider when conducting a RIF.

[1] — Existing Obligations.

The employer may have preexisting obligations, *e.g.*, to refrain from conducting a RIF, to conduct a RIF in a prescribed manner, or to refrain from terminating certain employees or classes of employees. One of the first steps in conducting a successful RIF is to determine if the RIF will breach commitments the employer has made in documents such as collective bargaining agreements, individual employment contracts, employee handbooks, and published layoff procedures. The next step is to determine whether the employer has inadvertently implied a promise to conduct RIFs in a certain way or to forego RIFs altogether. To avoid liability, employers should verify statements made to employees as well as general custom and practice.

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2 This chapter is patterned after a chapter authored by C. David Morrison, 24 *Energy & Min. L. Inst.* ch. 2 (2004), pp. 42-83.

[2] — Title VII of the Civil Rights Act of 1964, as Amended By the Civil Rights Act of 1991, 29 U.S.C. §§ 2000(e), *et seq.*

Title VII provides that an employer engages in unlawful employment discrimination when an employee is treated differently than another employee in similar circumstances due to sex, pregnancy, race, color, national origin, or religion.[3] Employment discrimination actions under this section tend to take one of two forms in the RIF context. The first, called "disparate treatment," is a case in which an employee alleges that he or she has been treated less favorably than his or her peers because of race, sex, etc. Thus, in a disparate treatment case, a plaintiff must prove a discriminatory motive.[4] This proof must be through either direct or circumstantial evidence.[5]

One form of disparate treatment case commonly seen in the RIF context is the "pattern or practice" case. In this type of case, the plaintiff alleges that the defendant has intentionally engaged in systematic disparate treatment of a specific race, sex, etc. In short, it is an allegation that discrimination is a standard operating procedure.[6] Proving isolated or sporadic discriminatory acts by the employer is insufficient to prove a "pattern or practice."[7] Instead, the employee must prove by a preponderance of the evidence that discrimination was "the regular rather than the unusual practice."[8] This sort of case can be proven by anecdotal testimony or by statistical evidence.[9]

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3 42 U.S.C. §§ 2000e-2(k), 2000e-2.

4 *See, e.g.*, St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502 (1993); Furnco Const. Co. v. Waters, 438 U.S. 567 (1978); Bd. of Trs. of Kings State Coll. v. Sweeney, 439 U.S. 24 (1978); McDonald Douglas Corp. v. Greene, 411 U.S. 792 (1973); Ross v. RBS Citizens, N.A., 667 F.3d 900 (7th Cir. 2011); Puffer v. Allstate Ins. Co., 675 F.3d 709 (7th Cir. 2012).

5 Reeves v. CH Robinson Worldwide, Inc., 594 F.3d 798 (11th Cir. 2010).

6 EEOC v. McDonnell Douglas Corp., 191 F.3d 948 (8th Cir. 1999).

7 Cooper v. Fed. Reserve Bank of Richmond, 467 U.S. 867 (1984); Apsley v. Boeing Co., 691 F.3d 1184 (10th Cir. 2012).

8 *Cooper*, 467 U.S. at 876 (quoting Int'l Brotherhood of Teamsters v. U.S., 431 U.S. 324 (1977)).

9 Adams v. Ameritech Servs., Inc., 231 F.3d 414 (7th Cir. 2000) (noting that while statistical evidence can be useful in proving discrimination in either a disparate treatment or a "pattern or practice" case, statistical evidence will likely not be sufficient in itself).

The second type of discrimination case, called "disparate impact," is one in which the plaintiff alleges that a facially neutral test or employment practice in fact impacts more harshly on one group and cannot be justified by business necessity. Proof of discriminatory motive is not required because the test focuses on the consequences of employment practices, not on the motivation. Statistical evidence plays a vital role in disparate impact cases.[10] Statistical proof can be offered through an expert witness who can testify that, based on his or her analysis of the observed outcome (*i.e.*, how many people of a given race, class, etc., were laid off), the result is so unlikely that it cannot be attributed to a neutral selection process; but rather, the outcome can only be accounted for by a discriminatory process.[11] Where simple arithmetic, rather than a sophisticated statistical theory, is used, courts have held that no expert witness is required.[12]

[3] — The Americans with Disabilities Act of 1990 (ADA) and the ADA Amendments Act of 2008 (ADAAA), 42 U.S.C. §§ 12101, *et seq.*

The ADA, which was considerably broadened in 2008 through the ADA Amendments Act, provides that "[n]o covered entity shall discriminate against a qualified individual on the basis of disability in regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment."[13] Employers, employment agencies, labor organizations, and joint labor-management committees are considered "covered entities."[14] Under the statute, an employer is defined as any "person engaged in an

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10 Puffer v. Allstate Ins. Co., 675 F. 3d 709 (7th Cir. 2012) (spelling out that a plaintiff must establish causation by offering statistical evidence of a kind and degree sufficient to show that the practice in question has caused the adverse circumstance (citing Watson v. Fort Worth Bank and Trust, 487 U.S. 977 (1988))).

11 Sheehan v. Daily Racing Form, Inc., 104 F.3d 940 (7th Cir. 1997) (noting that statistical evidence presented by an expert must satisfy the requirements of Daubert v. Merrell Dow Pharms., Inc., 509 U.S. 579 (1993)).

12 Stratton v. Dept. for the Aging, 132 F.3d 869 (2d Cir. 1997).

13 42 U.S.C. § 12112(a).

14 42 U.S.C. § 12111(2).

industry affecting commerce who has [fifteen] or more employees for each working day in each of [twenty] or more calendar weeks in the current or preceding calendar year."[15] Employers do not include the United States government, a corporation wholly owned by the United States government, an American Indian tribe, or a private membership club, other than a labor organization, that is exempt from taxation under 26 U.S.C. § 501(c)(3).[16]

The term "qualified individual" means "an individual who, with or without reasonable accommodation, can perform the essential functions of the employment position that such individual holds or desires."[17] In determining what functions of a job are essential, "consideration shall be given to the employer's judgment . . . and if an employer has prepared a written description before advertising or interviewing applicants for the job, this description shall be considered [as] evidence . . . ."[18]

The term "disability" means, with respect to an individual —

(A) a physical or mental impairment that substantially limits one or more major life activities of such individual;

(B) a record of such an impairment; or

(C) being regarded as having such an impairment.[19]

"[M]ajor life activities include, but are not limited to, caring for oneself, performing manual tasks, seeing, hearing, eating, sleeping, walking, standing, lifting, bending, speaking, breathing, learning, reading, concentrating, thinking, communicating, and working."[20] A major life activity may also include "the operation of a major bodily function, including but not limited to, functions of the immune system, normal cell growth, digestive, bowel, bladder, neurological, brain, respiratory, circulatory, endocrine, andreproductive functions."[21] An individual may

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15 *Id*. at § 12111(5)(a).
16 *Id*. at § 12111(5)(b).
17 *Id*. at § 12111(8).
18 *Id*.
19 42 U.S.C. § 12102(1).
20 *Id*. at § 12102(2)(A).
21 *Id*. at § 12102(2)(B).

be "regarded as" having an impairment if it is shown that "he or she has been subjected to an action prohibited [by the ADA and ADAAA] because of an actual or perceived physical or mental impairment whether or not the impairment limits or is perceived to limit a major life activity."[22]

In other words, a covered entity "regards" an individual as disabled if it takes an action prohibited by the ADA on the belief that the individual is impaired — even if there is no actual impairment, or the impairment does not rise to the level of substantially limiting a major life activity. An individual cannot be "regarded as" disabled, however, if the impairment is "transitory and minor."[23] A transitory impairment is one that has "an actual or expected duration of 6 months or less."[24] The definition of "disability" is "construed in favor of broad coverage of individuals . . . to the maximum extent permitted by the terms of [the ADA]."[25] "An impairment that is episodic or in remission is a disability if it would substantially limit a major life activity when active."[26] An impairment need only limit one major life activity to be considered a disability.[27]

Under the ADA and ADAAA, determination of whether an impairment substantially limits a major life activity is made without regard to the effects of mitigating factors, such as:

(I) medication, medical supplies, equipment, or appliances, low-vision devices (which do not include ordinary eyeglasses or contact lenses), prosthetics including limbs and devices, hearing aids and cochlear implants, or other implantable hearing devices, mobility devices, or oxygen therapy and supplies;

(II) use of assistive technology;

(III) reasonable accommodations or auxiliary aides or services;

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22 *Id*. at § 12102(3)(A).
23 *Id*. at § 12102(3)(B).
24 *Id*.
25 *Id*. at § 12102(4)(A).
26 *Id*. at § 12102(4)(D).
27 *Id*. at § 12102(4)(C).

or

(IV) learned behavioral or adaptive neurological modifications.[28]

The benefits of ordinary eyeglasses and contact lenses, on the other hand, *are* considered in determining whether an impairment substantially limits a major life activity.[29]

Disability discrimination in the context of a RIF presents difficult issues. As employers trim the workforce and ask fewer employees to perform more work, employers are sometimes tempted to reduce the disabled from the workforce because the disabled may not be able to work as fast or as efficiently. However, as the Seventh Circuit has noted, "[a] RIF is not an open sesame to discrimination against a disabled person."[30] "The law forbids the employer to disqualify [employees] on the basis of their disability unless the disability prevents them from doing the work even with a reasonable accommodation."[31]

At the same time, the *Matthews* court pointed out that the ADA "does not command affirmative action in hiring or firing."[32] The court explained that:

> Comparative considerations are particularly important in the context of a bona fide RIF because the employer must decide which qualified workers to retain; he can't retain them all. To require him to retain the least able because of a disability would handicap the able-bodied, and that is not required by the Act. . . . [S]uch discrimination in favor of the disabled[ ] would invite the same criticisms as "reverse" discrimination on racial and sexual grounds — especially in a RIF case, where a better worker would lose a job to a worse one merely because the better worker had the good fortune not to be disabled.[33]

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28 *Id*. at § 12102(4)(E)(i).

29 *Id*. at § 12102(4)(E)(ii).

30 Matthews v. Commw. Edison Co., 128 F.3d 1194, 1195 (7th Cir. 1997) (citing Christie v. Foremost Ins. Co., 785 F.2d 584, 587 (7th Cir. 1986)).

31 *Id*.

32 *Id*. at 1196.

33 *Id*. (citations omitted).

Presumably, therefore, if the employer can prove that he retained a non-disabled worker over a disabled worker because the non-disabled worker could better perform the job, the employer would not violate the ADA. The disabled worker would have to prove that he was a victim of intentional discrimination, *e.g.*, that he was laid off because the employer disliked employees with disabilities and that the employer's reliance on the alleged fact that he was unable to perform the job, as well as the non-disabled worker was pretext.

In an ADA case arising from a RIF, the plaintiff must establish that (1) he is a member of a protected class (*e.g.*, that he is "disabled" as defined by the ADA), (2) that he was qualified to perform the essential functions of the job, and (3) that he suffered an adverse employment decision because of his disability.[34] In those cases, individuals with disabilities frequently assert that it was their disability, which led to their selection for layoff. These cases more often turn on direct evidence than on statistical evidence because of the difficulty of classifying persons as "disabled" or "non-disabled" for purpose of compiling a data base suitable for statistical analysis.

[4] — Age Discrimination in Employment Act (ADEA), 29 U.S.C. §§ 621, *et seq.*

The employer may not discharge or otherwise discriminate against someone merely because the employee is 40 years old or older.[35] This is perhaps the most common claim arising out of a RIF. In certain industries, there has been little new hiring for many years; thus, nearly all of the employees are 40 or older. Often, it is almost impossible to conduct a RIF without negatively affecting some of these potential plaintiffs. Statistical evidence can be very important in these cases as well.[36] Although statistics

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34 *See* Willnerd v. First Nat'l Neb. Inc., 558 F.3d 770, 777 (8th Cir. 2008).

35 29 U.S.C. §§ 623, 631.

36 *See* Schechner v. KPIX-TV, 686 F.3d 1018 (9th Cir. 2012); Coleman v. Quaker Oats Co., 232 F.3d 1271 (9th Cir. 2000) ("[A]n important statistic to consider in the RIF context is the difference in the percentage of older employees in the work force before and after the RIF."); EEOC v. McDonnell Douglas Corp., 191 F.3d 948, 952 (citing Holley v. Sanyo Mfg., Inc., 771 F.2d 1161 (8th Cir. 1985) (no statistical basis for age discrimination claim where

can be successfully used to prove age discrimination, statistics alone will not always be enough. "To establish a *prima facie* case based solely on statistics, let alone raise a triable issue of fact regarding pretext, the statistics 'must show a stark pattern of discrimination unexplainable on grounds other than age.'"[37]

To prove a *prima facie* case of age discrimination, the employee must prove that he (1) was at least 40 years old, (2) suffered an adverse job action, (3) was qualified for the position, and (4) was replaced by a "substantially younger" employee.[38] A "substantially younger" employee generally means an employee who is at least 10 years younger than the plaintiff.[39] A 10-year age difference, however, is only a measuring stick. The plaintiff will not lose his case simply because the plaintiff was replaced by someone who was less than 10 years younger than him. The plaintiff could still satisfy his burden by presenting evidence that the employer considered the plaintiff's age to be significant to the employer's decision.[40]

[5] — State Human Rights Acts.

Like Title VII and other federal statutes, these Acts prohibit discrimination on the basis of factors such as age, race, sex, national origin, disability, religion, age, and familial status. As with federal statutes, employees can claim disparate treatment (including pattern or practice) or disparate impact. Claims pursuant to a state's Human Rights Act, or equivalent, can usually be brought before a state agency, in state court, or both. The employer

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percentage of employees in the protected class was 25.8 percent before layoffs and 26.0 percent after layoffs); *see also* Hanebrink v. Brown Shoe Co., 110 F.3d 644, 646 (8th Cir. 1997) (no statistical basis for age discrimination claim where the average age of employees declined by only one-half year after the layoffs).

37 *Coleman*, 232 F.3d at 1283 (quoting Rose v. Wells Fargo & Co., 902 F.2d 1417, 1423 (9th Cir. 1990)) (emphasis added); *see also* Rummery v. Illinois Bell Tel. Co., 250 F.3d 553 (7th Cir. 2001) (holding that statistics alone, without other evidence, were not enough to establish a disparate treatment under the ADEA).

38 *See* O'Connor v. Consolidated Coin Caterers Corp., 517 U.S. 308 (1996); Young v. Builders Steel Co., 754 F.3d 573, 577 (8th Cir. 2014).

39 *See* Fisher v. Wayne Dalton Corp., 139 F.3d 1137, 1141 (7th Cir. 1998); Nagle v. Vill. of Calumet Park, 554 F.3d 1106, 1118 (7th Cir. 2009).

40 Hoffman v. Primedia Special Interest Publ'ns, 217 F.3d 522, 524–25 (7th Cir. 2000).

should consult its applicable state law to determine the avenues available to employees in addressing the employees' discrimination claims.

[6] — The Worker Adjustment and Retraining Notification Act (WARN), 29 U.S.C. §§ 2101, *et seq.*

WARN requires an employer to give 60 calendar days' advance notice before it may close a plant or institute a "mass layoff."[41] WARN applies to any business that employs "100 or more employees, . . . or 100 or more employees who in the aggregate work at least 4,000 hours per week," excluding overtime.[42] WARN provides aggrieved employees with a civil cause of action to enforce its terms.[43] An employer found to be in violation of WARN is liable to *each* aggrieved employee who suffers loss of employment as a result of a plant closing or mass layoff for:

> (A) back pay for each day of violation at a rate of compensation not less than the higher of —
>
> (i) the average regular rate received by such employee during the last [three] years of the employee's employment; or
>
> (ii) the final regular rate received by such employee; and
>
> (B) benefits under an employee benefit plan . . . including the cost of medical expenses incurred during the employment loss which would have been covered under an employee benefit plan if the employment loss had not occurred.[44]

In addition, WARN also provides that reasonable attorneys' fees may be awarded.[45] Finally, a civil penalty of up to $500.00 a day may be levied against an employer who fails to comply.[46] This penalty does not apply "if the employer pays to each aggrieved employee the amount for which the

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41 29 U.S.C. § 2102; 20 C.F.R. § 639.5(a)(1); *see also* Bledsoe v. Emery Worldwide Airlines, Inc., 635 F.3d 836 (6th Cir. 2011).

42 29 U.S.C. § 2101 (a)(1).

43 *Id*. at § 2104.

44 *Id*. at § 2104(a)(1)(A)–(B).

45 *Id*. at § 2104(a)(6).

46 *Id*. at § 2104(a)(3).

employer is liable to that employee within [three] weeks from the date the employer orders the shutdown or layoff."[47]

A "plant closing" is defined as "the permanent or temporary shutdown of a single site of employment, or one or more facilities or operating units within a single site of employment, if the shutdown results in an employment loss at the single site of employment during any [thirty day] period for [fifty] or more employees excluding any part-time employees."[48] A "mass layoff" is defined as a reduction in force which:

(A) is not the result of a plant closing; and

(B) results in an employment loss at the single site of employment during any [thirty day] period for

(i)(I) at least [thirty-three] percent of the employees (excluding any part-time employees); and

(II) at least [fifty] employees (excluding any part-time employees); or

(ii) at least 500 employees (excluding any part-time employees).[49]

In the case of the sale of a business, the seller is responsible for providing notice up to and including the effective date of the sale.[50] Afterward, the purchaser is responsible for providing notice under WARN.[51] Anyone who, at the time of the sale, is a full-time employee of the seller as of the effective date of the sale is an employee of the purchaser immediately after the effective date of the sale.[52]

Not all plant closings require the employer to give notice under WARN. No notice is needed

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47 *Id*.

48 29 U.S.C. § 2101(a)(2).

49 *Id*. at § 2101(a)(3).

50 *Id*. at § 2101(b)(1).

51 *Id*.

52 *Id*.

if the closing is of a temporary facility, or if the closing or layoff is the result of the completion of a particular project or undertaking, and the affected employees were hired with the [clear] understanding that their employment was limited to the duration of the facility or the project or undertaking.[53]

Another exemption to the notice requirement exists for strikes and lockouts that are not intended to evade WARN.[54]

Under three circumstances, the employer may give less than 60 days' notice as long as the employer gives "as much notice as is practicable" and, at that time, gives "a brief statement of the basis for reducing the notification period."[55] These three circumstances are:

- The faltering company exception: if, at the time notice would normally be required, "the employer was actively seeking capital or business which, if obtained, would have enabled the employer to avoid or postpone the shutdown and the employer reasonably and in good faith believed that giving the notice required would have precluded the employer from obtaining the needed capital or business."[56]
- The unforeseeable business circumstances exception: the business circumstances must not have been "reasonably foreseeable as of the time that notice would have been required."[57]
- The natural disaster exception: if the closing or layoff is due to "any form of natural disaster, such as a flood, earthquake, or . . . drought . . . ."[58]

An employer should look ahead 90 days and behind 90 days to see whether employment actions "will, in the aggregate for any [ninety day] period, reach the minimum numbers for a plant closing or a mass layoff and

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53 20 C.F.R. § 639.5(c)(1).
54 *Id*. at § 639.5(d).
55 29 U.S.C. § 2102(b)(3).
56 *Id*. at § 2102(b)(1); *see also In re* Old Electralloy Corp, 162 B.R.121, 124–26 (Bank. W.D. Pa. 1993).
57 *Id*. at § 2102(b)(2)(A); *see also* Gross v. Hale-Halsell Co., 554 F.3d 870 (10th Cir. 2009).
58 *Id*. at § 2102 (b)(2)(B).

thus trigger the notice requirement."[59] But an employer need not give notice if it can show that the separate employment losses were caused by "separate and distinct actions and causes," rather than an attempt to evade WARN notice requirements.[60] An employer should also "[l]ook ahead [thirty] days and behind [thirty] days to determine whether employment actions both taken and planned will, in the aggregate for any [thirty day] period, reach the minimum numbers for a plant closing or a mass layoff and thus trigger the notice requirement."[61]

In most cases, WARN would require before both plant closings and mass layoffs that the employer provide a written notice to each affected employee as well as to the "State Dislocated Worker Unit" and the "chief elected official of the local governmental unit within which such closing or layoff is to occur."[62] If the employer's employees are represented by a union, then the employer would have to notify the union as well.[63] All notices must be specific.[64] Notice may be given conditional upon the occurrence or nonoccurrence of an event, such as the renewal of a major contract, only when the event is definite and the consequences of the occurrence or nonoccurrence will necessarily, in the normal course of business, lead to a covered plant closing or layoff less than [sixty] days after the event.[65]

Notices to affected employees' representative(s), such as a union, must contain:

- The name and address of the site where the closing or mass layoff will occur,
- The name and phone number of a company official to contact for information,

59 20 C.F.R. § 639.5(a)(1)(ii).
60 *Id*.
61 *Id*. at § 639.5(a)(1)(i).
62 29 U.S.C. § 2102(a).
63 *Id*.
64 29 C.F.R. § 639.7(a)(1).
65 *Id*.

- Whether the planned action is expected to be permanent or temporary,
- Whether the entire plant is to be closed,
- "The expected date of the first separation and the anticipated schedule for making separations," and
- The job titles of affected positions and the names of workers holding affected jobs.[66]

Notices to employees who are unrepresented must be "written in language understandable to the employees" and include:

- Whether the planned action is expected to be permanent or temporary,
- Whether the entire plant is to be closed,
- "The expected date when the plant closing or mass layoff will commence and the expected date when the individual employee will be separated,"
- Whether or not bumping rights exist, and
- The name and phone number of a company official to contact for information.[67]

Notice to the State Dislocated Worker Unit and the chief elected official of the unit of local government must contain:

- "The name and address of the employment site where the plant closing or mass layoff will occur, and the name and telephone number of a company official to contact for further information;"
- Whether the planned action is expected to be permanent or temporary;
- Whether the entire plant is to be closed;

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66 *Id*. at § 639.7(c).
67 *Id*. at § 639.7(d).

- "The expected date of the first separation, and the anticipated schedule for making separations;"
- "The job titles of positions to be affected, and the number of affected employees in each job classification;"
- "[W]hether or not bumping rights exist;" and
- "The name of each union representing affected employees, and the name and address of the chief elected officer of each union."[68]

As an alternative to these notices to the State Dislocated Worker Unit and the chief elected official of the unit of local government, the employer may instead provide these entities "with a written notice stating the name of address of employment site where the plant closing or mass layoff will occur; the name and telephone number of a company official to contact for further information; the expected date of the first separation; and the number of affected employees."[69] In this case, the employer must maintain the other information listed above "on site and readily accessible to the State dislocated worker unit and to the unit of general local government. Should this information not be available when requested, it will be deemed a failure to give required notice."[70]

The notice may be served by any reasonable method of delivery designed to ensure receipt of notice at least 60 days before separation.[71] Acceptable methods include first class mail, personal delivery with optional signed receipt, and insertion of notice into pay envelopes.[72] However, a "ticketed notice, *i.e*., preprinted notice regularly included in each employee's pay check or pay envelope, does *not* meet the requirements of WARN."[73]

WARN and its related regulations do not contain a "pay in lieu of notice" provision. Thus, pay in lieu of notice will not satisfy the provisions of WARN.

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68 *Id*. at § 639.7(e).
69 *Id*. at § 639.7(f).
70 *Id*.
71 20 C.F.R. § 639.8.
72 *Id*.
73 *Id*. (emphasis added).

Pay in lieu of notice does, however, effectively preclude substantive relief because the maximum damages under WARN are full pay and benefits for the 60 day period.[74] WARN reduces an employer's liability by any wages paid during the violation period, "any voluntary and unconditional payment" not legally required, and any payment to a third party or trustee for the violation period.[75] Thirty-one states and the District of Columbia have "mini-WARN" acts.[76] Thus, the employer should consult its applicable state law to determine the scope and effect of any applicable mini-WARN act.

[7] — Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001, *et seq.*

Almost inevitably, one of the considerations supporting an employer's decision to conduct a RIF is to contain or reduce employment-related costs. In addition to direct compensation (*e.g.*, wages and salaries), a significant amount of employment-related costs are generated from benefits voluntarily provided to employees by employers. Figures released by the United States Department of Labor's Bureau of Labor Statistics indicate that in December 2014, private employer costs for employee benefits (excluding legally required contributions such as workers' compensation and federal Social Security payments) constituted 22.6 percent of payroll on a national average.[77]

In pertinent part, ERISA Section 510 prohibits the "any person to discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the . . . plan,

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74 29 U.S.C. § 2104(a); *see also* U.S. Dep't of Labor Empl't and Training Admin., *WARN: Employer's Guide to Advance Notice of Closings and Layoffs*, www.doleta.gov/layoff/pdf/EmployerWARN09_2003.pdf (last visited June 19, 2015).

75 29 U.S.C. § 2104(a)(2)(B).

76 The states with mini-WARN Acts are Alaska, California, Colorado, Florida, Georgia,Hawaii, Idaho, Illinois, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, Nevada, New Jersey, New York, North Carolina, North Dakota, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Virginia, Washington and Wisconsin.

77 U.S. Dep't of Labor: Bureau of Labor Statistics, *Employer Costs for Employee Compensation – March 2015*, http://www.bls.gov/news.release/pdf/ecec.pdf (last visited June 19, 2015).

[or ERISA] . . . ."[78] Suit can successfully be maintained under Section 510 for claims regarding interference with the plaintiff's rights to either pension plans or welfare plans, such as medical benefits.[79] Because Section 510 simply refers to "the plan," it covers both pension plans and welfare plans.[80]

The analytical framework of an ERISA Section 510 claim is essentially the same as in cases under Title VII of the Civil Rights Act of 1964.[81] The Third Circuit has stated the elements of a Section 510 case as: "(1) prohibited employer conduct; (2) taken for the purpose of interfering; (3) with the attainment of any right to which the employee may become entitled."[82] This generally requires proof of a specific intent to interfere with the plaintiff's entitlement (or prospective entitlement) to benefits.[83] To prove his or her case, a plaintiff may use circumstantial evidence because, as at least one court has noted, direct proof (or the "smoking gun") is rare in Section 510 cases.[84] Still, the circumstantial evidence must be sufficient for a reasonable fact finder to find that "a causal connection existed between the adverse action and the likelihood of future benefits."[85] In other words, the plaintiff must prove that that the loss of benefits was a motive and not "a mere 'incidental result of his termination.'"[86]

The general cost-cutting associated with a RIF, however, is not actionable. Simply because a RIF will generally decrease employee benefit costs

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78 29 U.S.C. § 1140.

79 Inter-Modal Rail Emps. Ass'n v. Atchison, Topeka & Santa Fe Ry. Co., 520 U.S. 510, 514–15 (1997).

80 *Id*.

81 *See* Rowe v. Marley Co., 233 F.3d 825 (4th Cir. 2000) (applying burden-shifting analysis); Herring v. Oak Park Bank, 963 F. Supp. 1558 (D. Kan. 1997).

82 Romero v. SmithKline Beecham, 309 F.3d 113, 119 (3d Cir. 2002).

83 *See, e.g.*, Lindeman v. Mobil Oil Corp., 79 F.3d 647, 649 (7th Cir. 1996) (collecting examples of cases); Rogers v. Int'l Marine Terminals, 87 F.3d 755, 760 (5th Cir. 1996); Henson v. Liggett Grp., Inc., 61 F.3d 270 (4th Cir. 1995).

84 *See* Gavalik v. Cont'l Can Co., 812 F.2d 834, 851 (3d Cir. 1987).

85 Barnhardt v. Open Harvest Co-Op, 742 F.3d 365, 371 (8th Cir. 2014) (quoting Manning v. Am. Republic Ins. Co., 604 F.3d 1030, 1043–44 (8th Cir. 2010).

86 *Herring*, 963 F. Supp. at 1569 (quoting Babich v. Unisys Corp., 842 F. Supp. 1343, 1353 (D. Kan. 1994)).

(because it, *e.g.*, reduces the number of persons eligible for benefits) is usually insufficient to establish an ERISA Section 510 violation if the employment terminations are intended to cut costs in general.[87] Rather, a plaintiff must demonstrate that benefit costs are the determinative or primary motivating factor for the plaintiff's employment termination. Litigation triggered by the Continental Can Company's layoff selection system, which was referred to as the Liability Avoidance Program (LAP), illustrates what the Third Circuit viewed as "direct proof of [the] discrimination" prohibited by Section 510.[88] Under LAP, employees were selected for layoff based on the benefit costs generated by that individual, making benefit costs the determinative factor for individual employee layoff decisions. In expensive, protracted litigation, Continental Can was held to be in violation of ERISA Section 510.[89]

In another illustration of a failed § 510 claim, Gencorp, Inc. instituted a RIF in which the company first determined the number of positions to be eliminated and then ranked employees based on work performance and behavioral expectation assessments.[90] The plaintiff sued, asserting he was selected for discharge because of his six-figure medical expenses.[91] On summary judgment, the court found plaintiff failed to put forth any evidence that the defendant had the specific intent required to violate ERISA.[92]

Other employer decisions concerning RIFs may potentially raise ERISA Section 510 concerns where the employer's decision is solely or primarily

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87 *See, e.g.*, Unida v. Levi Strauss & Co., 986 F.2d 970 (5th Cir. 1993); Daughtery v. Honeywell, Inc., 3 F.3d 1488 (11th Cir. 1993); Humphreys v. Bellaire Corp., 966 F.2d 1037 (6th Cir. 1992); Meredith v. Navistar Int'l Transp. Corp., 935 F.2d 124 (7th Cir. 1991); Conkwright v. Westinghouse Elec. Corp., 933 F.2d 231, 239 (4th Cir. 1991); Millsap v. McDonnell Douglas Corp., 162 F. Supp. 2d. 1262 (N.D. Okla. 2001) ("Every time an employer closes part of his business, savings on employee benefits will be realized. That is not unlawful.").

88 *Gavalik*, 812 F.2d at 856.

89 *Id.*; McLendon v. Cont'l Can Co., 908 F.2d 1171, 1183 (3d Cir. 1990); *see also Millsap*, 162 F. Supp. 2d at 1306 (finding sufficient evidence to demonstrate that employer selected specific groups of employees for termination based on anticipated savings under retiree medical plan).

90 Smith v. Gencorp, Inc., 971 F. Supp. 1071, 1073 (N.D. Miss. 1997).

91 *Id.* at 1076.

92 *Id.* at 1077.

motivated by its desire to contain benefit costs. For example, there is a risk of a successful ERISA Section 510 suit if an employer must close either Plant A or Plant B and elects to close Plant A because Plant A employees have more lucrative benefits than those at Plant B.[93] Even an employer who decides to idle a plant indefinitely, rather than close it, is nonetheless at risk for a successful Section 510 suit.[94] With the Affordable Care Act's "Play or Pay" mandate embodied in 26 U.S.C § 4980H just going into effect in 2015, instances in which an employer who is subject to the mandate engages in a RIF, a principal purpose of which is to avoid paying Section 4980H penalties, may be a new area ripe for litigation.

Courts are divided regarding whether Section 510 applies solely in the context of an employer-employee relationship. For example, the Fifth Circuit has concluded that Section 510 reaches farther than the employment relationship and applies to retired employees.[95] Other courts disagree, holding that an employer-employee relationship is required.[96] Similarly, although ERISA Section 510 does not expressly address refusals to hire, courts are nevertheless divided regarding whether an employer's refusal to rehire an

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93 *See* Nemeth v. Clark Equip. Co., 677 F. Supp. 899, 904–05 (W.D. Mich. 1987). *But cf.* Deeming v. Am. Standard, Inc., 905 F.2d 1124, 1127 (7th Cir. 1990) (no ERISA violation where plant closure was due to foreign competition).

94 *See* Pickering v. USX Corp., 809 F. Supp. 1501, 1548 (D. Utah 1992).

95 Heimann v. Nat'l Elevator Indus. Pension Fund, 187 F.3d 493, 507 (5th Cir. 1999); *see also* Mattei v. Mattei, 126 F.3d 794, 804–06 (6th Cir. 1997), *cert. denied*, 523 U.S. 1120 (1998) (finding that a Section 510 claim could be stated when an estate stopped payments to ex-spouse as stipulated in will allegedly in retaliation for and/or to interfere with ex-spouse receiving death benefits from an ERISA plan); Straus v. Prudential Empl. Sav. Plan, 253 F. Supp. 2d 438, 441–42 (E.D.N.Y. 2003) (former employees who are "participants" of the plan); Choi v. Mass. Gen. Physicians Org., Inc., 66 F. Supp. 2d 251, 252 (D. Mass. 1999) (former employee and participant of deferred compensation program).

96 Stiltner v. Beretta U.S.A. Corp., 74 F.3d 1473, 1484 (4th Cir.), *cert. denied*, 519 U.S. 810 (1996) (requiring employer-employee relationship to be affected); Haberern v. Kaupp Vascular Surgeons Ltd. Defined Benefit Pension Plan, 24 F.3d 1491, 1503–04 (3d Cir. 1994); Anderson v. Chrysler Corp., 99 F.3d 846, 856 (7th Cir. 1996); Woolsey v. Marion Labs. Inc., 934 F.2d 1452, 1461 (10th Cir. 1991); Gavalik v. Cont'l Can Co., 812 F.3d 834, 851 (3d Cir. 1987).

employee due to benefit costs gives rise to a Section 510 claim.[97] Other courts, however, following *Shawley v. Bethlehem Steel Corp.,*[98] have held that former employees with no right or expectation of future employment cannot state a claim under Section 510.[99]

An employee who is not laid-off and who consequently is ineligible for an often lucrative exit incentive package will sometimes claim, under ERISA Section 510, that his or her employer discriminated against the employee with the intention of depriving the employee of benefits.[100] ERISA does not compel an employer to provide severance benefits to specific employees. Therefore, most of these claims ultimately are unsuccessful, but they can nonetheless cause an employer to incur litigation expenses.

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97 *See, e.g.*, Mercier v. Boilermakers Apprenticeship & Training Fund, 2009 WL 458556 (D. Mass. Feb. 10, 2009) (refusal to reenter apprentice); *Pickering*, 809 F. Supp. at 1536 (failure to recall an employee).

98 Shawley v. Bethlehem Steel Corp., 989 F.2d 652 (3d Cir. 1993).

99 *See, e.g.*, Becker v. Mack Trucks, Inc., 281 F.3d 372, 375 (3d Cir.), *cert. denied*, 123 S. Ct. 93 (2002) ("[Section] 510 simply does not require that employers blind themselves to the effect on future pension liability when making hiring decisions."); *see also* Lessard v. Applied Risk Mgmt., 307 F.3d 1020, 1024–27 (9th Cir. 2002) (regarding an asset purchase transaction, holding (a) both seller and purchaser may have Section 510 liability for impermissibly terminating medical benefits of employees who were on medical leave on the date of the corporate transaction and (b) such liability may extend to purchaser if the corporate transaction was executed for specific purpose of relieving seller of medical benefits liability or if purchaser has specifically assumed medical benefits liability). *But see* Nauman v. Abbott Labs., 669 F.3d 854, 857–59 (7th Cir. 2012) (finding no Section 510 liability for a no-hire policy adopted during a spin-off transaction because employer had no specific intent of interfering with employees' benefits); Ensley v. Ford Motor Co., 368 Fed. Appx. 658, 661 (6th Cir. 2010) (finding no Section 510 liability where rehires in a spin-off and reacquisition transaction had no legitimate expectation of credited service or future pension benefits).

100 *See, e.g.*, McNab v. Gen. Motors Corp., 162 F.3d 959 (7th Cir. 1998), *cert. denied*, 526 U.S. 1115 (1999); Noorily v. Thomas & Betts Corp., 188 F.3d 153 (3d Cir. 1999), *cert. denied*, 529 U.S. 1053 (2000); *see also* J.B. Piner v. E.I. DuPont De Nemours & Co., No. 00-1082, 2000 WL 1699837, at *4 (4th Cir. Nov. 14, 2000) (holding that severance plan with purely discretionary eligibility was permissible under ERISA), *cert. denied*, 532 U.S. 1033 (2001).

[8] — Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), 29 U.S.C. §§ 1161-1168; Internal Revenue Code (IRC) § 4980B(f), 26 U.S.C. § 4980B(f).

The COBRA rules, which are provided in both ERISA and the Internal Revenue Code, apply to many employers who maintain group health plans. COBRA requires a covered employer to offer each qualified beneficiary who would otherwise lose coverage under a group health plan as a result of a "qualifying event" an opportunity to elect continuation coverage under the plan on a self-pay basis. Generally, an employer may charge qualified beneficiaries up to 102 percent of the cost of group health plan coverage.[101] The termination of employment, as would occur in connection with a RIF, is a "qualifying event" for COBRA purposes. Consequently, an employer considering a RIF should plan for COBRA compliance to avoid unintended additional costs.

COBRA applies to almost all group health plans of private employers except certain small employers (*e.g.*, ones who employed fewer than 20 employees on a typical business day during the preceding calendar year).[102] If an employer's workforce decreases below 20 employees, COBRA will not apply in the following calendar year.[103] COBRA will continue to apply with respect to all qualifying events that occurred during the calendar year in which the decrease took place.[104] The employer must also continue to comply with COBRA for all qualified beneficiaries who experienced a qualifying event in any year prior to the year in which a decrease in the workforce occurred.[105]

A qualified beneficiary is eligible for COBRA continuation coverage if he experiences a qualifying event.[106] A qualified beneficiary may include a covered employee, retiree under the group health plan, and spouse or

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101 26 U.S.C. § 4980B(f)(2)(C); 29 U.S.C. § 1162.

102 29 U.S.C. § 1161(b); 26 U.S.C. § 4980B(d); Treas. Reg. § 54.4980B-2, Q&A 5(a).

103 Treas. Regs. § 54.4980B-2, Q&A 5(g).

104 *Id*.

105 *Id*.

106 29 U.S.C. § 1161(a); 26 U.S.C. § 4980B(f)(3).

dependent child.[107] The termination of a covered employee's employment (other than for gross misconduct) is one of six events that may trigger COBRA eligibility.[108] In the case of a termination of employment, a qualified beneficiary may continue his group health coverage for eighteen months.[109] This period may be extended if there is a second qualifying event or the qualified beneficiary becomes disabled.[110] ERISA requires a plan to describe certain aspects of COBRA continuation coverage in the plan's Summary Plan Description.[111] COBRA provisions must also be included in the plan's "Summary of Benefits and Coverage" or "SBC," a disclosure required under the Affordable Care Act.[112] With respect to the language in the SBC, the final regulations contain templates that include COBRA language that must be used without change.[113]

At the core of COBRA are the initial and election notice requirements. The plan administrator must furnish each employee a notice which outlines his COBRA rights and obligations when he is first covered under the plan and when he experiences a qualifying event (for example, termination of employment as a part of a reduction-in-force).[114] The U.S. Department of Labor maintains a model COBRA notice on its website, which was updated in 2014 to highlight the fact that individual coverage available through the Health Insurance Marketplace is an alternative to COBRA that qualifying beneficiaries should consider.[115] Delivery of the COBRA initial and election notices must be made in a manner "likely to result in full distribution," and

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107 Treas. Regs. § 54.4980B-3, Q&A 1(a)(1)(i); 26 U.S.C. § 4980B(g)(1); 29 U.S.C. § 11679(3).

108 29 U.S.C. § 1163; 26 U.S.C. § 4980B(f)(3); Treas. Regs. § 54.4980B-4, Q&A 1.

109 26 U.S.C. § 4980B(f)(2)(B)(i)(I); 29 U.S.C. § 1162(2)(A)(i).

110 *See* 26 U.S.C. § 4980B(f)(2)(B); 29 U.S.C. § 1162(2)(A)(ii).

111 29 C.F.R. § 2520.102–3(o).

112 *Id*. § 2590.715–2715(a)(2)(E).

113 *See* Preamble, Summary of Benefits and Coverage and Uniform Glossary-Templates, Instructions, and Related Materials, and Guidance for Compliance, 77 Fed. Reg. 8706 (Feb. 14, 2012).

114 26 U.S.C. § 4980B(f)(6); 29 U.S.C. § 1166.

115 29 U.S.C. § 2590.606-1(g). A model COBRA notice is available at http://www.dol.gov/ebsa/cobra.html (last visited May 15, 2015).

COBRA regulations specifically permit delivery by first-class mail, hand-delivery to the employee at the workplace, or electronic delivery if certain conditions are met.[116] From a practical perspective, proof of delivery is often critical to defending a COBRA claim that may be brought years after the delivery in question. Consequently, plan administrators are strongly urged to choose a method of delivery with care.

Courts have generally required that the plan show evidence of a good faith effort at delivery.[117] Indeed, a showing that methods of delivery are strong can be critical in defending COBRA notification cases. For example, in *Somers v. Cudd Energy Servs., Inc.*, the court granted summary judgment to the employer, even though the employee purportedly never received a COBRA notice after his qualifying event.[118] The court's holding indicates that evidence of an employer's regular business practices and good faith efforts at delivery can outweigh an employee's alleged non-receipt of a COBRA notice. Depending upon the size of the plan and tolerance for plan expenses and administrative load, many plan administrators (1) send COBRA notices by first-class mail or certified mail, return receipt requested, and (2) keep detailed records of the method of delivery.

Failure to furnish a COBRA initial or election notice can lead to a penalty of up to $110 per day under ERISA.[119] In imposing these penalties, courts often weigh evidence of bad — or good — faith and/or negligence on the part of the plan administrator, and injury or prejudice to the qualified beneficiary.[120] COBRA violators may also be subject to ERISA's civil and

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116 *See id*. at § 2590.606–1(f) (citing 29 U.S.C. § 2520.104b–1).

117 *E.g.*, Smith v. Rogers Galvanizing Co., 128 F.3d 1380, 1383–34 (10th Cir. 1997); Gibbs v. A. Finkl & Sons Co., No. 00 C 4546, 2002 WL 318291, at *4-5 (N.D. Ill. Feb. 26, 2002); Johnson v. N.W. Airlines, Inc., No. C 00-1169 SC, 2001 WL 210480, at *4 (N.D. Cal. Feb 23, 2001).

118 Somers v. Cudd Energy Servs., Inc., CIV-11-724-M, 2012 WL 1836269, at *11 (W.D. Okla. May 21, 2012).

119 29 U.S.C. § 1132(c)(1).

120 *See, e.g.*, Gomez v. St. Vincent's Health, 649 F.3d 583 (7th Cir. 2011) (no penalty); Simpson v. T.D. Williamson, Inc., 321 F. Supp. 2d 1247 (D. Okla. 2004), *aff'd*, 414 F.3d 1203 (10th Cir. 2005) (penalty of $25 per day); Veneziano v. Long Island Pipe Fabrication & Supply, 79 Fed. Appx. 506 (3d Cir. 2003) (penalty of $2 per day); Brown v. Aventis Pharm.,

criminal penalties.[121] Failure to comply with COBRA may also lead to significant penalties outside of ERISA, including an excise tax of up to $200 per day.[122] On or after January 1, 2010, excise taxes must be reported on IRS Form 8928 ("Return of Certain Excise Taxes Under Chapter 43 of the Internal Revenue Code") and paid by the due date of the liable party's income tax return for the relevant taxable year.[123] Failure to do so on a timely basis can lead to the assessment of interest and penalties.[124] A plan's failure to deliver required COBRA notices in a timely manner may also result in a qualified beneficiary's suit under ERISA to recover medical expenses incurred in the absence of COBRA coverage, less the COBRA premiums that would have been paid.[125] Whether such an award will be covered by applicable insurance (for an insured plan, the underlying coverage or, for a self-insured plan, any stop-loss coverage) will be determined by the terms of coverage, which may spawn additional litigation.

Of course in discussing COBRA compliance, it is important to note that a plan cannot act on its own. Depending upon applicable plan and/or third-party service agreement provisions (or a lack thereof) specifying and allocating responsibility for satisfying COBRA notice requirements, courts have placed such responsibility upon a plan's third-party administrator, plan sponsor, and even an individual employee with plan responsibilities.[126] Ideally, for a plan

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Inc., 341 F.3d 822 (8th Cir. 2003) ("maximum statutory damages allowed").

121 *See* 29 U.S.C. §§ 1131, 1132.

122 26 U.S.C. § 4980B(b)(1); 26 U.S.C. § 4980B(c)(3)(A).

123 *See* Treas. Reg. § 54.4980B-2, Q&A 11.

124 *See* Dep't of the Treas.: I.R.S., *Instructions for Form 8928 (December 2013)*, available at http://www.irs.gov/pub/irs-pdf/i8928.pdf.

125 *See, e.g.*, Starr v. Metro Sys., Inc., No. 01-1122, 2005 WL 2216288, at *3–4 (D. Minn. Sept. 12, 2005) (awarding medical expenses less co-pays and premiums), *aff'd*, 461 F.3d 1036 (8th Cir. 2006); Simpson v. T.D. Williamson, Inc., 321 F. Supp. 2d 1247, 1252 (D. Okla. 2004).

126 *See, e.g.*, Agosto v. Academia Sagrado Corazon, 739 F. Supp. 2d 90 (D.P.R. 2010) (employer/plan sponsor); Buchanan v. Golden Casting Corp. Hourly Health Benefit Plan, No. 4:03–CV–151–SEB–WGH, 2003 WL 22951936 (S.D. Ind. Oct. 10, 2003) (individual); Fox v. Law Offices of Shapiro & Kreisman, No. CIV. A. 97-7393, 1998 WL 175865 (E.D. Pa. April 13, 1998) (third party administrator); Thurston v. Borden Waste-Away Serv. Inc., No. 3:96–CV–674RP, 1998 WL 456441 (N.D. Ind. May 19, 1998) (plan administrator).

with a third-party administrator, the responsibility for COBRA administration should be clearly and consistently stated in the applicable service provider agreement(s). For any plan, the plan document and Summary Plan Description should accurately reflect (or at least not inaccurately reflect) the allocation of administrative responsibilities.

[9] — Health Insurance Portability and Accountability Act of 1996 (HIPAA), 42 U.S.C. §§ 300gg, *et seq.*

One of the goals of HIPAA was to provide special protections for an individual moving from one health plan to another, which HIPAA previously accomplished through a "certificate of creditable coverage," designed to reduce the amount of time the individual is subject to any preexisting condition limitation under the subsequent health plan. Sweeping changes introduced during the passage of federal health care reform legislation has had ripple effects on legislation such as HIPAA, including prohibiting group health plans from imposing preexisting condition limitations or conditioning eligibility upon the statutori*ly* enumerated health factors.[127] Thus, the HIPAA rules addressing preexisting conditions, including issuance of a "certificate of creditable coverage," have become obsolete. Other provisions of HIPAA, however, remain in effect. For example, group health plans are required to protect the privacy of a participant's protected health information.[128]

[10] — State Health Care Continuation Statutes.

In addition to COBRA itself, 38 states[129] maintain their own statutes — sometimes referred to as "mini-COBRA" — that mandate continuation of health care benefits in certain situations, such as termination of employment

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127 *See* 42 U.S.C. §§ 300gg-3(a); 300gg-4(a).

128 *See* 45 C.F.R. §§ 160; 164.

129 The states with mini-COBRA laws are Arkansas, California, Colorado, Connecticut, Florida, Georgia, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, West Virginia, Wisconsin and Wyoming.

in a RIF. Although some of these statutes mirror COBRA, others impose much more stringent requirements.[130] In light of how vastly different these state statutes are, an employer should consult experienced counsel regarding applicable state law and whether and to what extent such statutes may apply to a contemplated RIF.

[11] — Other Potential Plaintiffs.

Employees who have recently filed complaints or reports with regulatory agencies, such as OSHA, MSHA or the EPA, are potential plaintiffs. If these persons are included in a RIF, they may well argue that the only reason they were selected for layoff is that they contacted OSHA or the EPA shortly before the RIF. This type of action is known as a "retaliatory discharge" case.

Retaliatory discharge actions can also be brought by persons who have recently exercised other rights under various statutes. For instance, if an employee recently filed a claim for workers' compensation, that employee is protected from retaliation resulting from the exercise of that right. The following statutes, among others, explicitly protect employees from retaliatory discharge:

- State Workers' Compensation statutes;
- The Age Discrimination In Employment Act;
- State Human Rights Acts;
- Title VII of the Civil Rights Act of 1964, as amended by the Civil Rights Act of 1991;
- The Americans with Disabilities Act of 1990, as amended by the ADA Amendments Act of 2008;
- The Occupational Safety and Health Act;
- The National Labor Relations Act (non-union employees are also protected);
- The Clean Air Act;

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130 *See, e.g.*, Brooke Tomlinson, Chapter 3, "Weakening the Sting of COBRA's Bite," 41 *McGeorge L. Rev.* 655 (2010) (describing the interplay between California's version and COBRA).

- The Consumer Protection Act;
- The Wage Garnishment Act;
- The Employee Retirement Income Security Act; and
- The Health Insurance Portability and Accountability Act of 1996.

§ 10.03. Determine What Inducements, If Any, Will Be Offered for Voluntary Layoffs.

Once it is decided that a RIF is necessary, operations managers should first formulate a plan, which indicates the number of persons in each position required to successfully operate the company. When the operational plan is formulated, the employer will know how many positions must be eliminated. There are two possibilities: voluntary termination and involuntary layoff. An employer must determine (1) what inducements, if any, to offer those who may voluntarily terminate their employment prior to the layoff and (2) what benefits, if any, that will be provided to those whose employment is involuntarily terminated.

[1] — Analysis of Existing Severance and Retirement Plans.

An employer may already pay for other benefits upon severance. If so, that must be taken into account because employees do not lose their rights to preexisting benefits just because a different package is offered as part of the RIF. Rather, laid-off employees could get benefits under both plans unless the RIF package of severance benefits is an amendment of (rather than a supplement to) the preexisting benefit plan.[131] Thus, the first step in the establishment of a RIF-benefits package is to determine what benefits employees will receive under already established programs. Keep in mind that even informal, unwritten benefit programs have been found enforceable.[132]

Employers may wish to amend or terminate an existing severance plan in advance of the RIF to avoid undesired overpayment of benefits. Noting that a company's severance plan was a welfare benefit plan whose benefits

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131 *See, e.g.*, Gordon v. Barnes Pumps, Inc., 999 F.2d 133 (6th Cir. 1993); Adams v. Avondale Indus., Inc., 905 F.2d 943 (6th Cir.), *cert. denied*, 498 U.S. 984 (1990).

132 *See infra* pp. 53–57.

were not vested until paid, the First Circuit held that the company did not violate ERISA when it amended the severance plan shortly before a group of employees would have experienced an event triggering severance pay under the then-existing plan.[133] Although the *Campbell* case arose in the context of a sale of assets whereby the buyer agreed to offer employment to substantially all of the employees rather than lay them off, the analysis is presumably the same as in a RIF. When an employer amends an ERISA plan, it acts as a plan sponsor and not a fiduciary; consequently, an employer does not violate an ERISA fiduciary duty when it amends a plan, even when the amendment is adopted in connection with a RIF.[134] Keep in mind, however, that at least one court has indicated its willingness to consider whether a severance plan is a unilateral contract, thereby limiting the employer's ability to amend the severance benefit plan.[135]

With respect to an employer's current retirement plan, important issues include not only whether and what benefits will be paid upon a proposed RIF, but whether the RIF will result in other types of potential negative consequences for the plan. Proactive planning may lessen these types of negative consequences or at least permit an employer to take them into account in determining its course of action. For instance, an employer should consider the effect of a proposed RIF on various coverage and nondiscrimination testing for its qualified retirement plan. A qualified retirement plan is required to comply with complex annual testing requirements, some of which seek to ensure that such plan covers a sufficiently broad range of employees, while others seek to ensure that such plan does not impermissibly discriminate in

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133 Campbell v. Bank Boston, N.A., 327 F.3d 1, 8 (1st Cir. 2003).

134 *Id*.; Schultz v. Windstream Comm., Inc., 600 F.3d 948, 952 (8th Cir. 2010) (concerning a plan amendment granting additional service credit to certain employees, but not others, adopted in connection with a RIF); Sears v. Union Cent. Life Ins. Co., 222 Fed. Appx. 474, at *14 (6th Cir. 2007) (concerning a severance plan amendment limiting the circumstances in which benefits would be paid, adopted in connection with corporate transaction); Haran v. Dow Jones & Co., No. 99–9143, 2000 U.S. App. LEXIS 14114, at *5 (2d Cir. June 15, 2000).

135 *See* Amatuzio v. Gandalf Sys. Corp., 994 F. Supp. 253, 265–67 (D.N.J. 1998).

favor of highly compensated employees.[136] Because such tests are necessarily dependent upon relevant employee-based data, a change to such data may cause the plan to fail one or more tests. A failure to pass can result in higher costs for the plan sponsor (for instance, in the form of increased employer contributions to benefit the non-high*ly* compensated employees so that the plan passes one or more tests).

A potentially more expensive consequence occurs if a qualified plan is found to have experienced a partial plan termination. A partial plan termination occurs if a significant number or percentage of a plan's participants stops participating in the plan, either by plan amendment or because of their termination from employment.[137] If there is a partial plan termination, "affected employees" become fully vested in their accrued benefits, to the extent funded, or the amounts credited to their accounts.[138] The inquiry of whether and when a partial termination occurs is heavily fact-dependent and a number of different factors are relevant to the consideration.[139] However, the IRS applies a rebuttable presumption that a partial termination has occurred if there is a 20 percent or more "turnover rate," which essentially measures the number of plan participants who have an employer-initiated severance from employment, as compared with the number of plan participants prior to the severance.[140]

Although nondiscrimination test failures and partial terminations can occur with respect to both defined contribution plans (such as 401(k) plans) or defined benefit pension plans, some rules apply only to a particular type of retirement plan. For example, if a defined benefit pension plan is determined

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136 26 U.S.C. § 401(a)(4) (nondiscrimination rules); *id*. § 401(a)(26)(A) (minimum participation rules); *id*. § 401(k)(3) (actual deferral percentage test applicable to eligible deferrals to 401(k) plan); *id*. § 401(m)(2) (actual contribution percentage test applicable to matching contributions and after-tax contributions in 401(k) plan); *id*. § 410(b)(10) (minimum coverage rules).

137 *Id*. at § 411(d)(3); Treas. Reg. § 1.411(d)-2; Rev. Rul. 81-27 (finding a partial termination when an employer shut down a division resulting in 95 participants being discharged).

138 26 U.S.C. § 411(d)(3).

139 Rev. Rul. 2007-43.

140 *Id*.

by the Secretary of the Treasury to have experienced a partial termination, such a finding not only triggers the full vesting described above, but also a requirement to give notice to the Pension Benefit Guaranty Corporation (PBGC) of such partial termination as a "reportable event."[141] A proposed RIF may result in other reportable events, such as a significant decline in active plan participants.[142] The deadline for giving notice of a reportable event depends upon the particular reportable event, but is generally 30 days after knowledge of its occurrence or 30 days before its effective date.[143]

Moreover, an employer who maintains a defined benefit pension plan and who ceases operations at a facility involving more than 20 percent of plan participants may be viewed as having experienced a "substantial cessation of operations," which also triggers PBGC notice requirements, PBGC liability, and annual reporting requirements.[144] The PBGC promulgated proposed regulations concerning how liability will be calculated and satisfied.[145] Generally, the proposed regulations require calculation of Section 4062(e) liability as the amount of unfunded liability for the entire plan, multiplied by a fraction of the affected participants (numerator) to the active participant base (denominator).[146] The proposed regulations would require the employer to pay the liability into an escrow account or furnish a bond in an amount that is 150 percent of the liability.[147]

Employers who participate in a multiemployer pension plan should pay particular attention to whether a proposed RIF will result in any complete or partial withdrawal liability to the multiemployer plan, which can lead to significant funding requirements.[148] A withdrawing employer is responsible for funding its share of the multiemployer plan's "unfunded vested

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141 29 U.S.C. § 1343(c)(4).

142 *Id*. at § 1343(c)(3).

143 29 C.F.R. §§ 4043.20, 4043.61(a).

144 29 U.S.C. § 1362(e).

145 75 Fed. Reg. 48283-01 (August 10, 2010); Prop. PBGC Reg. § 4062.33(a).

146 Prop. PBGC Reg. § 4062.32(b).

147 *Id*. at § 4062.33(a); *see also id*. at § 4062.33(b) (noting the PBGC may permit alternate methods of satisfaction).

148 *See* 29 U.S.C. § 1381(a).

benefits,"[149] the calculation of which is highly dependent upon a number of variables, including actuarial assumptions and valuation dates.[150] The determination of whether withdrawal liability has attached is not only fact-specific, but industry-specific as well because the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), Pub. L. No. 96-364, has carve-outs for certain industries. An employer who participates in a multiemployer plan and is considering a potential RIF is strongly encouraged to request an estimate of withdrawal liability under ERISA § 101(l), as amended by the Pension Protection Act of 2006 (PPA), Pub. L. No. 109-280, § 502(b)(1). Receiving an estimate of withdrawal liability permits the employer advance notice of the likely size of such funding requirement and, if desired, time in which to resolve any dispute regarding such withdrawal liability.[151]

[2] — Funding RIF Benefits.

Whatever types of benefits the employer ultimately elects to offer, the employer must determine how it will pay for them.

[a] — Benefits Offered through Defined Benefit Plan

If the employer presently sponsors an existing defined benefit pension plan, the plan can be amended to permit RIF benefits to be provided through existing plan assets.[152] The following is a list of some enhanced benefits that employers have, at times, offered through their defined benefit pension plans:

- Use of additional years of service for benefit calculation purposes or eligibility for early retirement;
- Use of projected rather than actual pay;
- Imputing additional years to an employee's age;
- Using a shorter time to determine "final average compensation" in plans using that term;

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149 *Id*. § 1381(b)(1).

150 *Id*. § 1391.

151 *See id*. § 1401.

152 Defined contribution plans such as profit sharing plans and 401(k) plans do not accumulate assets that can be used to fund RIF benefits.

- Supplementing pension benefits until the employee reaches Social Security retirement age;
- Eliminating benefit reductions for early retirement;
- Making cost-of-living (COLA) adjustments to monthly retirement benefits;
- Accelerating benefit commencement dates;
- Paying retiree medical benefits; and/or
- Subsidizing survivor benefits for joint and survivor annuities.

Offering RIF benefits through an existing defined benefit plan is currently most attractive only to an employer whose pension plan is overfunded (meaning its assets exceed accrued liabilities). This is because the Pension Protection Act of 2006 added benefit accrual and payment restrictions that apply to a defined benefit plan whose funding status drops below certain floors.[153] Pivotal to these rules is a plan's "AFTAP," meaning its adjusted "funding target attainment percentage," determined on an annual basis.[154] Restrictions apply if a plan's AFTAP drops below either the 80 percent or 60 percent level. For instance, a plan whose AFTAP drops below eighty percent (or would drop below eighty percent if the anticipated amendment were adopted) may not be amended in a manner that increases liabilities by way of increasing benefits, establishing new benefits, changing the rate of benefit accrual, or changing the rate of vesting.[155] Also, a plan that provides "unpredictable contingent event benefits" (such as benefits payable upon a plant shutdown) is prohibited from paying such shutdown benefits if the plan's AFTAP drops below 60 percent (or would drop below 60 percent, taking into account the unpredictable contingent event benefits).[156]

The 60 percent floor also triggers limitations on paying "accelerated" benefits.[157] Although Section 436's prohibitions may be lifted if the plan

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153 *See* 26 U.S.C. § 436 (as added by the PPA, Pub. L. No. 109-280, § 113(a)(1)(B)).
154 26 U.S.C. § 430(d)(2).
155 *Id*. at § 436(c)(1).
156 *Id*. at § 436(b)(1).
157 *Id*. at § 436(d)(1).

sponsor makes sufficient additional funding contributions, the additional funding requirement undercuts the benefits of structuring severance benefits in this manner.[158] Applying these funding-based limitations in practice is complex and beyond the scope of this chapter. It is, however, important to note that, depending upon a plan's AFTAP, these rules may further complicate funding RIF benefits through an existing defined benefit plan.

In addition to the specific Code 436 rules, the Internal Revenue Service has also expressed its "concern[] that certain qualified defined benefit plans may include nontraditional benefits . . . ."[159] The Service indicated that it is considering issuing guidance that restricts the types of benefits permitted to be paid from a defined benefit plan and places additional restrictions on the size and triggers of such benefits.[160] Should the IRS move forward in this direction, its eventual guidance could significantly affect an employer's ability to offer RIF benefits through a defined benefit plan in the future.

[b] — Benefits Offered outside Defined Benefit Plans

With respect to benefits that are offered outside of a defined benefit plan, the following lists certain fairly common RIF benefits:

- Severance pay, either paid as a lump sum or as salary continuation, or partially as each;
- Extension of group life coverage for life or for a limited period;
- Financial or career counseling;
- Payment or partial payment of COBRA continuation coverage health care premiums;
- Continued or reduced-cost medical benefits for life or for a limited period of time; and/or
- Payment of health or life insurance costs under individual policies.

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158 *See, e.g.*, *id*. §§ 436(b)(2), (c)(2) (exempting a plan from benefit prohibitions if the plan sponsor makes sufficient additional funding contributions to the plan).

159 I.R.S. Notice 2007-14; *see also* 2007-1 C.B. 501.

160 *Id*.

Certain recent changes in the law stress the importance of involving experienced benefits counsel in the formulation of a proposed RIF.

Federal Health Care Reform Implications

While it has long been the case that employers have offered as a RIF benefit the payment of medical premiums or offering continued medical benefits coverage, the continued availability of such benefits offered in a tax-advantaged manner depends upon whether the employer's health plan is insured or self-insured and upon the future of federal health care reform. As to the first, it is helpful to understand the background tax rules. Employer-provided health coverage and benefits are generally excluded from taxation to the employee as compensation under Code Sections 105 and 106. The IRS has indicated that this rule extends when such benefits are provided to retired employees and laid-off employees.[161] Historically, in accordance with such guidance, an employer whose health plan is insured has offered continued coverage or the payment of premiums as a RIF benefit without adverse tax consequences to the terminated employee.

Offering such continued health coverage as a RIF benefit is not so simple for an employer with a self-insured health plan. This is because a self-insured group health plan is subject to additional nondiscrimination rules under Code Section 105(h).[162] Failing such nondiscrimination tests results in taxation of "excess reimbursements" to highly compensated individuals under the self-insured plan.[163] Thus, an employer who maintains a self-insured plan and wishes to offer continued medical coverage or payment of medical premiums as a RIF benefit must work within the strictures of the Section 105(h) nondiscrimination rules. Depending upon the facts and circumstances, such a benefit is either offered in a nondiscriminatory manner and thus not taxable to a RIF'ed employee, or (particularly if offered only to certain

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161 *See* I.R.S. Priv. Ltr. Rul. 9612008 (Mar. 22, 1996) (terminated employees); Rev. Rul. 85-121 (laid-off employees); Rev. Rul. 82-196 (retired employees).

162 26 U.S.C. § 105(h)(2).

163 *Id*. at § 105(h)(1).

executives who are RIF'ed, etc.) is offered but included as taxable income to the RIF'ed employee.

From an historical perspective, Section 105(h) nondiscrimination rules do not apply to insured health plans. However, federal health care reform legislation extends the application of the Section 105(h) nondiscrimination rules to insured arrangements as well.[164] Under the statutory provisions of federal health care reform, this change was to be effective for plan years beginning on or after September 23, 2010, but the IRS, in conjunction with the Department of Health and Human Services and the Department of Labor, announced that compliance is not required until the agencies have issued applicable regulations.[165] The PPACA provides that "rules similar to" Sections 105(h)(3), (4), and (8) will be enacted; however, no such regulations have yet been promulgated.

Code Section 409A Implications

Often an employer offers non-pension plan benefits on a "pay-as-you-go" basis, using general corporate assets. Alternatively, in limited cases (typically involving executive level employees), an employer uses a non-qualified deferred compensation plan as a vehicle for delivering such benefits. Because Code Section 409A adds a new layer of complexity to that approach, along with a hefty price for noncompliance, it is important that RIF benefits be structured in a manner that is either exempt from or compliant with Section 409A. It is also critical to note that Section 409A compliance is complex and reaches beyond what has been traditionally considered deferred compensation. Only a brief overview of the most basic rules applicable to a RIF will be given here.

Code Section 409A imposes strict limitations on the timing, manner, and payment of nonqualified deferred compensation.[166] Under Section 409A, deferral of compensation occurs when an employee earns in one taxable year

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164 42 U.S.C. § 300gg-16; 26 U.S.C. § 9815; 29 U.S.C. § 1185d (as amended by PPACA § 1562(e)); *see also* Treas. Reg. § 54.9815-1251T; 29 C.F.R. § 2590.715-1251.

165 *See* I.R.S. Notice 2011-1, 2011-2 I.R.B. 259.

166 26 U.S.C. § 409A.

a legally binding right to compensation that is or may be payable in a later taxable year.[167] Section 409A applies whether the deferred compensation is pursuant to a written plan or practical arrangement and whether benefits are paid to a single individual or a broader class.[168] As interpreted by the IRS, an individual's employment agreement, an individual severance agreement, or larger RIF programs can each fall within the purview of Section 409A.

A failure to comply with Section 409A's rules, whether in document or operation, results in the deferred compensation being immediately taxable, regardless of when it will be actually paid.[169] Moreover, such deferred compensation will be subject to an additional 20 percent tax, as well as interest from the time that the amount would have been includible in income.[170] If the deferred compensation is subject to a substantial risk of forfeiture (which is narrowly defined for this purpose), it does not trigger the negative tax consequences noted above.[171] A right to deferred compensation is subject to a substantial risk of forfeiture only if it is "conditioned upon the future performance of substantial services by any individual."[172]

There are a few types of programs that are exempt from Section 409A's rules, which may be useful in structuring RIF benefits. The first exemption is for short-term deferrals. If deferred compensation payments are required to be made, and are, in fact, made, no later than the fifteenth day of the third month after the taxable year in which an employee becomes vested in the payment, it is exempt as a short-term deferral.[173] An example may illustrate this exemption's application. Lump sum severance pay offered to employees whose employment is terminated in 2012, as a part of a RIF in 2012, where documents state that such severance pay must be paid no later than March

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167 Treas. Reg. § 1.409A-1(b).

168 26 U.S.C. § 409A(d)(3).

169 *Id*. at § 409A(a)(1).

170 *Id*.; *see also* 73 Fed. Reg. 74380-01 (Dec. 22, 2008); Treas. Reg. §1.409A-4 (setting forth provisions regarding the calculation of amount includible in income and additional taxes); I.R.S. Notice 2008-115, 2008-52 I.R.B. 1367 (Dec. 10, 2008).

171 26 U.S.C. § 409A(a)(1)(A)(i).

172 *Id*. at § 409A(d)(4).

173 *See* Section IV, Q&A4(c), I.R.S. Notice 2005-1, 2005-1 C.B. 274.

15, 2013, and where such payment is, in fact, paid no later than March 15, 2013, can fit within this exemption.

The second exemption is for a limited type of a separation pay plan that (a) is not collectively bargained; (b) provides benefits only upon an involuntary separation from service or a window program; and (c) abides by the "two times, two years" rule.[174] "Involuntary separation from service" refers to situations in which the employee is willing and able to continue working for the employer, but the employer chooses to end the employment, other than in response to the employee's request.[175] The parties' characterization of the involuntary nature will be presumed accurate, but the IRS may recharacterize based upon all the facts and circumstances.[176] The "two times, two years" rule requires that such a separation pay plan's benefits must not be more than two times the employee's compensation (or, if less, two times the IRS compensation limit for qualified plans as stated in Code Section 401(a)(17), which is $265,000 for calendar year 2015) and (b) payments must be completed by the end of the second calendar year after the year in which employment is terminated.[177]

[c] — Common Types of RIF Benefits.

Although by no means exhaustive, the following is a partial listing of common types of RIF benefits:

[i] — Enhanced Defined Benefit Pension Benefits.

- use of additional years of service for benefit calculation purposes or eligibility for early retirement;
- use of projected rather than actual pay;

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174 Treas. Reg. § 1.409A-1(b)(9)(iii)(A).

175 *Id*. at § 1.409A-1(n)(1).

176 *Id*.

177 *Id*.; *see also* Section IV(A), I.R.S. Notice 2007-78, 2007-2 C.B. 780; Treas. Reg. § 1.409A-1(b)(9)(ii) (providing that a collectively bargained severance pay arrangement is not subject to Code Section 409A if payments are made upon an involuntary termination of employment or a window program).

- imputing additional years to an employee's age;
- using a shorter time to determine "final average compensation" in plans using same;
- supplementing pension benefits until the employee reaches Social Security retirement age;
- elimination of benefit reductions for early retirement;
- making cost of living adjustments to monthly retirement benefits;
- acceleration of benefit commencement dates;
- payment of retiree medical benefits;
- subsidization of survivor benefits for joint and survivor annuities.

[ii] — Non-Retirement Benefits.

Fairly common non-retirement RIF benefits include all or some of the following:

- continued or reduced-cost group medical benefits for life or a limited period;
- payment or partial payment of COBRA continuation health care premiums;
- extension of group life coverage for life or a limited period;
- payment of health or life insurance costs under individual policies;
- financial or career counseling;
- severance pay, either paid in a lump sum or as salary continuation, or partially as both (*see infra*, regarding limits that should be applied to severance pay arrangements).

[d] — Determining the Amount or Level of RIF Benefits.

Determining the generosity of RIF-related exit incentive benefits often rises to the level of an art form. The employer wants to choose a level that

encourages enough people to leave so that the employer will not have to conduct a layoff. On the other hand, if the incentives offered are too generous, the RIF (1) will cost the employer more than necessary to achieve the desired workforce reductions; and (2) may cause the employer to lose too many productive employees, especially those who can easily find work elsewhere, which means the employer then ends up spending more money hiring and training additional workers.

[e] — Legal Requirements.

The employer is generally free to determine if RIF-related benefits will be offered and, if so, the scope of the benefits offered, provided that it does not illegally discriminate against workers or violate the provisions of ERISA, if applicable. However, to the extent that an employer can be described as consistently offering window plans, the employer runs the risk of developing expectations on the part of ongoing employees, or making it difficult to eliminate such benefits later.[178] Further, ERISA pension plans are governed by a number of requirements, a discussion of which is beyond the scope of this chapter. Particularly where RIF benefits are to be grafted onto an existing ERISA pension plan, experienced ERISA counsel should be consulted to determine how the RIF benefits will affect the plan.

Failure to properly integrate RIF benefits with an existing pension plan can cause significant, adverse consequences, including the loss of the plan's tax-favored status. For instance, if an employer offers a window program through an existing qualified retirement plan, the window benefits are subject to rigorous nondiscrimination rules designed to ensure that the window benefit does not improperly discriminate in favor of the plan's

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178 *See* Stiltner v. Beretta U.S.A. Corp., 74 F.3d 1473 (4th Cir.), *cert. denied*, 519 U.S. 810 (1996) (holding that ERISA Section 510 did not extend protection to gratuitous benefits, but noting that Section 510 may apply to non-gratuitous benefits which could be found by proving that such benefits were offered regularly and consistently, offered under a formal policy, or offered as an inducement to recruit new employees); s*ee also* Treas. Reg. § 1.411(d)-4, Q&A 1(c)(1) ("a pattern of repeated amendments [to a pension plan] providing for similar benefits in similar situations for substantially consecutive, limited periods of time" could create ongoing rights to the benefits).

highly compensated employees.[179] The nondiscrimination tests are very complicated, usually require highly specialized assistance to administer, and are often inadvertently violated. Moreover, if the amendment adding the window program is not properly structured, the benefits may become, in the eyes of the Internal Revenue Service and/or U.S. Department of Labor, an "early retirement benefit or retirement-type subsidy" that may be eliminated only as permitted under Code Section 411(d)(6) and/or ERISA Section 204(g).[180]

Particularly when pension benefits (which inherently have some relation to an employee's age) are involved, RIF benefits should be examined for compliance with the Age Discrimination in Employment Act (ADEA). The ADEA, as amended by the Older Workers Benefit Protection Act of 1990 (OWBPA), prohibits an employer from discriminating against older workers with respect to benefits, including benefits plans that relate to RIFs.[181] However, the ADEA further provides that,

> [it] shall not be unlawful for an employer, employment agency, or labor organization . . . (2) to take any action otherwise prohibited under . . . this section . . .
>
> (B) to observe the terms of a bona fide employee benefit plan . . .
>
> (i) where for each benefit or benefit package, the actual amount of payment made or cost incurred on behalf of an older worker is no less than that made or incurred on behalf of a younger worker . . .
>
> or
>
> (ii) that is a voluntary early retirement incentive plan consistent with the relevant purposes of this chapter.[182]

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179 *See* Treas. Reg. § 1.401(a)(4).

180 *See* Bellas v. CBS, Inc., 221 F.3d 517 (3d Cir. 2000), *cert. denied*, 531 U.S. 1104 (2001) (holding a permanent job separation benefit in a qualified plan was a protected benefit). *But cf.* Rev. Rul. 9266 (finding window benefits did not become permanent feature of plan).

181 29 U.S.C. § 623(f).

182 *Id.*

Options respecting benefits that are not part of an early retirement incentive plan include paying all employees the same benefit, *e.g.*, a flat dollar amount, and employing benefit criteria that are age-neutral such as a severance benefits equal to salary multiplied by years of service. However, an employer should be prepared to offer documented cost justification (*e.g.*, an actuary's report) if a lower incentive is given to employees over a specified age.

For voluntary early retirement incentive plans, although an employer can avoid ADEA complications by paying employees a flat dollar amount or by basing benefit amounts on ageneutral factors, retirement benefits are often inherently based on age-related factors. Since the legal standard for compliance (that the plan be consistent with the relevant purposes of the ADEA)[183] is vague, consideration should be given to adopting "safe harbor" benefit plans, which, according to the ADEA, will not discriminate against older workers. The safe harbors are:

- Amendment of a defined benefit pension plan to eliminate reductions for those who retire prior to normal retirement age, although this will provide a greater enhanced benefit to younger workers.[184]
- Social Security "bridge payments" under a defined benefit pension plan that are payable to employees who are not yet eligible for Social Security benefits.[185]
- Offsetting severance benefits by the amount of early retirement incentive payments the employee will receive (following special, complicated rules).[186]

§ 10.04. Choose the Layoff Criteria.

The next step is to choose the involuntary layoff criteria. Seniority is the safest, but often the least desirable, choice. Performance is sometimes the

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183 It is certainly arguable that a retirement plan which treats older workers less generously than younger workers can never be consistent with the ADEA.

184 *See* 29 U.S.C. § 623(l)(1)(A)(ii)(I).

185 *See id*. at § 623(l)(1)(A)(ii)(II).

186 *See id*. at § 623(l)(2)(A).

most desirable choice, but using performance as the guide raises potential liability issues. If an employer has a performance evaluation system, the employer can tentatively utilize that as a layoff criterion. It is best to use recent performance evaluations or use several years of evaluations and accord more weight to the most recent. It is also preferable from a liability defense standpoint to only use those performance evaluations completed prior to the time that the employer concluded that a RIF might be necessary.

Performance evaluations are subject to challenge, however, if the system does not incorporate the following elements: (a) immediate supervisors should have a role in the process; (b) managers who are in a decision-making position for purposes of determining who is, and is not laid off, should also have a role in the process; (c) the performance evaluations should have been shown to the employee and gone over in detail with him/her; and (d) the employee should have signed an acknowledgment that the performance evaluation was explained. If the employer does not have a written performance evaluation system, the employer should think hard before deciding to use performance as a layoff criterion. An undocumented subjective view is easy to challenge during a trial.

§ 10.05. Announce the Plan for Layoff.

After the operational plan is formulated and the employer has determined what benefits to offer those who voluntarily terminate their employment (and keeping in mind, *infra*, the timing implications of the "serious consideration" test discussed), the employer should advise all employees (a) of the number of positions to be reduced; (b) of the fact that this number can be reached through voluntary or involuntary terminations; (c) that if enough people voluntarily terminate, no layoff will be necessary; (d) what inducements, if any, the employer is offering to those who voluntarily terminate their employment; and (e) the method of selection for layoff (seniority, performance, or whatever other criteria the employer chooses). Providing this communication upfront will likely avoid confusion later. Moreover, giving this information to the employees, whose lives may be turned upside down by the layoff decisions, will likely been seen by any jury considering a liability issue later as simply the proper and fair thing to do.

§ 10.06. ERISA Compliance.

In planning for a potential RIF, employers should consider the applicability of ERISA to RIF benefits or policies. Noncompliance with ERISA does pose some risks, but employers who establish ERISA-compliant RIF programs can obtain significant advantages.

[1] — Advantages of ERISA Plan Status.

Severance and other RIF benefits engender a considerable amount of litigation since a discharged employee has little reason not to sue his or her prior employer.[187] Coverage under ERISA creates several important litigation advantages to employers which may often spell the difference between litigation success or failure. For example, because ERISA is a federal statute, disputed claims for RIF benefits can be heard in federal rather than in state court.[188] The federal court may also be willing to hear related statelaw claims.[189] Additionally, federal rather than state law will apply, which may be more advantageous to the employer in a benefit dispute and may allow for quicker (and therefore less expensive) resolution of a lawsuit.[190] Another great benefit to qualifying cases under ERISA is that punitive damages will generally be unavailable.[191] Similarly, jury trials will generally be unavailable for challenges to ERISA benefit plans.[192]

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187 As a general rule, virtually every termination decision should be based on the assumption that it will be challenged before an administrative agency, a court, or both.

188 29 U.S.C. § 1132(e); *see* Metro. Life Ins. Co. v. Taylor, 481 U.S. 58 (1987) (holding ERISA so preempts the field that a cause of action with claims under state law that are preempted by ERISA is removable); *see also* Schnonholz v. Long Island Jewish Med. Ctr., 87 F.3d 72 (2d Cir.), *cert. denied*, 519 U.S. 1008 (1996) (holding that federal courts have subject matter jurisdiction over claims brought under ERISA).

189 *See, e.g.*, Emmenegger v. Bull Moose Tube Co., 197 F.3d 929 (8th Cir. 1999); Cossette v. Minn. Power and Light, 188 F.3d 964 (8th Cir. 1999).

190 29 U.S.C. § 1144; Cassidy v. Akzo Nobel Salt, 308 F.3d 613 (6th Cir. 2002) (federal common law applies to cases involving ERISA plans); Feifer v. Prudential Ins. Co. of Am., 306 F.3d 1202 (2d Cir. 2002); Devlin v. Empire Blue Cross & Blue Shield, 274 F.3d 76 (2d Cir. 2001), *cert. denied*, 123 S. Ct. 1015 (2003); Aliff v. BP Am., 26 F.3d 486 (4th Cir. 1994) (severance pay claims subject to ERISA, not state laws).

191 *See, e.g.*, Darcangelo v. Verizon Commc'ns, Inc., 292 F. 3d 181 (4th Cir. 2002); Allison v. Bank One-Denver, 289 F.3d 1223 (10th Cir. 2002).

192 Tischmann v. ITT/Sheraton Corp., 145 F.3d 561 (2d Cir.), *cert. denied*, 525 U.S. 963 (1998); DeFelice v. Am. Int'l Life Assur. Co., 112 F.3d 61 (2d Cir. 1997); Biggers v. Wittek

Another advantage of ERISA status is that ERISA requires plans to follow certain mandated claims procedures.[193] These procedures set forth detailed timelines, procedural requirements, and notification specifics that a plan administrator must follow when reviewing and deciding a claim under the plan.[194] Similar rules apply for the review of appealed claims.[195] Under these claims procedures, issues are brought before and resolved by the plan administrator. Further, courts regularly require claimants to exhaust the plan's claims and appeal procedures before bringing suit.[196] Also, because courts are generally willing to apply a reasonable plan-imposed statute of limitations for claims brought against the plan, ERISA coverage also offers an opportunity to limit the window during which claims under the plan must be brought.[197]

Further, even once a plaintiff has exhausted a plan's claims and appeal procedures and subsequently files a lawsuit, a court will generally review a plan administrator's decisions under a favorable standard of review if the plan so provides.[198] Consequently, a plan sponsor should include language that awards to the plan administrator the discretionary authority to interpret the plan and determine eligibility for plan benefits.

Indus., 4 F.3d 291 (4th Cir. 1993); Pickering v. USX Corp., 809 F. Supp. 1501, 1548 (D. Utah 1992).

193 29 U.S.C. § 1133; 29 C.F.R. § 2560.503-1(b).

194 *Id*. at §§ 2560.503-1(e)–(g).

195 *Id*. at §§ 2560.503-1(h)–(j).

196 *E.g.*, Swanson v. Hearst Corp. Long Term Disability Plan, 586 F3d 1016 (5th Cir. 2009); Midgett v. Wash. Grp. Int'l Long Term Disability Plan, 561 F.3d 887 (8th Cir. 2009).

197 *See, e.g.*, Belrose v. Hartford Life & Accident Ins. Co., No. 10–2405, 2012 U.S. App. LEXIS 7506, at *9 (4th Cir. April 13, 2006) (upholding and applying a three-year statute of limitations).

198 *E.g.*, Geddes v. United Staffing Alliance Emp. Med. Plan, 469 F.3d 919, 923 (10th Cir. 2006) (citing Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 115 (1989)); Kosakow v. New Rochelle Radiology Assocs., P.C., 274 F.3d 706 (2d Cir. 2001); Tester v. Reliance Std. Life Ins. Co., 228 F.3d 372 (4th Cir. 2000); James v. Gen. Motors Corp., 230 F.3d 315 (7th Cir. 2000), *cert. denied*, 532 U.S. 973 (2001).

[2] — Disadvantages to Treatment as an ERISA Plan.

The only meaningful disadvantages to ERISA coverage of a RIF-related severance benefit program are (a) the cost and burden of ERISA compliance and (b) the risk of failing to fully adhere to ERISA's compliance requirements.

[3] — Applicability of ERISA to RIF-Related Benefit Plans.

ERISA is generally applicable to "employee welfare benefit plans" and to "pension plans."[199] In turn, an "employee welfare benefit plan," is defined in pertinent part as: "any plan, fund, or program, which . . . is maintained for the purpose of providing . . . unemployment . . . benefits . . . or . . . any benefit described in section 186(c) of [the Labor Management Relations Act (LMRA)]."[200] "Severance or other similar benefits" are among the benefits covered by LMRA § 302(c).[201] A pension plan is "any plan, fund, or program which . . . [is] maintained . . . to the extent that by its express terms or as a result of surrounding circumstances [it] . . . provides retirement income to employees . . . ."[202] A severance plan may qualify as a welfare benefit plan, a pension plan, or even a combination (part welfare benefit plan, part pension plan), depending on the plan's structure and whether it meets the other applicable requirements of ERISA. It is well established that severance plans can be considered ERISA plans if they meet the other criteria defined in the statute.[203]

Categorization of a severance plan as a welfare plan or a pension plan is not reached, however, unless the benefits are first determined to be part of an ERISA "plan."[204] In *Fort Halifax Packing Co. v. Coyne*, the U.S. Supreme Court held that a Maine statute requiring employers to pay a onetime lump sum benefit to employees affected by a plant closure did not require an employer to create an ERISA plan. The Court characterized an ERISA

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199 29 U.S.C. § 1002(1)–(2).

200 *Id*. at § 1002(1).

201 *Id*. at § 186(c).

202 *Id*. at § 1002(2)(A).

203 *See* Champagne v. Revco D.S., Inc., 997 F. Supp. 220, 221 (D.R.I. 1998).

204 Fort Halifax Packing Co. v. Coyne, 482 U.S. 1 (1987).

plan as a "commitment systematically to pay certain benefits" with a related commitment to make eligibility determinations, monitor funding, and engage in record keeping.[205] The onetime lump sum payment required under the Maine statute did not rise to the level of such an administrative scheme and was accordingly not a "plan" for ERISA purposes.

Courts are split on the issue of whether benefits arrangements that cover a single employee can nonetheless be ERISA plans. Some courts have held that if a benefits program qualifies as an ERISA plan, it is not disqualified simply because it only covers one employee.[206] Other courts hold that such benefit programs are simply employment contracts, not ERISA plans.[207] ERISA coverage is not determined by the degree of the program's formality. In an advisory opinion, the U.S. Department of Labor has gone so far as to state that, to be an ERISA plan,

> a benefit arrangement need not be described in a written document, completely disclosed, or specify in advance either precisely who may be selected as participants or the specific benefits to which they may be entitled. Neither is a benefit arrangement under which benefits are only infrequently offered necessarily excluded from ERISA coverage. Finally, the fact that only very few employees are selected to participate in benefits does not alone provide sufficient grounds to exclude a program from ERISA coverage.[208]

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205 *Id*. at 9.

206 *See, e.g.*, Knoll v. Moreton Ins. of Idaho, Inc., No. 1:11–cv–00637–CWD, 2012 WL 1883465 (D. Idaho May 22, 2012); Cvelbar v. CBI Ill., 106 F.3d 1368 (7th Cir.), *cert. denied*, 522 U.S. 812 (1997); Gilliam v. Nevada Power Co., 488 F. 3d 1189 (9th Cir. 2007); Duggan v. Hobbs, 99 F.3d 307 (9th Cir. 1996); Biggers v. Wittek, 4 F.3d 291 (4th Cir. 1993); Hand v. Church Dwight & Co., 962 F. Supp. 742 (D.S.C. 1997).

207 *E.g.*, Dakota, Minn. & E. R.R. v. Schieffer, 648 F.3d 935 (8th Cir. 2011); Donovan v. Branch Banking & Trust Co., 220 F. Supp. 2d 560 (S.D. W. Va. 2002); Nechero v. Provident Life & Accident Ins. Co., 795 F. Supp. 374 (D.N.M. 1992); In re Hooker Invs., 145 B.R. 138 (Bankr. S.D.N.Y. 1992); Barnett v. Petro-Tex Chem. Corp., No. H–85–1296, 1988 WL 159168 (S.D. Tex. Dec. 27, 1988), *rev'd on other grounds*, 893 F.2d 800 (5th Cir. 1990); Lackey v. Whitehall Corp., 704 F. Supp. 201 (D. Kan. 1988); McQueen v. Salida CocaCola Bottling Co., 652 F. Supp. 1471 (D. Colo. 1987).

208 Dep't of Labor, Advisory Opinion 9712A. *But see* Guilbert v. Gardner, 480 F.3d 140, 146 (2d Cir. 2005) (finding no establishment of an ERISA plan for oral promises of pension

The standard for determining whether there is an ERISA plan is whether there is a system of payments such that a reasonable person can ascertain the intended benefits, the beneficiaries, the source of financing, and the procedure for receiving benefits.[209]

The following are examples of cases in which severance benefit programs were held to be ERISA plans:

(a) Unwritten RIF benefit policy.[210]

(b) Pay in lieu of notice policy.[211]

(c) Letters to executives, or letter agreements with executives, promising benefits.[212]

(d) Retention or change in control agreements.[213]

(e) Separation agreement covering one employee with handwritten changes.[214]

(f) Guidelines for layoff and termination payments.[215]

(g) Unfunded severance pay policy.[216]

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benefits, when the only writing was a few terms on a legal pad with verbal assurance that pension benefits had been "taken care of").

209 Donovan v. Dillingham, 688 F.2d 1367 (11th Cir. 1982).

210 Smith v. Hartford Ins. Grp., 6 F.3d 131 (3d Cir. 1993); Gordon v. Barnes Pumps, Inc., 999 F.2d 133 (6th Cir. 1993); Scott v. Gulf Oil Corp., 754 F.2d 1499 (9th Cir. 1985).

211 Whittemore v. Schlumberger Tech. Corp., 976 F.2d 922 (5th Cir. 1992).

212 Cvelbar v. CBI Illinois, Inc., 106 F.3d 1368 (7th Cir. 1997); Warner v. J.P. Stevens & Co., 935 F.2d 1289 (4th Cir. 1991).

213 Bowles v. Quantum Chem. Co., 2001 U.S. App. LEXIS 20624 (7th Cir. 2001); Collins v. Ralston Purina Co., 147 F.3d 592 (7th Cir. 1998).

214 Hand v. Church Dwight & Co., 962 F. Supp. 742 (D.C. S.C. 1997).

215 Amatuzio v. Gandalf Sys. Corp., 994 F. Supp. 253 (D.N.J. 1998) (guidelines contained in manager's policy manual, unknown to certain high-level executives and which may not have been publicized to employees); Brown v. Ampco-Pittsburgh Corp., 876 F.2d 546 (6th Cir. 1989).

216 Schnonholz v. Long Island Jewish Med. Ctr., 87 F.3d 72, 76–77 (2d Cir. 1996) (memorandum promising severance benefits to employees from president without Board knowledge or approval); Holland v. Burlington Indus., Inc., 772 F.2d 1140 (4th Cir. 1985), *aff'd mem*., 477 U.S. 901 (1986).

(h) Statement in policy manual that employees will "receive appropriate severance pay where applicable."[217]

(i) Severance plan offering medical and outplacement benefits, requiring the employer to inquire regarding individual employee eligibility and ongoing financial obligations.[218]

(j) Termination plan where employees completed applications for certain benefits that began at retirement age and employees could choose between a lump sum or two years of salary continuation.[219]

(k) "Separation Allowance Plan" included in employee handbook where the employer had discretion to determine eligibility on a recurring basis.[220]

(l) Severance plan providing levels of benefits and terms for executive level employees different from those for hourly/salary employees and required employer discretion regarding whether termination was "for cause" and whether benefits were paid in a lump sum or over 52 weeks.[221]

(m) Employment agreement providing severance benefits for monthly installments over a 10-year period.[222]

Courts have looked to a variety of factors in determining whether a particular severance plan is an ERISA plan. For instance, one court summarized some of the salient factors as (1) whether the plan "requires managerial discretion" which calls for "ongoing, particularized, administrative analysis;" (2) whether a "reasonable employee would perceive an ongoing commitment by the employer to provide some employee benefits;" and (3)

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217 Kosakow v. New Rochelle Radiology Assocs., P.C., 274 F.3d 706, 737 (2d Cir. 2001) (alterations omitted).

218 Champagne v. Revco, 997 F. Supp. 2d 220 (D.R.I. 1998); Colon-Rodriguez v. Astra/Zeneca Pharms., LP, No. 11–1495, 2011 U.S. Dist. LEXIS 143239 (D.P.R. Dec. 13, 2011).

219 Cassidy v. Akzo Nobel Salt, 308 F.3d 613 (6th Cir. 2002).

220 Mullaly v. Ins. Servs. Office, Inc., 395 F. Supp. 2d 290 (M.D.N.C. 2005).

221 Barrow v. Aleris Int'l, Inc., No. 1:07CV–110–JHM, 2007 WL 3342306 (W.D. Ky. Nov. 7, 2007).

222 Robbins v. Friedman Agency, Inc., 760 F. Supp. 2d 564 (E.D. Va. 2010).

whether "the employer was required to analyze the circumstances of each employee's termination separately in light of certain criteria."[223] Clearly, a onetime lump sum payment made to all employees who satisfy specified objective and non-discretionary criteria is less likely to be an ERISA plan than an ongoing arrangement which requires benefit elections and/or requires the employer to make individualized benefit decisions.

Although courts tend to consider the same factors, their analysis and conclusions are not always easily reconciled.[224] For instance, in *O'Connor v. Commonwealth Gas Co.*, the First Circuit stated that severance obligations were likely an ERISA plan "if they require an ongoing administrative scheme that is subject to mismanagement," but if the benefits are "merely a one-shot, take-it-or-leave-it incentive," they are less likely to be an ERISA plan.[225] Following *O'Connor*, a district court in the First Circuit concluded that a Memorandum of Agreement ("MOA") between an employer and union that added new severance benefits for involuntarily terminated employees was not an ERISA plan.[226] The court reached this conclusion despite finding that the MOA amended pension plans by granting affected employees additional age and service credit, increasing early retirement benefits, adding a one-time lump sum special pension benefit equal to 234 percent of an employee's annual pay and a one-time lump sum transition payment, all to be paid from the pension plan's excess assets.[227] The *Arivella* court's conclusion seems directly in conflict with the First Circuit's analysis. In fact, the *Arivella* conclusion is perhaps best explained by the notation that another court had already concluded that the MOA was not an ERISA plan.[228]

Because of the advantages of ERISA coverage, many employers may wish to structure RIF benefits to avoid *Fort Halifax* and to create the best

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223 Kosakow v. New Rochelle Radiology Assocs., P.C., 274 F.3d 706, 737 (2d Cir. 2001) (internal quotations and citations omitted).

224 *See* Arivella v. Alcatel-Lucent, 755 F. Supp. 2d 353, 365 (D. Mass. 2010) (describing case law on this topic as "difficult and tangled").

225 O'Connor v. Commonwealth Gas Co., 251 F.3d 262, 266 (1st Cir. 2001).

226 *Arivella*, 755 F. Supp. 2d at 364–66.

227 *Id*. at 364.

228 *Id*.

possible case for ERISA coverage. Steps an employer may consider to further that purpose include:

- Stating the benefit formula as one that requires the employer to calculate years of service pursuant to a specific definition contained in the plan and not as one that is a predetermined single sum amount for each participant;
- Making benefit eligibility at least partially a function of non-objective, discretionary criteria — for instance, if the plan provides that benefits will not be paid for employees terminated for "just cause," its administration will require application of something in addition to simple, objective criteria. (Note that this may not be possible where benefits are provided as part of a pension plan);
- Structuring the plan such that employees may become eligible for benefits over an extended period of time — for instance, structuring benefit eligibility based on terminations of employment which occur at various times for different employees, rather than as a result of a single event such as a plant closure;
- Explicitly affording employer discretion in limiting the number of participants, determining eligibility, and/or determining benefits;
- Paying benefits as salary continuation, rather than lump sums;
- Permitting participants to elect among several payment options, at least two of which require payment over an extended period;
- Offering independent placement or counseling services (in so doing, care should be taken to ensure compliance with Revenue Ruling 92-69 to permit associated costs to be deductible by the employer and not included as taxable income to the employee);
- Including as benefits the payment of COBRA premiums or offering continued health plan coverage;
- Structuring the plan such that the employer has ongoing administrative requirements, such as monitoring benefit

payouts, financial coordination, and/or recordkeeping duties;

- Establishing a specific body (*e.g.*, a committee) or person to administer the plan;
- Including administrative provisions, including compliant claims procedures, and complying with ERISA compliance requirements; and
- Stating that the plan is subject to ERISA.[229]

The choice of which elements to include must be made with considered judgment. For instance, while the presence of discretion may help establish that the plan requires an ongoing administrative scheme (and thus is an ERISA plan), too much discretion can actually undercut the likelihood that a reviewing court will find the plan to be an ERISA plan. More particularly, if a plan's design includes too much discretion in determining eligibility and/or benefits, a court may conclude that it is too vague to permit a reasonable person to ascertain the intended benefits and/or beneficiaries under the ERISA tests discussed above.[230] A drafter must be sensitive also to the complexities of Code Section 409A when including the element of discretion in a plan that is not exempt from Section 409A compliance.[231]

In a similar manner, the application of other laws, and their tax consequences, may make certain of the above-listed elements undesirable features for a particular employer or in a particular setting. For example, as noted above, including the payment of COBRA premiums as a RIF benefit may increase the likelihood of ERISA status for the severance plan. However,

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229 Not surprisingly, this factor is not sufficient alone. *See* Langley v. Daimler Chrysler Corp., 502 F.3d 475, 481 (6th Cir. 2007).

230 *See, e.g.*, D'Oliviera v. Rare Hospitality Int'l, Inc., 150 F. Supp. 2d 346, 355 (D.R.I. 2001) (finding that the "lack of any explicit eligibility standards or distribution mechanisms result in an administration too unsophisticated" to qualify as an ERISA plan).

231 *See* Treas. Reg. § 1.409A-3(i)(1) (discussing the use of certain elements that are not under the control of the employee or subject to the discretion of the employer); *see also* discussion *supra* pp. 32–35.

if the employer's plan is self-insured, the tax consequences may make such benefit less desirable.[232]

It is also important to note that some courts are wary regarding the effectiveness of, what they see as, just tacking on some of the above features to what is otherwise a "one-shot, take-it-or-leave-it incentive."[233] In that case, the First Circuit described the employer's program as "a few enhanced benefits" that were simply "minor perks" added to "the centerpiece of the incentive," which was lump sum severance pay.[234] The First Circuit denied ERISA status, finding that the program's "primary component," the severance pay, required neither the exercise of discretion nor a complex administrative scheme that could permit mismanagement warranting ERISA oversight.[235] Such characterizations by reviewing courts underscore how and why structuring a RIF benefits package may often be considered an art form.

[4] — Basic ERISA Compliance.

For an employer who wishes to structure its severance plan as an ERISA plan, achieving ERISA compliance is important. In this regard, ERISA welfare benefit plans that are maintained to benefit a "select group of management or highly compensated employees" (known as "top hat" plans) are exempt from most reporting and disclosure requirements.[236] To qualify for this exemption, a plan must (a) benefit primarily executive-level employees, and (b) pay its benefits from the employer's general assets, an insurance policy whose premiums are paid from the employer's general assets, or a combination thereof.[237] Many employers anticipating a RIF, however, will not be able to take advantage of this exemption for their severance plans.

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232 *See* discussion *supra* pp. 30–32.

233 O'Connor v. Commonwealth Gas Co., 251 F.3d 262, 267 (1st Cir. 2001).

234 *Id*. at 270.

235 *Id*. at 267–68; *see also* Guatier-Figueroa v. Bristol-Myers Squibb P.R., Inc., 845 F. Supp. 444, 457 (D.P.R. 2012) (finding that a severance plan was not an ERISA plan because it involved "mechanical" calculations, the maximum payout period was six months, and the employer had no discretion in determining eligibility).

236 29 C.F.R. § 2520.104–24.

237 *Id*. at § 2520.104-24(c).

Accordingly, this section will briefly summarize some of the important steps of ERISA compliance.

First, ERISA requires that an ERISA plan maintain a written plan document.[238] In addition to being a substantive requirement of ERISA, having written documents allows an employer to specify precisely what benefits are payable under what conditions, thereby avoiding the potential pitfall of being required to pay unintended benefits. Similarly, every ERISA plan document must state how the plan may be amended, identifying individuals with authority to amend the plan.[239] Much of the relevant case law concerns the (important) fact that informal statements, actions, and/or writings cannot amend an ERISA plan.[240] Informal actions and documents are not the only swords that may be wielded as *de facto* plan amendments against a plan sponsor. The Fifth Circuit has held that a plan sponsor can effectively amend an ERISA welfare benefit plan via documents other than solely a single-purpose plan amendment.[241] Specifically, in that case, the Fifth Circuit found that a provision in an asset purchase agreement effectively amended a retiree welfare benefit plan, stating "as long as an agreement is in writing, it contains a provision directed to an ERISA plan, and the plan amendment formalities are satisfied, such agreement or other document will constitute a valid plan amendment."[242] Based on this ruling, it is in the best interests of plan sponsors to ensure benefits counsel are involved in reviewing corporate transactional documents.

A natural corollary is that an employer wishing to amend its ERISA plan should track the requirements of the plan's amendment provision.

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238 29 U.S.C. § 1102(a)(1).

239 *Id*. at § 1102(b)(3); *see also* Sprague v. Gen. Motors Corp., 633 F.3d 388 (6th Cir.), *cert. denied*, 524 U.S. 923 (1998) (upholding employer's right to amend benefits because of reservation of the right to amend or terminate the plan).

240 *See, e.g.*, Winterrowd v. Am. Gen. Annuity Ins. Co., No. 01–57184, 2003 U.S. App. LEXIS 3893 (9th Cir. Mar. 5, 2003); Abramowicz v. Rohm & Haas Co., No. 00-4645, 2001 U.S. Dist. LEXIS 17693 (E.D. Pa. Oct. 30, 2001).

241 *See* Evans v. Sterling Chem., Inc., 660 F.3d 862 (5th Cir. 2011), *cert. denied*, 132 S. Ct. 1769 (2012).

242 *Id*. at 871 (citing Halliburton Co. Benefits Comm. v. Graves, 463 F.3d 360 (5th Cir. 2006)).

For instance, some plans require that an amendment be adopted by the employer's board of directors, while other plans place such authority with a board committee or even a corporate officer. Failure to follow the plan's provisions regarding plan amendments may give rise to a later claim that an amendment was ineffective and should be ignored. "The [plan's amendment] procedure may be simple or complex, but 'whatever level of specificity a company ultimately chooses, in an amendment procedure or elsewhere, it is bound to that level.'"[243] Other provisions that the written plan should include are identification of one or more named fiduciaries to administer the plan;[244] procedures relating to the funding of benefits and to the allocation of administrative functions;[245] the basis upon which payments are to be made to and from the plan;[246] and a claims procedure that satisfies current ERISA requirements.[247]

Second, ERISA imposes obligations on plan fiduciaries, including plan administrators, to act in accordance with ERISA's fiduciary duties.[248] These duties include the duty of loyalty, the duty of prudence, the duty to act in accordance with the plan document (the "plan document rule"), and the duty to diversify the plan's investments (generally applicable to pension plans).[249] "The duties charged to an ERISA fiduciary are the highest known to the law."[250] The determination of what individuals or entities qualify as fiduciaries for an ERISA plan is highly fact- and plan-specific.[251] ERISA also proscribes certain activities in which a fiduciary deals with plan assets

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243 Tatum v. R.J. Reynolds Tobacco Co., No. 1:02CV00373, 2011 WL 2160893, at *8–9 (M.D.N.C. June 1, 2011) (citation omitted) (invalidating an amendment that was not adopted by action of committee as plan required).

244 29 U.S.C. § 1102(a)(1).

245 *Id*. at § 1102(b).

246 *Id*.

247 *Id*. at § 1133.

248 *Id*. at § 1104.

249 *Id*.

250 Duer Constr. Co. v. Tri-Cnty. Bldg. Trades Health Fund, 132 Fed. Appx. 39, 43 (6th Cir. 2005) (quoting Gregg v. Transp. Workers of Am. Int'l, 343 F.3d 833, 841 (6th Cir. 2003)).

251 *See* 29 U.S.C. § 1002(21) (defining "fiduciary").

or engages in self-dealing.[252] Fiduciaries who violate these rules can be subject to personal liability and even criminal prosecution.[253]

Third, the plan must also be described in a Summary Plan Description ("SPD") that is drafted in compliance with detailed regulations and distributed to plan participants and beneficiaries.[254] An SPD is required to be written in an understandable and non-misleading manner.[255] For example, an employer cannot attempt to minimize exceptions by placing them in fine print or footnotes. Although not specifically authorized by ERISA, many welfare benefit plans, including severance plans, have historically been drafted with a single plan document/SPD, drafted to satisfy all applicable requirements for both documents.[256] Such a combined plan document/SPD should be drafted to make clear the document's function and legal significance. For instance, a combined plan document/SPD should avoid using language otherwise common to a single-purpose SPD (*e.g.*, statements regarding the resolution of inconsistencies between the plan document and the SPD).

Language in a Supreme Court opinion may cast doubt on the single plan document/SPD approach. In addressing claims that participants' benefits should be calculated in accordance with the SPD's language rather than the plan document's language, the Supreme Court rejected the argument that an SPD could trump a plan document.[257] In so doing, the Court noted that the "syntax of [ERISA's provision mandating an SPD], requiring that participants and beneficiaries be advised of their rights and obligations 'under the plan,' suggests that the information *about* the plan provided by [an SPD] is not itself *part of* the plan."[258] This may suggest that the Court believes a plan document should be a separate document from an SPD. However, it is important to

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[252] *Id*. at §§ 1104, 1106.
[253] *See id*. at §§ 1109, 1111, 1131, 1141.
[254] *Id*. §§ 1022, 1024.
[255] 29 C.F.R. § 2520.1022(b).
[256] *See, e.g.*, *Collins*, 147 F.3d 592; *Schonholz*, 87 F.3d 72.
[257] CIGNA Corp. v. Amara, 131 S. Ct. 1866 (U.S. 2011).
[258] *Id*. at 1877 (emphasis in original).

note that the Court was not construing a combined plan document/SPD and, consequently, its opinion does not squarely address that specific legal issue.

SPDs must be distributed to an employee or beneficiary within ninety days of the individual becoming first eligible to participate in the plan or to receive benefits (or within 120 days of the plan's adoption, if later). An updated SPD must be distributed at least once every 10 years, or once every five years if substantially modified in the interim.[259] Also, an SPD must be provided to the Department of Labor upon request.[260] Applicable regulations require that an SPD include the following information:

- the plan's name;
- the type of plan, *e.g.*, a severance plan;
- a description of the plan's eligibility requirements;
- a description of the benefits provided by the plan;
- a summary of the circumstances which may result in disqualification, denial or loss of benefits, including a description of the employer's right to amend or terminate the plan;
- the source of contributions and the identity of any funding medium;
- the type of plan administration (*e.g.*, the employer administers the plan);
- the name, address, and telephone number of the plan administrator;
- a statement of ERISA rights, containing information specified by the Department of Labor;
- the plan's claims procedure and a procedure for appeal of denied claims;
- the name and address of the agent for service of legal process;
- the names, titles and addresses of the plan trustee(s), if any;

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259 29 C.F.R. § 2520.104b2(a).

260 29 U.S.C. § 1024(a)(6).

- the date the plan year ends;
- the name, address and employer identification number ("EIN") of the plan sponsor; and
- if the plan is collectively bargained, a statement to that effect.[261]

Fourth, when a material change is made to the plan, notice of the change (called a Summary of Material Modifications or an SMM) must be provided to participants and beneficiaries no later than 210 days after the close of the plan year in which the amendment became effective.[262] Contemporaneous or advance notice of plan changes is usually preferable but is legally required only for a "material reduction in covered services or benefits provided" in a group health plan,[263] or a "material modification" of plan terms as stated in the plan's SBC.[264] Note, however, that some courts have indicated a potential willingness to go farther than ERISA's requirements regarding notice responsibilities upon plan termination.[265]

Fifth, ERISA generally requires an annual report (IRS Form 5500 series) to be filed for an ERISA plan within seven months following the close of the plan year.[266] Failure to file this report can result in significant monetary penalties.[267] An ERISA plan is also required to distribute a Summary Annual Report to participants each year, unless the plan is exempt from Form 5500 requirements.[268] There are several exceptions, however, to the Form 5500

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261 29 C.F.R. § 2520.102-3 (note that, for group health plans, additional content requirements apply).

262 *Id*. at § 2520.104b3.

263 *See* 29 U.S.C. § 1024(b)(1) (requiring notice be distributed within 60 days after the adoption of such change).

264 *See* 42 U.S.C. § 300gg-15(d)(4) (requiring notice be issued 60 days before the date such modifications become effective).

265 *See* Peralta v. Hispanic Bus., Inc., 419 F.3d 1064, 1070 (9th Cir. 2005) (concluding that the "purpose and structure" of ERISA implicitly requires "timely notice" of a long term disability plan's termination); Ackerman v. Warnaco, 55 F.3d 117, 123–24 n.5 (3d Cir. 1995) (taking "no position" on whether compliance with SMM requirements provides sufficient notice of benefit termination).

266 29 U.S.C. § 1023(a)(1)(A).

267 *Id*. at § 1132(c).

268 29 C.F.R. § 2520.104b-10.

requirement. For RIF purposes, the most significant is the exception that excuses the requirement to file an annual report for a welfare benefit plan (i) with fewer than 100 participants at the beginning of the plan year; or (ii) where all benefits are paid directly from the plan sponsor's general assets.[269] Related to the annual report requirement, ERISA imposes a six year record keeping requirement.[270]

Additional reporting and disclosure requirements may be triggered by the request of participants or upon inquiry of the U.S. Department of Labor.[271] Failure to respond to such participant requests within 30 days of the request may subject the plan administrator to personal liability and to penalties of up to $110 per day.[272] When courts consider whether to impose a penalty, and the size of the penalty, they often consider factors such as the administrator's bad faith or intentional conduct, the delay's length, the documents withheld, the number of requests and any resulting prejudice to the participant.[273] "[A] court may refrain from awarding a penalty if a windfall [to the participant] would result."[274]

Sixth, although ERISA does not require plan fiduciaries to communicate to participants potential changes to an ERISA plan before such changes are actually adopted,[275] case law is evolving in that direction. Courts have imposed liability when plan fiduciaries make intentional or negligent misrepresentations to potential participants regarding an impending new

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269 *Id*. at § 2520.104-20.

270 29 U.S.C. § 1027.

271 *Id*. at § 1024.

272 *Id*. at § 1132(c)(1) (as adjusted by DOL Reg. § 1575.502c-1 (for violations after July 29, 1997)).

273 *See, e.g.*, Spradley v. Owens-Illinois Hourly Welfare Benefit Plan, 686 F.3d 1135, 1138 n.1 (10th Cir. 2012); Bannistor v. Ullman, 287 F.3d 394 (5th Cir. 2002); Devlin, 274 F.3d 76; Faircloth v. Lundy Packing Co., 91 F.3d 648 (4th Cir. 1996), *cert. denied*, 519 U.S. 1077 (1997); Moothart v. Bell, 21 F.3d 1499 (10th Cir. 1994); Daughtery v. Honeywell, Inc., 3 F.3d 1488 (11th Cir. 1993).

274 Gorini v. AMP Inc., 94 Fed. Appx. 913, 919–20 (3d Cir. 2004) (affirming award of $160,780 in penalties when participant had a colorable claim to benefits under severance plan and district court found evidence that the employer had acted in bad faith).

275 Berlin v. Mich. Bell Tel. Co., 858 F.2d 1154 (6th Cir. 1988).

severance benefit or an impending change in severance benefits that is under "serious consideration."[276]

These cases put particular pressure on an employer considering whether to implement a reduction-in-force. Generally, such an employer would like to announce its program as close to implementation as possible. This line of cases, however, requires the fiduciary to disclose the possibility of a RIF program to participants as soon as the plan is under "serious consideration."[277] In *Bins v. Exxon Co., U.S.A.*,[278] the Ninth Circuit noted the tension inherent in the timing of this requirement, stating that requiring disclosure too early could lead to "an avalanche of notices and disclosures" that "would become meaningless" to plan participants and would be "overly burdensome" to fiduciaries.[279] Balanced against those concerns, however, is the need to ensure that fiduciaries discharge their duty of loyalty to plan participants.[280] The Ninth Circuit concluded that the "serious consideration" test struck an appropriate balance so long as a court applies the test with attention to the "core inquiry" of whether the fiduciary "violated its fiduciary duty of loyalty to plan participants by failing to disclose material information."[281]

The First Circuit has stated the test as follows: "serious consideration" of a change in plan benefits exists when "(1) a specific proposal which would affect a person in the position of the plaintiff (2) is being discussed for purposes of implementation (3) by senior management with the authority to implement the change."[282] The Second Circuit has held that, beyond the

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276 *See, e.g.*, McAuley v. IBM Corp., 165 F.3d 1038 (6th Cir. 1999); Vartanian v. Monsanto Co., 131 F.3d 264 (1st Cir. 1997); Hockett v. Sun Co., 109 F.3d 1515 (10th Cir. 1997); Fischer v. Phila. Elec. Co., 96 F.3d 1533 (3d Cir. 1996) (known as "Fischer II"), *cert. denied*, 520 U.S. 1116 (1997).

277 Rashid v. First Energy Corp. Pension Plan, 183 Fed. Appx. 257, 258 (3d Cir. 2006); *see also* Mathews v. Chevron Corp., 362 F.3d 1172 (9th Cir. 2004); Bins v. Exxon Co., U.S.A., 220 F.3d 1042 (9th Cir. 2000) (en banc); Radley v. Eastman Kodak Co., 19 F. Supp. 2d 89 (W.D.N.Y. 1998), *aff'd*, 199 F.3d 1323 (2d Cir. 1999) (table); Fischer II, 96 F.3d 1533.

278 *Bins*, 220 F.3d at 1042.

279 *Id*. at 1049 (internal quotations and citations omitted).

280 *Id*.

281 *Id*.

282 *Vartanian*, 131 F.3d at 268.

"serious consideration" test, a court must also conduct a materiality analysis before finding in favor of the plaintiff.[283]

The Ninth Circuit has set forth several additional rules that are triggered once an employer has begun serious consideration of an impending new benefit or benefit change. If an employee asks about changes, the fiduciary must "completely and truthfully" answer the questions.[284] Absent those questions, however, the fiduciary has no affirmative duty to communicate such changes until they are adopted.[285] Finally, with respect to an employee who asks to be kept informed of any such changes, if the employer "provides assurances to that effect," then the employer has a fiduciary duty to communicate the changes to the employee.[286]

The law in this area continues to develop, sometimes in surprising ways. For instance, in *In re Unisys Corp. Retiree Med. Benefits ERISA Litig.*, the employer's medical plan SPD reserved the right to amend the plan. In counseling employees regarding retirement, employees were told accurate information about the current plan cost structure, including that retiree medical coverage was "at no cost to the retirees."[287] Although employees were not advised specifically of the employer's right to amend the plan, they were provided after enrollment with a copy of the SPD, which noted the employer's power to amend the plan.[288] Retirees brought suit after the employer changed the plan's cost structure such that retirees bore some of the cost of coverage. The Third Circuit found that, even though the plan cost changes were not under serious consideration at the time the statements were made and even though the employer's statements regarding cost were true at the time they were made, the employer breached its fiduciary duties "by

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283 Ballone v. Eastman Kodak Co., 109 F.3d 117 (2d Cir. 1997).
284 *Bins*, 220 F.3d at 1053.
285 *Id*.
286 *Id*. at 1054.
287 *In re* Unisys Corp. Retiree Med. Benefits ERISA Litig., 579 F.3d 220, 231 (3d Cir. 2009), *cert. denied*, 130 S. Ct. 1546 (2010),
288 *Id*. at 231–32.

both misrepresenting and inadequately disclosing material information" in those circumstances.[289]

[5] — Additional Compliance Requirements for ERISA Pension Plans.

Since almost all RIF benefits pay compensation after termination of employment, an employer must consider whether a RIF benefit program is properly viewed as a "pension plan," which is defined as a plan that provides retirement income or defers income beyond termination of employment.[290] Where RIF benefits constitute an ERISA pension plan, the general ERISA compliance requirements outlined above remain in effect, and significant substantive requirements become applicable.[291] These requirements include minimum age, service, funding, accrual, and vesting requirements. Most RIF benefits (apart from those that are offered as part of an existing pension plan) cannot satisfy such requirements without causing adverse tax consequences.

An employer whose severance plan is appropriately characterized as a pension plan may be exempt from the substantive ERISA requirements for pension plans in one of two ways. First, ERISA itself exempts "top hat" pension plans from ERISA's participation, vesting, funding, and fiduciary responsibility parts.[292] This exemption is available only for pension plans that benefit a "select group of management or highly compensated employees."[293] Consequently, broad-based RIF packages will not qualify. It is also important to note that top hat plans must be unfunded to qualify for this exemption,[294] which engenders a host of additional complexities beyond the scope of this chapter.

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289 *Id*. at 234.

290 29 U.S.C. § 1002(2); *see, e.g.*, Musmeci v. Schwegmann Giant Super Mkts., Inc., 332 F.3d 339 (5th Cir. 2003) (holding that a program offering in-kind grocery vouchers to retirees was an ERISA pension plan).

291 *See* Amatuzio v. Gandalf Sys. Corp., 994 F. Supp. 253 (D.N.J. 1998).

292 29 U.S.C. §§ 1051(2), 1081(3), 1101(a)(1).

293 *Id*.

294 *Id*.

Second, the U.S. Department of Labor has issued a regulation that indicates when a severance benefit program will not be treated as a pension plan.[295] Under that regulation, a severance benefit program will not be considered as a pension plan (and will not be subject to ERISA pension plan requirements) if the following requirements are satisfied:

(a) The plan's benefits cannot be contingent, directly or indirectly, upon an employee's retirement. This requirement is often overlooked since a violation can be caused by implicitly conditioning benefits on retirement.

Examples:

A severance pay plan that limited participation to employees with five years of service who had attained age 60 was held to be a pension plan because benefits were indirectly contingent on retirement.[296]

(ii) A severance pay plan that imposed eligibility requirements of age 62 and 15 years of service was a pension plan.[297]

(iii) Pension plan status results where severance benefits are available only to those who are age 60-65 and who waive the right to future employment.[298]

(iv) A severance plan that imposed a service eligibility requirement of 18 years indirectly conditioned benefits on retirement.[299]

(v) A severance plan that imposed an eligibility requirement of 10 years of service was not directly conditioned on retirement status and accordingly could qualify as a welfare benefit plan.[300] However, if payment of severance benefits

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295 29 C.F.R. § 2510.3-2(b)(1).

296 Dep't of Labor, Advisory Opinion 81-8A.

297 Dep't of Labor, Advisory Opinion 80-7.

298 Dep't of Labor, Advisory Opinion 80-37A.

299 Dep't of Labor, Advisory Opinion 84-15A.

300 Dep't of Labor, Advisory Opinion 95-28A.

"predominantly coincides" with the recipients' voluntary retirement, the plan may be held to be a pension plan.[301]

(b) The total amount of severance pay cannot exceed more than twice the employee's annual compensation during the year immediately preceding termination of employment.

Compensation for purposes of the regulation includes cash and non-cash compensation. Compensation can be annualized for any employee with less than a year's work.

(c) All payments must be completed within 24 months of termination of employment or, for persons terminated under "a limited program of terminations," within 24 months after they reach normal retirement age, if later.

The "limited program of terminations" is a program described in a written document that demonstrates that the program, at its commencement, had a definite (or definitely determinable) termination date and specifies the number, percentage, or class of employee whose employment is to be terminated.

§ 10.07. Waivers and Releases.

If an employer allocates substantial assets to providing RIF benefits, the employer often wants to obtain a waiver and release of claims. A waiver and release provides at least some evidence that the employee's acceptance of benefits was voluntary. To obtain an enforceable waiver and release of claims, an employer must offer something in addition to that which the employee is already entitled (called "consideration," this requirement is satisfied if the employer offers some sort of exit incentive benefits that are otherwise unavailable to the employee) and the employer must comply with requirements imposed by several statutes.

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301 *Id*.

[1] — ADEA, as Amended By the Older Workers Benefit Protection Act.

To be enforceable with respect to age discrimination claims in situations where a group of people are being offered severance pay,[302] the OWBPA provides that release must:

- specifically refer to age discrimination claims;
- not include claims that may arise after the execution of the release;
- be signed in exchange for consideration in addition to anything of value to which the employee is already entitled;
- advise the employee in writing that he or she should consult with an attorney;
- provide that the employee have at least 45 days within which to consider the agreement;
- provide that the employee has at least seven days to revoke the agreement;
- inform the employee in writing in a manner calculated to be understood by the average eligible employee of:
  - the class, unit or group or individuals to be covered by the program;
  - any eligibility factors for the program;
  - any time limits applicable to the program;
  - the job titles and ages of all individuals eligible for the program; and

[302] Although the specific listed criteria refer only to age discrimination claims, compliance with these requirements is likely to be effective to release other employment-related claims as well. A release should also serve to relieve the employer of any liability for race, sex, color, disability, national origin, religious and familial status discrimination, breach of contract, public policy violations and all other possible claims arising out of the termination from employment.

- the ages of all individuals in the same job classification or organizational unit who are not eligible for the program.[303]

If a release fails to comply with any of the above requirements, the release will not be valid and the ex-employee may bring an age discrimination claim against the employer.[304] In 1998, the U.S. Supreme Court held that an employee's refusal to "tender back" to the employer the severance the employee received did not prohibit an employee from bringing an age discrimination claim.[305] In *Oubre v. Entergy Operations, Inc*., an employee whose employment had been terminated signed a release and received severance pay in several installments. After receiving the last installment payment, the employee brought an age discrimination claim under the ADEA. Because the release did not comply with all of the specific statutory requirements discussed above, the release was not enforceable as to the employee's age discrimination claim. The employer argued that because the employee did not return any of the severance pay she received, the employee had ratified and validated the release. The Supreme Court disagreed with the employer and held that "the employer cannot invoke the employee's failure to tender back as a way of excusing its own failure to comply [with the statutory requirements.]"[306] The Supreme Court's rationale was that the OWBPA imposed specific requirements for waivers of a claim under the ADEA and did not incorporate any exceptions or qualifications to satisfying those requirements. Moreover, the Supreme Court noted that many discharged employees will likely have already spent the money that they received and would be unable to return the money. The Supreme Court did not want to impose a "tender back" requirement on employees because it could tempt

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303 29 U.S.C. § 626(f); *see also* Adams v. Ameritech Servs., Inc., 231 F.3d 414 (7th Cir. 2000); Bennett v. Coors Brewing Co., 189 F.3d 1221 (10th Cir. 1999); Lloyd v. Brunswick Corp., 180 F.3d 893 (7th Cir. 1999).

304 Oubre v. Entergy Operations, Inc., 522 U.S. 422 (1998); *Adams*, 231 F.3d at 414; *Bennett*, 189 F.3d at 1221.

305 *Oubre*, 522 U.S. at 422.

306 *Id*. at 428; *see also* Bennett, 189 F.3d at 1221.

employers to risk noncompliance with the OWBPA requirements, knowing that it would be difficult for employees to repay the money they received.[307]

[2] — ERISA.

Nothing in ERISA specifically precludes conditioning the receipt of RIF benefits on obtaining a release or waiver of claims from the employee. Moreover, the U.S. Supreme Court has held that an employer does not violate ERISA by requiring employees to release all employment-related claims as a condition of receiving severance benefits.[308] To the extent that an employer desires to require the signing of a release to obtain benefits from an ERISA plan, the plan and all communications should state this rule as a condition for eligibility.[309] Moreover, the Tenth Circuit has gone so far as to hold that when a release contained a non-solicitation provision and the plan did not state that the required release would contain that provision, the employee was not required to sign the release in order to receive benefits.[310] An employer contemplating a release as a condition of eligibility should discuss its specific release with experienced ERISA counsel to determine compliance requirements.

§ 10.08. Conclusion.

Conducting a RIF properly and safely is extremely complicated and tedious. Simply stated, the law creates a thicket of briars through which an employer must travel. To come through the thicket without being bloodied takes thorough advanced planning. But the advantages to the proper planning and implementation of a RIF, which include significantly reducing the risk of expensive and protracted litigation, are certainly worth the time and effort that proper planning and implementation require.

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307 *See also* Howlett v. Holiday Inns, Inc., 120 F.3d 598 (6th Cir. 1997); Long v. Sears Roebuck & Co., 105 F.3d 1529 (3d Cir. 1997).

308 Lockheed Corp. v. Spink, 517 U.S. 882 (1996).

309 *See* 29 U.S.C. § 1022(b); 29 C.F.R. § 2520.102-3(j)(2).

310 Cirulis v. UNUM Corp., 321 F.3d 1010 (10th Cir. 2003).

Chapter 11

Conflict and Cooperation: Real Property Issues Arising from the Interplay of Production and Storage Interests in a Post-Shale World

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§ 11.01. Introduction.

Recent technological advances have unlocked massive amounts of shale gas for production. In response, the production of shale gas in the United States has skyrocketed. Some analysts predict that shale gas will fundamentally alter U.S. energy strategy, raising energy independence from the realm of the unthinkable in decades past to an actual, feasible possibility.[1] Meanwhile, weather phenomena like the now-famous 2013 "polar vortex" are stretching natural gas demand to record levels. With rapidly increasing production and demand, underground storage infrastructure is now one of the most important issues facing industry leaders. This chapter reviews the

1 Edward L. Morse, "Why Shale Is the Next Shale," *Foreign Affairs* (June 2014), https://www.foreignaffairs.com/articles/2014-04-17/welcome-revolution.

basics of underground storage, discusses legal developments spurned by the recent growth in shale production, and analyzes common (and emerging) legal issues involving underground storage.

§ 11.02. Natural Gas Storage Basics.

[1] — History.

For nearly a century, the industry has been storing natural gas underground. The first natural gas storage facility was developed in 1916 in New York and located in the depleted Zoar production field south of Buffalo.[2] In 1930, gas storage facilities could be found in nine fields in six states. By the end of the 1930s, natural gas storage was a mainstream and integral part of the industry.

The core purpose of underground storage is to prepare for the seasonal fluctuations in natural gas demand. Surplus production is stored in a variety of underground facilities and structures so that it can be made available for supplemental distribution during severe cold weather.

Seasonal demand fluctuations can be quite severe. Recently, for example, repeated polar vortexes plunged massive volumes of frigid artic air southward deep into the United States. The air masses were unusual both in temperature and duration. Chicago hit a record low of minus sixteen degrees Fahrenheit.[3] Energy demand skyrocketed in affected areas. PJM Interconnection, the largest grid operator in the United States, set a new winter peak record during the polar vortex of 139,069 megawatts.[4] Weather phenomena like the 2013 polar vortex highlight the importance of underground storage. Ensuring the availability of adequate underground storage is critical to preparing for such events. Without adequate storage, providers will be severely compromised and unable to meet the needs of residential and commercial customers.

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2 Federal Energy Regulatory Commission, Natural Gas Storage – Background (2013), https://www.ferc.gov/industries/gas/indus-act/storage/background.asp.

3 Smith and Levs, *It's Too Darn Cold: Historic Freeze Brings Rare Danger Warning*, CNN (January 2014), http://www.cnn.com/2014/01/uswinter-weather.

4 Katherine Tweed, "Polar Vortex Drives Record Energy Use in PJM," Green Tech Media (January 2014), http://www.greentechmedia.com/articles/read/polar-vortex-drives-record-winter-energy-use-in-pjm.

[2] — Types of Underground Storage Facilities.

Natural gas may be stored in a variety of ways. It is, however, most commonly held in three types of facilities: (1) aquifers; (2) salt caverns; and (3) depleted production fields. Each type of facility has unique characteristics. Nonetheless, two of the most important characteristics of an underground storage reservoir are its capacity to hold natural gas for future use and the rate at which gas inventory can be withdrawn.[5]

[a] — Aquifers.

Aquifers are porous, natural rock formations that typically hold water, but can be repurposed for natural gas storage. This process, however, is extremely expensive. In fact, out of the approximately 400 storage facilities in the United States, only 43 are Aquifers.[6] These types of natural gas storage facilities are primarily located in Illinois and Indiana.

[b] — Salt Caverns.

Salt caverns are also used for natural gas storage. Although salt caverns have great structural integrity to prevent gas loss, few exist. Of the approximately 400 storage fields in the United States, 31 are salt caverns.[7] A large majority of these facilities are located in three states along the Gulf Coast.

[c] — Depleted Production Reservoirs.

Much of the gas stored in the United States is found in depleted natural gas or oil fields.[8] Depleted production reservoirs are by far the most common natural infrastructures for gas storage. The strata have been depleted of recoverable native reserves leaving ore space that is geologically capable of receiving injected gas. Once the fields are depleted of the native reserves, the wells and other equipment left over from when the field was productive can be used and ultimately reduce the costs of storage facility conversion. Of the

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5 Energy Info Admin., The Basics of Underground Natural Gas Storage, http://www.eia.gov/pub/oil_gas/natural_gas/analysis_publications/storagebasics/storagebasics.html.

6 *Id*.

7 *Id*.

8 *Id*.

400 storage facilities in the United States, 326 of those facilities are depleted production reservoirs.[9] Although these reservoirs are located throughout the United States, the greatest concentration of these fields is in Appalachia.

[3] — The Law of Storage.

As with many land rights, the creation of storage rights have specific nuances. Unless specifically addressed in any severance documents for natural gas production, the right to allow storage remains with the surface owner. With its genesis in coal law, storage law has been consistently litigated for decades, producing a significant body of case law.

[a] — *Lillibridge* v. *Lackawanna Coal*.

The legal underpinnings of gas storage law is founded in the case law governing coal. In *Lillibridge*, plaintiffs sued a coal company that had purchased the rights to the coal beneath plaintiffs' property.[10] Following the coal's extraction, the coal company used the empty cavern to transport coal underground to a surface extraction point. In this case, the court emphasized the severability of mineral rights to a piece of property from the surface rights of that same piece of property, "[M]ines are land, and subject to the same laws of possession and conveyance." Further, the court recognized that "[i]f a freeholder grants lands excepting mines, he severs his estate vertically; *i.e.*, he grants out his estate in parallel horizontal layers, and the grantee only gets the parallel layer granted to him, and does not get any underlying mineral layer or stratum. That underlying stratum remains in the grantor."[11] Here, the grantee in fee of all merchantable coal underlying the tract maintained ownership of the space left by the removal of coal.

The *Lillibridge* case began the slow progression towards the recognition of natural gas storage rights by establishing a precedent that mineral rights, *i.e.*, subsurface rights, not only could be severed from the surface estate, but, if sold, the layer of property granted to the mineral rights holder remained with that grantee even after the minerals had been removed.

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9 *Id.*

10 Lillibridge v. Lackawanna Coal Co., 143 Pa. 293, 299 (Pa. 1891).

11 *Id.* at 306.

[b] — *Tate* v. *United Fuel Gas Co.*[12]

Moving forward over a half century, the *Tate* court recognized that storage is something different from mineral rights. Here, the landowner sought to enjoin United Fuel from using his land and the area beneath his land for gas storage.[13] The landowner acquired the land by deed that excluded the rights to oil, gas and brine, and all minerals, except coal.[14]

United Fuel approached the owner of the mineral rights instead of the landowner to acquire storage rights beneath Mr. Tate's property.[15] United Fuel entered into a lease agreement with the owner of the mineral rights that gave United Fuel the right to import gas to, store gas in, and remove gas from the area beneath Mr. Tate's property.[16]

Ultimately the West Virginia Supreme Court held that the mineral interest owners had not, in fact, retained the rights to the area in which they had agreed to allow United Fuel to store gas. The court found that there were no recoverable minerals in that area. The mineral rights owner's rights were for the purpose of mining the land for the production of minerals.[17] This right could not be extended to the storage of gas.

[c] — *Miles* v. *Home Gas Co.*[18]

The *Miles* case turns on whether storage rights for gas were included as part of a mineral rights conveyance. In 1943, Federal Land Bank conveyed to Crandall, a predecessor in title "[a]ll the oil, gas and minerals on the following premises, together with the right at all times to enter upon said premises and to bore wells, make excavations, lay pipes and remove all oil, gas and minerals found thereon."[19] Crandall subsequently conveyed those rights, including

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12 Tate v. United Fuel Gas Co., 71 S.E. 2d 65 (W. Va. 1953).

13 Tate v. United Fuel Gas Co., 137 W. Va. 272, 274 (1952).

14 *Id*.

15 *Id*. at 275-276.

16 *Id*.

17 *Id*. at 283.

18 Miles v. Home Gas Co., 316 N.Y.S. 2d 908 (N.Y. Int. App. Ct. 1970).

19 *Miles v*. Home Gas Co., 35 A.D.2d 1042 (N.Y. App. Div. 3d Dep't 1970).

"gas storage rights" to Home Gas Co.[20] Here, the court found that Crandall did not, in fact, possess gas storage rights to convey. "The wording of the reservation and grant is clear and unambiguous in conveying rights solely relating to the production and transmission of gas from the property and cannot be construed as also covering the storage activity engaged herein by appellant."[21] This case establishes that gas storage rights are different than mineral rights, a distinct right that can be granted.

§ 11.03. The Shale Revolution.

The phenomenal recent growth in U.S. shale gas production also highlights the continued importance of maintaining sufficient underground storage. This section reviews the recent expansion of shale gas production in the United States. This section also analyzes critical legal challenges that have emerged and their potential impact on continued production and storage of shale gas.

[1] — Rapid Growth in U.S. Shale Production.

Industry commenters have described the recent growth in U.S. oil and natural gas production as "nothing short of astonishing."[22] Forecasters predict that U.S. overall production will rise from 23.0 trillion cubic feet in 2011 to 37.6 trillion cubic feet by 2040 — an increase of over 40 percent.[23] And according to the same commenters, the United States is not only now the world's fastest-growing hydrocarbon producer, but it is also poised to grow into one of the world's largest gas exporters by 2020.[24]

The production of natural gas from shale rock is a primary driver of this rapid expansion in overall U.S. energy production. Shale gas is natural gas that is trapped within shale formations of fine-grained sedimentary rock.

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20 *Id*. at 1043.

21 *Id*.

22 *Supra* note 1.

23 *Annual Energy Outlook 2014 with Projections to 2040*, Energy Information Administration, http://www.eia.gov/forecasts/aeo/pdf/0383%282014%29.pdf.

24 *See* Morse, *supra*.

Production of shale gas is thriving in the United States. Production from shale gas has risen dramatically over the past several years, to the tune of nine billion cubic feet over the short span of years between 2007 and 2012 nationwide.[25]

One major reason for the growth in shale gas production is its abundant availability in the United States. According to conservative estimates, the United States possesses enormous amounts of shale gas resources. The government estimates there are over 560 trillion cubic feet (tcf) of recoverable shale gas resources in the United States.[26] Private estimates range as high as 1,073 tcf.[27] When combined with other resources, shale gas raises the total amount of recoverable U.S. natural gas resources from approximately 1.8 tcf to 2.4 tcf.[28] These resources are distributed across the lower 48 states in several major shale plays.[29] Examples of significant shale gas plays include: Marcellus shale located in several Appalachian states, Barnett Shale located in central Texas, Haynesville-Bossier shale located in eastern Texas and Northern Louisiana, Woodford shale in Oklahoma, and Eagle Ford shale in southern Texas.[30] Given the vast extent of shale resources, shale gas clearly will play an important role in U.S. energy supply for the foreseeable future.

[2] — State and Local Government Action.

The growth in shale gas production has spawned a proliferation in state regulations that attempt to address a plethora of issues related to the extraction of gas from shale deposits.

State and local governments throughout the United States continue to push through regulations governing shale gas. Recently, the Pennsylvania, California, Michigan, and Texas legislatures passed new rules regulating

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25 Energy Information Administration, Shale Gas Production, http://www.eia.gov/dnav/ng/ng_prod_shalegas_s1_a.htm.

26 U.S. Dep't of Energy. *Modern Shale Gas Development in the United States: An Update*, September 2013.

27 Potential Gas Committee, 2013, Potential Supply of Natural Gas in the United States, http://potentialgas.org/press-release – April –– 2013.pdf.

28 *Supra* note 26.

29 *Id*.

30 *Id*.

hydraulic fracturing. Areas of particular concern to these states include water quality, methane gas migration into groundwater, diminished air quality caused by the escape of volatile organic compounds, and induced seismicity caused by the use of fracturing liquids too close to existing geological fault lines. As states continue to address these issues, the world of shale gas and its extraction will be an evolving landscape of regulation.

[a] — Pennsylvania.

Pennsylvania's new proposed regulations include additional requirements for abandoned wells in the state, new regulation of containment practices, and construction standards for wells.[31] These new regulations are primarily based on Pennsylvania's new Act 13, passed in late 2012.[32] The new proposed regulations require greater caution and safety practices by anyone engaging in hydraulic fracturing in Pennsylvania. This includes enhanced containment practices for unconventional well sites, restricting the temporary storage of production materials in open pits, mandating that these pits have a liner of certain thickness, and that there be 24 hour security on site.[33] Further requirements include protection of water resources, including enhanced containment practices for hydraulic fracturing fluids.[34]

[b] — California.

California has been through several iterations of new regulations and on June 13, 2014, released new proposed regulations.[35] If passed, these regulations would introduce new requirements addressing a wide-range of issues related to hydraulic fracturing. The new regulations would institute new standards for calculating the amount of acid used in wells, moving from

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31 *See* Environmental Protection Performance Standards at Oil and Gas Well Sites, 43 Pa. B. 7377 (proposed December 14, 2013) (codified at 58 Pa. C.S. §§ 2301-3504.Notice of Proposed Rulemaking, Pennsylvania Bulletin, Vol. 43, No. 50, December 14, 2013.

32 A portion of which has been held to be unconstitutional by Pennsylvania's Supreme Court, discussed *infra*.

33 43 Pa. B. 7377.

34 *Id*.

35 SB 4 Well Stimulation Treatment Regulations, 46-2 Cal. Regulatory Notice Reg. 1773 (November 15, 2013).

a concentration-based measurement to a volume-based measurement. The new regulations would also institute stringent new notification and monitoring obligations for producers. The rules would require drillers to provide written notice, in both Spanish and English, to any adjacent landowners to the drill site, and to test water surrounding the site both before and after any drilling.[36]

[c] — Michigan.

The State of Michigan is contemplating regulations similar to those proposed in California. Michigan's proposed regulations focus on, among others, protecting the state's water supply from hydraulic fracturing. The proposed rules would codify the existing practice that permit applicants use of the state's water withdrawal assessment tool to prevent adverse impacts to rivers and streams.[37] These rules would also require testing of water surrounding the site. Additionally, drilling companies would be required to disclose the chemical makeup of their fracturing fluids.[38] Companies would also be required to file separate applications for high-volume fracking permits, notify the Department of Environmental Quality at least 48 hours before a fracking operation starts, monitor fluid pressures and injection volumes and halt the process if something goes wrong.[39]

[d] — Texas.

Texas already had fairly stringent rules on hydraulic fracturing. It was one of the first states to require a well-by-well disclosure of the composition of hydraulic fracturing fluids.[40] In 2012, Texas implemented new rules, which went into effect this year, that add additional regulatory requirements to any well employing hydraulic fracturing. The rules, among other things, add new requirements for well control and blowout preventers, clarify standards for drilling, casing and cementing of wells, require cement across and above all zones permitted for injection. They also require pressure testing of

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36 *Id*.

37 *See* Oil and Gas Operatons, 5-2015 Mich. Reg. 2-34 (April 1, 2015).

38 *Id*.

39 *Id*.

40 Tex. Nat. Res. Code § 91.851.

surface casing and casing strings with advance notice to the Texas Railroad Commission office and add a new well category for minimum separation wells requiring special review and consideration for drilling, cementing and completions.[41]

[3] — Increased Local Resistance.

In addition to direct regulation of fracturing and increased drilling, local communities have grown resistant to increased drilling and hydraulic fracturing methods. Attempts have been made throughout the country to regulate gas production on the local level, especially through the use of zoning laws to restrict drilling. These attempts have resulted in a litany of litigation nationwide.

[a] — *Robinson Township v. Commonwealth.*

In a 4-2 decision in December, 2013, the Pennsylvania Supreme Court threw out portions of the law known as Act 13, including notably its implementation of statewide zoning standards for oil and gas operations. The decision will dramatically impact the oil and gas industry in many ways, requiring the industry to comply with a variety of differing regulations statewide. The sweeping decision "constitutionalizes" local zoning and limits state legislative oversight over local land use regulation.[42]

The case turned on the Environmental Rights Amendment to the state's constitution. The plurality opinion articulated a sweeping view of Pennsylvania's obligations under the Environmental Rights Amendment. The court held that the Amendment creates "an obligation on the government's behalf to refrain from unduly infringing upon or violating the right, including by legislative enactment or executive action."[43] Further, the Amendment "requires each branch of government to consider in advance of proceeding the environmental effect of any proposed action on the constitutionally protected features."[44] The Amendment's "constitutional obligation binds all

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41 16 Tex. Admin. Code § 3.13.

42 Robinson Township v. Commonwealth, 83 A.3d 901 (Pa. 2013).

43 *Id*. at 74.

44 *Id*.

government, state and local, concurrently.'"[45] The General Assembly has "no authority to remove a political subdivision's implicitly necessary authority to carry into effect its constitutional duties.'"[46]

The court concluded that the portion of Act 13 that imposed statewide environmental regulation of oil and gas undid existing environmental protections in certain localities and therefore violated the Environmental Rights Amendment.[47] The court also struck down Act 13's allowance of industrial oil and gas operations "as of right" throughout every zoning district in the state, including residential, commercial, and agricultural districts, finding it irreconcilable with the Constitution's mandate that the state act as the trustee of public lands.[48]

The court held that both provisions violated the Environmental Rights Amendment to the state constitution, which guarantees Pennsylvanians the right to "clean air, pure water, and to the preservation of the natural, scenic, historic, and esthetic values of the environment.'"[49]

The implications of this case in Pennsylvania's regulatory landscape for oil and gas are tremendous. For all practical purposes, statewide land use regulations for oil and gas will almost certainly always violate the Environmental Rights Amendment, thus failing to pass constitutional muster. Further, this may open the door to future challenges to statewide oil and gas regulations that, until this point, have been well settled.

[b] — *City of Munroe Falls, Ohio v. Beck Energy Corp.*

In March 2014, the Ohio Supreme Court held oral arguments to determine the scope of Ohio's constitutional guarantee of municipal "home rule." The case — brought by the city of Munroe Falls, Ohio against Beck Energy Corp. for violations of its local zoning laws — concerns the constitutionality of Ohio Revised Code Section 1509.02, which grants the

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45 *Id*. at 75.
46 *Id*. at 120.
47 *Id*. at 122.
48 *Id*. at 125-128.
49 Pa. Const. Art. I, § 27.

Ohio Department of Natural Resources sole authority to regulate oil and gas drilling activities (*i.e*., activities on the drilling site) within the state. The determining question is whether towns and municipalities can use local zoning laws to impose requirements or conditions on drillers beyond those imposed by the Department.

[c] — *Matter of Norse Energy Corp. USA v. Town of Dryden.*

The Town of Dryden's zoning ordinance was amended to ban all activities related to the exploration for, and the production or storage of, natural gas and petroleum.[50] The energy company sued, arguing that the state's Oil, Gas and Solution Mining Law preempted the Town's zoning ordinances and thus the new ordinance should be stricken.[51] The Oil, Gas, and Solution Mining law provides that the state code "shall supersede all local laws or ordinances relating to the regulation of the oil, gas and solution mining industries; but shall not supersede local government jurisdiction over local roads or the rights of local governments under real property tax law."[52]

Here, the court reasoned that the zoning ordinance did not seek to regulate the details or procedures of the oil, gas and solution mining industries.[53] Instead, the court found that the ordinance established permissible and prohibited uses of land within the Town of Dryden for the purpose of regulating land use generally.[54]

Here again is a victory for municipalities against statewide gas regulation. As in *Robinson,* discussed *supra*, New York's statewide oil and gas statutory scheme is held to be secondary to local zoning ordinances, provided those zoning ordinances do not seek to directly regulate the industry, but are drafted to regulate the use of land within a jurisdiction. This ruling subjects

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50 Matter of Norse Energy Corp. USA v. Town of Dryden, 108 A.D.3d 25, 28 (N.Y. App. Div. 3d Dept. 2013).

51 *Id*.

52 NY CLS ECL § 23-0303.

53 Matter of Norse, 108 A.D.3d at 36.

54 *Id*.

gas companies within the state of New York to a somewhat less powerful, but nonetheless highly localized regulatory framework.

[d] — Virginia Attorney General Opinion.

Virginia's Attorney General issued an advisory opinion in response to a decision by the Washington County Board of Supervisors to "delay action to amend the County Zoning Ordinance to allow for natural gas extraction until after the [U.S. Environmental Protection Agency] publishes its report on the public safety issues associated with hydro-fracturing."[55] It appeared from this decision that the Board of Supervisors at that time did not intend to allow gas drilling to proceed anywhere in the county. In response, the Attorney General opined that "although a local governing body may adopt a zoning ordinance that places restrictions on the location and siting of oil and gas wells that are reasonable in scope and consistent with the Virginia Gas and Oil Act and the Commonwealth Energy Policy, a local governing body cannot ban altogether the exploration for, and the drilling of, oil and natural gas within the locality's boundaries."[56]

§ 11.04. Common (and Emerging) Litigation Issues Impacting Storage

Gas storage, by its very nature, is inevitably impacted by litigation of various issues. Storage leases or ownership rights are, in many instances, so old that current surface owners are typically unaware that their property is above a gas storage facility. Migrating gas and a new gas drilling boom in this country can lead to further conflicts between gas storage facility operators and gas drillers. Environmental and safety concerns in local communities inspire litigation. This section discusses some prominent litigation issues impacting gas storage.

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55 Op. Att'y Gen., VA, January 11, 2013.

56 *Id*.

[1] — Gas Migration.

Gas in storage facilities can and often does migrate to neighboring properties. This can create litigation issues, especially when the neighboring property owner begins to drill for the gas and extract the gas after migration.

Under the common law, when migration occurs, the "rule of capture" applies. The "Rule of Capture" is rooted in the common law governing wild animals and says that the first person who captures migrating gas owns it.[57] Natural gas is considered "wild and migratory" such that "when [it] is gone, his title is gone."[58]

Modern case law tends to recognize that *injected* storage gas is not subject to the "rule of capture," even if it migrates beyond the boundaries of an established storage field. Courts and legislatures tend to protect ownership rights by endorsing the rule that title is not lost to injected natural gas simply because it migrates under adjoining property.

[a] — *Columbia Gas Transmission Corp. v. An Exclusive Gas Storage Easement.*

Columbia filed suit seeking to condemn an underground natural gas storage easement beneath a tract of land owned by the Arnholts.[59] This property was adjacent to Columbia's Weaver Storage field and gas was already migrating underneath the property.[60] The Arnholts claimed the migrating gas was "native" gas and began drilling it. In ruling against the adjoining owner, the court held that the gas was "storage gas", and therefore not subject to the landowner's capture even though it had migrated outside the storage field boundaries.[61]

The Arnholts challenged Columbia's claim to condemnation, and asserted a claim for trespass, alleging that Columbia had stored gas beneath their

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57 Hammonds v. C. KY… N. Gas Co., 255 Ky. 685, 687 (Ky. 1934).

58 *Id*. at 688.

59 Columbia Gas Transmission Corp. v. Exclusive Natural Gas Storage Easement, 747 F. Supp. 401, 402 (N.D. Ohio 1990).

60 *Id*.

61 *Id*. at 405.

property long before Columbia actually condemned the area for storage.[62] The Arnholts relied heavily on Ohio law and the Ohio state constitution to support their challenge. Resolving this point, the court held that, "[t]he storage of natural gas transported in interstate commerce comes within the purview of the Natural Gas Act."[63] Thus, the court held the Ohio state provisions cited by the Arnholts were pre-empted by the federal Natural Gas Act.

[b] — *Northern Natural Gas Co. v. Oneok Field Services Co. LLC.*

As a counter-example, the rule of capture still sometimes arises with regard to storage gas. In this case, Northern Natural Gas Company ("Northern") owned and operated an underground gas storage facility known as the Cunningham Storage Field.[64] Northern sued three drilling companies alleging that they had caused gas to migrate from the storage field beyond the FERC certificated boundaries by creating "pressure sinks."[65] While Kansas has a statute on point abolishing the rule of capture, that statute is limited to gas migrating to adjoining properties.[66] Here, the gas migrated beyond the adjoining properties and was harvested several properties away. Once the gas migrated beyond that initial buffer line of property surrounding the storage field, the rule of capture applied.[67] Accordingly, the gas company here lost title to the storage gas.[68]

[2] — Local Producer Claims.

Local producers on the edges of storage fields frequently drill and produce migrating storage gas, either deliberately or inadvertently. The recent expansion of shale gas production will create an increased demand

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62 *Id*. at 402.

63 *Id*. at 404.

64 Northern Natural Gas Co. v. Oneok Field Servs. Co., L.L.C., 296 Kan. 906, 911 (Kan. 2013).

65 *Id*. at 912.

66 *Id*. at 936.

67 *Id*.

68 *Id*.

for seasonal storage of produced shale gas, and, as a result, more potential for conflict between local producers and owners/operators of storage fields. Gas companies may seek injunctive relief and/or damages against local producers asserting any one of several legal theories, including: common law conversion, common law unjust enrichment, and, sometimes, statutory remedies.

Kansas has enacted legislation altering the landscape somewhat for this type of claim. Under their statute, the rule of capture is altered as applied to injected storage gas and grants the injector the right to enforce ownership rights through injunctive relief (but does not provide for recovery of attorney's fees).[69] As discussed, *supra*, this statute only provides relief for gas that has migrated under *adjoining* property. As gas moves beyond that adjoining property line, the common law rule of capture applies.

Generally, in a case of a producer drilling into a storage field, the field operator must act quickly to assert legal remedies. In many states, two-year and three-year statutes of limitation apply to common law actions for conversion and unjust enrichment. Under the "discovery rule," the limitation period runs from the time the fact of injury is reasonably ascertainable.

[a] — *Northern Natural Gas Co. v. Nash Oil & Gas Co.*

Nash drilled and produced stored gas that migrated through a geological fault in the adjoining Cunningham Gas Field.[70] Northern's investigation revealed that samples taken from Nash's wells "resembled" storage gas.[71] Northern wrote Nash, but instead of initiating litigation, Northern continued its investigation.[72] Northern ultimately filed suit four years later after the applicable statutes of limitation had expired. On appeal, the court affirmed summary dismissal of Northern's claims.

The outcome in *Nash* can be avoided through a signed tolling agreement. If the offender executes a tolling agreement, the statute of limitation period can be tolled throughout whatever investigation needs to occur. If the offender

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69 Kan. Stat. § 55-1210(d) (2014).

70 N. Natural Gas Co. v. Nash Oil & Gas, Inc., 526 F.3d 626, 628 (10th Cir. Kan. 2008).

71 *Id*. at 629.

72 *Id*. at 630.

refuses to sign, then legal proceedings should be instituted promptly to avoid a statute of limitation problem.

[3] — "Reasonable" Surface Use.

Surface landowners often sever and lease the underlying mineral interests for exploration and development from the fee property. The mineral lessee has the right to use and occupy the portion of the surface land necessary for exploration. Surface owners have a legal duty to allow the mineral owner to exercise its rights to extract oil and gas. Subsequent purchasers of the surface land subject to a prior gas lease (or severed gas rights) must also cooperate. Those purchasers take the land knowing their surface ownership may be burdened by the exercise of rights of the owners or lessees of the mineral estate.

The mineral lessee/owner is only entitled to *reasonable* use of the surface for oil and gas exploration. Surface owners may recover damages in trespass and/or obtain an injunction to stop or prevent unreasonable use.

[a] — *Oryx Energy Co. v. Shelton*.

A lessor landlord brought suit for property damage due to the lessee's unreasonable use of surface rights. The lessors alleged that the lessee of the mineral rights far exceeded the scope of their right to make use of the surface property by turning a large pasture, 40 to 50 acres, into a storage field for drilling and storage equipment for oil.[73] Further, lessor property owner alleged that the lessee oil company significantly polluted the surface area with oil.

The court found that the lessee oil company had, in fact, exceeded the scope of their mineral rights lease by unreasonably damaging the surface, setting the standard that "the holder of an oil and gas lease, in the absence of a specific contractual provision relating to surface damages, has the legal right to use as much of the surface as is reasonably necessary to comply with

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73 Oryx Energy Co. v. Shelton, 942 S.W.2d 637, 641 (Tex. App. Tyler 1996).

the terms of the lease and to carry out its purposes."[74] Further, the burden of proving excessive use is on the surface owner.[75]

[b] — *Magnolia Petroleum Co. v. Norvell.*

Magnolia Petroleum Company owned an oil and gas lease for the development of mineral rights on the subject property.[76] The oil and gas lease covered an 80-acre tract. Five wells were drilled on the tract within a period of a few months.[77] The alleged damages dealt primarily with erosion which was the result of a continuous operation on said parcel and the construction of a system of roads to each well location.[78] Defendant argued that they had a right to use the surface to access their mineral rights beneath the surface. While the court agreed with this, damages were still awarded because the lessee failed to take reasonable precautions against erosion while constructing its roads causing unnecessary permanent injury to the surface entitling lessor to damages.[79]

[c] — *Winslow v. Duval Coty Ranch Co.*

This case illustrates the point that pollution of the surface estate by a mineral owner or lessee can lead to a damages award. Plaintiff surface owner filed suit against the mineral lessees for their alleged damages to the surface estate caused by pollution. Plaintiff asked for and received a temporary injunction against the mineral lessees preventing them from producing any petroleum on lands of defendants.[80] They further claimed damages due to pollution of the surface estate caused by the oil lessees.[81]

The court vacated the injunction that it had issued, stating that Texas law does not allow an injunction "unless the party alleged to be committing

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74 *Id*.
75 *Id*.
76 Magnolia Petroleum Co. v. Norvell, 1952 OK 20, 240 P.2d 80 (Okla. 1952).
77 *Id*.
78 *Id*. at 81.
79 *Id*.
80 Winslow v. Duval County Ranch Co., 519 S.W.2d 217, 218-219 (Tex. Civ. App. 1975).
81 *Id*. at 220.

the wrongful act 'is shown to be unable to respond in damages for such injury as may result from such drilling or mining operations.'"[82] While the court dismissed the injunction the trial court issued against the production of petroleum on the property, the court did leave the door open for damages.

[4] — New and Modified Production Regulations.

In recognition of potential breach of storage fields by new technology, many Appalachian states have imposed or reinforced notification requirements on producers for new wells.

West Virginia recently enacted the Natural Gas Horizontal Well Control Act. This Act requires notification of storage owners for drilling within any field, intrastate or interstate.[83] The notice must be delivered by registered mail or any method of delivery that requires a signature confirmation of receipt, and must contain copies of the application, the erosion and sediment control plan, and plat.[84] On receipt of a notice of this type, storage field operators must move quickly to protect their interests.

Pennsylvania passed legislation requiring producers to notify storage operators by certified mail of potential drilling in storage fields.[85] This notice must contain a well location plat, the drilling, casing, and cementing plan, and the anticipated date of drilling.[86] The driller must also submit proof of notification to gas storage operators to the Department of Environmental Quality with any well application permit. Storage operators have a right to object to the drilling within 15 days of receipt of a notification.[87]

Ohio revised its mining and drilling regulations in 2012, defining well construction and specially regulating it and incorporating special requirements related to drilling wells near storage fields.[88] This change requires that the owner "set and cement intermediate casing in a competent

82 *Id*.at 225.

83 W. Va. Code § 22-6A-10.

84 *Id*.

85 25 Pa. Consol. Stat. § 78.76.

86 *Id*.

87 *Id*.

88 Ohio Admin. Code Ann. 1501:9-1-08.

formation [. . .] through a gas storage reservoir when drilling in strata beneath a gas storage reservoir within the storage protective boundary."[89] This change provides some degree of protection for storage field operators from drillers.

[5] — Field Location Considerations.

[a] — Legal and Regulatory Restrictions on Divulging "Critical Infrastructure" Information.

In a post-9/11 world, the landscape surrounding security of storage fields has changed tremendously. One of the nine exemptions for dissemination of information in the Federal "Freedom of Information Act" specifically prohibits disseminating information regarding natural gas wells.[90]

State FOIA acts vary widely, but many include provisions protecting information, the use of which could be useful in planning an attack on critical infrastructure. Some state FOIA statutes provide nothing specific in the text of the statute, but may refer to anything protected from disclosure under Federal FOIA.

Virginia's Freedom of Information Act provides a broad exclusion for public safely. The state excludes "[p]lans and information to prevent or respond to terrorist activity, the disclosure of which would jeopardize the safety of any person, including (i) critical infrastructure sector or structural components . . ."[91] Thus, under Virginia's FOIA, disclosure of a storage field location is not required.

Arising under the FERC Regulations, Critical Infrastructure Information or "CEII" keep private submissions keyed to specific engineering, vulnerability, or detailed design information about proposed or existing critical infrastructure. FERC defines CEII as "information about proposed or existing critical infrastructure that: (i) relates to the production, generation, transportation, transmission, or distribution of energy; (ii) could be useful to a person in planning an attack on critical infrastructure; (iii) is exempt from mandatory disclosure under the Freedom of Information Act, 5 U.S.C. 552;

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89 *Id*.

90 5 U.S.C. § 552. Amended by Public Law No. 104-231, 110 Stat. 3048.

91 Va. Code Ann. § 2.2-3705.2.

and (iv) does not simply give the location of the critical infrastructure."[92] These regulations are designed to allow storage operators to interact freely with FERC and the government generally, while still protecting the locations of storage fields and other critical infrastructure.

The Critical Infrastructure Information Act of 2002 designates certain of the nation's assets as "critical infrastructure" and establishes a program for the protection of critical infrastructure information from public dissemination.[93] Critical infrastructures have been defined as those systems and assets so vital to the United States that the incapacity of such systems and assets would have a debilitating impact on the United States. The Department of Homeland Security implemented regulations and instituted a program derived from the Act. The Protected Critical Infrastructure Information Program is an information-protection program that is designed to enhance voluntary information sharing between infrastructure owners and operators and the government.

[b] — Mechanisms for Producers to Identify Storage Field Locations.

There are resources available for the identification of storage fields without such maps being made public or even selectively disseminated. Most storage companies submit maps to state entities that permit the storage wells for use in the field. Although the maps are generally kept separately, as they are submitted with a cover letter detailing the FOIA exceptions, state oil and gas offices will often tell a producer that a proposed well location is in proximity to a field.

Further, title examinations, if done thoroughly and for an entire proposed unit, will often reveal the existence of a storage lease. These leases will be recorded in land records, just as other deeds and land conveyances are recorded. The recommendation is to go back at least 80 years in Appalachia, as many fields date to the early 1930s.

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92 *See* FERC Order NO. 630, P. 19, issued February 21, 2003.

93 6 U.S.C. §§ 131 *et seq.*

The U.S. Energy Information Administration provides the general county locations within states wherein a particular storage field may be found.[94] Preliminary research with the EIA can yield results as to what storage company, if any, is operating in the area of interest. Contacting the storage company identified with the EIA can be a quick source of information as to general storage field location.

[c] — Engineering Issues with Production in a Storage Field.

Drill-through agreements are common for vertical wells, as well as for horizontal wells for which the bore passes through the field before angling horizontally to the target formation. These agreements can be reached between a gas driller and a storage field operator. The agreement will often spell out the terms by which the driller will be permitted to drill in the storage field and/or the buffer, typically involving additional protections for the storage field gas.

Often, an agreement on a "frack-buffer" is reached if the horizontal hydraulic fracturing is anticipated to be within a certain vertical buffer space in a storage field. A "frack-buffer" will set a vertical limit on where the drilling or fracturing can occur in order to protect the storage field from the fracturing, while still permitting the fracturing within the shale to extract the native gas contained within. This is commonly considered where Marcellus tightly overlays Oriskany Storage fields and there is either incomplete or non-existent Needmore Shale or other strata between the formations.

[6] — Litigation between Production and Storage.

Tension exists between producers of natural gas and natural gas storage field operators. Storage field operators are continually trying to protect their injected natural gas. Natural gas drillers are constantly prospecting, searching for new sources of gas. This can create conflict between the two

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94 Energy Info. Admin., Natural Gas Annual Respondent Query System (2014), http://www.eia.gov/cfapps/ngqs/ngqs.cfm?f_report=RP7&f_sortby=&f_items=&f_year_start=&f_year_end=&f_show_compid=&f_fullscreen.

when a driller is unaware of a storage field location and begins to drill and produce storage gas.

[a] — *Columbia Gas Transmission Corp. v. Exclusive Natural Gas Storage Easement.*

Plaintiff Columbia Gas, the operator of a storage field, brought an action against defendant William Hill, driller and lessor of drilling rights from landowner, and Defendant Guy Hostettler, who owned the real estate, and the Hostettler well to condemn the well. Columbia further sought damages of two million dollars for alleged production from their storage field.[95] The Hostettler well was drilled in 1976 and was operated continuously since 1977 at the time of the suit.[96] The well itself was located within the protective area surrounding the Holmes Storage Field and extremely close to the active storage area. Through a series of testing performed by Columbia, they determined that the Hostettler well was producing storage gas, not native gas.[97] Columbia then sued to enjoin production from the Hostettler well, to condemn the well itself, and for damages for the converted gas.

The court considered Columbia's right to condemn the well, concluding that "Columbia's attempt to condemn the Hostettler well seems reasonable in light of the court's conclusion that the Hostettler well is probably producing storage gas."[98] Columbia was awarded a preliminary injunction against the production of gas from the Hostettler well based on the court's findings that the well was likely producing gas from the storage facility rather than native gas.[99]

[b] — *N. Natural Gas Co. v. L.D. Drilling, Inc.*

Plaintiff obtained certificates of public convenience and necessity that granted it authority to store natural gas over a 26,000 acres field. This field

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95 Columbia Gas Transmission Corp. v. Exclusive Natural Gas Storage Easement, 688 F. Supp. 1245, 1246 (N.D. Ohio 1988).

96 *Id*. at 1247.

97 *Id*.

98 *Id*. at 1249.

99 *Id*. at 1251.

was part of a former drilling site that was depleted.[100] The storage field remained stable for a period of time, but beginning in 1994, natural gas producers began extracting gas and water just north of the storage field, causing "pressure sinks" destabilizing the field.[101] Storage company sued three natural gas producers alleging the producers, drilling so close to the storage field, were producing migrating gas from Company's storage field. "[T]he issue is whether Defendants' production from their wells in the expansion area unreasonably interfered with Northern's storing its natural gas in the field."[102] The court granted the storage company a preliminary injunction against producer upon proof of a substantial likelihood that it was causing a "nuisance" to the storage operator in interfering with storage operations.

§ 11.05. Conclusion.

Underground storage of natural gas is a critical component in the natural gas economy today. With abundant production of shale gas, the United States has become one of the top producers of gas in the world. To support this new production, natural gas storage facilities will become an increasing necessity. Laws relative to storage are proliferating and keeping oneself apprised of the legal framework governing their existing or new storage facilities will help to ease operations.

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100 N. Natural Gas Co. v. L.D. Drilling, Inc., 697 F.3d 1259, 1264 (10th Cir. 2012).

101 *Id*.

102 *Id*. at 1272.

Chapter 12

All Our Yesterdays: The Increasing Risk of Landowner Liability for Legacy Discharges

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§ 12.01. Introduction: Recent Litigation Trends, Suits Against Landowners Under the Clean Water Act (CWA).

[1] — Overview.

Beginning in 2012, environmental advocacy groups in the Central Appalachian region began a new litigation offensive for alleged legacy mining-related water discharges against a class of defendants previously left alone — landowners. The focus on landowners as liable parties under the CWA is relatively recent, and particularly novel to landowners in the Central Appalachian region. Prior legacy discharge suits in other regions have almost exclusively focused on the discharge creator, not the owner of the land solely (usually they are one in the same in these cases).

This trend has the potential to reach back virtually indefinitely into the past. Coupled with the EPA's recent "Clean Water Rule" issuance,[3] this trend creates an unprecedented, virtually endless, expansion of alleged CWA jurisdiction and potential liability.

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3 *See* 80 Fed. Reg. 37054 (June 29, 2015).

The plaintiffs, a collection of environmental advocacy groups, are claiming that particular locations on either former mining permit sites that previously achieved bond release or pre-Surface Mining Control and Reclamation Act (SMCRA) sites disturbed before the enactment of the federal regulatory program in 1977[4] contain unpermitted point source discharges under the Clean Water Act (CWA).[5] The plaintiffs have brought their claims as statutory causes of action under the CWA's "citizen suit provisions.[6] Typical plaintiffs include:

- Appalachian Voices
- Kentuckians for the Commonwealth
- Ohio Valley Environmental Coalition
- Sierra Club
- Southern Appalachian Mountain Stewards
- West Virginia Highlands Conservancy

These are the same environmental advocacy groups commonly seen as plaintiffs in the large, complex CWA citizen suit cases seen in Central Appalachia against primarily coal mining interests since the late 1990s.

[2] — Environmentalist's New Offensive.

[a] — Dual Strategies.

In general, environmental plaintiffs in the region have focused on two "types of situations in their efforts to impose residual liability under the federal CWA for passive landowners based upon alleged ongoing point source discharges associated with inactive mining operations: (1) former mining sites where the applicable SMCRA and National Pollutant Discharge Elimination System (NPDES) permits recently have been released by the permitting authority, and (2) historic, "pre-law" mining sites where mining activity took place prior to the enactment of SMCRA in 1977. However, under

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4 30 U.S.C. §§ 1201 *et seq*.

5 33 U.S.C. §§ 1251 *et seq*.

6 33 U.S.C. § 1365.

both scenarios, the allegations are the same — that an unlawful, unpermitted discharge is occurring in violation of Section 301(a) of the CWA.[7]

The typical Complaint seeks both declaratory and injunctive relief — that is, a declaration that a violation of the CWA is occurring, an injunction against further discharges until the defendant obtains a permit, an order compelling the defendant to conduct environmental monitoring to assess the impacts of the alleged discharge, and the imposition of civil penalties up to the statutory maximum of $37,500 per day of violation. The plaintiffs also generally seek reimbursement of attorney's fees associated with bringing the citizen suit, as authorized by the CWA.

[i] — Low-Hanging Fruit: Recently Released Mining Permits.

In several cases, environmental plaintiffs have filed suit against a landowner shortly after a lessee mining company obtained a release from the applicable regulatory author of any permits under the CWA and SMCRA associated with its operations. Because information regarding permit release is readily available for review from state permitting authorities through the state's Freedom of Information Act or otherwise, the effort required by environmental plaintiffs to identify and investigate these sites is relatively minimal. Should water sampling within a reasonably close proximity downstream of the site, commonly focusing on someplace downstream of a valley fill,[8] reveal the presence of pollutants like selenium associated with

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7 33 U.S.C. § 1311(a) (prohibiting the discharge of a pollutant by any person except as in compliance with the Act).

8 The Plaintiffs have taken the position that released valley fills are point source discharges; however, the EPA initially viewed the responsibility of pollution abatement via NPDES permits as being terminated upon the release of the grading bond. 40 Fed. Reg. 19832-43 (1976). It is common upon reclamation bond release for the valley fill outfall to be removed upon reclamation and bond release for the valley fill outfall to be removed upon reclamation and bond release, rendering only diffuse seepage from the fill's rock drain as opposed to spillway during operations and active reclamation. *See also*, 46 Fed. Reg. 3136 at 3145 (January 13, 1981) ("Once [the Office of Surface Mining] authorizes removal of the sedimentation pond or treatment facility, and the performance bond is fully released, there generally will be no basis to apply EPA effluent limitations because there will generally be no point source.").

mining operations, then the prospective plaintiffs are likely to initiate a citizen suit as the evidentiary burden of bringing these claims is quite low.

[ii] — Gone, But Not Forgotten: Pre-Law Mining Sites.

Although comparatively less common, lawsuits have also been filed alleging that any flow associated with historic mine features that predate any regulation under the SMCRA constitute legitimate point source discharges that require authorization under a permit in accordance with Section 301 of the CWA — even when no active mining activity has occurred at the location for many decades, sometimes for over a century.

Examples of features that have given rise to such lawsuits are runoff from abandoned gob piles and flows to the surface through long-unused mine adits. Again, if the prospective plaintiffs are able to gather downstream sampling data showing the presence of pollutants associated with mining activity, then a lawsuit may be filed against the passive landowner as the owner of the property on which the alleged unpermitted discharges are occurring, despite being wholly unconnected to the activity that gave rise to those discharges.

[b] — Key Regional Precedents.

Some case authority within the 4th Circuit or its districts has held liability under the CWA can attach to either a landowner or entity reclaiming a legacy environmental issue, despite the fact that the property owner or third party had no role in the discharge's creation.

[i] — *W. Va. Highlands Conservancy v. Huffman.*[9]

Arguably a prelude to this latest litigation attack on land owners, here, a group of environmental organizations filed suit against the West Virginia Department of Environmental Protection (WVDEP), alleging that the agency was unlawfully discharging pollutants from bond forfeiture sites without a permit in violation of Section 301 of the CWA.[10] WVDEP argued that it was not required to obtain NPDES permits for discharges it had no role in

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9 W. Va. Highlands Conservancy v. Huffman, 625 F. 3d 159 (4th Cir. 2010).

10 *Huffman*, 625 F. 3d at 164.

creating.[11] The Fourth Circuit rejected the WVDEP's arguments, holding that the CWA is "broadly worded" and that no exclusions exist for activities pertaining to reclamation.[12] Additionally, the court noted that United States Environmental Protection Agency (USEPA) regulations issued in 1985 emphasize that post-mining discharges are covered under the NPDES permitting program.[13] The court further clarified that "under the [Act], the question of who generated pollutants is irrelevant. What matters is who is **currently discharging** pollutants into navigable waters."[14] Accordingly, the *Huffman* court affirmed the lower court's order requiring WVDEP to obtain NPDES permits for its discharges from sites administered by WVDEP through the Special Reclamation Fund.

[ii] — *Ohio Valley Environmental Coalition v. Hernshaw Partners, LLC.*[15]

The Fourth Circuit's decision in *Huffman* was cited by Judge Goodwin of the United States District Court for the Southern District of West Virginia to arrive at a similar result in *Hernshaw Partners*. In this case, plaintiff environmental organizations brought a citizen suit against a landowner for alleged unpermitted selenium discharges from a valley fill located on its property.[16] The selenium discharges at issue into Laurel Fork had a concentration of only 2.5 micrograms per liter (ug/L) — far below the acute standard and half of the chronic standard.[17] This figure was based on a single water sample taken approximately one mile downstream from the defendant's property.[18] The valley fill was constructed in conjunction with a surface mine operation begun in the 1970s by Chafin Branch Coal Company.[19] The

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11 *Id*. at 164-65.

12 *Id*. at 165-67.

13 *Id*. at 166.

14 *Id*. at 168 (emphasis added).

15 Ohio Valley Envtl. Coalition v. Hernshaw Partners, LLC, 984 F. Supp. 2d 589 (S.D. W. Va. 2013).

16 *Hernshaw Partners*, 984 F. Supp. 2d at 592.

17 *Id*. at 596.

18 *Id*.

19 *Id*. at 589, 596.

defendant landowner purchased the property in 2006, at which time mining had ceased and the valley fill was no longer subject to a permit.[20]

The landowner raised a variety of defenses — including that the discharge was "wholly past" as defined in *Gwaltney of Smithfield v. Chesapeake Bay Foundation*.[21] However, the landowner also argued that it could not be liable for discharged from the valley fill because it was merely a passive landowner and had no role in creating them.[22] Relying on Huffman, Judge Goodwin rejected this argument and held that any arguments regarding the landowner's "passive" status were irrelevant.[23] Following the District Court's denial of Hernshaw Partners' motion to dismiss and after briefing on summary judgment, the parties entered into a Consent Decree on August 7, 2014 under which Hernshaw Partners agreed to apply for an NPDES permit to cover the disputed valley fill.[24]

The operative facts in *Hernshaw* could readily be transferred to other non-mining related scenarios and industrial activities, including natural resource extraction and processing, as well as other commercial development and/or transportation projects.

[c] — The New Wave of Litigation: A Chronology of Key Cases.

Since 2012, 10 cases (in addition to *Hernshaw*) have been filed in either the federal district court for the Southern District of West Virginia, or the Western District of Virginia. Nine cases have been filed in the former, and two in the latter.

[i] — *Ohio Valley Environmental Coalition Inc. v. Boone East Development Co.*[25]

This citizen suit was filed against Boone East Development Co. as the owner of the property on which West Virginia' first mountaintop mining

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20 *Id*.

21 Gwaltney of Smithfield v. Chesapeake Bay Found., 484 U.S. 49 (1987).

22 *Hernshaw Partners*, 985 F. Supp. 2d 589, 600.

23 *Id*.

24 *Id*. at 600.

25 Ohio Valley Envtl. Coalition Inc. v. Boone East Dev. Co., No. 2:2012-cv-01173 (S.D. W. Va. 2012).

operation was located. The complaint alleged that unlawful discharges of pollutants were ongoing at the site despite the grant of WVDEP of Phase 3 bond release several years prior. Specifically, the Complaint alleges that a representative of plaintiffs had conducted water sampling near two formerly permitted outfalls that showed elevated levels of selenium and conductivity at both locations. After the filing of an answer by the defendant, a stipulation of dismissal for this civil action was filed on August 29, 2012.

[ii] — *Southern Appalachian Mountain Stewards v. Penn Virginia Operating Co., LLC.*[26]

In this civil action filed in late 2012, environmental plaintiffs alleged that at least seven unpermitted point source discharges of pollutants existed on property owned by Penn Virginia Operating Co, LLC in Wise County, Virginia. Each of the alleged point sources specified in the Complaint was a gob pile associated with long-concluded mining operations — the oldest gob pile being nearly a century old — and had been identified in a report prepared and submitted to the Virginia Division of Mined Land Reclamation by a third-party mining operator in conjunction with its permitting and reclamation efforts. The defendant filed a motion to dismiss the Complaint on the ground that it was based on conclusory allegations and speculation as to the nature of these sites, which was denied. Following discovery, including visits to the locations identified in the Complaint, the parties stipulated to a dismissal of this civil action on August 1, 2013.

[iii] — *Ohio Valley Environmental Coalition Inc. v. Baldwin.*[27]

Environmental plaintiffs instituted a citizen suit against Gary D. Baldwin, in his capacity as Trustee of the David L. Francis Testamentary Trust, on the ground that the defendant was the legal owner of real property in Mingo

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26 Southern Appalachian Mountain Stewards v. Penn Virginia Operating Co., LLC, No. 2:12-cv-00020 (W.D. Va.).

27 Ohio Valley Envtl. Coalition Inc. v. Baldwin, No. 2:13-cv-12063 (S.D. W. Va.).

County, West Virginia, on which an unpermitted discharge of pollutants was occurring through a valley fill constructed during the operation of the Sprouse Creek West Surface Mine. Phase III bond release for the mine was granted in November 2010 and the operator's NPDES permit was released in January 2011. The Complaint references only one instance of water sampling 0.25 miles downstream of the valley fill, which revealed a selenium concentration of 2.4 ug/L. Following discovery, the parties filed a joint stipulation dismissing the civil action with prejudice.

[iv] — *Ohio Valley Environmental Coalition Inc. v. Boone Coal Co.*[28]

In this case, environmental plaintiffs filed suit against Shepard Boone Coal Co. as the owner of land upon which a former surface mine is located. The Complaint alleged that unpermitted discharges of selenium continued from a reclaimed valley fill following the release of the mining operator's SMCRA and NPDES permits in 2012. Here, water sampling conducted less than one mile downstream of the valley fill revealed a selenium concentration of 10.56 ug/L. Shortly after the summons was issued to the defendant, the plaintiffs voluntarily dismissed this civil action without prejudice.

[v] — *Consolidated Pocahontas Land Cases.*[29]

In *West Virginia Highlands Conservancy v. Pocahontas Land Corp.*,[30] a consolidated case, the Complaints alleged that defendant Pocahontas Land Corporation was liable under Section 301 of the CWA for ongoing drainage through three valley fills located on its property for which bond release had been granted to the mining operators by the state permitting authority. With regard to all three locations, all coal removal activities had ceased in the formerly permitted area and the mine sites had been reclaimed.

The lawsuit was initiated after environmental plaintiffs collected water samples 0.5-0.6 miles downstream of the formerly permitted valley fills

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28 Ohio Valley Envtl. Coalition Inc. v. Boone Coal Co., No. 2:13-cv-12499 (S.D. W. Va.).

29 West Virginia Highlands Conservancy v. Pocahontas Land Corp., No. 2:13-cv-12500 (S.D. W.Va.); West Virginia Highlands Conservancy v. Pocahontas Land Corp., No. 2:13-cv-14877 (S.D. W.Va.).

30 *Id*.

that showed instream concentrations of selenium as high as 6.26 ug/L, 4.08 ug/L, and 6.90 ug/L for the three locations, respectively. On April 2, 2015, following an order denying both parties' motions for summary judgment, a Consent Decree in these consolidated civil actions was filed that would have instituted a selenium sampling regime and required Pocahontas Land to apply for the appropriate NPDES permits to regulate the three valley fills at issue; however, the Decree subsequently was vacated by the court on the same day and the docket reflects no further action in the case.

[vi] — *West Virginia Highlands Conservancy, Inc. v. Fund 8 Domestic, LLC.*[31]

Environmental plaintiffs instituted this citizen suit against Fund 8 Domestic, LLC as the owner of property in Mingo County, West Virginia, upon which a former surface mine was located, alleging that unpermitted discharges of selenium continue to occur through at least two reclaimed valley fills. Water samples collected downstream of each valley fill at issue showed selenium concentrations of 3.51 ug/L and 6.86 ug/L.

In a Memorandum Opinion and Order dated June 17, 2014, District Judge John T. Copenhaver, Jr. granted the defendant's motion to dismiss the civil action for lack of jurisdiction on the ground that the plaintiffs failed to establish a nexus between their members and the alleged injurious activity sufficient to establish organizational standing. Specifically, the Complaint did not name any specific member of the plaintiff organizations that had been harmed by the alleged unlawful discharges, but instead generally stated that the plaintiffs' members suffered injuries to their aesthetic, recreational, environmental, and/or economic interests as a result of the defendant's activity. The court concluded that the alleged harm was not "concrete and particularized" because no specific member had been identified, and therefore the case was dismissed without prejudice.[32]

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31 West Virginia Highlands Conservancy, Inc. v. Fund 8 Domestic, LLC, No. 2:13-cv-28801 (S.D. W. Va.).

32 *See* West Virginia Highlands Conservancy, Inc. v. Fund 8 Domestic, LLC, 2014 WL 2740388 (S.D. W. Va. June 17, 2014).

[vii] — *Southern Appalachian Mountain Stewards v. Penn Virginia Operating Co., LLC.*[33]

In this citizen suit, environmental plaintiffs again alleged that defendant Penn Virginia owned property upon which unpermitted point sources were discharging pollutants into waters of the United States in at least seven locations[34] in Wise County, Virginia. These alleged point sources had been identified in a report prepared by A&G Coal Company in conjunction with separate litigation. This case is ongoing, and a third-party Complaint has been filed against A&G by Penn Virginia regarding the source of the pollutants present in the alleged discharges. A jury trial has been set for February 22-24, 2016.

[viii] — *Ohio Valley Environmental Coalition Inc. v. Pocahontas Land Corp.*[35]

In this case, environmental plaintiffs once again filed a citizen suit against Pocahontas Land Corporation on the ground that the defendant owns property upon which ongoing discharges were occurring through three reclaimed valley fills. This case is significant, however, because it focuses not on selenium or other metals typically associated with historic mining activity, but instead on ionic pollution, alleging that discharges of total dissolved solids, sulfate and other ions associated with conductivity are resulting in a violation of West Virginia's narrative water quality standards. Specifically, samples were collected 0.25-0.5 miles downstream of the reclaimed valley fills at issue showing (1) total dissolved solids concentrations ranging from 502-802 mg/L, (2) sulfate concentrations ranging from 312-449 mg/L, and (3) conductivity values ranging from 746-1106 microsiemens per centimeter (uS/cm).

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33 Southern Appalachian Mountain Stewards v. Penn Virginia Operating Co., LLC, No. 2:14-cv-00004 (W.D. Va.).

34 This case involves different point sources from those at issue in the earlier 2012 litigation.

35 Ohio Valley Envtl. Coalition Inc. v. Pocahontas Land Corp., No. 3:14-cv-11333 (S.D. W. Va.).

In a Memorandum Opinion and Order issued on May 7, 2015, District Judge Robert C. Chambers denied the plaintiff's Motion for Summary Judgment on the ground that material issues of fact remained about whether the valley fills at issue meet the definition of a "point source" — fundamentally, a question of fact. In denying Pocahontas Land's motion for summary judgment, however, the court quickly rejected the defendant's arguments, concluding that (1) the CWA's jurisdiction can include discharges to surface water through hydrologically connected groundwater; (2) NPDES permits may be required for discharges that exist post-bond release, even where WVDEP historically has not required such permits, and therefore the citizen suit does not constitute an impermissible collateral attack on the agency's ongoing discharges of pollutants despite the fact that the fills are no longer actively managed and despite the fact that the landowner did not cause the discharge.

[ix] — *West Virginia Highlands Conservancy v. Penn Virginia Operating Co., LLC.*[36]

Environmental plaintiffs initiated this citizen suit against landowner Penn Virginia Operating Company almost immediately following the release by WVDEP in March 2014 of the NPDES permit issued to Penn Virginia's lessee mining company (the notice of intent to sue was dated April 3, 2014). The Complaint alleged that, despite the termination of the NPDES permit, drainage containing selenium continued to flow from the formerly permitted Valley Fill No. 4 and therefore Penn Virginia, as the owner of the land upon which the unpermitted discharge was occurring, was in violation of Section 301 of the CWA. After multiple rounds of joint sampling for selenium from the alleged discharge point, the plaintiffs voluntarily dismissed their Complaint in this civil action on April 17, 2015.

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36 West Virginia Highlands Conservancy v. Penn Virginia Operating Co., LLC., No. 5:14-cv-24467 (S.D. W. Va.).

[x] — *Ohio Valley Environmental Coalition Inc. v. Shepard Boone Coal Co.*[37]

In this case, environmental plaintiffs have filed suit against defendant Shepard Boone Coal Company as the owner of the property in Boone County, West Virginia upon which a former surface mine was located. The Complaint alleges that a valley fill remaining on the defendant's property continues to discharge selenium, total dissolved solids, conductivity, sulfates, "and other pollutants associated with alkaline mine drainage" to waters of the United States without an NPDES permit in violation of Section 301 of the CWA. The Complaint indicates that water samples collected downstream of the valley fill showed a selenium concentration of 10.56 ug/L, a total dissolved solids concentration of 670 mg/L, a sulfates concentration of 335 mg/L and conductivity value of 968 uS/cm. This case is in its early stages, and the defendant filed an answer on April 6, 2015.

[d] — Related Lawsuits.

Environmental advocacy groups have also petitioned (1) the EPA to revoke Virginia's NPDES program for alleged failure to properly permit discharges; (2) the WVDEP for alleged failure to issue mining permits under SMCRA with "proper" selenium limits; and (3) the Kentucky Energy and Environmental Cabinet for alleged failure to adjust performance bonding to address selenium discharges under a SMCRA program.

§ 12.02. How We Got Here: The Ever Evolving Expansion of Clean Water Act Liability.

[1] — In the Beginning: CWA Legislative History.

Interestingly, the term "landowner" is almost completely absent from the Federal Water Pollution Control Act amendments of 1972. The term only appears three times in the 1,766 pages of legislative debate and materials. In each instance the term is used, it is solely in the context of dealing with agricultural runoff and erosion (non-point source) or the need for easements for siting of municipal treatment systems.

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37 Ohio Valley Envtl. Coalition Inc. v. Shepard Boone Coal Co., No. 2:15-cv-01488 (S.D. W. Va.).

The 1977 amendments have considerably more references to the term "landowner," but virtually all are in the context of agricultural or silvicultural erosion (*i.e*., non-point source) or siting for municipal waste water treatment. Further, a research paper submitted into the hearing record by a constituent summarized water pollution regulation to date in 1977. That paper contains the following concluding paragraph,

> No case has ever held a landowner to be a "discharger" when water merely flowed across or through his land and the landowner neither affirmatively or negligently caused wastes to be added to that water. Neither the Refuse Act nor the FWPCA contemplated this passive owner being a discharger.[38]

Finally, there are some references to "orphan," or pre-1977 abandoned, coal mining discharges, commonly referred to at the time as "acid mine drainage." However, as these types of "orphaned" discharges were never included in permit categories post passage of the amendments, and in light of the fact that SMCRA's passage took place the same year (which included the AML program), there is a strong implication that Congress intended to remedy these discharges through the AML program.

Is this legislative history dispositive? It certainly will not be if no one attempts to argue so. Relying on legislative history is admittedly a challenge in statutory construction. However, the utter dearth of any indication of Congressional intent to hold landowners liable as dischargers in either the 1972 or 1977 legislative history seems at the very least a point which should be brought to the judiciary's attention. Coupling that with the fact that such a long gap of time passed before anyone even attempted to do so (some 28 to 33 years); and also that the regulatory development, at least for coal mining (see *infra*), made no indication that pre-surface mining act land owners would be subject to such liability, arguing that Congressional intent precluded such liability is at least plausible, if not compelling.

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[38] *See* Federal Water Pollution Control Act Amendments of 1977 (Fort Collins, Colo.), Hearing Before the Subcommittee on Environmental Pollution of the Committee on Environment and Public Works, United States Senate, 95th Cong. (June 13, 1977) at 461.

[2] — The Operative CWA Statutory Provisions.

[a] — "Citizen Suit."

Under § 505 of the Clean Water Act,[39] citizens are given the right to sue anyone alleged to be in violation of either an effluent limit contained in a permit or an order issued by the USEPA with respect to an effluent limit. Citizens may also commence a civil action under this section against the agency where there is alleged a failure of the agency to perform any nondiscretionary act under the CWA. The plaintiff(s) may obtain injunctive relief and the agency may face penalties. Most often, plaintiffs seek injunctive relief, likely due to the fact that any civil penalties assessed would be paid by the United States Treasury. If the plaintiff(s) is successful, § 505 also allows for the recovery of legal fees and expenses.

[b] — Sixty-day Notice of Intent to Sue.

The first step in filing a citizen suit is the filing of a notice-of-intent ("NOI") letter with the party the citizen intends to sue.[40] The NOI letter must be filed at least 60 days prior to the filing of a complaint. Prior to the filing of an NOI letter, the citizen suit can be preempted by the commencement of an administrative enforcement action by the regulatory agency with oversight.[41]

[c] — Elements of a Federal Clean Water Act Case.

Under the CWA, it is unlawful for "any person" to discharge "any pollutant" into "navigable water" from a "point source" without a NPDES permit. The CWA holds that all point source discharges into the nation's waters are unlawful, unless specifically authorized by permit.[42] Under the Act, jurisdictional waters include navigable surface waters of the United States, including small ephemeral and intermittent streams. "Discharge

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39 33 U.S.C. § 1365.

40 33 U.S.C. § 1365(b)(1); 40 C.F.R. § 135.2

41 While achieved post-lawsuit and not a the NOI stage, in at least one AML discharge based suit in the Western District of Virginia, defendants were able to convince plaintiffs to withdraw their complaint after the state regulatory authority listed the sites named in the complaint on the state's AML project list. *See*, SAMS v. PVOC¸LLC, No. 2:12-cv-00020 (W.D. Va.).

42 33 U.S.C. § 1311(a).

of a pollutant" means "any addition of any pollutant to navigable waters from any point source."[43] A "point source" is defined as "any discernible, confined and discrete conveyance, including but not limited to any pipe, ditch, channel, tunnel, conduit, well, discrete fissure, container, rolling stock, concentrated animal feeding operation, or vessel or other floating craft, from which pollutants are or may be discharged."[44]

Historically, at least in sites regulated by SMCRA, the removal of sediment ponds has been equated with the removal of the point source. "Once OSM authorizes removal of the sedimentation pond or treatment facility, and the performance is fully released, there generally will be no basis to apply EPA effluent limitations because there will generally be no point source."[45] Additionally, erosional channels have been held to constitute point sources if they discharge into jurisdictional waters.[46]

[3] — The Foundational Case: *Gwaltney of Smithfield v. Chesapeake Bay Foundation (Gwaltney).*[47] [48]

Alfred North Whitehead stated that all western philosophy might be characterized as footnotes to Plato.[49] It might similarly be said that all CWA Section 402 litigation may be characterized as footnotes to *Gwaltney.*

Chesapeake Bay Foundation, Inc. and Natural Resources Defense Council filed suit in federal court against Gwaltney of Smithfield, Ltd.,

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43 33 U.S.C. § 1362(14).

44 *Id*.

45 46 F.R. at 3145.

46 Sierra Club v. Abston Constr., 620 F.2d. 41 (5th Cir. 1980).

47 For an informative overview of the state of successor landowner CWA suits as of 2006, *see*, Zanan, Casenote, "Interpreting the Clean Water Act's Citizen Suit Provision: Successor Landowner Liability for Inactive Mine Discharges in Sierra Club v. El Paso Gold Mines, Inc.," *17 Vill. Envtl. L.J.* 515 (2006).

48 Gwaltney of Smithfield v. Chesapeake Bay Found.*,* 484 U.S. 49 (1987). The case holdings cited in the following sections are submitted not for the proposition that any or all of them are direct precursors to the present litigation trend against landowners in central Appalachia. However, each of these cases have addressed analogous issues that may make them persuasive authority in furtherance of either the plaintiffs' or the defendants' theories of their case.

49 A. N. Whitehead, *Process and Reality* (1979).

alleging that the company had violated, and continued to violate, its Virginia State Pollutant Discharge Elimination System (VPDES) permit by exceeding effluent limitations on five of the seven pollutants covered by the permit in violation of the CWA. Specifically, plaintiffs claimed Gwaltney discharged excessive amounts of federal coliform, chlorine, and total Kjedahl nitrogen (TKN) into the Pagan River.

Gwaltney attempted to clarify the circumstances under which a person is "in violation of" effluent standards, particularly with respect to whether active engagement polluting activity is required or whether past practices that have ceased by the time of suit can nevertheless still support a theory of liability. SCOTUS held that Congress did not intend to permit citizen suits based on "wholly past violations." To establish jurisdiction, citizens must make a good-faith allegation of continuous or intermittent violations. The Court, however, neglected to further define when a CWA violation is considered "continuous or intermittent," resulting in inconsistent lower court decisions where past conduct allegedly gave rise to current violations.

[4] — *Gwaltney's* Progeny: Expansive and Restrictive Views

Courts have attempted to apply the principles of *Gwaltney* to citizen suits. The inability of courts to reach a consistent terminological understanding of "past violations," however, has caused courts to expand, contract, and distort the *Gwaltney* standard. Some courts have interpreted the CWA and *Gwaltney* holding expansively, holding that the continuing migration of pollutants from past discharge is sufficient to establish jurisdiction. On the other hand, some courts have interpreted the CWA and *Gwalteny* holding narrowly, finding that the migration of residual contamination from prior discharges does not constitute an ongoing violation.

[a] — Expansive Line of Cases.

[i] — *Werlein v. United States*.[50]

In this case, the District Court addressed whether toxic waste introduced into a waterway over a period of time constitutes "ongoing pollution"

50 Werlein v. United States, 746 F. Supp. 887 (D. Minn. 1990).

prohibited by the CWA. The case was complex and involved application of the Clean Water Act, the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), and the Resource Conservation and Recovery Act (RCRA). The Plaintiffs alleged that the Twin Cities Army Ammunition Plant and Trio Solvents site, not in operation at the time of the alleged pollution, dumped contaminants containing trichloroethylene (TCE) into the soil that eventually migrated into a waterway over time. The Plaintiffs further alleged that rainwater infiltration of the contaminated soil caused the contaminants to discharge into two lakes. The court held that the gradual migration of the contaminants into water can constitute an ongoing violation if it constitutes a point source.

[ii] — *Umatilla Waterquality Protective Ass'n v. Smith Frozen Foods, Inc.*[51]

In this case, the District Court also addressed whether the ongoing migration of pollutants to waterways via hydrologically connected groundwater constitutes an ongoing discharge under the CWA. A nonprofit dedicated to protecting water quality alleged that wastewater pipelines from the defendant's vegetable processing facility periodically failed, thus discharging pollutants into a nearby creek. The plaintiffs also alleged that sodium and chloride pollutants from the defendant's unlined brine pond leached into the groundwater and were discharged into a creek, thus constituting an unpermitted continuing discharge.

While the court held that an unlined brine pond constitutes a confined and discrete conveyance within the CWA's definition of a "point source," the court left open for Ninth Circuit review the question of whether discharges of pollutants through hydrologically connected groundwater are subject to the NPDES permit requirement. The court further held that if the Ninth Circuit found that discharges via hydrologically connected groundwater do constitute discharges subject to NPDES regulation, then the ongoing residual migration

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51 Umatilla Waterquality Protective Ass'n v. Smith Frozen Foods, Inc., 962 F. Supp. 1312 (D. Or. 1997).

of pollutants from an old brine pond through groundwater to surface water, without an NPDES permit, would constitute an ongoing violation of the CWA.

The Ninth Circuit denied interlocutory appeal and the district court ruled that Congress did not intend NPDES to apply to groundwater. The latest proposed definition of "waters of the United States," also expressly excludes groundwater from the definition.[52]

[b] — Restrictive Line of Cases.

[i] — *Hamker v. Diamond Shamrock Chemical Co.*[53]

In this case, the court dismissed a landowner's complaint because, although lingering effects remained from crude petroleum that had leaked from the company's pipeline into a creak on the landowner's property, the discharge had ceased by the time of the lawsuit. The court held that continuing residual effects resulting from a prior discharge are not equivalent to a continuing discharge.

[ii] — *Pawtuxet Cover Marina, Inc. v. Ciba-Geigy Corp.*[54]

This case involved the dumping of wastewater into offshore waters. The First Circuit dismissed the plaintiff's lawsuit because the alleged polluter had ceased operations by the time of the lawsuit. The plaintiff landowners alleged that Ciba-Geigy's discharges of process wastewater caused economic property loss by preventing the dredging of the silted Pawtuxet River. The court, however, found that when reviewing CWA citizen suit complaints, a court must consider the isolated or recurrent nature of the infraction and the sincerity of the defendant's assurances against future violations. Given that Ciba-Geigy no longer operated under its NPDES permit due to a disposal agreement with a local municipal treatment facility, the court found no

52 *See* 80 Fed. Reg. 37054 (June 29, 2015).

53 Hamker v. Diamond Shamrock Chem. Co., 756 F.2d, 392 (5th Cir. 1985).

54 Pawtuxet Cover Marina, Inc. v. Ciba-Geigy Corp., 807 F.2d 1089 (1st Cir. 1986).

reasonable likelihood that the alleged infractions would continue, and the action was dismissed.

[iii] — *Connecticut Coastal Fishermen's Ass'n v. Remington Arms Co.*[55]

In *Remington*, the Second Circuit supported the First Circuit's view, holding that the CWA's present violation requirement would be undermined if a violation included the decomposition of pollutants. The case arose when deposits of clay targets and lead shot from a local skeet shooting club accumulated in the Long Island Sound over a 70-year period. Remington Arms successfully demonstrated that it did not operate the gun club at the time of the lawsuit and that it made a "final irrevocable decision never to reopen the [g]un [c]lub . . . at any time in the future." Although the court conceded that Remington Arms discharged pollutants without a permit, the court found Remington Arms' argument persuasive and dismissed the suit.

[5] — Naturally Occurring Water as a Pollutant.[56]

The question of whether unaltered water is a pollutant under the CWA is not a new question for the courts. In *Northern Plains Resource Council v. Fidelity Exploration and Development Company,*[57] the Ninth Circuit addressed whether naturally occurring water could be a pollutant subject to CWA enforcement.

In 1997, Fidelity Exploration and Development Company (Fidelity) began exploring and developing natural gas from coal seams located underground in Montana's Powder River Basin. The reserves, several hundred feet below the surface, contained reservoirs of methane gas. Fidelity drilled a conventional well into the coal seam and pumped the ground water to the surface. During

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55 Connecticut Coastal Fishermen's Ass'n v. Remington Arms Co., 989 F.2d 1305 (2nd Cir. 1993).

56 *See* Owen, Casenote, "When Naturally Occurring Water Is a Pollutant; Northern Plains Resource Council v. Fidelity Exploration and Dev. Co.," 8 *Great Plains Natural Resources J.* 65 (2003).

57 Northern Plains Resource Council v. Fidelity Exploration and Dev. Co., F.3d 1155, 1158 (9th Cir. 2003).

the extraction process of mining coal bed methane (CBM), ground water was pumped to the surface into holding ponds and into the Tongue River. But for the extraction process, the deep underground aquifer water would not have reached the Tongue River.

Although Fidelity did not add any chemicals to the CBM water, the court found that the discharged groundwater contained "calcium, magnesium, sodium, potassium, bicarbonate, sulfate, chloride, and fluoride . . . [and also] measurable quantities of the following metals: aluminum, arsenic, barium, beryllium, boron, copper, lead, iron, manganese, strontium, and radium." The salty CBM water is a "characteristic measured by total dissolved solids or specific conductance."

In August 1998, Fidelity contacted the state regulator about releasing CBM water into the Tongue River. The state regulator stated that the discharge was exempt under Montana Code, but also informed Fidelity that the "EPA, which provides state program oversight under the federal CWA, does not agree with the Montana Water Quality Act permit exclusion." Specifically, Montana's statutory code states:

> discharge to surface water of groundwater that is not altered from its ambient quality does not constitute a discharge requiring a permit under this part if: (i) the discharge does not contain industrial waste, sewage, or other wastes; (ii) the water discharged does not cause the receiving waters to exceed applicable standards for any parameters; and (iii) to the extent that the receiving waters in their ambient state exceed standards for any parameters, the discharge does not increase the concentration of the parameters.

The EPA believed Montana's statute created unauthorized exceptions to the CWA. In January of 1999, Fidelity, who at the time was releasing CBM water into the waterways, applied for a NPDES permit. On April 18, 2000, Northern Plains Resource Council filed a Notice of Intent letter to bring suit against Fidelity, the state of Montana, and the EPA. On June 23, 2000, Northern Plains filed a citizen's suit under the CWA in federal district court "alleging unpermitted discharges into Squirrel Creek." On June 26, 2000, Northern Plains filed an amended complaint to include unpermitted discharges into the Tongue River.

On August 23, 2002, Montana Federal District Court granted a summary judgment to Fidelity on the grounds that Northern Plains failed to establish a violation of the CWA. Northern Plains appealed the district court's decision, arguing that CBM water has constituents that are listed by the EPA as pollutant, and CBM water is produced industrial waste, even though there is not a presence of transformative human activity. On April 10, 2003, the 9th Circuit reversed the district court's ruling and remanded, holding that "CBM ground water was [a] 'pollutant' under the CWA, and state law could not create [an] exemption [from] the CWA requirements for challenged discharges."

The idea that naturally occurring water can be a pollutant had previously been determined in *Dubois v. U.S. Dept. of Agriculture*.[58] In that case, the United States Court of Appeals for the First Circuit held that the transfer of water for commercial purposes from one body of water to another distinct body of water requires a NPDES permit when the transfer would not happen naturally. The operative criteria was held to be when water leaves the "domain of nature and is subject to private control rather than [a] purely natural process[.]"

It is worth noting that in this latest trend of litigation against Central Appalachian landowners, there is no active mining or industrial activity occurring and the (alleged) discharges at issue are merely passive surface or percolating flows. The fact that no active pumping or interbasin transfer is occurring in the present cases is arguably grounds for distinguishing the *Northern Plains* and *Dubois* precedent should they be relied upon as authority by the plaintiffs.

[6] — Storm Water Discharge.[59]

Section 402(p) of the CWA requires permits for storm water "discharge[s] associated with industrial activity."[60] The EPA, in implementing regulations, defined "storm water discharge associated with industrial activity" as a

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58 Dubois v. U.S. Dept. of Agriculture, 102 F.3d 1273, 1300 (1st Cir.1996).

59 *See* Skoch, Casenote, "Regulation of Storm Water Discharges Under the Clean Water Act," 23 *Envtl. L*. 1087 (1993).

60 Clean Water Act § 402(p)(3)(A); 33 U.S.C. § 1342(p)(3)(A).

"discharge from any conveyance which is used for collecting and conveying storm water and which is directly related to manufacturing, processing, or raw materials storage areas at an industrial plant."[61] This definition includes "areas where industrial activity has taken place in the past and significant materials remain and are exposed to storm water."[62] The regulations specifically include active and inactive mining operations within the definition of industrial activities.[63] The EPA's inclusion of inactive mining sites within the definition of industrial activities forces owners of inactive mining sites to obtain permits for any storm water discharges. As a result, the owners of inactive mines are treated virtually the same under the regulations as currently operating industrial plant owners.

In *American Mining Congress v. EPA*,[64] the plaintiffs petitioned the Ninth Circuit for review of the regulations because it feared that its constituency — owners and operators of mines — would face large costs due to permitting. The court of appeals held that: (1) the rule was consistent with the CWA provision authorizing the EPA to require permits for any storm water discharge associated with industrial activity; (2) the rule was not inconsistent with SMCRA's AML program;[65] (3) the EPA's exemption of reclaimed mines was not arbitrary and capricious; (4) the rule did not impose retroactive liability on mine owners and operators; and (5) the EPA complied with notice and comment provisions of the Administrative Procedure Act (APA).

The scope of the holding is somewhat ambiguous because the court does a poor job of assessing the difference between pre-1977 AMLs and post-1977 inactive or abandoned mines. The court held that the storm water rule was not inconsistent with the SMCRA AML program, even though AMC pointed out much of the AML analysis described below, and also the fact that even EPA's Denver regional office said application of the rule would be

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61 40 C.F.R. § 122.26(b)(14).

62 *Id*.

63 *Id*. § 122.26(b)(14)(iii).

64 American Mining Congress v. EPA, 965 F.2d 759 (9th Cir. 1992).

65 30 U.S.C. §§ 1231-1243.

virtually impossible for historic inactive or abandoned mines because there were literally thousands of them. Although the court upheld the rulemaking, based on interviews with practitioners who handled the case, as a practical matter, such permitting of historic abandoned sites largely did not take place.

[7] — Successor Landowner Liability for Inactive Mine Discharges.[66]

While courts have historically interpreted federal laws to hold landowners and operators of active mines liable for drainage from mining activities, there is continued debate as to whether such laws apply to successor landowners of inactive or abandoned mines.[67] In *Sierra Club v. El Paso Gold Mines, Inc.*,[68] the 10th Circuit addressed liability for abandoned mine pollution of waterways, specifically in the context of successor landowner liability. Here, the Sierra Club and the Mineral Policy Center alleged that the El Paso Mine, an inactive gold mine, discharged pollutants into Colorado's Cripple Creek.

The mine, located on 100 acres of El Paso Gold Mine, Inc. (El Paso) property, was never in operation during El Paso's ownership of the property.[69] An abandoned vertical elevator shaft to a six-mile-long mine drainage tunnel constructed in 1910 was designed to drain groundwater from mines in the Cripple Creek Mining District.[70] However, when the tunnel system was physically terminated, water was discharged into Cripple Creek, which ultimately emptied into the Arkansas River.[71] Despite the lack of direct contribution from active mining operations, the magistrate ruled that CWA

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66 *See* Zanan, Casenote, "Interpreting the Clean Water Act's Citizen Suit Provision: Successor Landowner Liability for Inactive Mine Discharges in Sierra Club v. El Paso Gold Mines, Inc.," 17 *Vill. Envtl. L.J.* 515 (2006).

67 *See* Michael D. Bryan, Note, "Toward Strict Liability for Abandoned Mine Drainage," 71 *Ky. L.J.* 193, 196-203 (1983) (detailing historical evolution of common law and statutory law in context of liability for acid mine drainage).

68 Sierra Club v. El Paso Gold Mines, Inc., 421 F.3d 1133, 1135-36 (10th Cir. 2005).

69 *Id.*

70 *Id.*

71 *Id.*

liability is based on the ownership or operation of a point source, not on the activity which results in the point source discharge.[72]

El Paso appealed the ruling to the Tenth Circuit of Appeals, citing three separate grounds.[73] First, El Paso argued the magistrate erred in granting Sierra Club's summary judgment motion because the El Paso Mine was merely a conduit for the migration of residual effluence from a past discharge.[74] Second, El Paso proposed that a party could not be liable for a discharge of pollutants absent some form of affirmative conduct that resulted in the pollution.[75] Finally, El Paso asserted that, aside from the issue of jurisdiction, the magistrate failed to view the facts in the light most favorable to the non-moving party; thus, the plaintiffs had failed to proffer the facts necessary to meet their burden in establishing a hydrological connection.[76]

The Tenth Circuit remanded on the procedural grounds, but implicitly supported the view that a continuing migration of pollutants from a single, past discharge is a violation as defined by the CWA.[77]

The *El Paso* precedent, is arguably the most analogous case to the present litigation trend against landowners in Central Appalachia. However, there are some key differences that distinguish this case. The present trend involves landowners who leased land to industrial mining concerns who conducted the activities, the owner in *El Paso* was an individual who acquired the company and property transactionally, assuming all assets and liabilities. The discharges in *El Paso* were also found to have been significantly toxic, unlike the representative water chemistry found in the present suits where the alleged effluent exceedances are usually barely over the applicable water quality standards, often measured in parts per billion or even fractions of parts per billion. Media articles of the *El Paso* case disclose that the owner was a first to face enforcement for legacy discharge issues he or his business

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72 *El Paso*, 421 F.3d at 1137.
73 *Id*. at 1138-39.
74 *Id*. at 1140.
75 *Id*. at 1142.
76 *Id*. at 1149-50.
77 *Id*. at 1149-50.

had not created. The news coverage indicates that it was the seriousness of the toxicity that resulted in this passive owner being held to account while other similarly situated landowners with less problematic alleged discharges did not face such scrutiny.[78]

§ 12.03. Infinite Regress, the Strange Case of AML Discharges.

Both the 1972 amendments to the CWA and what would eventually become 1977's SMCRA were drafted as legislation by Congress in roughly the same time frame. Understanding Congressional intent regarding these statutes is key to understanding why historically abandoned coal mine lands were never intended to be regulated by the NPDES program.

In passing the CWA amendments of 1972, Congress provided absolutely no indication that lands containing historic abandoned mine sites were to be regulated under the CWA. Under 33 U.S. C. § 1314(b) & (c), in conjunction with § 1316 of the statute, the EPA Administrator was to publish effluent limitation guidelines for categories of point sources. Under 33 U.S.C. § 1316(b), Congress ordered the EPA Administrator to list categories of sources under the CWA, and list a minimum mandatory set of source categories that were required to be included.[79] Neither coal mines, nor lands containing historically abandoned coal mines were listed by Congress in the minimum required categories. However, the Administrator was given the authority to revise the list of categories from time to time.[80] Accordingly, in 1975, the Administrator issued effluent limitation guidelines for the coal mining point source category.[81] The EPA in no way ever included anything other than *active* coal mining operations in its effluent limitations guideline. No mention was made whatsoever to include inactive, abandoned mines under the NPDES rules.

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78 *See generally*, http://www.csindy.com/coloradosprings/they-got-the-gold-mine/Content?oid=1121278.

79 33 U.S.C. § 1316(b)(1)(A).

80 *Id*.

81 Fed. Reg. 48830 (Oct. 17, 1975).

There are a number of statutory reasons why this is the case, and why the defendant contends that the plaintiff's claims against those alleged point sources that qualify as AML sites are without merit. First, the language of the CWA itself reveals that land merely containing a historic, inactive legacy mine did not meet the definitions of "source" or "new source" under the statute. Under the CWA, a "new source" was only one which commenced construction after the publication of rules for national standards of performance.[82] Conversely, a "source" was defined as "any building, structure, facility, or installation from which there is or may be a discharge of pollutants."[83] Lands containing a historically abandoned coal mine would not fit either of these definitions. Clearly, EPA implicitly thought the same since its guidelines for the coal mine point source category did not apply to inactive, abandoned mines.[84]

Second, the legislative history of the two relevant statutes at issue — the CWA and SMCRA — strongly support a conclusion that Congress did not intend for lands containing legacy mines, abandoned prior to the effective dates of the applicable legislation, to be covered by the NPDES program. Immediately following the passage of the 1972 CWA amendments, Congress took up the issue of regulating coal mining. Congress passed coal mining regulation legislation in 1973 and 1975, but both bills were vetoed by then-President Ford.[85] These bills would ultimately be re-worked to become the Surface Mining Control Reclamation Act of 1977.

It is abundantly clear from the legislative history of SMCRA that Congress did not intend for any parties other than the coal mining industry itself to bear the cost of dealing with environmental liabilities from legacy abandoned mines. In the Congressional Record for the "Surface Mining Act of 1973," Congress noted that the "purpose of this bill is to effect the internalization of mining and reclamation costs . . . now being born by society . . . of coal . . . mining . . . The cost of the environmental controls

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82 33 U.S.C. § 1316(a)(2).

83 33 U.S.C. § 1316(a)(3).

84 *See infra*.

85 *See generally*, H.R. Rep. No. 95-218, 95th Congress, 1st session at 57 (1977).

and reclamation requirements . . . under the Act are properly borne by the mine operators[.]"[86] Two years later, following the 1975 veto of the "Surface Mining Control and Reclamation Act of 1975," one U.S. Representative argued for overriding the veto, again articulating that intent of the statute was to "internalize mining and reclamation costs . . . being borne by society[.]"[87] Had Congress intended for landowners of abandoned mines to be held accountable for legacy environmental liability, they would have articulated a *transfer* rather than an *internalization* of such costs. Use of the term *internalization* of legacy costs of mining cases can only be taken to mean that those engaged in mining were to bear such costs. Again, these earlier statutes later were re-worked to become the SMCRA of 1977.

Congress created an innovative way to deal with such legacy mining costs under SMCRA. Instead of saddling property owners of lands with such legacy mines with permitting and/or reclamation requirements, or making current mining operators do the same, mining operators were required to pay a per ton reclamation fee, which was and is deposited in the Abandoned Mine Lands Trust Fund.[88] The funds from the AML Trust Fund are used to reclaim legacy mine sites abandoned prior to the passage of SMCRA. There simply is no other legislative/statutory language that specifically addresses regulating legacy abandoned coal mines. The SMCRA program has always incorporated by reference NPDES permitting for *active* coal mines, but it has never incorporated any such permitting requirement for AML sites.[89]

It is also important to keep in mind that Congress passed amendments to the CWA in 1977 as well, the same year as the passage of SMCRA. Yet, the 1977 CWA amendments added no language to make abandoned mine lands covered by NPDES. If legacy abandoned mine lands were intended by Congress to have been covered by the 1972 CWA amendments (under the rules of which EPA expressly limited to *active* mines), then why wasn't the EPA's omission rectified in either the 1977 CWA or SMCRA? The clear

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86 119 Cong. Rec. 33181 (Oct. 8, 1973).

87 121 Cong. Rec. 15238 (May 20, 1975).

88 30 U.S.C. § 1232.

89 *See generally*, 30 C.F.R. Part 434.

conclusion is that Congress had no such intent and EPA, OSM, the states, and the regulated community, knew this to be the case.

Although SMCRA contains a clause that it does not supersede the CWA,[90] that fact does not create CWA jurisdiction over AML sites. The lack of any reference to mere property ownership of legacy abandoned coal mining sites as a regulated activity under the CWA, must be read in light of the specific and express regulation of such properties under SMCRA. As the statutory passages in the CWA identifying categories of sources to be regulated were passed in 1972, SMCRA's more recent and specific addressing of such lands should control as a matter of statutory construction.[91] As explored in the following sections, this reading of the statute is entirely consistent with how the EPA in fact implemented its regulations related to coal mining point sources.

[1] — From the Outset of the CWA Regulatory Program, the United States Environmental Protection Agency (USEPA) Made Clear that Only Active Coal Mine Sites Were Subject to Permit Requirements Under Its Regulations.

The Plaintiffs in at least one current case argue that the landowner should be held liable for any discharges from alleged point sources on property containing legacy coal mines where mining activity concluded prior to August 3, 1977, the effective date of SMCRA.[92] However, a review of the history of USEPA's Effluent Guidelines and Standards for the Coal Mining Point Source Category (the "Coal Mining ELGs"), which establish specific requirements for discharge permits issued to coal mines under Section 402 of the CWA,[93] demonstrates that discharges that were never permitted as

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90 30 U.S.C. § 1292(a)(3).

91 *See generally,* 82 C.J.S Statutes §§ 363-364.

92 30 U.S.C. §§ 1234 *et seq*.

93 Section 402 of the CWA, 33 U.S.C. § 1342 authorizes USEPA or any delegated State to "issue a permit for the discharge of any pollutant, or combination of pollutants" under certain circumstances. 33 U.S.C. § 1342(a)(1). Permits issued pursuant to Section 402 are called National Pollutant Discharge Elimination System (NPDES) permits.

active coal mining operations under SMCRA after August 2, 1977 were never covered under the NPDES program.

From the inception of the Coal Mining ELGs (Effluent Limitations Guidelines), the EPA recognized that abandoned mine lands that were inactive as of the initial rulemaking were not intended to be subject to effluent limitations under the CWA. After Congress enacted SMCRA in 1977, subsequent USEPA rulemaking continued to make clear that lands with coal mines abandoned prior to SMCRA's rulemaking continued to make clear that lands with coal mines abandoned prior to SMCRA's effective date were not required to obtain NPDES permits. Thus, under the NPDES program itself, Plaintiffs' claims against a landowner — at least with regard to those properties never mined post-SMCRA — have no historic basis in the development of the NPDES regulations.

Sections 301(b) and 306 of the CWA establish three levels of compliance to be achieved by two different categories of point sources. Existing sources — which, if applicable, by definition would have included existing Abandoned Mine Land (AML) sites — were required to meet effluent limitations based on best practicable control technology ("BPT") by July 1, 1977 and limits based on best available technology economically achievable ("BAT") by July 1, 1983. By contrast, new sources (eventually defined by rulemaking effective dates between '81 and '84) were to meet discharge limits based on best available demonstrated control technology ("BADT"). By definition, existing AML sites could *not* have been "new sources," at the time of the passage of the CWA and, therefore, are not subject to regulation under the CWA.

[2] — Pre-1977 AML Sites Have Never Been Subject to NPDES Unless They Were Subsequently Re-mined Under SMCRA.

From the first iteration of the Coal Mining ELGs in 1975, it was clear that the "existing sources" subject to these regulations did not include abandoned coal mines that were no longer active as of the implementation of the CWA — *i.e.*, what would come to be known after 1977's SMCRA passage as AML sites. Indeed, "coal mine" was initially defined as "an **active** mining area of

land . . ."[94] Any "mine drainage" governed by the Coal Mining ELGs, in turn, had to come from a "coal mine" — by definition, only an **active** one.[95] EPA's supporting document for the 1975 rulemaking also defined "coal mine" as "an **active** mining area of land . . ."[96]

The Coal Mining ELGs were amended by USEPA in 1977.[97] USEPA retained its prior limitation on the definition of "coal mine," restricting it to "**active** mining area[s]" only.[98] Notably, the 1977 regulations also adopted a definition for "active mining area," which was defined as "a place where work or other activity related to the extraction, removal, or **recovery of coal is being conducted** [except where reclamation is being conducted]."[99] USEPA's persistent use of the present tense when discussing coal recovery in these preambles clearly establishes that existing sources under the Coal Mining ELGs did not include AML sites. These definitions of "coal mine and "active mine area" were retained when USEPA promulgated further amendments to the Coal Mining ELGs in 1979 in response to recent amendments to the CWA and to a litigation settlement with environmentalists.[100]

Early in 1981, USEPA published proposed rulemaking to amend certain provisions of the Coal Mining ELGs yet again.[101] The Preamble to these proposed regulations include many references to the interplay between the SMCRA program and the CWA's NPDES program. Although USEPA does not categorically state that the Coal Mining ELGs do not apply to AML sites, several passages strongly support such a reading and further imply that USEPA agreed that SMCRA's AML program was the appropriate regulatory vehicle to address legacy water issues associated with AML

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94 40 Fed. Reg. 48830, 48837 (October 17, 1975) (emphasis added).

95 *Id*. (discussing previous 40 C.F.R. § 434.31(c)).

96 *See* USEPA, *Development Document for Interim Final Effluent Limitations, Guidelines and New Source Performance Standards for the Coal Mining Point Source Category* (October 1975) (emphasis added).

97 *See* 42 Fed. Reg. 21380 (Apr. 26, 1977).

98 *Id*. at 21384 (emphasis added).

99 *Id*.

100 42 Fed. Reg. 2589 (Jan. 12, 1979).

101 46 Fed. Reg. 3136 (Jan. 13, 1981).

properties. USEPA acknowledged that "successful control of post-mining water pollution is largely dependent on the pre-mining planning and active mining practices employed" and that Title IC of SMCRA "**addresses the problem of presently abandoned mines by authorizing and funding abandoned mine reclamation projects**."[102]

Moreover, USEPA also recognized that SMCRA "requires [US]EPA to cooperate 'to the greatest extent practicable' with the Secretary of the Interior."[103] SMCRA's legislative history states Congress' view that "it is imperative that maximum coordination be required and that **any risk of duplication or conflict be minimized**."[104] Finally, although discussed in the context of post-bond release, as opposed to AML, mine drainage, USEPA further noted that while SMCRA's "requirements do not, and cannot, guarantee that pollution will never occur after bond release . . . [these] requirements represent state-of-art management practices, and **should reverse the legacy of abandoned mine acid drainage.**"[105]

USEPA finalized amendments to the Coal Mining ELGs in the fall of 1982.[106] These 1982 amendments also established effluent limitations for discharges from post-mining areas, but only for those coal mines subject to SMCRA permitting and bond release procedures.[107] As adopted in the 1982 amendments, "[t]he term 'post-mining area' means: (1) [a] reclamation area or (2) [t]he underground workings of an underground coal mine after the extraction, removal, or recovery of coal from its natural deposit has ceased and prior to bond release."[108] The term "abandoned mine" was not defined in the 1982 regulations.

Concurrently with the publication of the 1982 amendments to the Coal Mining ELGs, the USEPA published its *Final Development Document for*

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102 *Id*. at 3144-45 (emphasis added).
103 30 U.S.C. 1292(c).
104 H.R. Rep. No. 45, 94th Cong., 1st Sess.134 (1975) (emphasis added).
105 46 Fed. Reg. 3146 (Jan. 13, 1981).
106 47 Fed. Reg. 45382 (Oct. 13, 1982).
107 *Id*. at 45396.
108 *Id*. at 45394; 40 C.F.R. § 434.11(k).

Effluent Limitations, Guidelines and Standards for the Coal Mining Point Source Category[109] (hereinafter "1982 EPA Development Document"). Again, numerous passages in the 1982 EPA Development Document indicate that USEPA view AML properties as a known environmental concern, but one to be regulated by the SMCRA AML program and **not** under the CWA NPDES program. For instance, when discussing the federal Office of Surface Mining's (OSM) separate rulemaking to regulate surface mining under SMCRA, USEPA commented that the two agencies "have and will continue to work closely in establishing a comprehensive, efficient program for regulation of surface coal mining operations."[110] Later, USEPA confirmed that "[t]he post-mining discharges from either a reclamation area at a surface mine **or from an abandoned underground mine** can contain significant amounts of pollutants. **These problems are addressed by SMCRA**.[111]

Although nothing in the regulatory history of the Coal Mining ELGs or the two Development Documents directly or categorically excludes AML sites from the NPDES program, the very absence of USEPA's consideration of AML sites suggests strongly that the agency always has understood that they were "grandfathered" out of the NPDES program. The language discussed above deferring to SMCRA's AML program to address water quality concerns from these sties supports this interpretation.[112] Moreover, as a historical matter, Virginia has not permitted AML projects through the NPDES program. IT is only when a re-mining permit is issued on an AML site that NPDES permitting occurs, and even when it has been recognized that alternate effluent limitations were appropriate due to the degraded water quality already present at the legacy sites.[113] In spring of 1984, USEPA

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109 Environmental Protection Agency, *Final Development Document for Effluent Limitations, Guidelines and Standards for the Coal Mining Point Source Category* (Oct. 1982), *available at* http://water.epa.gov/scitech/wastetech/guide/coal/upload/Coal-Mining_DD_1982.pdf .

110 *Id*. at 21.

111 *Id*. at 149 (emphasis added).

112 Under SMCRA, AML sites are not subject to any permitting requirement, unless re-mined.

113 33 U.S.C. § 1311(p); 40 C.F.R § 434.70.

again published proposed amendments to the Coal Mining ELGS.[114] When finalized in 1985, these rules became the current 40 C.F.R. Part 434. Of particular relevance to the question of whether AML lands were subject to NPDES was the redefining of "new source coal mine" to include the re-mining of an abandoned mine. "The proposed revision makes clear that re-mining of an abandoned mine . . . triggers the requirements applicable to new sources."[115] The new rules also modified the trigger date for a new source coal mine to May 4, 1984. Additionally, USEPA adopted the following definition of "abandoned mine":

> The term "abandoned mine" means a mine where mining operations have occurred in the past and:
>
> (r)(1) The applicable reclamation bond or financial assurance has been released or forfeited; or
>
> (r)(2) If no reclamation bond or other financial assurance has been posted, no mining operations have occurred for five years or more.[116]

At first blush, the new definition may appear problematic, as all AML sites are locations where "no reclamation bond or other financial assurance has been posted, [and] no mining operations have occurred for five years or more."[117] However, through Part 434, the term is used **only** in contexts that clearly involve post-SMCRA mines. There is no mention whatsoever of pre-1977 "abandoned" mines being subject to the Coal Mining ELGs outside the context of re-mining that was conducted on or after May 4, 1984. The term "abandoned" only appears in the definition of "new source coal mine,"[118] and there, only in re-mining context. The term "abandonment" only appears in subsection (d) in reference to underground mine site reclamation within the definition of "bond release."[119] Accordingly, read *in pari materia,* it is clear

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114 49 Fed. Reg. 19240 (May 4, 1984).
115 *Id*. at 19241.
116 40 C.F.R. 434.11
117 *Id*.
118 40 C.F.R. § 434.11(j)(1).
119 40 C.F.R. § 434.11(d).

that the requirement that "no mining operations have occurred for five years or more" does not provide a basis to retroactively regulate pre-1977 AML sites that have not been re-mined. Indeed, by 1982, there were post-1977 mines that had not been mined for five years or more. This limited application of the term is not surprising, given that the definition of "coal mine" for existing sources in 1975 **only** included "**active** mining area of land."[120]

Given that existing sources at the inception of the NPDES program excluded AML sites by definition, subsequent revisions to the definition of "new source coal mine" should not be construed to alter the scope of the Coal Mining ELGs absent the most clear and unambiguous expression of intention by USEPA to include such sources. No such clear and unambiguous statement by USEPA exists in the 1984 rulemaking. AML discharges were never intended to be regulated under the Coal Mining ELGs.

[3] — The Fourth Circuit Has Made Clear that All Regulation of Post-mining Discharges Must Be Consistent with the Secretary of the Interior's Administration of SMCRA.

USEPA, citing the United States Court of Appeals for the Fourth Circuit in the Preamble to its 1981 proposed amendments to the Coal Mining ELGs, affirmed that its "regulation of post-mining discharges 'must be consistent with the Secretary's enforcement and administration of SMCRA.'[121]"[122] In *Consolidation Coal Co. v. Costle*,[123] the Fourth Circuit plainly stated that:

> The passage of [SMCRA] also must be taken into account in determining whether [USEPA] acted arbitrarily by deferring regulation of post-mining discharges. That statute does not supersede or modify the [CWA]; therefore, [USEPA] remains responsible for

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120 *See* 42 Fed. Reg. 21384 (Apr. 26, 1977).

121 46 Fed. Reg. at 3145 (citing Consolidation Coal Co. v Costle, 604 F.2d 239, 252 (4th Cir. 1979)).

122 *Costle*, 604 F.2d 239, 252 (reversed on other grounds, E.P.A. v. Nat'l Crushed Stone Ass'n, 449 U.S. 64 (1980)).

123 *Id*.

> promulgating regulations concerning effluent limitations for point source discharges from post-mining areas in accordance with §§ 301 and 304 of the [CWA]. But **[SMCRA] requires [USEPA] to cooperate '[t]o the greatest extent practicable' with the Secretary of the Interior. Conversely, the Secretary is also required to cooperate with [USEPA].** The purpose of this cooperation is 'to minimize duplication of inspections, enforcement and administration.' We therefore conclude that [USEPA] responsibly decided to gather further data **before issuing the regulations that must be consistent with the Secretary's enforcement and administration of [SMCRA]**.[124]

Thus, the lack of any clear and unambiguous indication by USEPA that it intended the Coal Mining ELGs to apply to pre-1977 AML properties, and the absence of any coordinated regulatory effort between USEPA and the Secretary of the Interior to that effect, strongly supports a conclusion that — outside of the re-mining context — it is SMCRA's AML program only that governs pre-1977 AML properties.

§ 12.04. The Risk to Individual or Non-Mining Related Landowners.

At this point, you may be thinking, "Well, I'm not a mining company or a large land company with previously mined property, so what?"

The "so what" is this, even those who own non-mining related land should be concerned with the broad reach of the citizen suit provision of the CWA. There is nothing at issue in the CWA statutory or regulatory provisions at issue, nor is there anything unique to the general nature of the discharges involved in the current litigation that would prohibit the application of this theory of CWA liability to either individual landowners or to non-mining property owners. In other words, any piece of property that has some kind of discharge, running through some kind of erosion channel or other discrete

124 *Costle*, 604 F.2d at 252 (emphasis added).

conveyance, contributing some kind of water chemistry that is different from the receiving drainage is arguably at risk for this kind of litigation attack.

§ 12.05. Defense and Risk Management Options.

[1] — Potential Legal Landowner Defenses.

Several defenses have or can be raised in these types of cases. In several instances, there have been indicia of trespass on the part of the plaintiffs in obtaining of water sampling data. Counter-claiming for trespass can and should be pursued when the facts so warrant. Defenses based on the alleged discharge not meeting the criteria of a point source should be raised if the facts support doing so. Modified "permit shield" defenses can be raised, and/or the impleading or cross-claiming against regulatory authorities for not meeting statutory duties (e.g. improper release of permit/bond), to the detriment of the landowner. And finally, as previously mentioned, in cases of alleged discharges from AML period mines, pre-empting litigation by the listing of the sites on the applicable state's AML project list.

[2] — Equitable Defense of Laches?

Total authority reflecting that laches is generally not favored in the environmental context is too abundant to cite.[125] However, the defense of laches has been upheld in a minority of environmental cases where the delay has been significant. The delays in those cases where a laches defense has been upheld involve delays much less lengthy than the time frames involved in any cases involving abandoned mine lands. Even in non-AML cases, there are at least colorable grounds for claiming laches as a defense in permit and bond release cases. This is because the plaintiffs, with full knowledge of the permittee's identity, often monitor the permit and bond release databases on the regulatory websites and "lie in wait" for months or even years for permit and bond release to occur. This practice allows the plaintiffs to come directly after the landowners, despite the plaintiffs clearly knowing the identity of

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125 *Cf.* Oregon Natural Resources Council Action v. U.S. Forest Service, 445 F. Supp. 2d 1211 (D. Or. 2006) (holding that the doctrine of laches should be invoked sparingly and rarely in public interest environmental litigation).

the NPDES permittee well in advance. Such tactics are questionable to say the least.

The generally recognized requirements for claiming a laches defense are (1) unreasonable delay in bringing suit and (2) the party asserting the defense has been prejudiced by the delay.[126] A common factor in showing unreasonableness of delay is establishing that the plaintiff knew or should have known of the activity being sought to be enforced against.[127]

The most unfavorable precedent is *United States v. Smithfield Foods, Inc*.[128] However, *Smithfield* involved delay that was only around two years from the agency's discovery of the defendant's issues. The court in *Smithfield* rejected laches in part because it was a civil penalty case and thus the relief sought was primarily legal as opposed to equitable. At least two cases have held that laches did not bar citizen suits brought under the Clean Water Act, but the delays involved were not of a scale as found in the cases involving AML, and also did not involve activities pre-dating the statutory schemes themselves.[129]

While definitely a minority result, in certain instances where plaintiffs long delayed in bringing suit, courts have upheld the defense of laches on numerous occasions.[130]

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126 Ky. Heartwood, Inc. v. Worthington, 20 F. Supp. 2d 1076 (E.D. Ky. 1998).

127 Allens Creek/Corbetts Glen Preservation Group, Inc. v. Caldera, 88 F. Supp. 2d 77 (W.D.N.Y 2000); Jersey Heights Neighborhood Ass'n v. Glendening, 2 F. Supp. 2d 772 (D. Md. 1998).

128 United States v. Smithfield Foods, Inc., 969 F. Supp. 975 (E.D. Va. 1997) (*see supra)*.

129 *See* National Wildlife Fed'n v. Consumers Power Co., 657 F. Supp. 989 (W.D. Mich. 1987); Student Public Interest Research Group of New Jersey, Inc. v. P.D. Oil & Chem. Storage, Inc., 627 F. Supp. 1074 (D. N.J. 1986).

130 *See, e.g.,* Sierra Club v. Otter Trail Corp., 608 F. Supp. 2d 1120 (D.S.D. 2009) (barring plaintiff's claim by laches when delayed more than 32 months in initiating the action; by the time the action was initiated the defendants had completed 30 percent of the road construction project and spent more than $20 million); Marshall v. City of Albany, 845 N.Y.S.2d 855 (N.Y. App. Div. 2007) (petitioners' inordinate delay in bringing proceeding asserting third, fourth, and fifth extensions of option agreements entered into by the city to purchase parcels of land for a new solid waste site violated State Environmental Quality Review Act (SEQRA) and sought equitable relief, implicated doctrine of laches); Grand Canyon Trust v. Tuscon Elec. Power Co., 269 F. Supp. 2d 1195 (D. Ariz. 2003) (conservation group lacked

[3] — Potential Landowner Risk Management Strategies.

As daunting as the potential exposure is, the there are some tangible ways in which landowners can minimize their exposure risk to this kind of litigation. Risk management strategies for potential landowners include limiting public access to former mine sites and rigorously monitoring reclamation of mining by their lessees. Additionally, potential landowners can require more robust reclamation bonding and insurance requirements, and negotiate more protective indemnification clauses in coal leases to cover environmental liabilities. In acquisitions, severe due diligence must be performed on all acquired properties, and also utilization of corporate structure to minimize breadth of exposure risk in certain circumstances.

§ 12.06. Conclusion.

The application of the CWA in the most recent trend against landowners in Central Appalachia represents a significant expansion of CWA liability exposure. It could be utilized to broadly affect other private and public facilities, even those outside of mining or other extractive industries, such as mall parking lots and highway construction fills. While the scope of risk is broader than ever before, one positive aspect of this development is that the broad-based impact could have the effect of creating a political coalition for reigning in CWA application. Such a coalition would arguably have broader and deeper political clout than the coal mining industry alone has had in the past.

Federal legislative amendment to the CWA is likely the only avenue to curtail this trend.

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diligence, as required to support electric utility's laches defense against suit under Clean Air Act; group initiated action more than a decade after power plant was constructed despite group's knowledge); Allen Creek/Corbetts Glen Pres. Group v Caldera, 88 F. Supp. 2d 77 (W.D. N.Y. 2000) (local residents' suit challenging construction project as violative of Clean Water Act was barred by laches; although plaintiffs knew of construction schedule, they did not commence action until over eight months after a federal permit was issued and over six weeks after existing wetlands were filled and construction of new wetland system was nearly complete); Peshlakai v. Duncan, 476 F. Supp. 1247 (D. D.C. 1979) (under National Environmental Policy Act, plaintiffs were barred by laches where individual plaintiffs' seven-year delay was unreasonable).

Landowners should begin to make political leaders aware of the devastating economic effect this application could have for various types of property owners nationwide and work for common sense statutory reform of the CWA, to make express in the statute what is clearly implied by the legislative history — *i.e.*, that Congress never intended passive landowners to be held accountable for legacy discharge liability under the CWA.

Chapter 13

Rejection of Leases and Executory Contracts in Bankruptcy: What Does It Mean?

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§ 13.01. Overview.

Section 365 of the Bankruptcy Code governs the assumption and rejection of executory contracts and unexpired leases. The Code specifies that the rejection of an executory contract or lease constitutes a breach of the agreement. It further specifies that the rejected contract or lease shall be treated as if the debtor had breached the agreement immediately before the date of filing of the petition. The Code does not, however, fully delineate the consequences of rejection, particularly with regard to the rights and remedies available for non-debtor parties to the agreements. Where the Code is silent, courts have attempted to clarify what rejection means for the contract or lease at issue and what rights the other party to the agreement has upon rejection.

§ 13.02. Plain Language of the Statute.

It is commonly known that a trustee or debtor-in-possession can assume or reject an executory contract or unexpired lease. Section 365(a) provides:

> (a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, <u>the trustee</u>, subject to the court's approval, <u>may assume or reject any executory contract or unexpired lease of the debtor</u>.[1]

An executory contract is an agreement where "'the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.'"[2] An unexpired lease is just that, a lease that has not expired.

A number of agreements may appear to be executory contracts, but are not upon closer review. The first requirement is that there is a bona fide contract or lease, and often what appears to be a contract may not be when reviewed under applicable state law. For instance, property rights are not executory contracts, and often are held not to be contracts at all.[3]

Second, contracts must also be executory. Simply because there remains some obligation to be performed, is not dispositive.[4] Rather, the unperformed

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1 11 U.S.C. § 365(a) (emphasis added).

2 *In re* Magness, 972 F.2d 689, 694 (6th Cir. 1992) (quoting "Executory Contracts in Bankruptcy," Part I, 57 *Minn. L. Rev*. 439, 460 (1973)); *see also In re* Terrell, 892 F.2d 469, 471 n.2 (6th Cir. 1989) (citing same); *In re* Jolly, 574 F.2d 349, 350-51 (6th Cir. 1978) (same).

3 *In re* KY USA Energy, Inc., 439 B.R. 413, 415 (Bankr. W.D. Ky. 2010) (finding Farmout Agreement was "conveyance of an interest in realty" and "not subject to the provisions of 11 U.S.C. § 365, as it is not an executory contract or unexpired lease."); *In re* KY USA Energy, Inc., 444 B.R. 734, 737 (Bankr. W.D. Ky. 2011) (reaching same conclusion in later proceeding in same case); *see also In re* Beeter, 173 B.R. 108, 114–16 (Bankr. W.D. Tex. 1994) (homeowners association obligations and dues in deed are covenants running with land and not subject to rejection); *In re* Raymond, 129 B.R. 354, 358-59 (Bankr. S.D.N.Y 1991) (same); Gouveia v. Tazbir, 37 F.3d 295, 297, 299 (7th Cir. 1994) (restrictive covenant was "an interest in real property. As such § 365 of the bankruptcy code is inapplicable."); *In re* Hayes, 2008 WL 8444812, at *10–11 (B.A.P. 9th Cir. Mar. 31, 2008) (relying upon *Gouveia* to support holding that restrictive covenants were not subject to rejection under § 365).

4 *Gouveia*, 37 F.3d at 298–99 ("[A]lmost all agreements to some degree involve unperformed obligation [sic] on either side, such an expansive definition of the term 'executory' is not what Congress enacted through its choice of language in § 365." (citations omitted)); *In re* Columbia Gas Sys., Inc., 50 F.3d 233, 244 n.20 (3d Cir. 1995) ("[N]ot every contract that appears executory because it has not been completely performed is executory for purposes of § 365.").

obligation must be sufficient to constitute a material breach of the agreement if ultimately not performed. Administrative or ministerial obligations are not sufficient.[5]

§ 13.03. What Does a Rejection Mean?

Once a debtor moves to reject a contract or lease, questions arise as to what rejection means to the contract or lease at issue and what rights the non-debtor party has upon rejection.[6]

[1] — What the Code Provides.

Section 365(g) simply states:

> (g) Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease —
>
> (1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition; . . . .[7]

Thus, upon rejection, the executory contract is treated as being breached by the debtor, and the non-debtor can file a claim for money damages resulting from the breach. However, the claim is treated as pre-petition claim, even

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5 See, e.g., *In re* Sudbury, Inc., 153 B.R. 776, 779 (Bankr. N.D. Ohio 1993) ("Whether the Debtor's duties under the Cooperation Clauses are characterized as conditions or ministerial obligations, they are of a different character than bargained for consideration. Obviously an insurance company does not bargain for the Debtor's cooperation in handling claims. It bargains for premiums. The Cooperation Clauses merely reflect the fact that the insurer's ability to defend claims may require the insured to furnish information relating to the claim and not to prejudice the insurer's defense." (emphasis added)); Kent's Run P'ship, Ltd. v. Glosser, 323 B.R. 408, 421 (W.D. Pa. 2005) (concluding that preparing property description, creating and filing documents were ministerial tasks that did not amount to material breaches); *see also In re* Streets & Beard Farm P'ship, 882 F.2d 233, 235 (7th Cir. 1989) (holding unperformed delivery of legal title to be a formality rather than "the kind of significant legal obligation that would render the contract executory.").

6 From the debtor side, the effect of rejection can also be a question and consideration — for example, whether a debtor retains lease-provided rights to complete reclamation after rejection. The applicable law should be the same from the debtor side, but for purposes of this chapter, we are only addressing these issues from the perspective of a non-debtor party.

7 11 U.S.C. § 365(g) (emphasis added).

though the breach (rejection) occurred after the debtor filed bankruptcy. This means that the non-debtor claimant now stands with the other pre-petition creditors, paid in the order of priority, and sometimes receiving only pennies on the dollar, if anything at all. Only those executory contracts and leases that are assumed post-petition are treated as administrative claims requiring payment in full or adequate assurance that the payments will be made.[8]

Nevertheless, this does not answer the question of what happens with respect to the rights under the rejected agreement. Some rights are provided by statute. The Code specifies the rights of a non-debtor lessee when the debtor is the landlord and rejects a lease — the non-debtor retains all rights granted to it under the lease or it has the option to consider the lease terminated if the breach resulting from the termination is substantial enough. While the non-debtor/lessee cannot collect from the debtor for obligations under the lease, it may set off those amounts from any rent or payments owed to the debtor under the lease. Section 365(h)(1) provides, in pertinent part:

> (h)(1)(A) If the trustee rejects an unexpired lease of real property under which the debtor is the lessor and —
>
> if the rejection by the trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by virtue of its terms, applicable nonbankruptcy law, or any agreement made by the lessee, then the lessee under such lease may treat such lease as terminated by the rejection; or
>
> if the term of such lease has commenced, the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.

8 See 11 U.S.C. § 365(b); 11 U.S.C. § 503.

(B) If the lessee retains its rights under subparagraph (A)(ii), the lessee may offset against the rent reserved under such lease for the balance of the term after the date of the rejection of such lease and for the term of any renewal or extension of such lease, the value of any damage caused by the nonperformance after the date of such rejection, of any obligation of the debtor under such lease, but the lessee shall not have any other right against the estate or the debtor on account of any damage occurring after such date caused by such nonperformance.[9]

Sublessees, however, should be aware that if a debtor is the lessee (and then, in turn, the sublessor) and rejects the sublease and the master lease, then the sublessee's rights under the sublease are not guaranteed. This is because the sublessee's rights are dependent on those held by the debtor as lessee, and if the debtor/lessee rejects the main lease, the sublessee risks losing its interest in the leased property. As a sublessee, it is preferable to obtain an agreement with the original lessor protecting your rights under the lease in such an event.

[2] — Where the Code Is Silent, Courts Have Clarified.

The Code simply states that the rejection constitutes a breach for which a non-debtor party may assert a damages claim, and it provides for certain relief of the debtor as the landlord. It does not say anything with respect to the status of the contract or the lease following rejection when it comes to other executory contracts, including leases where the debtor is the lessee.

Many courts have held that a rejection of a contract or lease resulting in a breach, consistent with non-bankruptcy law, does not automatically terminate the contract or lease.[10] Nor does the rejection "invalidate, rejudicate, repeal,

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9 11 U.S.C. § 365(h)(1).

10 *In re* Giordano, 446 B.R. 744, 748–49 (Bankr. E.D. Va. 2010) (rejection "does not make the contract disappear"); *In re* Miller, 282 F.3d 874, 878 (6th Cir. 2002) ("The rejection of the lease . . . is not a termination, thus, the debtor's lease continued until termination by either party." (internal citations omitted)); *In re* Flagstaff Realty Assocs., 60 F.3d 1031, 1034 (3d Cir. 1995) (holding that rejection does not alter substantive rights of the parties to lease); *In re* Austin Dev. Co., 19 F.3d 1077, 1083 (5th Cir. 1994) (debtor lessee's failure to

or avoid an executory contract."[11] Rather, rejection merely excuses the debtor from performance, and the counterparty cannot assert an administrative claim arising from the non-performance.[12] However, rejection does not permit the debtor to breach the contract in a way that entirely cuts off the rights of

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assume nonresidential real property lease does not effect a termination of the lease or the forefeiture of the third parties' rights in such lease); Leasing Serv. Corp. v. First Tenn. Bank Nat'l Ass'n, 826 F.2d 434, 436 (6th Cir. 1987) (discussing rejection's effect on creditor's security interest in property and concluding that debtor lessor's rejection of lease had no effect on creditor's security interest in property securing the lease); Osprey-Troy Officentre LLC v. World Alliance Fin. Corp., 822 F. Supp. 2d 700, 707–08 (E.D. Mich. 2011) (debtor lessee's rejection of lease was not a termination (citing *Leasing Serv.*, 826 F.2d 434)); *In re* Park, 275 B.R. 253, 259 (Bankr. E.D. Va. 2002) ("[T]he rejection of the lease by the trustee did not, standing alone, terminate the debtors' leasehold interest.")).

[11] *In re* Walnut Assocs., 145 B.R. 489, 494 (Bankr. E.D. Pa. 1992); *see also In re* Alongi, 272 B.R. 148, 154 (Bankr. D. Md. 2001) ("[R]ejection does not cancel, repudiate, or terminate contracts; . . . and . . . rejection does not . . . terminate state-law rights in or to specific property." (internal quotations and citations omitted)); Sunbeam Prods., Inc. v. Chicago Am. Mfg., LLC, 686 F.3d 372, 376–77 (7th Cir. 2012), *cert. denied*, 133 S. Ct. 790 (2012) (rejection does not vaporize rights of the other contracting party and notes that for a debtor lessee "rejection does not abrogate the lease"); Thompkins v. Lil' Joe Records, Inc., 476 F.3d 1294, 1308 (11th Cir. 2007) ("[T]he rejection of the Agreement . . . did not effectively rescind [the agreement] and reverse the executed transfer of the . . . copyrights . . . ."); *In re* Taylor-Wharton Int'l LLC, 2010 WL 4862723, at *3 (Bankr. D. Del. Nov. 23, 2010) ("[T]he effect of rejection is to relieve a debtor from future performance under the contract; rejection does not undo past performance under the contract. Consequently, to the extent that both or either of the parties have performed under the executory contract, the debtor's rejection has no effect on such performance."); *In re* Bachinski, 393 B.R. 522, 544 (Bankr. S.D. Ohio 2008) ("Courts consistently have held that rejection of an executory contract does not unwind transactions that already have been consummated — or void property rights that already have been obtained — under the contract prior to rejection."); Sir Speedy, Inc. v. Morse, 256 B.R. 657, 659 (D. Mass. 2000) ("Rejection does not cause a contract magically to vanish."); *In re* Bergt, 241 B.R. 17, 35 (Bankr. D. Alaska 1999) ("Rejection does not 'nullify,' 'rescind,' or 'vaporize' the contract or terminate the rights of the parties; it does not serve as an avoiding power separate and apart from the express avoiding powers already provided in the Bankruptcy Code."); *In re* Hughes, 166 B.R. 103, 105 (Bankr. S.D. Ohio 1994) ("Consistent with the bankruptcy law's general deference to state-law rights in or to specific property, rejection of a contract does not terminate such rights that arise from rejected contracts. Rejection is not itself an avoiding power." (internal citations omitted)).

[12] *In re* Weinstock, No. 96-31147, 1999 WL 1041406, at *6 (E.D. Pa. Nov. 12, 1999) (citing *In re Walnut Assocs.*, 145 B.R. at 494; *In re* Sokoloff, 200 B.R. 300, 301 (Bankr. E.D. Pa. 1996)).

the counterparty.[13] Some courts have even held that certain enforcement rights still exist, and some have allowed the enforcement of post-termination enforcement rights.[14]

§ 13.04. Case Study: A Real Life Rejection Scenario.[15]

The above sections address and provide the law on the consequences of rejection. This assumes that the debtor is able to reject the agreement or lease in issue. However, that situation is not always a given, and there are several bases to fight rejection of a contract or lease if maintaining those rights in their complete form (*i.e.*, the debtor is not permitted to escape its obligations) is desired. The United States Bankruptcy Court for the Eastern District of Kentucky recently rendered a decision finding that the debtor was not permitted to reject two agreements. The non-debtor party made a number of arguments contesting rejection, including that the agreements were property rights not subject to § 365; that if they were, they were not executory; and that the agreements were part of and consideration for a larger transaction and could not be rejected separately from the other contracts and leases involved in that transaction. This scenario is interesting in its illustration of what the court found compelling and as to what the decision to preclude rejection was eventually based on.

[1] — Background.

Two coal producers owned or held rights with regard to certain adjacent tracts of land. The parties each mined their respective properties but soon

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13 *In re* Qimonda AG, 482 B.R. 879, 898 (Bankr. E.D. Va. 2012) (rejection does not give debtor license to engage in breaches of contract or cut off counterparty's right entirely).

14 *In re Walnut Assocs.*, 145 B.R. at 494 ("[I]f state law does authorize specific performance under the rejected executory contract, it means that the non-debtor should be able to enforce the contract against the Debtor, irrespective of his rejection of it."); *Sir Speedy*, 256 B.R. at 660 (finding rejection did not result in termination and allowing enforcement of covenant not to compete to the extent enforceable under state law, whose "very purpose [was] to govern the relationship between the parties after the demise of the underlying contract"); Abboud v. Ground Round, Inc., 335 B.R. 253, 261–63 (B.A.P. 1st Cir. 2005) (citing *Sir Speedy* and finding non-debtor lessor could enforce term of lease requiring post-termination transfer of liquor license back to lessor because right did not result in a monetary "claim" but was enforceable by specific performance under state law).

15 *In re* Trinity Coal Corp., 514 B.R. 526 (Bankr. E.D. Ky. 2014).

realized that the way the property was divided was not conducive to either's use of its respective property. To remedy the situation, the parties entered into several comprehensive and interrelated property exchanges and agreements, all executed or deemed to be executed on the same day as part of the master Property Exchange Agreement (the "Exchange Agreement"). The Exchange Agreement transferred certain rights and interests in property to allow the parties to operate more efficiently, and it also included a number of ancillary agreements that were part of the same transaction.

The principal consideration for the Exchange Agreement was some sixteen documents executed by the parties (the "Ancillary Documents") whereby certain of the parties' real property interests in the area were exchanged. This included the exchange of coal reserves, as well as a Disposal Agreement and an Easement Agreement. The parties agreed that if the parties did not complete all of the Ancillary Documents, the entire Exchange Agreement was void — it was all or nothing. The Exchange Agreement stated, in pertinent part:

> 2.6 *Simultaneous Actions*. Each of the actions required under this Section 2.2 [execution of the Ancillary Documents] shall be deemed to have occurred simultaneously at the Closing and unless all such actions are taken none of the actions provided for in this Agreement shall be taken or deemed to have been taken, and any acts which may have been performed in respect thereof shall be canceled and treated as if void and of no force and effect.

The Exchange Agreement also included an incorporation clause where the parties agreed that the Exchange Agreement and all of its schedules and exhibits, including the Ancillary Exchange Agreements, were the entire agreement.

One of the parties to the Exchange Agreement became a bankruptcy Debtor. The Debtor eventually sought to reject two of the Ancillary Documents, the Easement Agreement and the Disposal Agreement.

[a] — Easement Agreement.

In the Easement Agreement, the Debtor "grant[ed] and convey[ed]" the right of an easement for a roadway across the adjoining Debtor's property.

The Easement Agreement was filed in the public land records with the applicable counties. The Debtor's only obligations under the agreement were to allow the other party to cross the land and to submit usage reports. Thus, the Debtor's sole *de facto* obligation under the Easement Agreement was to continue to allow the non-debtor to use the roadway across its property.

The Easement Agreement also referenced the Exchange Agreement, providing that it was entered into pursuant to a specific section of the Exchange Agreement. The Easement Agreement also included an incorporation clause providing that the Easement Agreement and the Exchange Agreement embodied the entire agreement between the parties.

[b] — Disposal Agreement.

The Disposal Agreement was also recorded in the land records of the respective counties. In the Disposal Agreement, the parties granted each other reciprocal rights to dispose of spoil materials generated in connection with their respective mining activities on real property controlled by the other.

Like the Easement Agreement, the Disposal Agreement also provided it was made "in exchange for and in consideration of the various property rights exchanged between [the parties] pursuant to the Exchange Agreement" and that the sole consideration for the agreement was the property right exchanges in the Exchange Agreement. It too included the same incorporation clause as the Easement Agreement.

[2] — Defenses to the Debtor's Motion to Reject the Easement and Disposal Agreements.

The Debtor filed a motion to reject the Easement Agreement and Disposal Agreement but desired to assume all remaining agreements under the Exchange Agreement. The non-debtor counterparty to the agreements objected, arguing:

- The Easement Agreement and the Disposal Agreement constituted property rights, vested and recorded, and could not be executory contracts or leases;
- The Easement Agreement and the Disposal Agreement were not executory because the Debtor's obligations thereunder were minimal;

- The Easement Agreement and Disposal Agreement could not be rejected because they were part of a larger transaction that had been concluded and the consideration exchanged upon execution of the Agreements; and
- Even if the Easement and Disposal Agreements could be rejected, the rejection constituted a breach by the Debtor but did not deprive the counterparty of the rights under the agreements, or, similarly, the agreements were more analogous to an unexpired lease, with the Debtor as the lessor, such that the counterparty was afforded the rights under 11 U.S.C. § 365(h).

[3] — The Court's Ruling.

The court declined to determine whether or not the agreements embodied property rights or to decide whether property rights could be rejected. In addition, the court declined to determine whether the agreements were executory. Both of these arguments would appear to involve threshold issues, that is, whether the agreements were even subject to 11 U.S.C. § 365 in the first instance. Instead, the court effectively assumed that the agreements were subject to rejection and decided to base its decision on the fact that the two agreements the Debtor sought to reject were part and parcel of a larger transaction — the remainder of which agreements the Debtor desired to retain.

Generally, in order for an executory contract or unexpired lease to be rejected, the contract or lease must be rejected in its entirety. Where multiple contracts are intended to comprise one agreement, the debtor may not sever them for purposes of rejection.[16] Relying primarily on *KFC Corp. v.*

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[16] *See, e.g.*, *In re* LG Philips Displays USA, Inc., 2006 WL 1748671, at *4 (Bankr. D. Del. June 21, 2006) ("[A]ll of the contracts that comprise an integrated agreement must be either assumed or rejected, since they all make up one contract." (internal citations omitted)); *In re* Philip Servs., Inc., 284 B.R. 541, 546 (Bankr D. Del. 2002), *aff'd* 303 B.R. 574 (D. Del. 2003) (holding that a non-assignable promissory note that former shareholders

Wagstaff Minnesota, Inc. (In re Wagstaff Minnesota, Inc.),[17] the court noted that under general principles of contract interpretation, state law governs the determination of whether "several documents form one indivisible contract" and that the parties' intentions determine whether several contracts form one indivisible agreement.[18] Here, the court held that under applicable Kentucky law, which was also in issue in *KFC Corp.*,[19] the clear and unambiguous terms of the Exchange Agreement evidenced the parties' intent that the Transaction Agreements formed one indivisible contract, finding:

- The Transaction Agreements were executed contemporaneously by and between the same parties and all related to the same subject matter (*i.e.*, the operations of the parties' respective mining operations);
- The Exchange Agreement specifically provided that the Transaction "shall be canceled and treated as if void and of no force and effect" unless the Easement and Disposal Agreements, along with other Ancillary Documents, were entered into at the Closing;
- The Exchange Agreement defined the "entire agreement" to include the schedules and exhibits, and models of the Easement

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of acquired company received as part of consideration paid in connection with merger had to be regarded as non-separable part of merger agreement itself because "[u]nder general contract law, the parties' intentions determine whether two separately executed documents are in reality one agreement."); *In re* Annabel, 263 B.R. 19, 24-25 (Bankr. N.D.N.Y. 2001) (holding that where the components of an agreement (*i.e.*, the purchase of assets, seller's covenant not to compete and the consulting agreement) were "intimately bound to one another with no apparent intention that the parties thereto intended anything other than a single, unseverable contract," they could not be severed for purposes of rejection).

17 Ch. 11 Case No. 11-43073, Adv. No. 11-2450, 2012 WL 10623 (D. Minn. Jan 3. 2012).

18 *See also*, *e.g.*, *In re* Ritchey, 84 B.R. 474, 476 (Bankr. N.D. Ohio 1988) (in deciding whether several writings are in fact "one contract" or "several contracts," the Bankruptcy Court should look to state law as to whether the contract is divisible or indivisible).

19 *See* O'Bryan v. Mengel Co., 6 S.W.2d 249, 250 (Ky. 1928) (under Kentucky law, test for "whether a contract is to be treated as an entirety, or as severable, is the intention of the parties, to be gathered from the object and terms of the contract itself." (internal citations omitted).

Agreement and the Disposal Agreement were included as exhibits;

- The Easement Agreement and the Disposal Agreement both defined the "entire agreement" as including the Exchange Agreement; and
- The sole consideration for the Transaction was the various property rights that the parties exchanged pursuant to the Exchange Agreement (and with respect to the Disposal Agreement, the reciprocal rights granted to the parties in that agreement).

Based on these findings, the court concluded that the Agreements were an "integral, interdependent, and non-severable part" of the Transaction.[20] Because the Easement Agreement and the Disposal Agreement constituted an indivisible part of the Transaction, the court held that the Debtor could not reject the Agreements and denied the Debtor's motion. Thus, careful drafting at the transaction stage pre-empted the Debtor's ability to pick and choose which agreements from an integrated transaction it wanted to take advantage of and which it wanted to reject.

§ 13.05. Conclusion.

Questions often arise regarding the consequences of rejection of contracts and leases in bankruptcy, especially with respect to the rights of the non-debtor party to the agreement. Some rights are provided by statute, and where the Code is silent, courts have attempted to fill in the gaps. Most

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[20] *In re* Trinity Coal Corp., 514 B.R. at 531 (citing *In re* Buffets Holdings, Inc., 387 B.R. 115 (Bankr. D. Del. 2008) ("multi-part agreement is not severable if the parties entered into the agreement as a whole, without which there would have been no agreement"); *Interstate Bakeries Corp.*, 751 F.3d at 963 ("determining an asset purchase agreement and a license agreement were integrated under Illinois law where the agreements were executed the same date, both agreements defined the 'entire agreement' as including both agreements, and a model of the license agreement was attached as an exhibit to the asset purchase agreement"); *In re* Physiotherapy Holdings, Inc., 506 B.R. 619, 626 (Bankr. D. Del. 2014) (considering whether agreements were executed at the same time as a factor in determining whether agreements were integrated)).

courts agree that a rejection of an executory contract or lease resulting in a breach does not automatically terminate the agreement. Rather, rejection simply excuses the debtor from performance. Beyond that, courts differ in their approaches to the effect of rejection, with some courts even holding that certain enforcement rights still exist. It is important to consider these principles when drafting leases, contracts, and integrated transactions and to consider ways to protect your client in the event that an agreement is rejected, as well as to understand the client's rights under state law in the event of a breach of either an executory contract or a lease.

Chapter 14

The Treatment of Oil and Gas Leases in the Context of Chapter 11 Bankruptcy Sales

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§ 14.01. Introduction.

As prices for domestic crude oil have continued the slide from 2014, and natural gas prices have languished, more and more oil and gas producers have joined the march to bankruptcy court. The year ending December, 2014 saw several small companies file for relief, and 2015, as of late July, has seen significantly larger companies joining them.[1]

For cyclical businesses like oil and gas production, Chapter 11 bankruptcy can afford the type of temporary relief necessary to restructure debt obligations, jettison burdensome contracts, and adjust operations to reflect business realities, enabling the business to emerge from bankruptcy more fit to meet the economic challenges of the times. At least that's the idea.

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1 Milagro Oil and Gas, Sabine Oil and Gas Corp. ($2.5 billion in assets and 2.9 billion in debt), Quicksilver Resources ($1.2 billion in assets and $2.3 billion in debt), BPZ Resources, Dune Energy, American Eagle Energy Corp.

For a variety of reasons, some will face the liquidation of substantially all of their assets in Chapter 11, while others may actually turn to Chapter 11 as a vehicle to sell substantially all of their assets.

§ 14.02. How Does Chapter 11 Bankruptcy Facilitate Assets Sales in a Distressed Industry?

In the past one could assume, probably correctly, that buyers would be hard to come by in a distressed industry. Unstable markets, unreliable valuations, and fear of successor liability did little to attract buyers to an insolvent seller.

The bankruptcy courts offer mechanisms to address those concerns, and perhaps in part for that reason, the "distressed asset" market has become an industry in itself. A bankruptcy filing mandates disclosure by the debtor of substantial information that a buyer outside of bankruptcy may have to discover on its own. The automatic stay against creditor action and the protections afforded lenders and suppliers willing to do business with a Chapter 11 debtor help preserve the "going concern" value of the debtor's business pending a sale.

The sales process is conducted according to published procedures authorized by the bankruptcy court and is fairly transparent. This process can be for the particular assets, industry, and exigencies at work. Bidders willing to serve as the "stalking horse" may receive economic incentives such as expense reimbursement and breakup fees.

Assets will be acquired without fear of fraudulent transfer claims after the sale. And, of greatest interest to buyers, a sale properly conducted according to 11 U.S.C. § 363 will be authorized by an order of the U.S. Bankruptcy Court declaring the assets to be sold free and clear of liens, claims, interests, and encumbrances.

Of equal importance to Section 363 in a sale of substantially all of the assets of a Chapter 11 debtor is Section 365. This section governs the assignment of certain of the debtor's contractual rights. In the oil and gas production business, where the "going concern" value resides in the oil and

gas leases, Section 365 may provide additional advantages to the debtor and its buyer which would not be available to them outside of bankruptcy.

§ 14.03. How Does Section 365 Facilitate Assignments of Unexpired Leases of the Debtor?

An oil and gas producer will be a lessee, either directly or by assignment, under numerous oil and gas leases. These leases commonly condition the lessee's right to transfer its interest in the lease on the consent of the lessor. In a nonbankruptcy sale and assignment of the lessee's interests under oil and gas leases, the seller will very likely be required to warrant to the buyer that all necessary consents to assignment have been obtained.

In many cases, particularly those involving smaller producers, the lessor was "Mom and Pop," both of whom are now deceased, and their interests belong in varying portions to their children and/or their children's heirs. Obtaining the consents necessary to assign leases and provide related warranties can be problematic, perhaps even impossible.

The Bankruptcy Code at 11 U.S.C. § 365(f)(1) provides that except in situations not applicable here, a Chapter 11 debtor may assign an "unexpired lease" of the debtor "notwithstanding a provision in an . . . unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions, the assignment of such . . . lease . . . ."

Thus, in a bankruptcy sale of substantially all of the assets of an oil and gas producing debtor, the debtor can assign its oil and gas leases which include consent requirements without obtaining such consents if its oil and gas leases qualify as "unexpired leases" under Section 365.

That said, the Code restores fairness to the lessor by imposing two other conditions on any assignment of an unexpired lease. The assignee must provide adequate assurances of its ability to perform under the lease, and both prepetition and postpetition defaults must be cured. In most cases, the first requirement is readily met. Either the buyer is well known in the industry or simply presents a better alternative to the insolvent seller such

that the lessors are willing to go along. Typically, the cost of curing defaults is considered in the calculation of the purchase price.

§ 14.04. Is an Unexpired Oil and Gas Lease an "Unexpired Lease" of the Debtor?

As the Fifth Circuit Court of Appeals wrote in 1990, "the term 'oil and gas lease' is a misnomer because the interest created by an oil and gas lease is not the same interest created by a lease governed by landlord and tenant law."[2] In other words, an oil and gas lease in existence on the date of the bankruptcy filing is not always an "unexpired lease" under Section 365.

The interest created by an oil and gas lease recognizes the migratory nature of oil and gas and its tendency to move toward areas of lesser pressure.[3] Oil and gas located under a tract of land may actually be produced by a well located on another tract of land.

Therefore, as a general matter, oil and gas leases convey rights to explore for oil or gas on a given tract, conduct drilling activities on the tract, produce oil or gas from wells located on the tract, and sell the oil or gas produced from the wells on the tract.

Whether those rights constitute a lease governed by Section 365 of the Bankruptcy Code depends upon the law of the State where the land subject to the lease is located.[4] Some states take the view that the owner of the land on which the lease is located does not own the oil and gas beneath his land, and, therefore, cannot convey any interest in the oil and gas. Instead, as the property owner, he has the exclusive right to use the land to explore for and develop oil and gas. In these states, called "nonownership" states, an oil and gas lease is considered a lease of the property owner's right to explore for and produce oil and gas on the subject land.[5]

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2 *In re* Topco, Inc., 894 F.2d 727, 740, n. 17 (5th Cir. 1990).

3 *See* Wayne C. Byers and Timothy N. Tuggey, "Oil and Gas Leases and Section 365 of the Bankruptcy Code: A Uniform Approach," *63 Am. Bankr. L.J.* 337, 338 (Fall, 1989).

4 *In re Topco, supra*.

5 *See* Byer and Tuggey, *supra* n. 3 at 338, 339, 340 n.14; (California, Illinois, Indiana, Kentucky, Louisiana, New York, Oklahoma and Wyoming are considered "nonownership"

Other states consider the property owner to be the owner of all oil and gas under the property, subject to divestment of such interest upon migration of the oil and gas from beneath the tract. In these "ownershipinplace" states, an oil and gas lease is a conveyance of a fee simple interest in the oil and gas rather than a lease.[6]

As might be expected, oil and gas leases in nonownership states are generally considered to be true leases, thus subject to Section 365 of the Bankruptcy Code.[7] The logical corollary is that oil and gas leases in ownershipinplace states, where oil and gas leases are considered transfers of a fee simple interest in the oil and gas, would never be subject to Section 365 of the Bankruptcy Code. However, although ownershipinplace states transfer a fee interest in the oil and gas, the fee interest is not vested at the time the lease is signed.[8] Generally, in those states, the fee interest does not vest in the lessee until oil or gas has been produced in paying quantities from the leased property.[9]

While upon and after vesting the lease would fall outside the scope and effect of Section 365, what about the period of time after the lease is signed but before it has vested? What is the nature of an oil and gas lease in an ownershipinplace state prior to vesting, and does Section 365 apply?

It has been held that an oil and gas lease in Pennsylvania prior to vesting was an agreement "to use real property." And, since Section 365(m) provides

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states). *See* Kirk B. Burkley, "Navigating Oil and Gas Leases," XXX *ABI Journal* 5, 18, 7879, June 2011; *see also* Adam H. Isenberg and Monique B. DiSabatino, "The 'Peculiar' Lease; Powell and the Treatment of Oil and Gas Leases," XXXII *ABI Journal* 3, 14,15, n. 6 at 14, April, 2013.

6 *See* Byers and Tuggey, *supra* n.3 at 338, 339, 340 n.14. (Alabama, Arkansas, Colorado, Michigan, Mississippi, Montana, New Mexico, Ohio, Pennsylvania, Tennessee, Texas and West Virginia are considered "ownershipinplace" states). *See* Burkley, "Navigating Oil and Gas Leases," *supra* n.6 at 18, 7879; *see also* Isenberg and DiSabatino, "The 'Peculiar' Lease: Powell and the Treatment of Oil and Gas Leases," *supra* n.7 at 14.

7 Frontier Energy, LLC v. Aurora Energy Ltd., 439 B.R. 674, 680 (Bankr. W.D. Mich. 2010).

8 *See* Kirk B. Burkley, "Navigating Oil and Gas Leases," XXX *ABI Journal* 5, 18, 7879, June 2011.

9 *Id.*

that for purposes of Section 365, leases of real property shall include "any rental agreement to use real property," the lease was, on the date of the lessee's bankruptcy filing, an unexpired lease of property subject to Section 365.[10] Thus, even in ownershipinplace states, Section 365 may govern oil and gas leases.

§ 14.05. If an Oil and Gas Lease Is Not a Lease Under Section 365, Then What Is It, and What Difference Does This Make in a Chapter 11 Case?

The commencement of the bankruptcy case creates an estate comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case," including its proceeds, product and profits.[11] If an oil and gas lease is not a lease under Section 365 of the Bankruptcy Code, and the applicable state law provides that the debtor is the owner of a fee simple interest in the oil and gas, the interest of the debtor is simply property of the debtor's bankruptcy estate under Section 541 of the Code, with one relevant exception.

"Property of the estate" does not include any interest of the debtor in "liquid or gaseous hydrocarbons" to the extent that the debtor has transferred or agreed to transfer the interest under a farmout agreement or a written agreement related to a farmout agreement. In addition, a production payment from gaseous or liquid hydrocarbons is not property of the estate if transferred by the debtor pursuant to a written conveyance to an entity that does not participate in the operation of the property against which the payment is granted.[12]

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10 *Id*.

11 11 U.S.C. § 541.

12 *Id*.

As we have stated, a debtor may sell property of the estate under Section 363 of the Bankruptcy Code. Unlike Section 365, Section 363 does not abrogate consent requirements that may be contained in the lease. Arguably, such requirements are binding notwithstanding the treatment of the lease as a conveyance of the oil and gas. An argument may be made that the appropriate remedy for a breach of such an obligation is a claim for damages assessable against the bankruptcy estate and subject to proof. In that case, assuming no damages have, in fact, been suffered, the breach would have no consequence but the cost of litigation. However, in a liquidating Chapter 11, the estate may not have the ability to pay those litigation costs, and the uncertainty such litigation presents could complicate the process.

On the positive side, however, under Section 541 the debtor is not required to assume or reject the "lease," but under Section 365, it is, and these concepts have consequences. Further, before any lease governed by Section 365 may be assigned to a buyer, it must be assumed by the debtor. Assumption is the commitment of the estate to fulfill the terms of the lease. Any default thereafter gives rise to a claim against the estate for damages. Rejection is a breach of the contract, and gives rise to a claim against the estate for damages as well.

However, the claim created upon rejection is a pre-petition claim, but the claim created upon default after assumption is a post-petition "administrative" claim which is entitled to be paid ahead of any pre-petition claim. Moreover, the debtor may not be permitted to confirm a plan of reorganization (and thereby obtain a discharge of certain debt) if it is financially unable to pay all administrative claims in full. Thus, classification of a lease as a true lease governed by Section 365 means that any default after assumption of the lease places an economic burden on the debtor which could jeopardize its ability to confirm a plan. Section 363 which governs the sale of the oil and gas conveyed under the lease in ownership in place states contains no assumption or rejection requirement.

Additionally, under Section 365, unexpired (true) leases must be "assumed" or "rejected" by the debtor by the earlier of the date 120 days

after filing or the date of the entry of an order confirming a plan, subject to one extension of no more than 90 days.[13]

A failure to timely assume renders the lease rejected, and therefore, breached, and of no value to the debtor or its buyer. Absent this deadline, a debtor would delay assumption until it had procured a buyer because it does not want to create the potential for a post assumption default that will increase the cost to a buyer (or until it knows the lease will be assigned and the resulting claim will be paid from the purchase price).

Thus, the imposition of this deadline relatively early in a Chapter 11 case forces the debtor into one of a few undesirable situations. It must either assume leases before it is certain it has a buyer in order to preserve the going concern value of the business, thus creating the potential for an administrative claim; or, it must devote its time and resources very early in the case to procuring a buyer whether it has determined a buyer is both necessary and possible, and when it could be exploring reorganization prospects; or, it delays filing until it has a buyer lined up, so that it can assume on a timely basis and immediately sell.

The latter risks too much delay, which can damage the company's value, the ability to reorganize, and the potential for a sale. In ownership in place states, where Section 365 is not applicable to oil and gas leases, at least after vesting, the debtor is not constrained by these concerns.

§ 14.06. Conclusion.

Before any oil and gas producer seriously considers a Chapter 11 filing, or any buyer seriously considers a purchase of oil and gas leases from a Chapter 11 debtor, it is critical that he or she first determine whether the state in which the leases are located is a non-ownership state, or an ownership-in-place state.

This determination will indicate whether the oil and gas leases will be treated as true leases subject to 11 U.S.C. § 365, or will be treated as conveyances of fee simple interests in the oil and gas underlying the leased properties, which are not subject to Section 365. The distinction dictates

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13 11 U.S.C. 365(d)(4), (5).

certain conditions upon which the oil and gas interests may be assigned, whether assumption is required and when, and what the lessor is entitled to receive in connection with assumption and assignment of the oil and gas interests, all of which should bear on the decision to file, and any decision by a buyer to seek to acquire such interests.

Chapter 15

OSHA's Proposed Rule on Respirable Crystalline Silica and Its Impact on MSHA

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§ 15.01. Introduction.

This chapter examines the Occupational Safety and Health Administration's (OSHA) proposed rule on respirable crystalline silica. The rule can potentially have profound impacts on Energy and Mineral Law Foundation members. Members involved in oil and gas exploration or well services, particularly hydraulic fracturing, will be among the most impacted by the rule. More commonly known as "fracking," the hydraulic fracturing process involves the use of significant amounts of sand, which contains silica. Members involved in mining operations should follow the OSHA rulemaking process as well. Mining work obviously implicates potential exposure to silica; silica is the world's second-most-common element. The Mine Safety and Health Administration (MSHA) is monitoring OSHA's rulemaking, and will likely propose a rule substantially similar to OSHA's final rule.

§ 15.02. Respirable Crystalline Silica.

Silica is a compound composed of the elements silicon and oxygen (chemical formula SiO2). It exists in crystalline and amorphous states. It is odorless, has no vapor pressure, and creates non-explosive dusts when

particles are suspended in air.[2] It is the second-most common substance on the planet, behind only oxygen.[3] Crystalline silica is most commonly found in quartz, which makes up nearly 12 percent of the earth's crust by weight.[4]

Crystalline silica is used in a wide variety of industries. Sand and gravel are used in road building and concrete construction.[5] Glass and ceramic industries use high-silica sand.[6] Metal foundries form their molds for metal castings with silica sand.[7] Any industry deploying sandblasting will expose employees to respirable crystalline silica.

Silica is also used as a filler in plastics, rubber, and paint.[8] It is used as an abrasive in soaps and scouring cleansers. Municipal water and sewage treatment plants utilize silica sand to remove impurities from local water supplies.[9] If your home has an artificial stone kitchen or bathroom countertop, congratulations – those products were manufactured using silica.[10]

If you go for a walk anywhere outside, you will likely be exposed to some amount of respirable crystalline silica in the ambient air.[11] Any industry involving outdoor work — mining and oil and gas well drilling and servicing, to name a few — will entail some work exposure to respirable crystalline silica. In short, silica is everywhere.

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2 International Agency for Research on Cancer., Monographs on the evaluation of carcinogenic risks to humans: Silica, some silicates, coal dust and para-aramid fibrils (1997) ("IARC 1997").

3 W.E.G. Müller, *Silicon Biomineralization: Biology – Biochemistry - Molecular Biology* 3 (Springer-Verlag Berlin Heidelberg, 2003).

4 Graham Thompson and Jon Turk, *Earth Science and the Environment* 33 (Thomson Corp., 4th ed. 2007).

5 *Occupational Exposure to Respirable Crystalline Silica, Proposed Rule* (hereinafter "OSHA Proposed Rule for RCS"), 78 Fed. Reg. 56, 274, 56,296 (Sept. 12, 2013).

6 *Id*.

7 *Id*.

8 *Id*.

9 *Id*.

10 *Id*. (citing Kramer MR, Blanc PD, Fireman E, Amital A, Guber A, Rhahman NA, Shitrit D, *Artificial stone silicosis [corrected]: disease resurgence among artificial stone workers* (2012)).

11 Society for Mining, Metallurgy, and Exploration, Crystalline Silica 16 (1998).

For over the past 20 years, scientific studies have suggested links between exposure to respirable crystalline silica and lung cancer and other diseases, such as silicosis, chronic obstructive pulmonary disease (COPD), among others.[12]

§ 15.03. OSHA's Current Rule on Respirable Crystalline Silica.

[1] — The Permissible Exposure Level (PEL).

OSHA's current rule on respirable crystalline silica is currently codified at 29 C.F.R. §1910.1000, commonly known as the Airborne Contaminants Rule. The Airborne Contaminants Rule lists several hundred potentially harmful airborne contaminants and sets a specific threshold on each of them, known as a Permissible Exposure Level (PEL). For respirable crystalline silica, OSHA currently employs separate PELs for general industry and construction.

For general industry, the PEL for respirable crystalline silica in the form of respirable quartz is based on two alternative formulas in Table Z-3 of the Airborne Contaminants Standard: (1) A particle-count formula, PEL mppcf= 250/(% quartz + 5); or (2) a mass formula proposed by ACGIH in 1968, PEL = (10 mg/m3)/(% quartz + 2).[13] General industry PELs for cristobalite and tridymite are one-half of the value calculated from either formula.[14]

For construction (as well as shipyards), the formula for the PEL for respirable crystalline silica in the form of quartz is mppcf= 250/(% quartz + 5).[15]

Rather than spend significant resources attempting to discern the percentage of respirable crystalline silica in a product, many employers will assume the product contains 100 percent respirable crystalline silica. Under these assumptions, the PELs are approximately100 $\mu g/m^3$ for an eight-hour

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12 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,275.

13 29 C.F.R. §1910.1000, Table Z-3.

14 *Id*.

15 29 C.F.R. §1926.55, Appendix A (construction); 29 C.F.R. §1915.1000, Table Z (shipyards).

time-weighted exposure for general industry, and 250 $\mu g/m^3$ for an eight-hour time-weighted exposure for construction.[16]

[2] — The Hierarchy of Controls.

To achieve compliance, an employer must use feasible engineering and administrative controls to reduce employee exposure to a contaminant to below the PEL. If such controls do not suffice to lower the contaminant to below the PEL, an employer may resort to the use of personal protective equipment to achieve compliance, most commonly by the use of respirators.[17] This structure is also known as the "hierarchy of controls," and is often referenced and conceived as a pyramid.[18]

Under the hierarchy of controls, the most preferable manner in which to abate a hazard is to attempt to eliminate the hazard, by removal or substitution. Complete elimination of the hazard is the most effective means of compliance. If an employer removes all respirable crystalline silica from the workplace, no hazard exists and the employee has no exposure to the hazard.[19] But elimination often cannot be achieved.

If elimination cannot be achieved, the hierarchy pyramid then seeks to eliminate or substantially reduce the hazard through engineering controls.[20] Engineering controls are controls that require a physical change to the workplace.[21]

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16 *See* Occupational Exposure to Respirable Crystalline Silica, Proposed Rule (hereinafter "OSHA Proposed Rule for RCS"), 78 Fed. Reg. 56, 274, 56,275 (Sept. 12, 2013).

17 *See* Occupational Safety and Health Administration, Chemical Hazards and Toxic Substances, *available at* https://www.osha.gov/SLTC/hazardoustoxicsubstances/control.html.

18 *See* Appendix A for OSHA's illustration of the hierarchy of controls.

19 For instance, some hydraulic fracturing companies now resort to an alternative proppant in lieu of sand on fracking jobs, such as ceramics or in rare cases, peanut or walnut shells. Frank R. Spellman, *Environmental Impacts of Hydraulic Fracturing* xiii, 3 (2013).

20 *See* Appendix A.

21 *See* Occupational Safety and Health Administration, Chemical Hazards and Toxic Substances, *available at* https://www.osha.gov/SLTC/hazardoustoxicsubstances/control.html.

If engineering controls cannot eliminate or substantially reduce the hazard, the hierarchy pyramid then resorts to administrative controls.[22] Administrative controls are often work rules or practices, such as evacuating the workplace in the event of a fire, or a rule prohibiting employees from working around silica for, say, more than a certain length of time.[23] Administrative controls are perceived to be less effective than engineering controls, but they often can eliminate more potential hazards than elimination or engineering controls can.[24]

If none of the above achieve compliance, then the Hierarchy pyramid resorts to the use of personal protective equipment (PPE).[25] PPE is viewed as less effective than elimination, engineering, and administrative controls.[26] But oftentimes compliance cannot be achieved through the use of such controls. A construction site with hundreds of workers, for instance, can never realistically eliminate the potential hazard of employees being struck by construction materials. Hence, the now-universal requirement of hard hat use on a construction site.

OSHA, however, often does not strictly enforce the hierarchy of controls in the Airborne Contaminants Rule. An industrial hygienist conducting a workplace inspection oftentimes may see employers protecting employees from respirable crystalline silica through the use of respirators. The industrial hygienist may feel the employer could do more to eliminate or substantially reduce exposure to silica through engineering or administrative controls. But if the industrial hygienist's sampling comes back from the lab with exposures all below the PEL, the industrial hygienist is unlikely to cite the employer for failing to strictly adhere to the Hierarchy of controls. The law only requires

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22 *See* Appendix A.

23 Occupational Safety and Health Administration, Chemical Hazards and Toxic Substances, *available at* https://www.osha.gov/SLTC/hazardoustoxicsubstances/control.html.

24 *See id*.

25 *See* Appendix A.

26 Occupational Safety and Health Administration, Chemical Hazards and Toxic Substances, *available at* https://www.osha.gov/SLTC/hazardoustoxicsubstances/control.html.

employers to utilize technically and economically feasible controls. What exactly is technically feasible or economically feasible can be the subject of contentious and expensive litigation. Since respirators achieve compliance with the PEL, rare is the industrial hygienist, typically overworked, who insists on spending considerable time and agency resources on a subject that is arguably moot because compliance is achieved through the use of respirators.

§ 15.04. History of OSHA Attempts to Update the Respirable Crystalline Silica PEL.

The PELs for respirable crystalline silica have not changed since 1971.[27] OSHA adopted formulas drafted by the American Conference of Governmental Industrial Hygienists (ACGIH) in 1968 and incorporated them into the Airborne Contaminants Standard.[28] Three years after promulgation, in 1974 the National Institute for Occupational Safety and Health (NIOSH) issued a recommendation that occupational exposure to respirable crystalline silica be limited to a time-weighted average (TWA) no greater than 50 $\mu g/m^3$ as determined by a full-shift sample for up to a 10-hour workday, 40-hour workweek.[29] NIOSH also recommended employer monitoring of exposure and medical surveillance.[30]

OSHA embraced the NIOSH recommendations. In December 1974, OSHA issued an Advanced Notice of Proposed Rulemaking (ANPRM), seeking to implement NIOSH's recommendations into an updated standard.[31] After publication, however, OSHA pursued other priorities, and the 1974 ANPRM died on the vine.[32] OSHA kick-started another attempt to update

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[27] OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,275.

[28] *Id*. at 56,292.

[29] NIOSH Publication No. 75-120, *Criteria for a Recommended Standard: Occupational Exposure to Crystalline Silica* (1974), *available at* http://www.cdc.gov/niosh/docs/1970/75-120.html.

[30] *See id*.

[31] Standard for Occupational Exposure to Crystalline Silica, Advance Notice of Proposed Rulemaking, 39 Fed. Reg. 44,771 (Dec. 27, 1974).

[32] *See* OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,293.

the standard in 1989.[33] Not long after, in 1991, the U.S. National Toxicology Program concluded that respirable crystalline silica was a human carcinogen, which would seem to bolster OSHA's case for updating the standard.[34] But the unique process in which OSHA promulgated the standard would ultimately create its demise.

Rather than initiate rulemaking over the respirable crystalline silica standard alone, in 1989 OSHA engaged in an ambitious attempt to lower or set new PELs for 428 substances listed in the Z Tables of the Airborne Contaminants Standard, including respirable crystalline silica, all at the same time and in the same NPRM. This became known as the Air Contaminants Final Rule.[35] The Air Contaminants Final Rule's economic analysis on most substances was cursory. Various industry groups and the AFL-CIO filed legal challenges, which were consolidated in the United States Court of Appeals for the Eleventh Circuit.

Industry petitioners challenged OSHA's use of generic findings, the lumping together of 428 substances in one rulemaking, and the short time provided for comment. The AFL-CIO, on the other hand, challenged the agency for not doing more. The union complained OSHA overlooked other standards that required updating as well, and that the process resulted in standards that were "systematically underprotective of employee health."[36] OSHA defended its use of the procedure, arguing that the pace of updating the Airborne Contaminants Standard was too slow. From 1971 to 1992 the agency could only issue 24 new substance-specific health standards. At this rate, the agency argued, it would take decades to update the Airborne Contaminants Standard. In other words, it was impossible to timely update PELs in the Airborne Contaminants Standard without resorting to omnibus rulemaking.[37]

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33 *See id*.

34 *See id*.

35 Air Contaminants, Final Rule, 54 Fed. Reg. 2,332 (Jan. 19, 1989).

36 AFL-CIO v. OSHA, 965 F.2d 962, 971 (11th Cir. 1992).

37 *Id*. at 971.

In 1992 the Eleventh Circuit vacated the 1989 Air Contaminants Final Rule.[38] The Court of Appeals found that nothing in the Occupational Safety and Health Act prohibited such omnibus or "generic" rulemaking. "However, we believe the PEL for each substance must be able to stand independently, *i.e*., that each PEL must be supported by substantial evidence in the record considered as a whole and accompanied by adequate explanation," wrote Circuit Judge Fay for the three-judge panel.[39] "OSHA may not, by using such multi-substance rulemaking, ignore the requirements of the OSH Act."[40] From the record it was impossible to tell whether OSHA established economic or technical feasibility, as it had grouped substances into categories and industries into aggregates. The court of appeals found OSHA's position as hubristic and engaging in a "fundamental misperception" of the OSH Act and federal case law interpreting the OSH Act.[41] The court then struck down the Airborne Contaminants Final Rule:

> It is clear that the analytical approach used by OSHA in promulgating its revised Air Contaminants Standard is so flawed that it cannot stand. OSHA not only mislabeled this a "generic" rulemaking, but it inappropriately treated it as such. The result of this approach is a set of 428 inadequately supported standards. OSHA has lumped together substances and affected industries and provided such inadequate explanation that it is virtually impossible for a reviewing court to determine if sufficient evidence supports the agency's conclusions.
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> We have no doubt that the agency acted with the best of intentions. It may well be, as OSHA claims, that this was the only practical way of accomplishing a much needed revision of the existing standards and of making major strides towards improving worker health and

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38 AFL-CIO v. OSHA, 965 F.2d 962 (11th Cir. 1992).
39 *Id*. at 972.
40 *Id*.
41 *Id*. at 979-80.

> safety. Given OSHA's history of slow progress in issuing standards, we can easily believe OSHA's claim that going through detailed analysis for each of the 428 different substances regulated was not possible given the time constraints set by the agency for this rulemaking. Unfortunately, OSHA's approach to this rulemaking is not consistent with the requirements of the OSH Act. Before OSHA uses such an approach, it must get authorization from Congress by way of amendment to the OSH Act. Legislative decisions on the federal level are to be made in the chambers of Congress. It is not for this court to undertake the substantial rewriting of the Act necessary to uphold OSHA's approach to this rulemaking.[42]

After the defeat of the Airborne Contaminants Final Rule, in 1994 OSHA, NIOSH, and MSHA convened a priority planning committee to start over from scratch, and determine which substances should be first in line for updating on a one-by-one basis through rulemaking.[43] Respirable crystalline silica made the agencies' priority list.[44] In 1997, OSHA announced on its Unified Agenda a Long-Term Action to promulgate a standalone rule for respirable crystalline silica.[45] Respirable crystalline silica quickly moved to the Pre-Rule stage in 1998.[46] OSHA conducted stakeholder listening sessions in 1999 and 2000, and convened Small Business Regulatory Enforcement Fairness Act (SBREFA) proceedings in 2003, as required by law.[47] OSHA then tinkered with the proposed rule for the next ten years, after meeting with industry and union groups. The proposed rule purportedly sat dormant for over two years at the White House Office of Information and Regulatory

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42 *Id*. at 986-87.

43 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,293.

44 *See id*.

45 United States Department of Labor, Semi-Annual Agenda, 62 Fed. Reg. 57,714, 57,758 (Oct. 29, 1997).

46 United States Department of Labor, Semi-Annual Agenda, 63 Fed. Reg. 61,967, 62,006 (Nov. 9, 1998).

47 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,294 – 56,295. *See also* United States Department of Labor, Semi-Annual Agenda, 68 Fed. Reg. 30,551, 30,584, May 27, 2003.

Affairs (OIRA) and Office of Management and Budget (OMB).[48] After union complaints to the White House, OMB finally approved the respirable crystalline silica proposed rule for publication.[49]

§ 15.05. OSHA's Proposed Rule.

On September 12, 2013, OSHA published a Notice of Proposed Rulemaking (NPRM) for respirable crystalline silica in the Federal Register. The proposed rule, along with OSHA's comments and rationale, runs 232 pages long. The agency's Preliminary Economic Analysis (PEA) is over 1,400 pages long, excluding the hydraulic fracturing industry.[50] OSHA notably omitted hydraulic fracturing from the PEA. Instead, OSHA published its PEA on hydraulic fracturing as a separate document, running 80 pages long.[51]

Why a new rule for respirable crystalline silica? OSHA claimed it "conducted an extensive review of the literature on adverse health effects associated with exposure to respirable crystalline silica."[52] The agency concluded that respirable crystalline silica can cause numerous debilitating conditions or diseases, such as autoimmune diseases and chronic obstructive pulmonary disease, better known as COPD.[53] OSHA therefore "preliminarily finds that worker exposure to respirable crystalline silica constitutes a significant risk and that the proposed standard will substantially reduce this risk."[54] The proposed rule will, according to the agency, "prevent 688

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48 *See* Christopher Cole, "Public Citizen Chief Says Group was Gearing Up to Sue OSHA Over Silica Rule," *Inside OSHA Online*, Dec. 17, 2013, *available at* www.insideoshaonline.com.

49 *Id*.

50 *See* Preliminary Economic Analysis and Initial Regulatory Flexibility Analysis Supporting document for the Notice of Proposed Rulemaking for Occupational Exposure to Crystalline Silica, OSHA-2010-0034-1720 ("OSHA PEA"), *available at* http://www.regulations.gov.

51 *See* Appendix A to Silica PEA, Hydraulic Fracturing, OSHA-2010-0034-1720 ("OSHA Hydraulic Fracturing PEA"), *available at* www.regulations.gov.

52 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,402.

53 *See id*.

54 *Id*. at 56,402.

fatalities and 1,585 silica-related illnesses annually once it is fully effective . . . ."[55]

OSHA estimates that the rule will cost all affected employers $637 million annually.[56] Benefits amount to $5.3 billion annually, in terms of lives saved and diseases prevented.[57] While touting the net $4.6 billion benefit, OSHA cautioned that it cites the numbers for informational purposes only, noting that federal courts prohibit the agency from deploying a cost-benefit or max-benefit analysis as a basis for setting OSHA standards.[58] The agency proposes to locate the rules for respirable crystalline silica at 29 C.F.R. §1910.1053 for general industry and 29 C.F.R. §1926.1053 for the construction industry.[59]

[1] — Scope.

The scope of the proposed rule is broad. The proposed rule would include all employers in the United States covered by general industry standards, 29 C.F.R. Part 1910, as well as all employers covered by the construction industry standards, 29 C.F.R. Part 1926. Significantly, OSHA excluded employers in the Agriculture industry from coverage under the respirable crystalline silica proposed rule. The agency indicated that they had insufficient data on exposures and control measures in agriculture, such that it was unable to determine whether the proposed rule was feasible or even needed in the industry.[60]

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55 *Id*.

56 *Id*.

57 *Id*. at 56,393, 56,427.

58 *Id*. at 56,276 & n.1 (citing Am. Textile Mfrs. Inst., Inc. v. Nat'l Cotton Council of Am., 452 U.S. 490, 513 (1981); Pub. Citizen Health Research Group v. U.S. Dep't of Labor, 557 F.3d 165, 177 (3d Cir. 2009); Friends of the Boundary Waters Wilderness v. Robertson, 978 F.2d 1484, 1487 (8th Cir. 1992)).

59 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,486, 56,494.

60 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,442. This is due, in no small part, to Congress' annual appropriation riders to OSHA, restricting OSHA's use of funds for farming operations that employ less than ten workers. *See id*.

[2] — Permissible Exposure Limit (PEL) and Action Level (AL).

OSHA proposes to eliminate the current PEL formulas for respirable crystalline silica in General industry and Construction and replace them with a universal, gravimetric measurement PEL of 50 $\mu g/m^3$. The agency abandoned the old formulas, which they described as obsolete.[61] OSHA also felt the old particle-counting formulas were confusing and hindered compliance. This new approach "gives employers a simple option to identify the control measures that are appropriate for these operations."[62]

OSHA explored regulatory alternatives to the new PEL, specifically setting it at either 100 $\mu g/m^3$ or 25 $\mu g/m^3$. The agency quickly dismissed the idea of setting the PEL at 100 $\mu g/m^3$, because it already found that a 50 $\mu g/m^3$ PEL was technically and economically feasible.[63] OSHA stated that, therefore, it could not accept the PEL at 100 $\mu g/m^3$ "without violating its statutory obligations under the OSH Act."[64]

Nor could OSHA lower the PEL down to 25 $\mu g/m^3$. While lowering to such a level would save more lives – preventing 1,023 fatalities and 1,770 silica-related illnesses, according to OSHA's analysis[65] — the lower PEL "would not be feasible."[66] OSHA assumed compliance with a 25 $\mu g/m^3$ PEL would not be achievable without near-universal respirator use, and would more than double employer compliance costs to more than $1.3 billion.[67]

OSHA also proposes to set an "action level" for respirable crystalline silica. An action level triggers certain additional exposure assessment requirements.[68] In essence, OSHA deems employers with exposure at or above the action level but below the PEL as at increased risk, and accordingly

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61 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,292.
62 *Id*. at 56,276.
63 *Id*. at 56,280-56,281.
64 *Id*. at 56,281.
65 *Id*. at 56,280.
66 *Id*. at 56,281.
67 *Id*. at 56,280.
68 *Id*. at 56,406.

requires more frequent exposure assessment. The agency proposes to set the action level at 25 μg/m^3.[69]

Action levels are not a new concept. Other OSHA regulations, such as lead, benzene, and hexavalent chromium, contain similar provisions requiring increased exposure assessment when sampling indicates that employees are exposed to levels of contaminants above the action level but still below the PEL.[70]

[3] — Exposure Assessment.

OSHA's Notice of Proposed Rulemaking requires all covered employers to assess their workplaces for potential exposure to respirable crystalline silica above the action level.[71] Employers who suspect any of their employees may potentially be exposed to respirable crystalline silica should at least conduct an initial assessment.

[a] — Air Sampling.

The proposed rule requires all air samples taken for compliance efforts meet either OSHA ID —142; NMAM 7500, NMAM 7602; NMAM 7603; MSHA P —2; or MSHA P —7 analytical methods.[72] Only laboratory analysis under either X-ray diffraction (XRD) or infrared (IR) spectroscopy is allowed.[73]

[b] — Initial Exposure Assessment.

Upon the implementation of the final rule, employers must "perform initial monitoring of employees who are, or may reasonably be expected to be, exposed to airborne concentrations of respirable crystalline silica at or above the action level."[74] OSHA chose the action level as the trigger point because most employee exposure will not be static:

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69 *Id*. at 56,406.

70 *See* 29 C.F.R. §§1910.1025(b), 1910.1026(b), 1910.1028(b).

71 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,487, 56,494-56,495.

72 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,448.

73 *Id*. at 56,448-56,449.

74 *Id*. at 56,494.

> Because of the variable nature of employee exposures to airborne concentrations of respirable crystalline silica, maintaining exposures below the action level provides reasonable assurance that employees will not be exposed to respirable crystalline silica at levels above the PEL on days when no exposure measurements are made. Even when all measurements on a given day may fall below the PEL (but are above the action level), there is some chance that on another day, when exposures are not measured, the employee's actual exposure may exceed the PEL. When exposure measurements are above the action level, the employer cannot be reasonably confident that employees have not been exposed to respirable crystalline silica concentrations in excess of the PEL during at least some part of the work week. Therefore, requiring periodic exposure measurements when the action level is exceeded provides the employer with a reasonable degree of confidence in the results of the exposure monitoring.[75]

OSHA also proposes two alternatives in lieu of conducting air sampling. First, if, within the twelve months prior to the date the final rule goes into effect, the employer has taken air samplings of employees working in conditions closely resembling the currently-prevailing conditions, the employer may rely upon that relatively recent sampling data.[76] Second, the employer is excused from initial sampling where it possesses "objective data that demonstrate that respirable crystalline silica is not capable of being released in airborne concentrations at or above the action level under any expected conditions of processing, use, or handling."[77]

What exactly is "objective data?" Lifting a provision from the asbestos and formaldehyde standards, the proposed rule currently defines the term as industry-wide air monitoring surveys, or "calculations based on the composition or chemical and physical properties of a substance,

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75 *Id*. at 56,281.

76 *Id*. at 56,495.

77 *Id*.

demonstrating employee exposure to respirable crystalline silica associated with a particular product, material, process, operation, or activity."[78]

[c] — Periodic Exposure Assessment.

Sections 1910.1053(d)(3) and 1926.1053(d)(3) of the proposed rule requires employers with employees exposed to levels of respirable crystalline silica above the action level to maintain periodic air sampling and monitoring of affected employees.[79] If the affected employees remain below the PEL, OSHA allows employers to conduct periodic assessments every six months, so long as employees stay below the PEL.[80] If two rounds of subsequent monitoring for a specific worker or representative group of workers, taken at least seven days apart, reveals that affected employees are under the Action level, the employer may discontinue monitoring.[81]

For employees exposed to respirable crystalline silica in amounts above the PEL, the proposed rule contemplates employers conducting periodic sampling every three months, until affected employees are under the PEL for at least two straight rounds of sampling.[82] OSHA believes frequent monitoring will allow employers to better assess the success or failure of their efforts to control exposure, and of course, create an incentive to have zero employees exposed to levels above the Action level.[83]

OSHA also proposes an alternative "performance" option for exposure assessment, acknowledging that periodic air sampling "may present challenges in certain instances, particularly when operations are of short duration or performed under varying environmental conditions."[84]

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78 *Id*. at 56,444.
79 *Id*. at 56,487, 56,495.
80 *Id*. at 56,447.
81 *Id*. at 56,448.
82 *Id*. at 56,447.
83 *See id*. at 56,447.
84 *Id*. at 56,448.

[d] — Additional Exposure Assessment.

Employers who achieve a workplace with zero employees above the Action level cannot rest on their laurels. The proposed rule contains a provision to prevent complacency, by requiring a new exposure assessment whenever any change in the workplace "that may reasonably be expected to result in new or additional exposures to respirable crystalline silica at or above the action level."[85]

[e] — Lab Accreditation.

To ensure accuracy of sampling data, the proposed rule only allows analysis by laboratories accredited to ANS/ISO/IEC Standard 17025:2005 by an accreditation body that is compliant with ISO/IEC Standard 17011:2004.[86] But that's not all; accredited labs must also participate in round-robin testing with at least two other accredited labs at least every six months.[87] Accredited labs must also meet certain quality control and National Institute of Standards and Technology (NIST) or NIST traceable standards for instrument calibration, among other things.[88]

[f] — Employee Notification.

Finally, OSHA proposes that employers notify employees of the results of their assessment results within 15 working days (three weeks) of the assessment.[89] If the assessment reveals that employees are exposed to levels of respirable crystalline silica above the PEL, employers must provide a written action plan to the employee, describing how the employer intends to achieve compliance with the standard.[90]

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85 *Id*. at 56,448.
86 *Id*. at 56,487-56,488.
87 *Id*. at 56488.
88 *Id*. at 56488.
89 *Id*. at 56,488.
90 *Id*. at 56,488.

[2] — Regulated Areas and Access Control.

OSHA borrows from its asbestos standards a requirement to have either regulated areas or a written access control plan for those areas of the workplace determined or reasonably expected to expose employees to respirable crystalline silica levels above the PEL.[91] The agency strongly believes in these measures, as they "serve to limit exposure to respirable crystalline silica to as few employees as possible."[92]

[a] — Regulated Areas.

Regulated areas are intended for fixed workplaces, such as plants, where an affected area can be effectively demarcated and access can be controlled. They are easier to implement, and OSHA assumes most employers will choose this option when available.[93]

Employers must demarcate regulated areas by any means that adequately warns employees of the boundaries of the regulated area. "Signs, barricades, lines, or textured flooring may each be effective means of demarcating the boundaries of regulated areas," the agency explained.[94] "Permitting employers to choose how best to identify and limit access to regulated areas is consistent with OSHA's belief that employers are in the best position to make such determinations, based on their knowledge of the specific conditions of their workplaces."[95]

Access to the regulated area is limited only to authorized employees, and only when the authorized employee is wearing all appropriate personal protective equipment.[96] Respirator use is a must.[97] Protective clothing, such as coveralls, are also mandatory if the potential exists for an employee's work clothing to become "grossly contaminated with finely divided material

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91 *Id*. at 56,488. *See also, e.g.,* 29 C.F.R. §1910.1001(e) (asbestos standard for general industry).

92 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,283.

93 *Id*. at 56,365.

94 *Id*. at 56,450.

95 *Id*.

96 *Id*.

97 *Id*.

containing crystalline silica."[98] An authorized employee is one whose job duties require him or her to work in the regulated area.[99] OSHA inspectors are also allowed in regulated areas.[100]

[b] — Access Control Plans.

OSHA also gives employers the option of creating a written access control plan. Such a plan designates a competent person to identify and designate areas with exposure levels above (or reasonably expected to be above) the PEL.[101] A "competent person" is one who is "capable of identifying existing and predictable respirable crystalline silica hazards in the surroundings or working conditions and who has authorization to take prompt corrective measures to eliminate them."[102] The written access control plan must also contain procedures to notify employees and third-parties of the designated areas, as well as provisions for respirator use, restricted access to the designated areas, and similar provisions required by the regulated-areas option.[103] Annual review of the effectiveness of the written access control plan is required at least annually.[104] Plans must be made available for examination and copying upon request of any employee or OSHA representative.[105]

[3] — Methods of Compliance.

[a] — Hierarchy of Controls.

Unsurprisingly, the agency adhered to the priority system established by the hierarchy of controls. From OSHA's perspective, engineering controls control the hazard at the source; are reliable and predictable; provide consistent protection to a large number of workers; are easily monitored;

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98 *Id*. at 56,488.
99 *Id*. at 56,450.
100 *Id*. at 56,488.
101 *Id*. at 56,488.
102 *Id*. at 56,487.
103 *Id*. at 56,488.
104 *Id*. at 56,488.
105 *Id*. at 56,488.

and "not as susceptible to human error as is the use of personal protective equipment."[106]

Aware of lax enforcement issues on this subject, OSHA made clear that it intended to strictly enforce the hierarchy of controls provisions, and emphasized that employers who simply place affected employees in respirators and little else will not be in compliance with the proposed regulations. "To permit the use of respiratory protection as an alternative to engineering and work practice controls as a primary means to achieve the PEL" would not be considered a "legitimate regulatory alternative."[107] While OSHA inspectors regularly allows employers to meet the current PEL by providing respirators to employees, the agency insists the new rule will require "primary reliance on engineering controls and work practices because reliance on these methods is consistent with long-established good industrial hygiene practice, with the Agency's experience in ensuring that workers have a healthy workplace, and with the Agency's traditional adherence to a hierarchy of preferred controls."[108]

OSHA conceded that respiratory protection is important, but in an attempt to boost reliance on hierarchy of controls, strangely attacked respirator use as ineffective and complicated. "[R]espirators must be individually selected; fitted and periodically refitted; conscientiously and properly worn; regularly maintained; and replaced as necessary," the agency explained in its comments.[109] "In many workplaces, these conditions for effective respirator use are difficult to achieve."[110] OSHA then presented respirator use, as quite literally, a nightmare:

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106 *Id*. at 56,452.

107 *Id*. at 56,278.

108 *Id*. OSHA also noted that several federal circuit courts of appeals have upheld the agency's insistence on adherence to the Hierarchy of controls. *Id*. (citing AFL–CIO v. Marshall, 617 F.2d 636 (D.C. Cir. 1979) (cotton dust standard); United Steelworkers v. Marshall, 647 F.2d 1189 (D.C. Cir. 1980), *cert. denied*, 453 U.S. 913 (1981) (lead standard); ASARCO v. OSHA, 746 F.2d 483 (9th Cir. 1984) (arsenic standard); Am. Iron & Steel v. OSHA, 182 F.3d 1261 (11th Cir. 1999) (respiratory protection standard); Pub. Citizen v. U.S. Dep't of Labor, 557 F.3d 165 (3rd Cir. 2009) (hexavalent chromium standard)).

109 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,278.

110 *Id*.

> Respirators impose substantial physiological burdens on some employees. Certain medical conditions can compromise an employee's ability to tolerate the physiological burdens imposed by respirator use, thereby placing the employee wearing the respirator at an increased risk of illness, injury, and even death. Psychological conditions, such as claustrophobia, can also impair the effective use of respirators by employees. These concerns about the burdens placed on workers by the use of respirators are the basis for the requirement that employers provide a medical evaluation to determine the employee's ability to wear a respirator before the employee is fit tested or required to use a respirator in the workplace. . . . Safety problems created by respirators that limit vision and communication must also be considered. In some difficult or dangerous jobs, effective vision or communication is vital. Voice transmission through a respirator can be difficult and fatiguing.[111]

[b] — Optional Table 1 for Construction.

The proposed rule for respirable crystalline silica contains one new innovation — the introduction of an optional compliance table for engineering and administrative controls. Created to resolve concerns raised by the Small Business Regulatory Enforcement Fairness Act (SBREFA) panel, the table, labeled "Table 1," sets forth a pre-approved list of control and personal protective equipment requirements for common tasks in the construction industry. Following Table 1 relieves the employer of the burden of making the determination on the hierarchy of control for themselves.[112] For example, when using a jackhammer or impact driller, an employer conducting such tasks for less than four hours per day are in compliance so long as: (1) the employer utilizes either a continuous stream or spray of water at the point of impact or tool-mounted shroud and HEPA-filtered dust collection system; (2) no visible dust is emitted during the process; and (3) if indoors, sufficient

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111 *Id*.

112 *Id*. at 56,456.

ventilation is provided to prevent build-up of visible airborne dust.[113] For drywall work with silica-containing material, an employer will be deemed in compliance if employees use a pole sander or hand sander equipped with a dust collection system, in accordance with manufacturer specifications, or use wet methods to smooth or sand the drywall seam.[114]

OSHA did not create such a table for general industry, likely because general industry is a "none of the above" category. OSHA has promulgated standards specific to certain industries, such as construction, agriculture, longshoring, and marine terminals.[115] All other industries regulated by OSHA fall under general industry.[116] Creating a "Table 1" list for every primary job task that may fall into general industry may be next to impossible. Such a tome could easily stretch for thousands of pages to cover various industries governed under 29 C.F.R. Part 1910. On the other hand, OSHA could develop lists for certain industries covered under general industry, with the industry's help. For example, the Edison Electric Institute, which represents the electric utility industry, suggested the creation of a similar "Table 1" list for common tasks in the electric utility industry.[117]

[c] — Abrasive Blasting.

OSHA's proposed rule directs employers engaged in abrasive blasting to comply with the requirements of OSHA's ventilation standards.[118] The agency stopped short of banning silica sand as a blasting agent, however. While acknowledging that several substitutes are currently in use, OSHA conceded it has little to no data on the toxicity of the alternatives.[119] In other

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113 *Id*. at 56,497.

114 *Id*. at 56,499.

115 *See* 29 C.F.R. Parts 1915, 1917, 1918, 1926.

116 *See* 29 C.F.R. §§1910.1, 11.

117 *See* Mary Miller, Comments of Edison Electric Institute, Feb. 11, 2014, OSHA-2010-0034-2357 ("EEI Comments), at 15, 17, 26-27. Disclosure: the author participated in the drafting of EEI's comments. See *id*. at 1.

118 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,465, 56,499.

119 *Id*. at 56,465.

words, OSHA is hesitant to ban silica sand without definitively knowing whether the alternatives in the marketplace are less harmful to employees.

[d] — HEPA Vacuums and Wet Methods.

The proposed rule requires only one of two methods to clean accumulations of respirable crystalline silica — either high-efficiency particulate arrestance (HEPA) vacuums, or wet methods.[120] OSHA primarily relies on NIOSH data to conclude these are the most effective means on cleaning silica dust.[121]

Compressed air, dry sweeping, and dry brushing are banned, if such methods "contribute" to employee exposure to respirable crystalline silica in excess of the PEL.[122] OSHA's explanation, however, seems to go further and suggest a complete ban on such methods.[123]

[e] — Prohibition on Rotation.

Significantly, the proposed rule bans employee rotation as a work practice control, when the rotation is used to get employee exposure under the PEL.[124] HSE professionals, however, have long recognized employee rotation as a recognized and effective control. Employee rotation may also be utilized for several other valid safety considerations, such as managing employee fatigue on job tasks involving heavy manual labor.

"This provision is not a general prohibition of worker rotation wherever workers are exposed to crystalline silica," OSHA cautions in its comments.[125] "It is only intended to restrict its use as a compliance method for the proposed PEL."[126] OSHA inspectors, however, rarely read the explanations offered by OSHA deep within the Federal Register. Ultimately, the purpose of a

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120 *Id*. at 56,499.

121 *Id*. at 56,466.

122 *Id*. at 56,499.

123 *See id*. at 56,466 ("This section also prohibits the use of compressed air, dry sweeping, and dry brushing to clean clothing or surfaces contaminated with crystalline silica.").

124 *Id*. at 56,499.

125 *Id*. at 56,466.

126 *Id*.

rotation, however, may largely depend on the eye of the beholder. Whereas an employer believes they use rotation to alleviate worker exposure to physically demanding jobs, an OSHA inspector may perceive it as an end-around on the proposed rule's ban on employee rotation.

[4] — Respiratory Protection.

OSHA's proposed rule also contains a section governing respiratory protection, which is unremarkable. The section essentially instructs employers that if they must resort to respiratory protection to protect employees, it reminds them to follow the agency's respiratory protection standard, already in place at 29 C.F.R. §1910.134.[127]

[5] — Medical Surveillance

Sections 1910.1053(h) and 1926.1053(h) of the proposed rule introduces a medical surveillance requirement for employees exposed to respirable crystalline silica above the PEL for more than 30 days per year.[128] OSHA estimates that 15,172 workers in general industry (excluding hydraulic fracturing) and 336,244 employees in construction will undergo medical surveillance under the proposed standard.[129] Other OSHA standards, such as asbestos, contain medical surveillance provisions. The proposed rule for respirable crystalline silica, however, contains a few new ideas, such as chest x-ray readings by a certified "B" reader, and testing for latent tuberculosis.

[a] — Medical Evaluation.

The proposed rule requires employers to make available an initial, "baseline" medical examination within 30 days after an employee's initial job assignment, unless the employee has previously received a compliant medical examination within the last three years. The baseline examination must contain:

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127 *Id*. at 56,500.
128 *Id*. at 56,489, 56,500.
129 *Id*. at 56,406.

(i) A medical and work history, with emphasis on: Past, present, and anticipated exposure to respirable crystalline silica, dust, and other agents affecting the respiratory system; any history of respiratory system dysfunction, including signs and symptoms of respiratory disease (e.g., shortness of breath, cough, wheezing); history of tuberculosis; and smoking status and history;

(ii) A physical examination with special emphasis on the respiratory system;

(iii) A chest X-ray (posterior/anterior view; no less than 14 x 17 inches and no more than 16 x 17 inches at full inspiration), interpreted and classified according to the International Labour Organization (ILO) International Classification of Radiographs of Pneumoconiosis by a NIOSH-certified ''B'' reader, or an equivalent diagnostic study;

(iv) A pulmonary function test to include forced vital capacity (FVC) and forced expiratory volume at one second (FEV1) and FEV1/FVC ratio, administered by a spirometry technician with current certification from a NIOSH-approved spirometry course;

(v) Testing for latent tuberculosis infection; and

(vi) Any other tests deemed appropriate by the PLHCP [physician or other licensed health care professional].[130]

The agency justifies B-reader analysis on the grounds that "the evaluation of X-ray films and digital images by certified, qualified individuals is warranted by the prevalence and seriousness of silicosis."[131] B-readers, however, have been blamed for creating a false epidemic of silica cases, most notably in the federal Silica Productions Multi-District Litigation in the early

130 56,489, 56,500.
131 56,470.

2000s.[132] B-readers are also scarce. At the time the proposed rule was issued, there were only 224 certified B-readers in the country.[133]

OSHA explained the rationale for testing for latent tuberculosis as, generally, a good idea. "OSHA believes that a general requirement for testing during the initial medical examination will serve to protect workers exposed to respirable crystalline silica by identifying latent tuberculosis infection so it can be treated before active (infectious) tuberculosis develops."[134] That may be noble, but tuberculosis cases are caused by a wide variety of factors, many of which are non-work related.[135]

[b] — Employer Duties.

In addition to the initial examination requirements, employers must ensure affected employees receive a medical examination every three years, or sooner if recommended by a physician. Employers must also ensure that PLHCPs receive a copy of the OSHA standard and the following information:

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132 In 2005, United States District Judge Janis Jack dismissed what she described as a "phantom epidemic" of silicosis cases, created by plaintiffs' lawyers, and physicians and B-readers retained by them. *In re* Silica Prods. Liab. Litig., 398 F. Supp. 2d 563, 572-573 (S.D. Tex. 2005). Many claimants had previously been diagnosed with asbestosis, often by the same physician, which is "scientifically virtually impossible." *Id*. at 674. Judge Jacks singled out the physicians, and B-readers in particular:

> [T]hese diagnoses were driven by neither health nor justice: they were manufactured for money. The record does not reveal who originally devised this scheme, but it is clear that the lawyers, doctors and screening companies were all willing participants. And if the lawyers turned a blind eye to the mechanics of the scheme, each lawyer had to know that Mississippi was not experiencing the worst outbreak of silicosis in recorded history.

Id. at 635-36.

Representative Ed Whitfield, chair of the House Oversight and Investigations Subcommittee, called hearings into the matter, and subpoenaed three of the most active B-readers in the silica products MDL to testify before Congress. All three appeared and invoked their Fifth Amendment right against self-incrimination. "Silicosis Clam-Up," *Wall Street Journal*, March 13, 2006.

133 *See* EEI Comments, at 34 & n.60 (citing http://www.cdc.gov/niosh/topics/chestradiography/breader-list.html).

134 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,470.

135 *See* Centers for Disease Control and Prevention (CDC), Tuberculosis (TB) Disease: Symptoms & Risk Factors, available at http://www.cdc.gov/features/tbsymptoms.

(i) A description of the affected employee's former, current, and anticipated duties as they relate to the employee's occupational exposure to respirable crystalline silica;

(ii) The employee's former, current, and anticipated levels of occupational exposure to respirable crystalline silica;

(iii) A description of any personal protective equipment used or to be used by the employee, including when and for how long the employee has used that equipment; and

(iv) Information from records of employment-related medical examinations previously provided to the affected employee and currently within the control of the employer.[136]

It is unclear how OSHA intends to enforce the employer's obligation to guess at anticipated future job duties and levels of occupational exposure to respirable crystalline silica. Does an employer, for example, expose itself to liability if it incorrectly guesses an employee's exposure level?

Employers must also obtain a PLHCP's written medical opinion from the PLHCP within 30 days of each medical examination performed on each employee.[137] While the purpose of this provision is clear — to provide employees with timely information — OSHA seems to make the employer strictly liable if the PLHCP drags his or her feet and issues medical opinions beyond the 30-day window.[138]

[6] — Hazard Communication.

The proposed rule mandates the inclusion of respirable crystalline silica into an employer's hazard communication program.[139] Employers must ensure that all containers of crystalline silica are properly labeled and

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136 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,500.

137 *Id*. at 56,500.

138 *See id*. at 56,472.

139 *Id*. at 56,500.

Safety Data Sheets (SDS) are provided.[140] Employee training and SDS must be updated to include the cancer, lung, immune system, and kidney hazards of respirable crystalline silica.[141] Employee training must also include the provisions of the final standard.[142]

[7] — Recordkeeping.

OSHA reminds employers of their recordkeeping obligations. All air samples, sampling details, lab results, identity of labs used, records of personal protective equipment worn by employees during monitoring, names, social security numbers, job classification of all employees represented by the monitoring, indication of employees actually monitored must all be kept in accordance with OSHA's standard on employee access to exposure and medical records.[143] The standard generally requires employers to keep such records for the duration of an individual's employment, plus 30 years.[144]

[8] — Effective Dates.

OSHA proposes that all provisions of the standard go into effect within 180 days of publication of the final rule, with two exceptions.[145] First, OSHA gives employers one year from publication to implement engineering controls. "This is to allow affected employers sufficient time to design, obtain, and install the necessary control equipment," the agency explains.[146] "During the period before engineering controls are implemented, employers must provide respiratory protection to employees . . . ."[147] Second, OSHA gives laboratories two years from publication to obtain ANS/ISO/IEC Standard 17025:2005 accreditation.[148] "OSHA recognizes that the requirements

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140 *Id*.
141 *Id*.
142 *Id*. at 56,501.
143 *Id*.
144 *See, e.g.*, 29 C.F.R. §§ 1910.1020(d)(1)(i)-(ii).
145 OSHA Proposed Rule for RCS, 78 Fed. Reg. at 56,501.
146 *Id*.
147 *Id*.
148 *Id*.

for monitoring in the proposed rule will increase the demand for analysis of respirable crystalline silica samples," especially the "requirements for accreditation and round robin testing."[149]

§ 15.06. Reaction to the Proposed Rule.

[1] — NIOSH Response.

NIOSH welcomed the proposed rule, noting that the proposed PEL matched the recommended exposure level the agency suggested back in 1974.[150] NIOSH submitted 62 pages of comments with very precise feedback to OSHA's questions to stakeholders and the proposed regulations.[151]

NIOSH mentioned its 11-site, 5-state NIOSH study of worker exposure to respirable crystalline silica in the hydraulic fracturing process.[152] NIOSH collected 111 voluntary personal samples for respirable silica at hydraulic fracturing sites in Arkansas, Colorado, North Dakota, Pennsylvania, and Texas for workers in 15 job titles that comprised most members of a fracking crew.[153] NIOSH indicated that 51.4 percent of all samples collected in the study were above OSHA's present PEL for respirable crystalline silica.[154]

NIOSH's comments largely supported OSHA's proposed rule. But NIOSH expressed reservations about Table 1 for construction, noting that "[f]ully implementing the exposure control methods described in Table 1 would not automatically ensure compliance with the proposed PEL."[155] NIOSH also believed that some of the terms used in Table 1 needed additional clarification or explanation.[156]

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149 *Id*.

150 Comments of the National Institute for Occupational Safety and Health on the Occupational Safety and Health (OSHA) proposed rule on Occupational Exposure to Respirable Crystalline Silica, OSHA-2010-0034-2177 (hereinafter "NIOSH Comments"), at 2, *available at* www.regulations.gov.

151 *See generally* NIOSH Comments.

152 NIOSH Comments, at 4.

153 *Id*.

154 *Id*. at 5.

155 *Id*. at 17.

156 *Id*. at 27.

Some of NIOSH's suggestions were expansive. For instance, NIOSH suggested that NIOSH-designed and -tested clothes cleaning booth technology be listed as a possible option when dealing with contaminated work clothing, as well as listed as an approved compliance method.[157] The agency also suggested daily evaluations of engineering controls.[158] NIOSH suggested continued medical surveillance even after employees are no longer exposed, "because silica retention in the lung is prolonged and can cause progressive lung damage even after exposure ends."[159]

[2] — Union Response.

American labor unions have aggressively pushed for the proposed respirable crystalline silica rule. Unions such as the AFL-CIO called on OSHA to implement a new rule, and many were involved at various stages of development of the proposed rule. When the proposed rule suffered from rulemaking lag, such as when the proposed rule was under review by the White House Office of Management and Budget (OMB) for two-and-a-half years, labor unions aggressively lobbied the Obama Administration to push the rule through to the NPRM stage.[160]

After publication of the NPRM, unions generally welcomed the new proposed rule as long overdue.[161] But amidst the praise were also some

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157 *Id*. at 15, 48.

158 *Id*. at 21.

159 *Id*. at 39.

160 *See, e.g.,* Peg Seminario, Testimony of Peg Seminario, Director Safety and Health, AFL-CIO Before the Subcommittee on Oversight, Federal Rights, and Agency Action Senate Judiciary Committee Hearing on "Justice Delayed: The Human Cost of Regulatory Paralysis," August 1, 2013, available at http://www.aflcio.org/Legislation-and-Politics/Testimonies/Seminario-on-Justice-Delayed-The-Human-Cost-of-Regulatory-Paralysis; Mike Hall, "Council Urges Action on Deadly Silica Dust Rule, Condemns N.Y. Pension Cuts," March 14, 2012, available at http://www.aflcio.org/Blog/Political-Action-Legislation/Council-Urges-Action-on-Deadly-Silica-Dust-Rule-Condemns-N.Y.-Pension-Cuts.

161 *See* Peg Seminario, Testimony/Comments of the AFL-CIO on the Occupational Safety and Health Administration's Proposed Rule on Occupational Exposure to Respirable Crystalline Silica, Feb. 10, 2014, OSHA-2010-0034-2256 ("AFL-CIO Comments") at 1, *available at* www.regulations.gov; James Frederick and Rami Katrib, Comments of United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service

criticisms; largely that the proposed rule did not go as far as they had hoped. Several unions requested that the PEL be set lower to 25 μg/m^3,[162] requirements for written exposure control plans,[163] and a ban on silica sand in abrasive blasting.[164] Many also urged OSHA to have the action level serve as the trigger for medical surveillance in general industry.[165] The AFL-CIO suggested the elimination of an alternative for written access control plans. [166] USW also urged OSHA to adopt a medical removal provision, to remove affected employees from the workplace when exposed to certain levels of respirable crystalline silica.[167]

[3] — Employer Response.

Industry response was generally negative of the proposed rule. Industry was critical of the relatively short time frame OSHA gave for comments, especially when OSHA placed over 1,700 technical documents in the rulemaking record.[168]

Workers International Union on OSHA's Proposed Rule on Occupational Exposure to Respirable Crystalline Silica, Jan. 16, 2014, OSHA-2010-0034-2336 ("USW Comments") at 3, available at www.regulations.gov; Julie A. Plavka, Rick Inclima, and LaMont Byrd, The International Brotherhood of Teamsters Comments On Occupational Exposure to Respirable Crystalline Silica, Feb. 11, 2014, OSHA-2010-0034-2318 ("Teamster Comments"), at 3, *available at* www.regulations.gov.

162 Other unions suggested that OSHA fully evaluate supports a lower limit, and if so, to set a lower PEL. AFL-CIO Comments, at 8.

163 AFL-CIO Comments, at 12; USW Comments, at 8-9.

164 AFL-CIO Comments, at 12.

165 AFL-CIO Comments, at 9; USW Comments, at 11.

166 AFL-CIO Comments, at 11.

167 USW Comments, at 12.

168 Randel Johnson and Marc Freedman, U.S. Chamber of Commerce Comments on Occupational Safety and Health Administration Proposed Rule on Occupational Exposure to Respirable Crystalline Silica, Feb. 11, 2014, OSHA-2010-0034-2288 ("U.S. Chamber Comments"), at 32, *available at* www.regulations.gov; Brad Hammock, Extension of Silica Rulemaking Deadlines, Sept. 27, 2013, OSHA-2010-0034-1736, at 2, *available at* www.regulations.gov; Comments of the National Association of Manufacturers before the U.S. Occupational Safety And Health Administration, Feb. 25, 2014, OSHA-2010-0034-2380 ("NAM Comments"), at 4, *available at* www.regulations.gov.

Several prominent industry trade associations questioned the need for a proposed rule, when CDC statistics indicated that silica illnesses and deaths in the United States are steadily declining.[169] For example, the U.S. Chamber of Commerce noted CDC data showing a 93 percent decline in silicosis mortality rates from 1968 to 2007.[170]

Many cried foul at OSHA's decision to not reconvene a SBREFA panel, since the panel was convened in 2003.[171] The U.S. Chamber of Commerce remarked, "Congress did not intend for a more than ten year-old SBREFA review that left out key industries and data, to satisfy its concern for providing small business with meaningful input."[172]

Others noted OSHA's own lax enforcement of the current rule for respirable crystalline silica. How could the agency determine the necessity for an updated rule when it admits it does not effectively enforce the current rule?[173] The proposed rule "attempts to fix a compliance problem by creating a new standard," remarked the U.S. Chamber of Commerce.[174]

Several trade groups attacked OSHA's Preliminary Economic Analysis of the proposed rule.[175] The National Association of Manufacturers noted that the agency excluded 24 manufacturing industry subsectors substantially affected by the proposed rule, such as asphalt paving products, asphalt roofing materials, foundries, concrete products, dental equipment and supplies,

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169 U.S. Chamber Comments, at 7-8; Dan Danner, National Federation of Independent Business, Docket No. OSHA–2010–0034 – Occupational Exposure to Respirable Crystalline Silica, Feb. 10, 2014, OSHA-2010-0034-2210 ("NFIB Comments), at 1, *available at* www.regulations.gov; Kenny Jordan, Association of Energy Service Companies comments to Occupational Exposure to Respirable Crystalline Silica, Feb. 11, 2014, OSHA-2010-0034-2344 ("AESC Comments") at 1, *available at* www.regulations.gov.

170 U.S. Chamber Comments, at 7-8.

171 *See* NFIB Comments, at 3, 5-6; NAM Comments at 4; U.S. Chamber Comments, at 5.

172 U.S. Chamber Comments, at 5.

173 *See* U.S. Chamber Comments, at 8; NFIB Comments, at 3.

174 U.S. Chamber Comments, at 32.

175 NFIB Comments, at 8-9; NAM Comments, at 4-6.

hydraulic fracturing, jewelry, non-ferrous and ferrous sand casting foundries, and ready-mix concrete, from the PEA.[176]

In an effort to discredit OSHA's suggested PEL, U.S. Chamber of Commerce introduced studies suggesting that an exposure level of 200 $\mu g/m^3$ or more is necessary to cause a silica-related disease.[177] The National Association of Manufacturers noted that measuring samples at such small levels is difficult and has a high margin of error. Because of the margin of error, NAM contended that "OSHA is not proposing a PEL of 50 $\mu g/m^3$, but a PEL of 37 $\mu g/m^3$."[178]

The American Chemistry Council introduced an entire panel of scientists challenging nearly every technical justification underpinning OSHA's proposed rule.[179] The Council was highly critical of the fact that OSHA relied on the study of one B-reader in concluding that silicosis cases were underreported.[180]

Finally, many companies and groups assailed OSHA's economic analysis as unrealistic. For instance URS Corporation submitted a study asserting that annualized compliance costs for general industry would not be $132.5 million, as OSHA claimed, but rather $6.1 billion.[181] The National Association of Home Builders commissioned a study suggesting that the cost of annualized compliance for the construction industry will exceed $5 billion, 10 times more than OSHA's estimate.[182]

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176 NAM Comments at 4-5.

177 U.S. Chamber Comments, at 13.

178 NAM Comments at 17.

179 *See* Post Hearing Brief of the American Chemistry Council, Aug. 18, 2014, OSHA-2010-0034-4209 ("ACC Post Hearing Brief"), available at www.regulations.gov.

180 ACC Post Hearing Brief, at 5.

181 ACC Post Hearing Brief, at 101. *See also* Environomics, Inc. and URS Corporation, "Estimated Costs and Adverse Economic Impacts of a Potential New OSHA Occupational Exposure Standard for Crystalline Silica With a PEL of 50 ug/m3 and Ancillary Requirements," Draft Final Report For the American Chemistry Council Crystalline Silica Panel, July 2011.

182 National Association of Home Builders, *Study Finds that OSHA Underestimated Cost of Silica Rule by $4.5 Billion a Year*, March 26, 2015, *available at* http://www.nahb.org/en/news-and-publications/Press-Releases/2015/march/study-finds-that-osha-underestimated-cost-of-silica-rule-by-4point5-billion-dollars-a-year.aspx.

[4] — Energy Industry Response.

OSHA notably omitted hydraulic fracturing from the PEA, and instead introduced a separate PEA. OSHA's explanation for fracking's omission from the PEA is that the agency only became aware of the proposed rule's potential effect after the PEA was finished.[183]

OSHA's Preliminary Economic Analysis on the hydraulic fracturing industry came under intense scrutiny from industry groups. The U.S. Chamber of Commerce assailed OSHA's PEA on the fracking industry as "woefully inadequate."[184] The Chamber was particularly critical of the fact that OSHA relied on "visual impressions" from photographs to conclude certain engineering controls, such as local exhaust ventilation (LEV) on thief hatches were feasible:

> Local Exhaust Ventilation (LEV) systems are the main way OSHA proposes to reduce exposure levels to or below 50 μg/m^3. It proposes implementing systems at various points on sand-handling equipment used in the fracking industry. According to OSHA, LEV systems would capture dust at emission points on conveyor belts, sand movers and blender hoppers. Importantly, the Agency admits that it did

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183 OSHA Proposed Rule on RCS, 78 Fed. Reg. at 56,277. At first glance this explanation seems implausible. Hydraulic fracturing has been in existence since the late 1940s, with the general concept dating back to Col. Edward A. L. Roberts' 1866 patent for an "exploding torpedo." Improvement in Exploding Torpedoes in Artesian Wells, U.S. Patent No. 59,936 (issued November 20, 1866). The general process of hydraulically fracturing a well has not changed over that time.

But for decades the process was cost-prohibitive to develop wells in shale fields in the United States. Shale fields have low permeability. Starting in 1999, however, companies such as Mitchell Energy began experimenting with hydraulic fracturing techniques, deploying significantly higher pressures than earlier processes, in the Barnett Shale near Fort Worth, Texas. Once proven highly successful, others jumped on the bandwagon, leading to a shale fracking boom in the United States. According to the U.S. Energy Information Administration (EIA), in 2011 the United States became the top natural gas producing in the world, outpacing Russia. U.S. Energy Information Administration, Dry Natural Gas Production — 2012, *available at* http://www.eia.gov/beta/international/?fips=sa#pet. In 2013 the United States surpassed Saudi Arabia as the top petroleum producing country in the world. U.S. Energy Information Administration, Total Petroleum and Other Liquids Production — 2014, *available at* http://www.eia.gov/beta/international/rankings/#?prodact=53-1&cy=2014.

184 U.S. Chamber Comments, at 5.

not identify any studies demonstrating that LEV systems would be effective in controlling silica exposure in the fracking industry.

Yet, OSHA concludes that companies can reduce exposure levels by 50 percent using LEV controls on fracking industry "thief hatches," based solely on the Agency's "best available evidence," namely its "visual impression" from photographs of fracking operations. In other words, OSHA surmises from photographs that about half the respirable dust (not visible to the human eye) at fracking sites is attributable to emissions from thief hatches. As demonstrated by the comments of leading ventilation expert Knutson, this position does not survive scrutiny. Moreover, even if OSHA is correct, it acknowledges that the LEV systems at fracking sites are "unproven."[185]

Several companies and industry groups submitted comments. The American Petroleum Institute (API) and the Independent Petroleum Association of America (IPAA) submitted 82 pages of joint comments, critical of both the proposed rule and OSHA's preliminary economic analysis on the hydraulic fracturing industry.[186] The API and IPAA noted that OSHA's own analysis "demonstrates that compliance with the PEL is not technologically feasible without the continued use of respirators to protect the workforce."[187] They were puzzled by OSHA's statements about the industry, such as the agency's claim that a "typical" large fracking crew contained exactly 16 employees at one point in the agency's PEA on the fracking industry, and 17.5 at another point.[188] The two groups suggested that, due to a lack of evidence that lowering the PEL will reduce illnesses

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185 U.S. Chamber Comments, at 22 (citations omitted).

186 *See* Comments of the American Petroleum Institute (API) and the Independent Petroleum Association of America (IPAA) in Response to the Occupational Safety & Health Administration (OSHA) Proposed Rule entitled "Occupational Exposure to Respirable Crystalline Silica," Feb. 11, 2014, OSHA-2010-0034-2301 ("API/IPAA Comments"), *available at* www.regulations.gov.

187 API/IPAA Comments, at 3.

188 API/IPAA Comments, at 19. The two groups indicated that while "crew size and functional distribution are variable depending on region, well size, depth, pressure needs, complexity, and company policies," 16 to "17.5" employees is a bit small for a typical "large" fracking crew. *See id*. at 20 (more like 24 employees).

or injuries, OSHA should keep the PEL at its current 100 $\mu g/m^3$ level for general industry, and establish an action level of 50 $\mu g/m^3$.[189]

The API and IPAA criticized NIOSH's 2011-13 study of fracking sites as non-representative of the industry. Seven of the 11 sites sampled were in one region (Denver-Julesburg Basin), and the sole site sampled in North Dakota did not even use silica sand as the proppant.[190] They questioned why OSHA included hydraulic fracturing within the scope of the proposed rule on the basis of 75 samples, yet the 200 samples taken in the agricultural industry constituted "limited data" that justified the exclusion of that industry.[191] Finally, the groups noted that annualized compliance costs for the industry were likely to exceed $366.7 million, far more than OSHA's estimated costs of $102.9 million for the initial year and $16 million for subsequent years.[192]

The Association of Energy Service Companies (AESC), the largest well servicing company association in the United States, expressed concern over OSHA's mandate for the industry to use unproven engineering controls, and skepticism at how OSHA calculated the costs of unproven controls.[193] The AESC convened a silica focus work group to identify potential engineering controls.[194] "While there are numerous designs and a few test models, a proven and commercially available engineering solution has not yet been developed," wrote Executive Director Kenny Jordan. "Given the present unavailability of engineering controls, we have difficulty understanding how OSHA was able to estimate the cost for such an engineering solution."[195]

Halliburton assailed OSHA's analysis as failing to include any hydraulic fracturing-specific engineering control studies or research.[196] "Rather, OSHA relies primarily on reasoning by analogy that engineering controls that were

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189 API/IPAA Comments, at 4.

190 API/IPAA Comments, at 30.

191 API/IPAA Comments, at 34.

192 *Compare* OSHA Hydraulic Fracturing PEA, at 62, *with* API/IPAA Comments, at 76.

193 AESC Comments, at 2.

194 *Id*.

195 *Id*.

196 Comments on the Proposed OSHA Rule on Occupational Exposure to Respirable Crystalline Silica Submitted by Halliburton Energy Services, Inc., Feb. 11, 2014, OSHA-2010-0034-2302 ("Halliburton Comments"), at 4.

helpful in other industries will also be effective in hydraulic fracturing," wrote Halliburton.[197] "OSHA needs to do more, in our view, to establish the need for the proposal, its feasibility, and its proposed benefits."[198] Halliburton questioned the utility of NIOSH's study, when the agency "failed to examine a statistically representative group of hydraulic fracturing sites in its technological feasibility analysis, did not measure exposures with accepted sampling devices, and did not account for the bias demonstrated by the sampling devices they used, which operates at a much higher flow rate and is biased towards the collection of large, non-respirable dust particles."[199]

[5] — Congressional Reaction.

Republicans in Congress reacted negatively to the proposed rule. At a budget hearing held on March 17, 2015, Republican members of the House Labor, Health and Human Services, Education, and Related Agencies Subcommittee assailed Secretary of Labor Tom Perez with criticisms of the proposed rule.[200] Rep. Charles Dent (R-PA) questioned its necessity, noting the 70-percent compliance rate.[201] Why not focus on improving compliance rates, rather than move forward with a new rule?[202]

Rep. Andy Harris (R-MD) asked Perez about the proposed rule's failure to permit personal air-filtered helmets as the primary dust control measure.[203] They "work kind of great," Harris said, and noted that such respirators can protect against bacteria as well as silica.[204]

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197 Halliburton Comments, at 4.

198 *Id*.

199 Halliburton Comments, at 4.

200 *See* "Perez defends upcoming silica rule, as GOP members raise concerns," *Safety + Health Magazine* (March 17, 2015), http://www.safetyandhealthmagazine.com/articles/12005-perez-defends-upcoming-silica-rule-as-gop-members-raise-concerns. A video recording of the hearing is available at https://www.youtube.com/watch?v=6R4GpuxRrW0.

201 *See id*.

202 *See id*.

203 *See id*.

204 *See id*.

As expected, Secretary Perez defended the proposed rule, declining to get into specifics. "We're trying to save lives here," Perez said, "and exposure to silica kills."[205]

§ 15.07. Forecast.

[1] — Estimated Time of Arrival for the Final Rule.

The agency currently does not formally indicate when they expect to issue the Final Rule on Respirable Crystalline Silica. OSHA's current Regulatory Agenda indicates that, as of June 2015, the agency is currently reviewing written comments filed with the agency and reviewing testimony received during three weeks of contentious hearings held in Washington, D.C. in March 2014. Informally, however, the agency has all but guaranteed the Final Rule will be issued prior to the conclusion of the Obama Administration in January 2017.

At a safety conference in Maryland on June 3, 2015, OSHA deputy assistant secretary Jordan Barab told the audience to expect the issuance of the Final Rule in 2016.[206] Dr. David Michaels has echoed this sentiment in several speeches throughout the country.[207] Deputy Secretary of Labor Christopher Lu echoed this sentiment, telling union advocates at a Workers Memorial Day event on April 28, 2015 that "I guarantee you that we will get [the proposed silica rule] done."[208]

[2] — Industry Reaction to the Final Rule

Industry reaction will obviously depend on the extent to which OSHA responds to concerns raised in comments and testimony. But OSHA seems

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205 *See id*.

206 Christopher Cole, *OSHA* " 'Will Issue' Final Silica Standard, Top Official Promises Worker Health Activists," *Inside OSHA Online*, June 5, 2015, www.insideoshaonline.com.

207 *See, e.g*., Christopher Cole, "Lag in Silica Data Review Seen Endangering Rule Under Obama As GOP Gears Up To Block Action," *Inside OSHA Online*, Nov. 25, 2014, www.insideoshaonline.com; Christopher Cole, "OSHA Fully Intends to Issue Silica Rule By End of Obama's Term," Michaels Says, *Inside OSHA Online*, Oct. 21, 2014, www.insideoshaonline.com

208 "Top Labor official: Silica to get done under Obama," *Inside OSHA Online*, April 28, 2015, www.insideoshaonline.com.

unlikely to alter the proposed PEL or action level, so litigation is very probable.[209]

[3] — MSHA Reaction to the Final Rule

The Mine Safety and Health Administration is keeping close attention to the OSHA rulemaking process. In the Unified Rulemaking Agenda published by the Department of Labor in Spring 2015, MSHA announced its intention to issue a NPRM on respirable crystalline silica in April 2016.[210] Although OSHA has not announced the time of when it expects to release the final rule, MSHA's announcement suggests that OSHA will either publish their final rule by that time, or at least have a very good draft of its final rule.[211]

Expect the main form of MSHA's proposed rule to bear a striking resemblance to OSHA's final rule. That is not say the substance of MSHA's proposed rule will be identical; after all, MSHA regulates a unique industry. But MSHA has the benefit of going second, and can learn from the rulemaking record established in the OSHA rulemaking.

§ 15.08. Conclusion.

OSHA's proposed rule for respirable crystalline silica is one of the agency's most significant rulemaking efforts over the past decade. While there is no timetable currently set for OSHA's final rule, the agency has made it clear that the final rule will issue before the end of the current White House administration. The fact that MSHA announced their proposed rule

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209 Christopher Cole, *OSHA OSHA* " 'Will Issue' Final Silica Standard, Top Official Promises Worker Health Activists*," Inside OSHA Online* (National COSH executive director Mary Vogel conceding that silica rule opponents "plan nonetheless to challenge the final rule in court.").

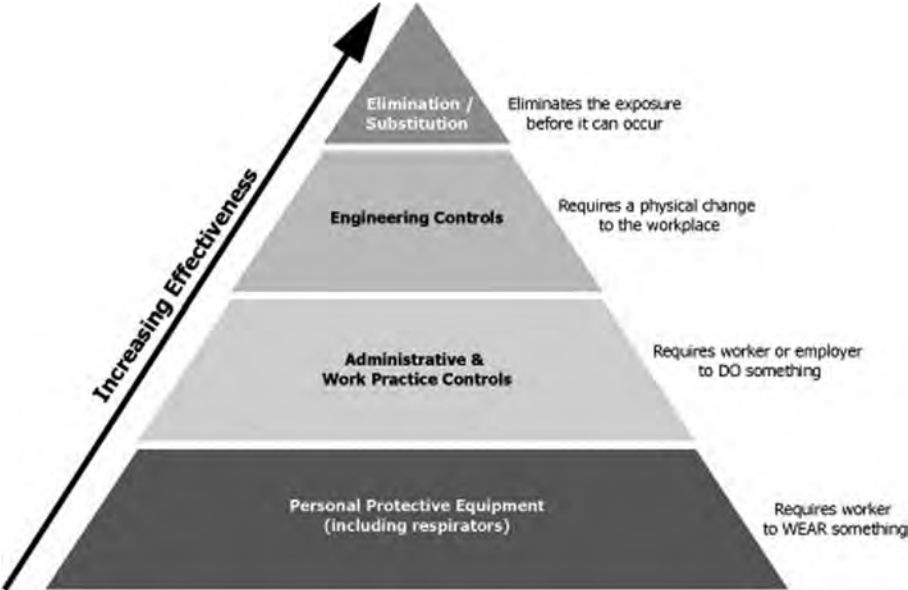
210 *See* Department of Labor Unified Agenda and Regulatory Plan, Agency Rule List, Spring 2015, DOL/MSHA, Respirable Crystalline Silica, available at http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201504&RIN=1219-AB36.

211 See Christopher Cole, *Experts: Final Silica Rule Many Months Away as OSHA Combs through Mounds of Data*, Inside OSHA Online, Sept. 9, 2014, www.insideoshaonline.com (quoting former Assistant Secretary Ed Foulke, noting that OSHA would have to get the final rule to OMB four to six months before the end of the term).

for respirable crystalline silica will issue in April 2016 suggests that OSHA's final rule will likely be published by then, or at least in near-final form.

Appendix A

OSHA hierarchy of controls



Chapter 16

Midstream Assets — How to Get Those Pipes in the Ground

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§ 16.01. Introduction.

The rapid expanse of natural gas production throughout the United States has placed an increased burden on the current pipeline transmission network and capacity. Accordingly, it is of prime importance that companies responsible for natural gas production and pipeline construction understand the various legal mechanics affecting the expansion of the pipeline network. The purpose of this chapter is to provide an overview and general background of state and federal pipeline easement law. The overview will offer a refreshed look at the basic principles of easements and will take a focused look on certain nuances within those jurisdictions. Most notably, the creation of new pipeline easements, eminent domain power at both federal and state levels, and the expansion and variation of easements already in existence will be examined.

§ 16.02. State and Federal Pipeline Easement Law.

[1] — General Easement Background.

[a] — Definition.

An easement is known as an "intangible or non-possessory right to use another's land for a precise and definite purpose not inconsistent with the other's simultaneous right to use the same property, or, [to be technical], an incorporeal hereditament."[1]

Although numerous variations of this definition exist, an easement is most commonly referred to "as an interest in the land in the possession of another which: (a) entitles the owner of such interest to a limited use or enjoyment of the land in which the interest exists; (b) entitles him to protection as against

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1 *Black's Law Dictionary*, 8th ed. (2004), at 1108.

third persons from interference in such use or enjoyment; (c) is not subject to the will of the possessor of the land; (d) is not a normal incident of the possession of any land possessed by the owner of the interest; and (e) is capable of creation by conveyance."[2] As such, the interest obtained through an easement carries with it only a non-possessory right to use the land of another for a special purpose.[3] Furthermore, a right-of-way is an easement to pass or cross the lands of another, thus an 'easement' and 'right-of-way' are often regarded as synonymous.[4]

Regardless of the name given to the estate acquired, all rights to the land which, by legislation or in the nature of the thing, are necessary for the business to be carried on are acquired.[5] Easements give an owner the right to use the servient estate in any way not inconsistent with the limited use permitted to the easement owner.[6]

[b] — Types of Easements.

Commonly there are two distinct classes of easements: easements appurtenant and easements in gross. An easement appurtenant is an easement that runs with the land and arises when, at the time of the easement's conveyance, the grantee holds an estate in land that is benefitted [35] by the easement obtained.[7] "The benefitted estate is the dominant estate or dominant tenement, and the burdened estate is known as the servient estate or servient tenement."[8]

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2 Johnson & Hardin Co. v. NLRB, 49 F.3d 237, 242 (6th Cir. 1995) (quoting Smith v. Gilbraith, 599 N.E.2d 798, 802 (Ohio 1991)); *see also* Restatement (First) of Property § 450 (1944).

3 *Id.*

4 Cellco P'ship v. Shelby Cnty., 172 S.W.3d 574 (Tenn. Ct. App. 2005); *accord* Amerikohl Min. Co. v. Peoples Natural Gas Co., 860 A.2d 547, 550 (Pa. Super. Ct. 2004); Newman v. Michel, 688 S.E.2d 610, 616 W. Va. (2009); Queen v. Hanna, 2012-Ohio-6291, at ¶ 24; *see also* Ballington v. Paxton, 488 S.E.2d 882, 886 (S.C. Ct. App. 1997) (defining a "right of way" as a right "to pass and repass in a reasonable manner," absent any restrictive language in the grant (quoting Watson v. Hoke, 53 S.E. 537 (S.C. 1906)).

5 Hall v. Del., L. & W. R. Co., 113 A. 669, 670 (Pa. 1921).

6 Colburn v. Maynard, 675 N.E.2d 1333, 1338 (Ohio 1996).

7 Kent's Run P'ship v. Glosser, 323 B.R. 408, 422, 2005 U.S. Dist. LEXIS 10203, 35 (W.D. Pa. 2005).

8 *Id.*

On the contrary, an easement in gross is entirely servient; it has no dominant estate.[9] An easement in gross is purely independent from any other estate in land.[10] It is considered a mere personal right and cannot be assigned or conveyed by descent or by any words in the deed through which it was granted.[11] For instance, the grant of an exclusive right to place signs or billboards on a wall or fence acts as an easement in gross, and thus cannot be transferred or assigned.[12] Additionally, an easement giving the grantee the right to use the servient property for the erection and maintenance of a utility pole line is considered in gross.[13]

As a general principle, already mentioned, easements in gross cannot be transferred or assigned; however, an exception to this general rule may arise. If an easement in gross is of a commercial nature, it may be considered an alienable property interest.[14] Therefore, easements for pipelines, telephone and telegraph lines, and railroads are generally assignable, although considered to be in gross.[15]

Even though an easement in gross is one of the two distinct classes of easements, many courts will, as a rule of construction, favor the appurtenant easement.[16] If an easement in gross can be fairly construed as being appurtenant, it will never be construed as in gross.[17]

[2] — Easement Formation.

A number of recognized legal mechanisms exist for the creation of an easement. In considering the formation of an easement, not only is the

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9 *Id.*

10 *Id.*

11 Consolidated Gas Transmission Corp. v. Miller, No. 378, 1988 WL 42477, at *2 (Ohio Ct. App. Apr. 25, 1988).

12 Rochester Poster Adver. Co. v. State, 27 Misc. 2d 99, 102, 213 N.Y.S.2d 812, 815 (Ct. Cl.) *aff'd sub nom.* Rochester Poster Adv. Co. v. State, 15 A.D.2d 632, 222 N.Y.S.2d 688 (1961) *aff'd sub nom.* Rochester Poster Adver. Co. v. State, 183 N.E.2d 911 (N.Y. 1962).

13 Mumaugh v. Diamond Lake Area Cable TV Co., 456 N.W.2d 425, 430 (Mich. App. 1990).

14 Rochester Poster Adver. Co., 27 Misc. 2d at 102, 213 N.Y.S.2d at 815.

15 *Mumaugh*, 183 Mich. App. at 697, 456 N.W.2d at 430 (citing Johnston v. Michigan Consolidated Gas Co., 60 N.W.2d 464 (Mich. 1953)).

16 Ballengee v. Beckley Coal & Supply Co., 161 S.E. 562, 563 (W. Va. 1931).

17 *Id.*

creation mechanism of great importance, but also knowing a respective state's laws for writing and recording the easement. The state's own Statute of Frauds, as well as the state's recording statutes, provides an assurance of the easements' lawful validity.

[a] — Express Grant, Implied Grant, Prescription, Estoppel.

An easement may be created by any one of several different means: (1) by express grant, reservation, or exception; (2) by implied grant, reservation, or exception; (3) by prescription; or (4) by estoppel.[18] The focus of the remaining sections is based on an easement created through an express grant.

The grant's language, interpreted as the complete expression of the parties' final agreement,[19] provides the essential terms of the easement. Determining the extent and limitations created by the express grant derives from the language of the grant and the circumstances surrounding the transaction.[20] A court is restricted from expanding upon the instrument with preliminary oral statements.[21] If a grant is unrestricted, the grantee is entitled to all such rights as are necessary to the reasonable and proper enjoyment and use of the easement.[22] Not even the landowner holding title in fee has a right to interfere with the proper enjoyment of the easement.[23] Furthermore, it is unnecessary for an easement and a landowner's fee interest to be created by the same instrument or have the same stated duration.[24]

Not all easements, however, require writing and recordation to be effective.[25] "An easement may arise by implication when a landowner severs a parcel with the clear intent that a portion of the land conveyed be subject

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18 *See, e.g.,* O'Dell v. Stegall, 703 S.E.2d 561, 576 (W. Va. 2010); Kapp v. Norfolk S. Ry., 350 F. Supp. 2d 597, 607 & n.8 (M.D. Pa. 2004) (applying Pennsylvania law).

19 *Ballengee*, 161 S.E.2d at 563.

20 Rueckel v. Tex. E. Transmission Corp., 444 N.E.2d 77, 84 (Ohio App.1981).

21 *Ballengee,* 161 S.E.2d at 563.

22 *Rueckel,* 444 N.E.2d at 84.

23 *Id*.

24 *Ballengee,*161 S.E.2d at 563.

25 *Kapp,* 350 F. Supp. at 609.

to a particular use for the benefit of the land retained."[26] Effectively, the easement created by an implied grant will reserve certain rights in the parcel of land conveyed to another for the benefit of the grantor's retained property.[27]

Unlike easements created through express or implied grants, an easement by prescription arises from using another's property adversely.[28] The necessary elements required for an easement by prescription closely resemble the elements of adverse possession. In order to claim an easement by prescription, a person must prove "(1) the adverse use of another's land; (2) that the adverse use was continuous and uninterrupted [for the statutory period]; (3) that the adverse use was actually known to the owner of the land, or so open, notorious and visible that a reasonable owner of the land would have noticed the use; and (4) the reasonably identified starting point, ending point, line, and width of the land that was adversely used, and the manner or purpose for which the land was adversely used."[29]

The final way to create an easement is through the doctrine of estoppel. Estoppel relies heavily on the basic but key principles of inducement and justifiable reliance.[30] If an owner of land induces and permits a grantee to use part of the land for their own benefit or to benefit their property, and the grantee justifiably relies on this permission, the landowner is estopped from later denying such use.

[b] — Statute of Frauds and Recordation.

In order for an express easement to be valid, most jurisdictions require them to be evidenced in writing to satisfy the Statute of Frauds.[31] Along the same theory, most jurisdictions also require the easement be recorded

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26 *Id.*

27 *Id.*

28 *O'Dell*, 703 S.E.2d at 576.

29 *Id.* at 608, 579.

30 Louis W. Epstein Family P'ship v. Kmart Corp., 13 F.3d 762, 774 (3d Cir. 1994).

31 *See* 33 P.S. § 1; W. Va. Code § 55-1-1; *see also* Morning Call, Inc. v. Bell Atl.-Pennsylvania, Inc., 2000 PA Super. 294, 761 A.2d 139, 142 (2000); Pence v. Darst, 574 N.E.2d 548, 551 (Ohio App. 1989) (citing Ohio Rev. Code Ann. § 1335.04 (West)).

in the county in which the easement is situated.[32] Such a recording provides prospective purchasers with notice of any encumbrances on the land. A bona fide purchaser is bound by an encumbrance on the land only if he has actual or constructive knowledge of the encumbrance.[33]

To provide a bona fide purchaser with constructive notice, the easement must be recorded.[34] Even if the prospective purchaser does not read the recorded document, constructive notice is still provided purely because of the recording.[35] Alternatively, if the easement is not recorded, the bona fide purchaser must have actual notice of the easement to be subject to its terms.[36] An unrecorded land use restriction is not enforceable against a bona fide purchaser for value unless the purchaser has actual knowledge of the restriction.[37]

It should be noted, however, that the Statute of Frauds does not absolutely invalidate an oral contract relating to land; it is merely intended to "guard against perjury on the part of one claiming under the alleged agreement."[38]

A notion that is murkier compared to the basic theories behind the Statute of Frauds and the recording statutes is whether the express grant of an easement must be recorded or if a memorandum of the agreement will suffice to satisfy the recording requirements. In West Virginia, for instance, the recording statute does not address the validity of recorded memoranda in lieu of the full text of an easement; however, the West Virginia Statute of Frauds considers a memorandum of an agreement as sufficiently evidencing a writing if it is signed by the party to be bound by the agreement's terms.[39]

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32 *See* 21 P.S. § 351; W. Va. Code Ann. § 40-1-9 (West); Ohio Rev. Code Ann. § 5301.25 (West).

33 Emrick v. Multicon Builders, Inc., 566 N.E.2d 1189, 1193 (Ohio1991).

34 *Id.*

35 Thames v. Asia's Janitorial Serv., 611 N.E.2d 948, 953 (Ohio App. 1992).

36 *Id.*

37 *Emrick*, 566 N.E.2d at 1194 (Ohio).

38 Schuster v. Pennsylvania Turnpike Com., 149 A.2d 447, 451-452, 1959 Pa. LEXIS 638, 12-14 (quoting Zlotziver v. Zlotziver, 355 Pa. 299, 302, 49 A.2d 779, 881 (Pa. 1959)); *see also* Amerikohl Mining Co. v. Peoples Natural Gas Co., 860 A.2d 547, 161 Oil & Gas Rep. 208 (Pa. Super. Ct. 2004), *appeal denied by* 876 A.2d 392.

39 W. Va. Code § 55-1-1.

It can be reasoned that a memorandum of an easement, containing the same terms required by the relevant Statute of Frauds and recording statute, will effectively provide the same notice of the encumbrance as the instrument itself, thus effectuating the purpose of the statute(s). This idea is further supported by the many jurisdictions that have express allowances for memoranda of trust and/or memoranda of lease being acceptable instruments for recordation.[40] Although there is not an express delineation for memoranda of easements, one could make the argument that such a memorandum is closely related to those expressly allowed as acceptable instruments for recordation, making the easement's memoranda acceptable for recordation. Of course, one could also make the argument that the previous observation may stand for the idea that by expressly allowing for memoranda of trusts and/or leases in their statutory language, such jurisdictions are impliedly disallowing other memoranda from qualifying under the ambit of the statute.

In most circumstances, the best practice is to have the full agreement recorded. Files and records can be lost or destroyed, and although a memorandum of such an agreement proves the agreement actually exists, it likely will not speak to any of the detailed terms and conditions of the full agreement. The parties to the agreement may be placed in a position where courts determine the nature and intent of the rights granted at the time the contract was made instead of looking to the language within the agreement itself as the best indicator of the parties' intentions.

[c] — Effects of Adverse Title Actions on Easements.

Consequences of adverse title actions, such as tax sales or foreclosure proceedings, pose an uncertain effect on the interest held under an easement. Such consequences are discussed here to offer a legal perspective and interpretation for the uncertainties of these title actions.

40 *See* 21 P.S. § 405; *see also* W. Va. Code § 40-1-8.

[i] — Tax Sales.

Pennsylvania authority suggests if a parcel of land is sold at a tax sale, "an easement [appurtenant]. . . is not destroyed, but the purchaser takes subject thereto."[41]

In Ohio, a purchaser of forfeited land pursuant to a tax sale obtains clear title, free from all liens and encumbrances, except any easements running with the land as were created prior to the time the taxes became due and payable.[42] If pipeline easements are characterized as in gross, they would not run with the land. Such easements, therefore, would not be preserved beyond the tax sale.

Conflicting authority exists in Ohio on whether or not the title obtained by a purchaser of forfeited land is truly "free from all liens and encumbrances."[43] In one instance, the outstanding tax lien itself is said to continue to attach to the land until the taxes are paid in full.[44] Conversely, a taking by eminent domain appears to grant the taker a fee simple title, free and clear of all claims.[45] From this juxtaposition it appears to be implied that any underlying tax lien must be released, but there is no authority on point that confirms such an operation of law.

[ii] — Foreclosure Proceedings.

An additional adverse title action that is common among the states is foreclosure proceedings. At common law a mortgage was said to convey the absolute legal title to the estate designated therein.[46] The mortgagee was entitled to immediate possession of the premises, and could rightfully

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41 Locust Lake Vill. Prop. Owners Ass'n v. Wengerd, 899 A.2d 1193, 1198 (Pa. Commw. Ct. 2006) (quoting Tide Water Pipe Company v. Bell, 124 A. 351, 355 (1924)).

42 Ohio Rev. Code Ann. 5723.12; *see also* Cookston v. Box, 160 N.E.2d 327 (Ohio Ct. App., Cuyahoga County 1959).

43 *Id*.

44 Monroe v. Doe, 1835 WL 51 (Ohio Dec. 1835); Makley v. Whitmore, 56 N.E. 461, 463 (1900); *see also* Ohio Rev. Code Ann. 323.11.

45 Muskingum Watershed Conservancy Dist. v. Frautschy, No. 12858, 1935 WL 1460 (Ohio Prob. Dec. 17, 1935).

46 Western Educ. Soc. v. Huntington, 1914 Ohio Misc. LEXIS 89, 10-11 (Ohio Cincinnati Super. Ct. 1914).

maintain ejectment proceedings against the mortgagor, before default if desired.[47] Even where the mortgagor performed his part of the contract, title was not restored to him by operation of law. A reconveyance of title by the mortgagee was necessary to effectuate that goal.[48] If there was a default or a breach of the conditions of the mortgage, the mortgagor's interest in the property terminated, and the mortgagee's title to the property became absolute and indefeasible.[49] There is a large body of authority that follows the common law doctrine of mortgages, although it has been modified by equitable principles.[50]

Based on the foregoing, Ohio, for example, follows the opinion that an easement appurtenant is not terminated because of a foreclosure proceeding over a default in a mortgage.[51] The purchaser at the foreclosure sale will take title to the mortgaged property subject to the appurtenant easement.[52]

In addition, foreclosure law in Pennsylvania dictates that, upon a sheriff's sale pursuant to a foreclosure action, the title of a purchaser relates back to the date of the mortgage and defeats all intervening estates and interests on the property, including easements acquired subsequent to the mortgage.[53] In other words, "upon foreclosure, a mortgagee takes the property subject only to the liens and encumbrances thereon at the time the mortgage was granted; any encumbrances on the land that postdate the mortgage are eliminated."[54]

These two adverse title actions are merely examples of what could transpire regarding an effect on an easement. To be fully prepared for any

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47 *Id.*

48 *Id.*

49 *Id.*

50 *Id.* at 15.

51 *Id.* at 16.

52 *Id.* at 21-22.

53 *In re* Dulgerian, 2008 Bankr. LEXIS 248, 13-14, 49 Bankr. Ct. Dec. 136 (Bankr. E.D. Pa. Jan. 25, 2008); *see also* Ernst, Jr. v. Kwik-Check Realty Co., Inc., 1972 WL 14772 (Pa. Com. Pl. 1972); Vanderwerff v. Consumers Gas Co., 71 A.2d 809 (1950); Dexter v. Pennsylvania Power Co., 193 A. 94 (Pa. 1937).

54 *Id.*

effects that may negatively impact the pipeline easement, it is important to determine each state's authority for the different adverse title actions.

§ 16.03. New Pipeline Easements.

Because of the remarkable increase in burden on the current pipeline transmission of natural gas, an understanding of certain areas within the realm of new pipeline easements is warranted to keep abreast of the challenges facing the industry today.

[1] — Scope of Title Search.

When looking to create a new pipeline easement to assist in the transmission of natural gas production, it is of the utmost importance to perform a title search. At the very minimum, a 60-year title search should be conducted. This title search allows a grantee to discover any claims or restrictions that may prevent or alter the pipeline easement in the future. In order to determine what kind of search will be the most effective, an analysis of the cost of the proposed facilities, time constraints, likelihood of an asset sale in the near future, and cost of the title opinion should be done first. Often times, a certified title opinion is a cost effective measure to protect company assets. An additional analysis may and should be done to determine if support for the surface is necessary for the type of facility planned. If surface support is needed, a coal search (back to patent) might be warranted.

[2] — Encumbering Land on Behalf of Non-Joining Co-Tenants.

In determining to what extent a co-tenant can encumber land that is held jointly with others, *i.e*. granting an easement that will encumber a portion of or the entire premises, it is of great importance to first determine the co-tenancy initially established between the co-tenants. The co-tenancy will be one of three: a tenancy in common, a joint tenancy, or a tenancy by the entirety. Of these co-tenancies, only one allows for encumbering the land of the grantee/co-tenant's interest without consent from the other co-tenants. This permission results from the parties having separate and distinct titles. The other two co-tenancies lack the separate and distinct title element, thus

resulting in consent from the other co-tenant being required prior to any encumbrance.

If a co-tenant is considering granting a new pipeline easement that will encumber the property, understanding the rights of each co-tenant will theoretically prevent future disruption of the easement.

[a] — Tenants in Common.

"A tenancy in common is an estate in which there is a unity of possession but separate and distinct titles. Thus, a tenant in common may, without the consent of his cotenant, sell, convey or dispose of his undivided interest in the property."[55] Each tenant in common will hold this separate and distinct title completely independent of the other co-tenant, resulting in each co-tenant's allowance to encumber their own interest without the other co-tenant's consent.[56] However, the co-tenant whose interest was involuntarily injured due to the encumbrance may seek monetary damages for harm done to his interest in the property.[57] While obtaining an easement from one co-tenant is generally legally sufficient, it is commonly considered a best practice to obtain an easement from all tenants in common.

[b] — Joint Tenants.

"A joint tenancy is [an estate] held jointly by two or more persons with each joint tenant being entitled to enjoyment of the land."[58] "Furthermore, a joint tenancy could not exist at common law without the right of survivorship."[59] In many jurisdictions, one co-joint tenant cannot encumber the property on behalf of the other co-joint tenant without their consent. If a co-joint tenant encumbers the property without consent, the joint tenancy

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55 Werner v. Quality Service Oil Co., 486 A.2d 1009, 1012 (Pa. Super. Ct. 1984) (quoting 14 P.L.E. Estates in Property § 41 (1959)).

56 Koster v. Boudreaux, 463 N.E.2d 39, 43 (Ohio 1982).

57 *Werner,* 486 A.2d at 1012.

58 *Koster*, 11 Ohio App. 3d at 5, 463 N.E.2d at 43.

59 *Id*.

dissolves into a tenancy in common.[60] Consequently, it is necessary to obtain an easement from all joint tenants.

[c] — Tenants by the Entireties.

A tenancy by the entirety requires:

> the same four unities as did a joint tenancy [time, title, possession, and interest], along with the fifth unity of person between husband and wife. Each spouse owns the whole, so that upon the death of one spouse, the deceased spouse's interest is extinguished and the surviving spouse owns the whole estate by the terms of the entirety estate rather than through a survivorship right . . . Finally, neither spouse has a separate, divisible interest in the estate and, therefore, a sole spouse cannot convey, transfer, or sell his/her interest.[61]

Most jurisdictions follow some derivative of the foregoing definition and limitations for a tenancy by the entirety.[62]

In order to prevent potential future disputes over the grant of an easement, it is generally considered to be a best practice to obtain consent for the easement from all parties of a co-tenancy, regardless of the specific co-tenancy involved.

[3] — Standard Form Contracts.

The rigidity of grammar and lack of specificity regarding language used in standardized contract forms can raise serious questions of ambiguity in an express grant. Furthermore, the generic and sometimes incomplete appearance of standardized contracts may prompt individuals with no legal expertise to attempt to manipulate the material terms of the document or

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60 *See, e.g.*, CitiMortgage, Inc. v. Firestone, 2012-Ohio-2044 (Ct. App.); Commercial Factors of Denver v. Clarke & Waggener, 684 P.2d 261, 263 (Colo. App. 1984); Franklin Credit Mgmt. Corp. v. Hanney, 2011 UT App 213, 262 P.3d 406, 411 (2011).

61 *Koster*, 463 N.E.2d at 44.

62 *See, e.g.*, *In re* Meyer's Estate, 81 A. 145 (Pa. 1911); *In re* Strausbough, 426 B.R. 243, 247 (Bankr. E.D. Mich. 2010); Mitchell v. Wilmington Trust Co., 449 A.2d 1055, 1058 (Del. Ch. 1982) *aff'd sub nom.* Wilmington Trust Co. v. Mitchell, Mitchell, 461 A.2d 696 (Del. 1983).

populate fields in the document where additional terms should not be added. The following case illustrates the pitfalls in utilizing standard forms for express grants of easements.

[a] — *Sigal v. Manufacturers Light & Heat Co.*

In *Sigal v. Manufacturers Light & Heat Co*., the Pennsylvania Supreme Court was required to determine whether or not the appellee, a holder of a pipeline easement, was entitled to construct a new 20-inch pipeline across the appellant's land pursuant to the terms of the parties' express easement. The express grant was effectuated by a standard form grant used by the appellee.[63]

The appellant, Serena Nemer Sigal, was the owner of approximately 3.66 acres of land in Palmer Township, Northampton County. On November 12, 1947, the appellant, with her husband, executed an express grant of an easement in favor of the appellee, the Manufacturers Light & Heat Co. The easement authorized the construction of a 14-inch pipeline, which was subsequently built and maintained by the appellee for approximately 23 years without incident.[64]

In 1970, the appellee notified the appellant [2] of its intention to construct a new 20-inch pipeline across her land, parallel to the 14-inch pipeline. The appellant refused to acquiesce to the addition of the 20-inch pipeline and instructed the appellee not to enter the land. Appellee insisted it was acting within the rights granted to it under the original express easement, prompting them to begin construction of the 20-inch pipeline across appellant's property.[65]

The instrument granting the 1947 easement was a standard form grant used by the appellee. The appellant landowners refused to sign the standard form grant as it was originally presented and only signed after certain objectionable clauses were typed over. Said clauses were crossed out by typing a series of lower case letter "m's" over certain words in the standard form. The nature of the alteration was as follows:

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63 Sigal v. Mfrs. Light & Heat Co., 299 A.2d 646, 647 (Pa. 1973).

64 *Id*.

65 *Id*.

> For and in consideration of $ 1.00 . . . Arthur P. Sigal . . . and Serena Nemer Sigal . . . do hereby grant to the Manufacturers Light & Heat Co. . . . its successors and assigns, the right to lay a 14 inch pipe line, [first typed-over portion], and maintain, operate, repair and remove said lines along a line which has been surveyed for the same over and through our land . . . and said Company to pay any damages which may arise to crops and fences from the relaying, maintaining and operating said pipe line . . . [second typed-over portion]; also may change the size of its pipes, the damages, if any, to crops and surface in making such change to be paid by the company.[66]

The first typed-over portion originally read, "construct a telegraph and telephone line." The second typed-over portion, and the one of primary concern to the court read, "[a]nd it is hereby further agreed, that said company, its successors and assigns, may at any time lay, maintain, operate, repair and remove a second line of pipe alongside of the first line as herein provided, upon payment of a like consideration and subject to the same conditions."[67]

When there is doubt concerning the meaning of terms within a contract, the court looks to ascertain the meaning of the ambiguous term in a manner so that the agreement will "receive a reasonable construction [a]nd one that will accord with the intention of the parties, and [i]n order to ascertain their intention, the court must look at the circumstances under which the (contract) was made."[68]

Before engaging in construction of the ambiguous term, the court must first determine that the term was indeed ambiguous. Although this can often be a point of great contention between parties to a lawsuit, here, the court found that the grant of easement was ambiguous on its face due to the grammatical inconsistencies caused by the utilization of the standard form, as well as patent contradictions regarding the juxtaposition of singular and plural terms.[69]

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66 *Id.* at 648.

67 *Id.*

68 *Id.* at 649 (quoting *United Refining Co. v. Jenkins*, 189 A.2d 574 (Pa. 1963)).

69 *Id.*

In ascertaining the intention of the parties, the court correctly turned to the attending circumstances at the time the 1947 grant was signed. The attending circumstances were that the appellant and her husband refused to sign the appellee's standard form grant as printed and only signed the grant after the clauses in question were typed over.[70]

After considering the circumstances surrounding the signing of the instrument, the court determined that the parties never intended for a second pipeline to be constructed in addition to the 14-inch pipeline. The appellee was required to remove the 20-inch pipeline, as it constituted an unlawful invasion of the appellant's property and a continuing trespass.[71]

While standardized forms are a business necessity, caution should be practiced while attempting to modify them. Incorrect usage of language coupled with the potential for grammatical errors may render the standard form ambiguous, thus resulting in later challenges and disagreements over the supposedly agreed upon terms.

[3] — Assigning Interests in an Easement.

[a] — General Background for Assigning Interests.

In *Pilkington N. Am., Inc. v. Travelers Cas. & Sur. Co.*, the Ohio Supreme Court stated:

> It is long-standing tradition in the common law that all contract rights may be assigned except under three conditions. First, if there is clear contractual language prohibiting assignment, an assignment will not be enforced. Second, an assignment must not materially change the duty of the obligor, materially increase the insurer's burden or risk under the contract, materially impair the insurer's chance of securing a return on performance, or materially reduce the contract's value. Third, the assignment will not be valid if it is forbidden by statute or by public policy.[72]

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70 *Id.*

71 *Id.* at 650.

72 Pilkington N. Am., Inc. v. Travelers Cas. & Sur. Co., 861 N.E.2d 121, 128 (Ohio 2006) (internal citations omitted).

Interests in real estate have been held to be permissible assignments.[73] As a general notion previously discussed, an easement appurtenant is the right to use the servient estate to benefit the dominant estate. This type of easement is passable and assignable with the transfer of title to the dominant estate.[74] Easements in gross are typically known as a mere personal right and neither run with the land nor create a dominant or servient estate.[75] As such, easements in gross are not assignable; they apply to specific people, not assignees.[76] However, easements in gross that are of a commercial character have been considered alienable property interests (for example, natural gas pipelines).[77]

As a conveyance of a property interest, assignments of easements should be evidenced in writing, signed by the parties to the easement, and recorded in the county in which the easement is situated. The writing and recording requirement, as previously mentioned, will ascertain the parties' true intentions, as well as provide constructive notice of the encumbrance to bona fide purchasers.

[b] — Assignment of Right of Way in Oil and Gas Leases as a Standalone Interest.

An area of easement law that does not have much authority that is directly on point is the nature of the easement(s) often granted in an oil and gas lease that allows the operator to construct pipelines to gather and remove oil and/or natural gas from the Subject Land. A review of relevant case law, though not squarely on point, would lead to the proposition that it may be possible to alienate and/or acquire an interest in a pipeline right of way that is created under an oil and gas lease, but not inasmuch as would make the interest a standalone one.

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73 Consolidated Gas Transmission Corp. v. Miller, 1988 Ohio App. LEXIS 1757, *6-7, 1988 WL 42477 (Ohio Ct. App., Holmes County Apr. 25, 1988).

74 Newman v. Michel, 688 S.E.2d 610, 616 (W. Va. 2009).

75 *Id.* at 617.

76 *Id.*

77 Consolidated Gas Transmission Corp., 1988 Ohio App. LEXIS 1757, at 6.

The first step in this analysis is to determine if the language of the lease permits the apportionment of rights to third parties.[78] Where an instrument, such as a lease, contains language granting to an operator, "its successors, assigns, lessees, and tenants" the right to drill for oil and gas and maintain a pipeline right of way, such language clearly and unambiguously shows an intent by the parties to permit assignment and apportionment of the rights and privileges granted by the lease.[79]

In *Jolliff v. Hardin Cable Television Co*., the Ohio Supreme Court held that an electric company had the right to assign a portion of its interest in their easement to a television cable company "to construct, erect, operate and maintain a line of poles and wires for the purpose of transmitting electric or other power, including telegraph or telephone wires."[80] The court found that the installation of the television cable constituted "*a use similar to that granted in the easement* and does not create an additional burden on the land of the original grantor."[81]

"The [critical] words of the grants which are determinative of the intention of the grantors [to allow alienation] are 'successors, assigns, lessees, and tenants.'"[82] The court found that "the words 'lessees and tenants' [specifically indicated that it was clearly] intended by the parties to the grants that [the grantee] could lease some portion of its interests to third parties."[83] The language distinguishing "its lessees" means "its sub-lessees" in such a context, and in the absence of any restrictive definition of "lessee" in the granting instrument, is open to no other interpretation.[84]

The second part of the analysis is to determine the nature and duration of the interest that would be acquired. Based on the following case's reasoning, it appears that the interest acquired in an easement found in an oil and gas

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78 Popa v. CNX Gas Co., LLC, 2014 U.S. Dist. LEXIS 103968,*11, 2014 WL 3749415 (N.D. Ohio July 30, 2014); *see also* 68 Ohio Jur. 3d Mines and Minerals §59.

79 *See* Jolliff v. Hardin Cable Television Co., 269 N.E.2d 588, 591-592 (Ohio 1971).

80 *Id*. at 592.

81 *Id*. (emphasis added).

82 *See* Jolliff v. Hardin Cable Television Co., 269 N.E.2d 588, 591-592 (Ohio 1971).

83 *Id*.

84 *Id* at 590.

lease would not be a "standalone" right of way in the sense that it would be a wholly new interest severed from the original lease, with its own terms and/or duration, rather it would be an interest subject to the terms and duration of the original lease.

In *Marshall v. Beekay Co.* (*Marshall*), the Ohio Court of Appeals for Washington County was left to determine whether continuous production in paying quantities by an operator from shallow wells, held the deep rights on behalf of various assignees under an oil and gas lease, or whether the assignments of the deep rights severed the leases and created a new leasehold with separate rights and responsibilities conferred upon the assignees.[85]

In deciding a case similar to *Marshall*, the court determined "that the assignment 'did not constitute a new, separate conveyance or contract.'"[86] Rather, the rights retained by the assignee remained subject to the terms of the original lease agreement.[87] The original lease had outlived its primary term as was now being held indefinitely by production in paying quantities.

The court in *Marshall* concluded its rationale by stating that "it would thus follow, based upon the reasoning set forth in *Popa*, that Sandbar's production in paying quantities from the shallow wells holds the entire lease, even as to Appellees' deep rights, and that such production by Sandbar constitutes finding oil and gas in paying quantities for purposes of the original lease, to which all parties are still bound."[88]

To tie the above holding into our first piece of analysis, namely that as long as there is not language in the lease limiting apportionment, an oil and gas operator could potentially assign or sublease an interest in the pipeline rights of way granted in an original oil and gas lease to a third party. *Marshall* stands for the prospect that such an assignment would not sever the lease to create a standalone interest, but rather, the third party assignee could utilize that right of way to their full benefit, as the original lessee would have, with the understanding that the interest in the right of way would only last as long

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85 Marshall v. Beekay Co., 27 N.E.3d 1, 5-6 (Ohio Ct. App. 2015).

86 *Id*. at 7.

87 Marshall v. Beekay Co., 27 N.E.3d 1, 7 (Ohio Ct. App. 2015).

88 *Id.*

as the term of the lease, whether that be for a term of years or as long as gas is being produced in paying quantities.

§ 16.04. Eminent Domain and the Regulation of Natural Gas.

This section primarily concerns the basic concepts and over-arching issues regarding: first, the regulation of state and federal natural gas production and transportation, and second, the use and exercise of eminent domain/condemnation authority in the federal and state levels. Much of the law regarding eminent domain is procedural in nature, and therefore, will not be exhaustively discussed.

[1] — The Natural Gas Act at 15 U.S.C.S. § 717.

The Natural Gas Act at 15 U.S.C.S. § 717 regulates:

> the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, and to the importation or exportation of natural gas in foreign commerce and to persons engaged in such importation or exportation, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

15 U.S.C.S. § 717(b). The Natural Gas Act does not apply to the production or transportation of natural gas that is purely intrastate.[89] Such transactions are governed through the powers given to a State via their own statutes.

[a] — Regulation.

The interstate natural gas industry is regulated by the Federal Energy Regulatory Commission (FERC). Any natural gas company regulated under

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89 15 U.S.C.S. § 717 (c).

the FERC wishing to expand or construct interstate pipeline transmission lines must first apply for a certificate of public convenience and necessity prior to the start of any project commencing.[90] Along the same lines, any natural gas company wishing to exercise eminent domain power to condemn a right of way for the construction or expansion of a natural gas transmission line must first apply for a certificate of public convenience and necessity.[91]

In contrast to regulating bodies at the federal level, the regulating agencies for natural gas production and transportation at the state level may vary. Mainly, though, the agencies are some combination or variation of the state's departments of transportation and energy.

[2] — State Eminent Domain Powers and Condemnation Proceedings.

Condemning real or personal property at the federal level is governed by the Federal Rules of Civil Procedure Rule 71.1.[92] State eminent domain powers and condemnation procedures, however, are primarily governed through state statutory law. In some states, the eminent domain statutes are constructed to be quite narrow, thus limiting the companies or entities that may qualify for use of appropriation powers. In other states, the statutes make use of broad terms, such as "public utility," to incorporate a large and diverse number of companies operating in the oil, gas, and utility industries.

This narrow or broad construction of a state's statute is highly driven and dependent upon the public policy of that individual state. If a state is more opposed to the development of natural resources and expansion of their infrastructure, their statutes are likely narrower. If, on the other hand, a state's public policy exploits the need and use for natural resources and supports expansion of their infrastructure, the statute's language will be a broader construction, of which many companies or entities would qualify.

Both at the state level, as well as the federal level, the condemnation procedures regarding application, survey, notice, possession, and

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90 15 U.S.C.S. § 717 f(a).
91 15 U.S.C.S. § 717f(h).
92 Fed. R. Civ. P. 71.1.

compensation are handled in a manner unique to the jurisdiction in which the land is situated.[93] For example, some states allow possession by the condemning authority upon approval of their application to condemn lands, while others require compensation to be paid in full to the landowner before they can take possession.[94] Furthermore, with regards to compensation valuation procedures, some states utilize a jury trial to determine property value, while others rely on the good faith of the landowner and condemnor to fix a value.[95] If, however, the good faith offer is found to be outside of certain appraisal parameters, penalties will be handed down. Finally, there are certain matters within federal condemnation actions that will adhere to a state's condemnation procedures; such matters may include trying an issue of compensation by jury.[96]

Since property rights are of such great public concern, almost every state's eminent domain statute provides that the application to condemn lands, or the certificate awarding the right to condemn lands, or both, be recorded in the county recorder's office of the state where the condemned lands are situated.[97] Recording such documents places a high priority on a landowner's rights by providing them with constructive notice of a potential future taking against their will.

[3] — Interest Obtained in the Condemned Property.

In order to first apply for the use of eminent domain powers at the state level, it is typical to require a showing of a public purpose or a public need. Some jurisdictions predicate their eminent domain authority on this idea that a taking is for public use or necessity; therefore, the interest obtained in the condemned property is all of the right, title and interest therein. In

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93 *See, e.g.*, Va. Code Ann § 25.1-201; 26 Pa. Cons. Stat. Ann. § 301 (West); W. Va. Code § 54-2-1.

94 *See, e.g.*, 26 Pa. Cons. Stat. Ann. § 302 (West); V.T.C.A., Property Code § 21.021.

95 See, e.g., 735 Ill. Comp. Stat. Ann. 30/10-5-45; Fla. Stat. Ann. § 73.071 (West); 26 Pa. Cons. Stat. Ann. § 301 (West); W. Va. Code, § 54-3-1.

96 Fed. R. Civ. P. 71.1(k).

97 *See, e.g.*, 26 Pa. Cons. Stat. Ann. § 304 (West); A.R.S. § 12-1126; Neb. Rev. Stat. § 76-713; 25 Del. C. § 81-107(d).

Pennsylvania, for instance, it is "a matter of public policy that condemnation operates against all interest directly connected with the title of land, including all unrecorded equities or hidden interests indirectly connected with or growing out of such title."[98] However, in other jurisdictions, the interest obtained in the condemned property is not all of the right, title and interest. For example, in Texas "the settled rule is that in condemnation proceedings only an easement is acquired."[99]

Regardless of the actual interest obtained in the condemned property, it is a seemingly uniform principle in eminent domain actions that the support below the condemned land is also taken. "An entry upon land by virtue of the power of eminent domain also constitutes an appropriation of the subjacent strata so far as necessary to support the surface."[100] "We hold that the owner of the dominant estate, the easement owner, is entitled to lateral and subjacent support for its easements, its lines and its property lawfully thereon, and that the trial court correctly applied the doctrine of lateral and subjacent support."[101] The Texas courts have impliedly recognized that easements are entitled to lateral support.[102]

Based on the preceding information, the regulation of natural gas production and transportation throughout the United States, as well as the

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98 Briegel v. Briegel, 160 A. 581, 582 (Pa. 1931).

99 Calvert v. Harris County, 46 S.W.2d 375, 376 (Tex. Civ. App. 1932).

100 Rueckel v. Texas Eastern Transmission Corp. 444 N.E.2d 77, 84 (Ohio Ct. App. 1981). Petition of Carpentertown Coal & Coke Co., 351 Pa. 139, 40 A.2d 404 (1945); Dilts v. Plumville R. Co., 222 Pa. 516, 71 A. 1072 (1909); Jefferson Gas Co. v. Davis, 147 Pa. 130, 23 A. 218 (1892). McGregor v. Equitable Gas Co., 139 Pa. 230, 21 A. 13 (1891); Penn Gas Coal Co. v. Versailles Fuel Gas Co., 131 Pa. 522, 19 A. 933 (1890); Lawrence's Appeal, 78 Pa. 365 (1875); Brownfield v. Commonwealth, Dep't of Transp., 26 Pa. Commw. 308, 364 A.2d 767 (1976).

101 Salt Lake City v. J.B. & R.E. Walker, Inc., 123 Utah 1, 253 P.2d 365; Village of Haverstraw v. Eckerson, 124 A.D. 18, 108 N.Y.S. 506, aff'd., 192 N.Y. 54, 84 N.E. 578, 20 L.R.A., N.S. 287; City of Troy v. Murray, 128 Misc. 419, [346] 219 N.Y.S. 681; Cincinnati & Suburban Bell Telephone Co. v. Eadler, 75 Ohio App. 258, 61 N.E.2d 795; Scranton v. Peoples Coal Co., 256 Pa. 332, 100 A. 818; East Ohio Gas Co. v. James Bros. Coal Co., 40 Ohio Op. 440, 85 N.E.2d 816; Sumrall v. United Gas Pipe Line Co., 232 Miss. 141, 97 So.2d 914.

102 Calvert v. Harris County, 46 S.W.2d 375 (Tex.Civ.App. 1932).

procedures for condemning such property for natural gas use, depends heavily on whether we are within the realm of federal law or state law. Although the procedures and laws may differ slightly, the basic principles remain the same: in order to condemn any property, it is necessary to show a public purpose or a public need first; procedures for condemnation purposes depends on the jurisdiction in which the land is situated; and an emphasis on property rights and public policy highly dictate the regulations behind condemnation proceedings.

§ 16.05. Pre-existing Easements.

In order to facilitate the increased burden on the transmission of natural gas, a multitude of ways exists to tackle the challenge; two of which have already been discussed. First, by creating new pipeline easements, and second, by condemning property through federal and state condemnation proceedings, thus granting the authority to establish new pipelines if necessary. The third method may be to expand upon the "use," the width, and the diameter or number of pipes in already existing pipeline easements. This process may provide a more efficient manner to lessen the burden on the ever-increasing need for oil and gas transmission capacity.

[1] — Varying the Use of an Easement.

As previously stated, an easement is a non-possessory right to use another's property for a particular purpose. Easements are not expressed in terms of their possession or occupancy of land; instead, they are expressed in terms of their use.[103] Therefore, an owner of an easement is not necessarily injured when an adverse party occupies the land itself; the easement owner is injured when the use of his easement is interfered with or prevented.[104] In particular reference to pipeline easements, the owner of the land in fee is permitted to use the property through which the easement runs in any manner

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103 Rueckel v. Texas Eastern Transmission Corp., 3 Ohio App. 3d 153, 153, 444 N.E.2d 77, 78, 1981 Ohio App. LEXIS 10034, 1, 3 Ohio B. Rep. 172, 77 Oil & Gas Rep. 124 (Ohio Ct. App., Fairfield County 1981).

104 *Id.*

he desires, but he may not interfere with the grantee's use or enjoyment of the existing rights in the pipeline.[105]

The best way to determine the extent or limitations of an easement's use is to look at the actual language of the easement, in light of the contract's surrounding circumstances.[106] Although the easement's language theoretically contains the final agreement between the parties, it is possible to expand upon the easement's purpose. Because of the modern advances of today, courts have recognized and held that normal developmental changes and technological improvements over time may entitle an easement holder to change the mode of the easement's enjoyment or use, if doing so would more easily effectuate its purpose.[107] One difficulty in constructing this last concept is that technological advances may arise drastically and/or unexpectedly. Such a severe occurrence can hardly be classified as being contemplated between the grantor and the grantee. In this regard, courts are more inclined to say that they simply realize the parties would have contemplated *some* reasonable, varied use of the easement over time, even if they could not have contemplated what that varied use or developmental change would entail.[108]

Although changes resulting from normal development and technological advances are seemingly permissible, the holder of an easement "may not increase the burden upon the servient estate by engaging in a new and additional use of the easement."[109] Often this determination comes down

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105 Minard Run Oil Co. v. Pennzoil Co., 419 Pa. 334, 336, 214 A.2d 234, 235 (1965).

106 Lakewood Homes, Inc. v. BP Oil, Inc., 1999 Ohio 851 (citing Apel v. Katz, 697 N.E.2d 600).

107 Crane Hollow, Inc. v. Marathon Ashland Pipe Line, L.L.C., 740 N.E.2d 328, 334 (2000) (citing Ohio Oil Gathering Corp. II v. Shrimplin, 1990 WL 108737, 1990 Ohio App. LEXIS 3160 (Ohio Ct. App., Coshocton County, July 23, 1990) *dismissed*, 565 N.E.2d 834 (Ohio 1990); Hash v. Sofinowski, 487 A.2d 32, 34 (Pa. Super. Ct. 1985); Diemling v. Kimble, 2012-Ohio-3323 (Ct. App.).

108 Crane Hollow, Inc., 740 N.E.2d at 335.

109 *Id*. at 334; Lakewood Homes, Inc., 3rd Dist. No. 5-98-29, 1999 Ohio 851 (citing Centel Cable Television Co. v. Cook, 567 N.E.2d 1010, 1014-1015 (Ohio 1991)); *see also* Ozehoski v. Scranton Spring Brook Water Service Co., 43 A.2d 601, 603 (Pa. Super. Ct. 1945) (saying "[t]he owner of a dominant estate may enter on a servient tenement and do any act necessary for the proper use of the easement but only in such manner as not to needlessly increase the burden on the servient tenement.").

to a very fact-specific inquiry: if the owner of the dominant estate can show their enlargement or variation of the easement's use was necessary and reasonable, the likelihood of a court upholding the variation is great. To aid in this inquiry, multiple courts have identified certain factors to determine if the dominant tenement's new or additional use of the easement was actually "reasonable." These factors include:

> 1) the intent of the parties regarding the easement's purpose; 2) the circumstances surrounding the easement's creation; 3) the nature and condition of the premises over which the easement was granted; 4) the manner in which the easement has been used in the past; and 5) the advantage to the dominant tenement and the disadvantage to the servient tenement.[110]

In the most general sense, varying the use of an easement will be permissible if such an action is not explicitly prevented by the language in the grant, the variation aids in achieving the easement's purpose, and the variation does not unreasonably increase the burden on the servient estate.

[2] — Varying the Width of an Easement.

As previously cited, any restrictive language in an easement strongly evidences the parties' intent to limit the easement's use. Courts are willing to give such restrictions full consideration to ascertain if a post-agreement variation of the easement's use materially alters or burdens the servient estate. Conversely, if an easement is silent in its limiting language, those terms are regarded as ambiguous.[111] The grantee, therefore, will be afforded "reasonable and necessary" use of the right-of-way within the purpose of the easement and consistent with the intentions of the original parties to the grant.[112]

In similar analysis to varying the use, if an easement is silent on its dimensions or width, courts engage in a factual inquiry to determine its

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110 Fruth Farms, Ltd. v. Vill. of Holgate, 442 F. Supp. 2d 470, 480 (N.D. Ohio 2006); *see also* 28A Corpus Juris Secundum Easements § 161.

111 Zettlemoyer v. Transcon. Gas Pipeline Corp., 657 A.2d 920, 924 (Pa. 1995).

112 *Id.*

parameters.[113] As part of the factual determination, courts look to the grantee's subsequent agreement, use, and acquiescence over the course of the time the easement has been held.[114]

The court in *Zettlemoyer v. Transcon. Gas Pipeline Corp.*, for instance, was tasked with determining the width of an easement. It rejected the notion that because the pipeline company had maintained a 100-foot right-of-way for over 30 years, the width of the easement had become fixed at a maximum of 100 feet.[115] Upon a showing that the pipeline right-of-way was too narrow for the maintenance trucks to safely maneuver, the court allowed the pipeline company to increase the right-of-way by another 30 feet.[116] The court recognized that a grantee's past use has some evidentiary value in interpreting the grant, but it should not be the sole extrinsic evidence considered by a court.[117]

Likewise, in *Tex. E. Transmission, LP v. Perano*, with facts closely related to the above case, the Third Circuit Court set a pipeline company's easement width at 50 feet, where the width was not originally delineated in the easement grant, and where evidence was introduced to show the pipeline previously maintained at only a 25-foot width.[118] The court further intimated that Texas Eastern had a stronger argument for its proposed right-of-way than the pipeline company in *Zettlemoyer*, because here, Texas Eastern had a reasonable probability of success on the merits.[119] Texas Eastern sought to enforce and exact the right-of-way to which it had always been entitled, where by contrast, the pipeline company in *Zettlemoyer* sought an expansion of an easement that had been sufficient for its uses for over 30 years.[120]

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113 Strahm v. Buckeye Pipe Line Co., L.P., 2011-Ohio-1171, P22, 2011 Ohio App. LEXIS 1016, 15-16, 2011 WL 915575 (Ohio Ct. App., Allen County Mar. 14, 2011).

114 Tex. E. Transmission, LP v. Perano, 230 Fed. Appx. 134, 136, 2007 U.S. App. LEXIS 9147, 4 (3d Cir. Pa. 2007).

115 *Zettlemoyer*, 657 A.2d at 925.

116 *Id.*

117 *Id.* at 926.

118 *Tex. E. Transmission, LP*, 230 F. App'x at 136.

119 *Id.*

120 *Id.*

In contrast, the Ohio Court of Appeals in *Strahm v. Buckeye Pipe Line Co., L.P.*, would not permit the Buckeye Pipe Line Co. to use the "reasonable and necessary" standard to justify clearing bushes and trees from the right-of-way under the guise of "maintaining" the pipeline.[121] As discussed above, the "reasonable and necessary" standard is a fact-driven inquiry. Where Buckeye Pipe Line Co. showed virtually no evidence of the trees and/or bushes interfering with their use and enjoyment of the easement, they were not entitled to a finding by the court that their actions were "reasonable and necessary" to satisfy the purpose of their right-of-way.[122]

Varying the width of an existing pipeline easement may provide an efficient way to combat the increased need for oil and gas transmission capacity; however, this variation does not give the easement owner the right to increase the burden on the servient estate.

[3] — Increasing the Diameter and/or the Number of Pipes in an Existing Easement.

A cost effective and efficient way to increase the transmission capacity of oil and natural gas, without obtaining new rights-of-way or constructing an entirely new system, is to increase the diameter of the pipe or the number of pipes in the ground. The language of the grant, as previously mentioned, best indicates the terms, the limitations, and the extent of the easement. If the grant provides no language expressly forbidding a change to the diameter and/or number of pipelines, the parties to the grant are left to consider and use whatever means reasonable and necessary to accomplish the purpose of the easement.[123]

As we have clearly established, easements are expressed not by their possessory interest in an estate, but by their use. It is reasonable to assume the use of a pipeline easement would likely increase in the future. The transmission of oil and natural gas provides consumers with fuel, heat, and light, and parties to the agreement would be wise to consider the

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121 *Strahm*, 2011-Ohio-1171, at P22.

122 *Id.* at P26.

123 State ex rel. Wasserman v. City of Fremont, 20 N.E.3d 664, 669-670 (Ohio 2014).

likelihood of consumer's needs changing and increasing. Not only a look at consumers and their needs provides insight into the potential requirement for increased transmission capacity, but also the history of the United States and the exponential increase in the fuel market. For example, the discovery of Spindletop in 1901 led to the United States' global expansion of the oil industry. Additionally, the development of the hydraulic fracturing process allowed the exploitation of our country's expansive shale reserves. Both of these occurrences had the same impact on the natural gas industry; an increased need for oil and gas transmission capacity. Consequently, a larger volume of transmission lines was a reasonable necessity.

Although an increase in the diameter or the number of pipes in an already existing easement corridor would certainly alleviate any pressures on current pipeline transmissions, it is of the utmost importance to first see if the grant explicitly prohibits such changes. If the grant is silent, then determining if these changes result in an increased burden on the servient estate becomes the next point of investigation.[124] If there is an increased burden on the servient estate, the courts look to whether this burden is a result of "engaging in a new and additional use of the easement."[125] If the court determines that a new or additional use of the easement has occurred, it becomes the dominant tenement owner's burden to show reasonableness and necessity.[126]

An analysis of the following cases leads to the determination that, absent restrictive language in the grant, expanding the diameter of pipes or placing additional pipelines in the ground are not new or additional "uses" of the easement. These modifications are simply efforts to use the easement for its intended purpose in a more efficient and effective manner.

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124 Crane Hollow, Inc. v. Marathon Ashland Pipe Line, L.L.C., 740 N.E.2d 328, 334 (Ohio Ct. App. 2000) (citing Murray v. Lyon, 642 N.E.2d 41, 44-45 (Ohio Ct. App. 1994)`; Sheldon v. Flinn, 624 N.E.2d 1109, 1111-1112 (Ohio Ct. App. 1993)).

125 *d.*

126 Fruth Farms, Ltd. v. Vill. of Holgate, 442 F. Supp. 2d 470, 480 (N.D. Ohio 2006); *see also* 28A Corpus Juris Secundum Easements § 161.

[a] — *State ex rel. Wasserman v. City of Fremont.*

In 2014, the Ohio Supreme Court addressed the legality of a change to an established easement. The court looked to the construction of the easement's "use" language in the grant to determine if the switch from two eight-inch drainage pipes to one 12-inch drainage pipe was reasonable and did not increase the burden on the servient estate.

The Wassermans were the successors in interest of an easement, the purpose of which was to drain water off of their property into a creek. The easement ran over land owned by the city of Fremont (hereinafter Fremont). In 2005, the two parties originally replaced old drainage tiles with two eight-inch drainage pipes. Four years later, however, in 2009, Fremont unilaterally replaced the two pipes with one 12-inch drainage pipe.[127] After the installation of the new 12-inch pipe, the Wassermans claimed the removal of the two eight-inch drainage pipes damaged certain tiles, resulting in improper drainage of water off of their property *i.e*., the purpose of the easement was no longer being satisfied.[128] The court looked to the language of the original grant to determine the extent or limitations of the easement with regards to Fremont's actions. The relevant language of the grant is as follows:

> [The Wassermans' predecessor in interest] may construct and maintain a twelve (12) inch field tile drain from the west line of said lands of [Fremont's predecessor in interest] through her said lands on lines and at a depth to be fixed by her or her agents, and emptying into [Minnow] creek at a point about fifty (50) feet south east of the point where said creek crosses said right of way and enters her lands . . . .[129]

The court found the two pertinent features of the easement were, first, that the Wassermans' predecessor had the right to "construct and maintain" a drainage tile. Of further importance was the inclusion of the language that gave Fremont's predecessor the right to determine the path of the drainage

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127 State ex rel. Wasserman, 20 N.E.3d at 665.

128 *Id*. at 667.

129 *Id*. at 669.

tile "on lines and at a depth to be fixed by her." Second, the drainage tile was to empty into the creek about 50 feet southeast of where the creek entered Fremont's land.[130]

Under the express terms of the agreement, Fremont's predecessor had the right to fix the line and depth of the original drainage tile. The question before the court was whether the right to fix the line and depth meant that the servient estate holder (now the city of Fremont) retained the right to change the size of the line once fixed, or if it was to remain the fixed size. The court found the terms of the easement to be ambiguous on this point.[131]

In its interpretation of the ambiguous term, the court focused on the "use" of the easement. The clear use and purpose of the easement was to drain the water off of the property. If the new 12-inch pipe still accomplished that purpose, the rerouting did not violate the purpose or use of the easement.[132] Evidence was presented by two engineers that the 12-inch pipe was better suited to meet the original goal of the easement; to drain the water from the land. Therefore, the court held the 12-inch pipe as being effective in accomplishing the purpose of the easement, which, again, was to drain water off of the Wassermans' land.[133]

The second pertinent feature of the express easement is that the tile must empty into the creek "at a point about fifty (50) feet south east of the point where said creek crosses said right of way and enters" what is now the Fremont property.[134] Thus, the easement expressly dictates where the tile or pipe is to discharge water into the creek. However, neither party provided any evidence of exactly where that point was at the time of the original grant, nor is it on the current landscape.[135] If the Wassermans had presented evidence that the eight-inch tiles discharged at the point described in the grant of easement, and that Fremont's rerouting/switching the eight-inch pipes for

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130 *Id.* at 670.
131 *Id.*
132 *Id.*
133 *Id.*
134 *Id.* at 669.
135 *Id.* at 672.

a 12-inch drainage pipe actually changed the discharge point significantly, they might have had an argument for violation of the easement.[136] Without such a showing, however, the Wassermans failed to prove a violation of the terms of the easement, and the change in size of the existing drainage pipe was within Fremont's rights.

[b] — *Sigal v. Manufacturers Light & Heat Co.* Revisited.

In *Sigal v. Manufacturers Light & Heat Co.*, by crossing out certain portions of the standard contract form's language,[137] the parties to the express easement clearly did not intend to allow for additional pipelines to be added. Both the language of the easement and continued conduct of the parties supported such a finding. However, specific language within the easement's grant lends the conclusion that Manufacturers would have been within their rights if their decision was to increase the diameter of the established pipeline rather than add a new one. The relevant language authorizing this assertion states,

> Arthur P. Sigal . . . and Serena Nemer Sigal . . . do hereby grant to the Manufacturers Light & Heat Co . . . its successors and assigns, the right to lay a 14 inch pipe line . . . [the grantee] also *may change the size of its pipes* . . . .[138]

This language clearly authorizes Manufacturers the right to change the size (increase the diameter) of their pipe, if the purpose of the easement would still have been achieved.

In general, absent explicit, limiting language or conduct, it is possible that an easement owner would be within his rights if he added an additional pipeline or changed the diameter of the current pipe to accommodate and effectuate the use of the easement. This contention is not to say, though, that easement owners have an unlimited right to increase the efficiency or

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136 *Id.*

137 Sigal v. Mfrs. Light & Heat Co., 450 Pa. 228, 233, 299 A.2d 646, 648 (1973).

138 *Id.* at 234, 648.

effectiveness of their easement any time they feel it is warranted. The case law indicates that it is crucial to first look at the language of the easement to determine if such restrictions are ascertained. When the grant falls silent, a factual inquiry regarding the necessity and reasonableness of the changes to the lines would then be required. If a pipeline easement owner can provide evidence of increased volume in their lines, and a depreciating ability to service that volume with the current pipeline, they may be able to meet the burden of showing that their changes to the lines are necessary and reasonable for their use and enjoyment of the easement.

§ 16.06. Conclusion.

The escalating demand for natural gas requires us to consider a variety of methods to alleviate the pressure on the transmission network's capacity. Creating new pipeline easements, condemning property through federal and state condemnation proceedings for construction of new pipelines, and varying the use, width, or addition of pipelines to pre-existing easements all attempt to assuage the burden on the natural gas transmission capacity. Each method requires various elements to be satisfied, but it would behoove attorneys best to know the basic principles behind each method as well as keep abreast of changes within their laws.

The ultimate goal should be to meet the recent demand for natural gas with strategy, knowledge, and accuracy so production and transmission is tactically accomplished now and in the future.

Chapter 17

Internal Investigations of Well Site Events: Observations on Common Practical, Legal and Ethical Issues

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1 We would like to thank our *Vorys* colleague Timothy J. Cole, for his hard work on and many contributions to this chapter.

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§ 17.01. Introduction and Organization of the Chapter.

Well site emergencies are complex, multi-faceted events that require a range of skills, knowledge and experience to handle properly. So, too, are the investigations that follow those events. This chapter addresses some of the more common practical, legal and ethical issues faced by lawyers called on to handle Occupational Safety and Health Administration (OSHA) and internal company investigations of well site events.

Inasmuch as the proper handling of well site emergencies requires both technical and practical skills, this chapter provides legal information *and* practical advice relevant to planning for and conducting well event investigations. Section § 17.02 addresses the increasing OSHA oversight of drilling activities and OSHA site visits and investigations. Section § 17.03 addresses the application of the major privileges (attorney-client privilege, work product doctrine, and the self-critical analysis privilege) that may apply in the context of well event investigations, including an examination of the treatment of the different privileges within specific Appalachian Basin states. As discussed more below, privilege laws differ from state to state so it is critical that the lawyer understand the specific state's privilege laws before conducting a well site investigation. Section § 17.04 discusses some of the more common ethical issues that may arise in the course of well event investigations. Section § 17.05 provides a basic, immediate plan of action for lawyers called on to conduct internal company investigations of well events. Section § 17.06 applies the legal and ethical issues raised in the initial sections of this chapter to this conduct of an investigation, highlighting how the various legal and ethical issues inform the internal investigation of a well site event.

No single chapter can address the myriad of issues that might arise in the investigation of a given well site emergency, and this chapter does not pretend to do so. Rather, it is the authors' hope that this chapter will provide a basic framework for planning for and conducting thorough, thoughtful, and ethical investigations of well site events.

§ 17.02. Well Site Investigations under OSHA.

[1] — OSHA Has Increased Its Focus on the Oil and Gas Industry.

[a] — The OSHA Severe Violator Enforcement Program.

On February 11, 2015, OSHA designated oil and natural gas production and support activities of the gas industry as High-Emphasis Hazards under its Severe Violator Enforcement Program (SVEP):[2]

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2 Memorandum from Thomas Galassi, Director of Enforcement Programs, on inclusion of Upstream Oil and Gas Hazards to the High-Emphasis Hazards in the Severe Violator

> This policy is targeted to upstream well and gas drilling and well servicing employers based on their industry's significant worker fatality rate over time. Over the last 20 years, upstream operations have experienced a fatality rate that is ranged from five to eight times greater than the national average for all U.S. industries [U.S. DOL BLS]. Therefore the Agency believes that a change in its SVEP policy related to upstream oil and gas drilling and well servicing operations is warranted.

The designation has led to new requirements for the industry and will likely lead to new and additional well site investigations. In addition, reporting requirements have changed. As of January 1, 2015, employers with facilities located in states subject to federal OSHA jurisdiction are required to report: (1) any work-related fatality; (2) any work-related inpatient hospitalization of one or more employees; (3) any work-related amputations; and (4) any work-related losses of an eye. A fatality must be reported within eight hours of the employer learning about the death, but an employer will only have to report a fatality that occurs within 30 days of a work-related event. An employer must report an inpatient hospitalization, amputation, or loss of an eye within 24 hours of the employer learning about the event. Employers are only required to report an inpatient hospitalization, amputation, or loss of an eye if it occurs within 24 hours of a work-related event, however.

[b] — Local and Regional Emphasis Programs.

The SVEP designation continues OSHA's increasing focus on the oil and gas industry. For example, beginning no later than October 1, 2014, OSHA Regions III (DE, DC, MD, PA, VA, WV), VI (AR, VA, NM, OK, TX), VII (IA, KS, MO, NE), VIII (CO, MT, ND, SD, UT, WY) and X (AK, ID, OR, WA) have established Local or Regional Emphasis Programs (LEPs or REPs) targeting various aspects of the oil and gas industry.[3] LEPs or REPs "are

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Enforcement Program (Feb. 11, 2015) available at, https://www.osha.gov/dep/enforcement/memo_SVEP_oilandgas_022015.html.

3 *See, Local Emphasis Programs,* https://www.osha.gov/dep/leps.html, Region III Directive 2015-01 (CPL04) *Regional Emphasis Program for the Oil and Gas Service*

enforcement strategies designed and implemented at the regional office and/or area office levels . . . to address hazards or industries that pose a particular risk to workers in the office's jurisdiction."[4] Such local and regional programs include specific provisions for targeting and selecting sites for inspections, descriptions of inspection procedures, outreach and education programs, and criteria for evaluating the effectiveness of LEPs or REPs in reducing injuries and increasing employer compliance.[5]

[c] — OSHA Inspections May Occur at Any Time.

Additionally, OSHA may schedule an inspection of a well site to respond to notice from an employer, news accounts of a fire or explosion, or for any number of other reasons. With limited exception, OSHA does not give advance notice of the inspection. In fact, giving advanced notice of an inspection can result in the imposition of criminal penalties including imprisonment for up to six months and a fine of up to $1,000.[6] As a result, members of the upstream oil and gas industry should always be prepared to manage an OSHA inspection.

[2] — Prepare for OSHA Inspections.

Preparation for an OSHA inspection requires knowledge of applicable laws and regulations as well as a practical understanding of how such visits are conducted.

In Appendix A is a checklist of things that an employer should consider putting into an Emergency Response Plan or program (ERP) so, in the event of an emergency, the employer will have ready access to needed information and resources. In addition to federal requirements, many states require

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Industry [pdf]; Region VI Directive CPL 2 02-00013, *Regional Emphasis Program for the Upstream Oil and Gas Industry* [pdf]; Region VII Directive CPL 207-134, *Local Emphasis Program on Oil and Gas Operations* [pdf]; Region VIII Directive 15-05 (CPL 04-01), *Regional Emphasis Program for the Oil and Gas Industry*; Region X Directive 14-05 (CPL04), *Local Emphasis Program for Off-shore Oil and Gas Drilling Platforms* [pdf].

4 *Id*.

5 *See, e.g., id*., at Region III Directive 2015-01 (CPL04), *Regional Emphasis Program for the Oil and Gas Industry* [pdf].

6 29 C.F.R. § 1903.6.

operators to develop and in some cases file their ERPs with state and local agencies.[7] With regard to OSHA compliance, the following areas should be explored by any employer:

- Have all required OSHA notices been posted?
- Has the OSHA 300A form been posted each year? (29 C.F.R. § 1904.32(b))
- Has the OSHA 300 log been checked for accuracy? (29 C.F.R. § 1904.32(a))
- Who is responsible for maintaining the log?
- Who is responsible for recording injuries and illnesses? (29 C.F.R. § 1904.32)
- Who maintains and completes the OSHA 301s? (29 C.F.R. § 1904.29)
- What training does the OSHA record keeper have?
- Does the employer have a written safety program?;
- Are regular and periodic safety and health audits or inspections performed?;
- Does the employer have a written hazard communication program? (29 C.F.R. § 1910.1200);
- Does the employer have a blood-borne pathogen program and has there been training therein? (29 C.F.R. § 1910.1030);
- Does the employer have a written exposure control plan? (29 C.F.R. § 1910.1030);
- Has the employer conducted firefighting training? (29 C.F.R. § 1910.156);

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7 *See, e.g.,* in Pennsylvania 43 Pa. Bull 526, Volume 42, Number 4, Saturday, January 26, 2013, identifying new regulations governing emergency response plans. *See also,* Commonwealth of Pennsylvania, Department of Environmental Protection, *Guidelines for the Development and Implementation of Environmental Emergency Response Plans*, 400-2200-001.

- Does the employer have a confined spaces program? (29 C.F.R. § 1910.146);
- What documentation does the employer have of its training programs?;
- Has the employer complied with the requirements for employee use of powered industrial trucks? (29 C.F.R. § 1910.178);
- Does the employer have a personal protective equipment assessment program? (29 C.F.R. § 1910.132);
- Who maintains the employer's medical records for occupational exposure? (29 C.F.R. § 1910.1020);
- Does the employer have a lockout/tag out program? (29 C.F.R. § 1910.147); and
- Has the employer made certain that employees may communicate with the company from the remote locations?.

Employers involved in well production might also pay particular attention to the following areas:

- Does the employer have an emergency action plan? (29 C.F.R. § 1910.88);
- Has the employer complied with the requirements of the hazardous waste operations and emergency response standard (Hazwoper)? (29 C.F.R. § 1910.120);
- Has the employer insured that there is adequate medical treatment within a reasonable distance of all worksites? (29 C.F.R. § 1910.151); and
- Has the employer implemented a Job Safety Analysis process?

[3] — Practical Tips for Handling an OSHA Inspection.

When an OSHA inspector arrives on the premises, whether as a result of an injury or for some other reason, a favorable first impression is important. The company that has the above in place is going to make a better impression on an OSHA compliance officer.

Where there is an on-going emergency, such as during the immediate aftermath of an explosion or fire, OSHA may take more of an advisory role, deferring to the incident commander. During such a phase, the OSHA compliance officer will observe whether the employer's evacuation plan was implemented, or if it was not, whether the safeguards of the HAZWOPER standard were met.[8] Other observations of a compliance officer during the response time to an emergency include first aid, firefighting, and personal protective equipment. In such a situation, the more customary inspection would take place later.

As a general matter, an OSHA inspection will have three phases: (1) an opening conference and records review; (2) a walk-around, which includes employee and management interviews; and (3) a closing conference.[9] At the opening conference, the employer should ask for the compliance officer's credentials. The employer should also inquire into what precipitated the inspection. If, for example, it was an employee complaint, the employer should request a copy of the complaint. If the inspection was because of an administrative plan, the employer might ask the compliance officer how the plan operates and under what circumstances it was selected for an inspection. In other words, the employer should attempt to uncover as much detail as possible while the compliance officer is at the well site about what he or she intends to do. Questions that might be asked include:

- What specific areas/operations will be inspected?
- What records will the compliance officer want to review?
- Will the compliance officer take photographs or videotapes?
- Will the compliance officer take any type of sampling?

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8 HAZWOPER stands for OSHA's Hazardous Waste Operations and Emergency Response Standard program to protect workers at hazardous sites. *HAZWOPER Training*, OSHA, http://www.osha.com/courses/hazwoper.html.

9 For reference to procedures potentially applicable under OSHA local and regional programs, see, for example, *Local Emphasis Programs*, https://www.osha.gov/dep/leps.html, Region III Directive 2015-01 (CPL 04) *Regional Emphasis Program for the Oil and Gas Industry* [pdf], at Sections VIII (Inspection Scheduling) and IX (Inspection Procedures).

An employer should also identify in advance whether there is any proprietary information that it wishes to protect. While there are several phases at which it may assert the proprietary nature of information, there is no reason not to start with the OSHA compliance officer.

Although it sounds obvious, while the compliance officer is otherwise busying him or herself with the opening conference and any document review, an employer should take the opportunity to have the worksite inspected to see if there are any obvious hazards that can be cured. The site should also be as neat and orderly as time permits. In many instances, a "comprehensive safety inspection of the site will be conducted."[10] Further, "[i]f the site is a drilling rig site, the rig itself may also be included in the inspection."[11]

An employer should also develop a protocol regarding how it will deal with an OSHA inspection and who will be involved on behalf of the company. Someone knowledgeable about the operation should be chosen to accompany the OSHA inspector. Because OSHA inspections are often unannounced, there should be at least two people within an organization who are knowledgeable about OSHA inspections and who can accompany the OSHA inspector. As a result of the unique situation with oil and gas production and the remoteness of the worksites, the employer should be mindful that the OSHA inspector is not going to wait several hours for the company's representative to appear.

Those persons selected to take the lead in the inspection should be versed in the conduct of OSHA inspections. For example, the individual should understand that the OSHA inspector may have the right to interview non-managerial employees in private, but also that in some jurisdictions if the employee signs an election of representation form, then the employer may assert a right to be present during the interview.[12] Additionally, the

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10 *Id.*

11 *Id.*

12 Trinity Indus. v. Dole, 760 F. Supp. 1194, 1200 (N.D. Tex. 1991) (court granted summary judgment for employer stating "the right to waive a private interview is best left in the hands of the employee. This enables the employee to decide whether the interview should be conducted in private, where he can speak freely against his employer if necessary, or whether he wants a company representative to be present to minimize whatever confusion

individual should be aware that the OSHA inspector may not shut down an operation to interview employees. Further, interviews with management representatives can take place with legal representation. Photographs and videos should be taken where a compliance officer does the same. The person who is designated to orchestrate the employer's response to the inspection should know where the OSHA-required records are located and where the various program descriptions are kept.

In summary, there are two basic things that the wise employer will do to prepare for an OSHA inspection. First, the employer will periodically review and make certain that all of OSHA's required programs have been implemented, training has been undertaken, and that the programs are up to date. Second, because OSHA inspections are not announced, the employer will have in place a procedure that will be implemented immediately upon the OSHA inspector's arrival at the employer's premises. While that may sound like a lot of work, there is any number of resources available to the employer to accomplish those ends, including OSHA on-site consultation services.[13] The admonition that an ounce of prevention is worth a pound of cure is more than true in this area.

§ 17.03. Know the Local Law Concerning Applicable Privileges: Overview of the Attorney-Client Privilege, Work-Product Doctrine, and Self-Critical Analysis Privilege.

As mentioned above and repeated throughout (*i.e.*, this is important), in drafting and executing an investigative plan, the lawyer should turn his or her immediate attention to the law of the local jurisdiction. Proper advanced planning for an investigation requires knowledge of the legal context in which the event took place, and of the context in which the courts may later view

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might be inherent in, or arise from, the questioning.") However, a subsequent decision found that the employer did not have standing and vacated the prior holding. Trinity Indus., Inc. v. Martin, 963 F.2d 795, 798 (5th Cir. 1992)).

[13] For a general list of available OSHA training and compliance resources, *see, e.g.* OSHA website at *OSHA Training, Courses, Materials and Resources*, www.osha.gov/dte/index.html.

the investigation itself. This is particularly true with regard to the application of privilege protections. The law regarding privilege protections varies from state to state, so elements of an investigation that may be protected from disclosure in one state may not be protected in the next. The same may be said of ethics rules; though state ethics rules may be similar, conduct deemed acceptable in one state may in fact be regarded as unethical in another. Hence, prior knowledge of the law of the local jurisdiction is critical to the proper conduct of an internal investigation of a well site event.

Generally, three privileges are applicable to internal investigations: (1) the attorney-client privilege; (2) the work-product doctrine; and (3) the self-critical analysis privilege. The common interest or co-client privileges may also come into play. Each privilege has different elements and applications and each may receive different treatment depending on the state or federal circuit in which an action is pending.

[1] — The Attorney-Client Privilege.

The attorney-client privilege is the oldest and most well-established privilege of confidentiality in the United States' common law system.[14] By assuring confidentiality, the privilege encourages clients to make "full and frank" disclosures to their attorneys, who are then more equipped to provide candid advice and effective representation.[15]

The attorney-client privilege protects confidential communications between a client and the client's attorney and representatives when the communication's purpose is for the client to gain legal advice. Therefore, the attorney-client privilege is invoked when the following three conditions are met: (1) the client communicates with the attorney or its representatives; (2) the communication is confidential; and (3) the communication is to gain legal advice to advance the client's own interests.[16]

The attorney-client privilege is absolute. Only the client may grant permission for an attorney to share any of the confidential communications.

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14 Upjohn v. United States, 449 U.S. 383, 389 (1981).

15 *Id*.

16 Wiley v. Marley Co., 891 F.2d 1463, 1471–72 (10th Cir. 1963).

Moreover, the privilege applies in any context including at trial, at a grand jury, and during pre-trial and irrespective of whether there is a court or other legal proceeding.

[a] — Who Is the Client?

In general, a "client" is defined as the intended and immediate beneficiary of the lawyer's services. Although the definition of a client is seemingly straightforward, defining a client in an organizational setting is considerably more difficult. Historically, courts applying the attorney-client privilege to corporations struggled to determine which corporate employees should be included in the protection and which corporate employees should control the privilege. Under federal law, two different tests developed to determine who in a corporate setting is considered a client: the original 'Control Group Test' and the newer 'Subject Matter Test.'

[b] — The Control Group Test.

Under the Control Group Test, to gain protection as a client under the attorney-client privilege in a corporate setting, the employee involved in the communication with the attorney must be in a position to control, or take a substantial part in, a corporate decision based on the advice of the attorney.

[c] — The Subject Matter Test.

The United States Supreme Court rejected the Control Group Test in 1981 in *Upjohn*[17] and instead set out a five factor test, commonly referred to as the Subject Matter Test, to guide federal courts in determining the validity of attorney-client privilege claims for communications between legal counsel and lower-level corporate employees. Some state courts have adopted the Subject Matter Test, while other states continue to use the Control Group Test.[18]

To invoke attorney-client privilege in a corporate setting under the Subject Matter Test, the following five factors are necessary: (1) the solicited

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17 *Upjohn*, 449 U.S. at 394–95.

18 *Wiley*, 891 F.2d 1471–72 (10th Cir. 1963).

information must be necessary to supply the basis for legal advice to the corporation or superior officers ordered for the communication of the information; (2) the information was not otherwise available from the control group management; (3) the communications concerned matters within the scope of the employees' duties; (4) the employees were aware that they were being questioned in order for the corporation to secure legal advice; and (5) the communications were considered confidential when made and kept confidential.[19] When each of the elements is met, the lower level employee is considered a client under the attorney-client privilege, and the employee's communications with corporate counsel are privileged.[20]

However, the control group (directors, executives, etc.) within the corporation continues to control the privilege and has the power to waive it. The individual employee, who provided the information to the attorney, even if considered a client under the Subject Matter Test, does not decide when the privilege is waived unless the employee is a part of the control group.

[d] — Internal Investigations and the Predominant Purpose Test.

In an important decision regarding internal investigations, the U.S. Court of Appeals for the D.C. Circuit held in *In re Kellogg Brown & Root*[21] that communications and materials created as part of a confidential internal investigation are protected by the attorney-client privilege where "one of the significant purposes" of the investigation is to obtain or to provide legal advice. The court's decision reversed a lower district court decision that reports relating to Kellogg Brown & Root's internal investigation conducted pursuant to regulatory requirements were not protected from disclosure by either the attorney-client privilege or the work product doctrine. The lower court had held that in order to establish the privilege, the defendant needed

19 *Upjohn,* 449 U.S. at 394-95.

20 *Id*. *See also*, discussion of the use of *Upjohn* warnings with corporate witnesses, *infra,* at Section 17.06[2]. *Upjohn* warnings are statements made during communication with lower level employees to establish the criteria for application of the attorney-client privilege under the Subject Matter Test adopted in *Upjohn*.

21 *In re* Kellogg Brown & Root, 2014 WL 2895939 (D.C. Cir. June 27, 2014).

to establish that the communications would not have been made "but for" the fact that legal advice was sought.[22] The lower district court further concluded that the investigation at bar differed from the investigation found privileged in *Upjohn* because it was a routine, corporate, on-going compliance investigation required by a regulatory law and corporate policy, and not conducted solely for the purpose of obtaining legal advice on potential wrongdoings. The court of appeals rejected the lower court's reasoning, holding that the investigation at bar was "materially indistinguishable" from the investigation reviewed by the Supreme Court in *Upjohn*. The court of appeals disagreed with the district court on several points, but perhaps most importantly, with the district court's conclusion that the purpose of KBR's investigation was not to obtain legal advice, but instead to comply with federal regulations. The circuit court rejected the district court's assessment of the primary purpose test as a "but for" test, and instead held that "so long as obtaining or providing legal advice was one of the significant purposes of the internal investigation, the attorney-client privilege applies, even if there were also other purposes for the investigation and even if the investigation was mandated by regulation."[23]

Kellogg is significant because it expressly rejected rigid application of the predominant purpose test, which by its terms, restricts application of the attorney-client privilege to those investigations conducted for the primary purpose of obtaining legal advice, which, the court held, is difficult to determine in many cases. The court opted instead for a less restrictive and more practical rule that would apply the attorney-client privilege to investigations where only one of the purposes of the investigation was to obtain legal advice. This means that the attorney-client privilege could apply even in those circumstances where an internal investigation was conducted pursuant to company policy or was required by statute or regulation. Whereas most well incident events investigations will be conducted with the primary purpose of obtaining legal advice as to liabilities arising out of the incident,

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22 United States, *ex. rel.* Barko v. Halliburton, 2014 WL 1016704 (D. D.C. March 6, 2014).

23 *In re Kellogg,* 2014 WL 2895939, at *3.

such that the rationale of *Kellogg* will not come into play; the decision in *Kellogg* does provide greater protection for internal corporate investigations.

[e] — What Is and Is Not Protected by the Privilege.

As discussed in greater detail below, some states have applied the Subject Matter Test, some the Control Group Test, and others still a hybrid of the two. Accordingly, it is important to know your state's rules before conducting the investigation. It is also helpful when planning for an investigation to keep in mind what IS protected by the attorney-client privilege and what is *not* protected.

The attorney-client privilege protects confidential communications for the purpose of obtaining legal advice between:

a. The attorney and the client;

b. A representative of the attorney and a representative of the client;

c. The attorney and the attorney's representatives;

d. The client and a representative of the client;

e. Representatives of the client;

f. Attorneys and their representatives for the same client; and

g. The attorney, the client, or their representative to any attorney or his representative on a subject matter of common interest in pending litigation.

However, the attorney-client privilege does *not* protect the following:

a. It does not protect the basic facts from disclosure;

b. It does not protect every discussion with a lawyer;

c. It does not protect every document copied to a lawyer;

d. It does not protect non-legal business information shared between the attorney and the client;

e. It does not protect materials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation; and

f. It does not protect an in-house attorney communicating a business decision to a business unit, or performing another task in a non-legal role.

It is essential that the investigator be mindful of these key limitations to the attorney-client privilege.

[2] — The Work-Product Doctrine.

The work-product doctrine provides broader protections than the attorney-client privilege in that it protects more than just confidential communications between attorney and client. Its primary purpose is to protect an attorney's mental impressions, opinions, and legal conclusions from discovery.[24] However, it is limited to materials prepared *in anticipation of litigation*.[25]

Federal Rule of Civil Procedure 26(b)(3) substantially codifies the work-product doctrine for tangible materials. In interpreting Rule 26(b)(3), courts have generally applied a three-part test to determine if specific materials are subject to work-product protections. To qualify for protections of the work-product doctrine, items must be (1) documents or tangible things; (2) prepared by or for a party to the litigation; and (3) prepared in anticipation of litigation.[26]

Whether a document has been prepared in anticipation of litigation often depends on both the imminence of the anticipated litigation and the motivation behind the preparation of the material.[27] This is an area of significant litigation. It is important to look at the tests set out in each jurisdiction. As set forth below, the privilege may require that a document be prepared because of litigation, or the likelihood of litigation must be shown subjectively and objectively.

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24 Hickman v. Taylor, 329 U.S. 495 (1947).

25 *Id*. at 508.

26 Aktiebolag v. Andrx Pharm., Inc., 208 F.R.D. 92, 104 (S.D.N.Y. 2002).

27 U.S. ex rel. Fago v. M&T Mortg. Corp., 238 F.R.D. 3, 7 (D.C.C. 2006).

Although a valuable means of protecting confidential documents, the privilege is not absolute like the attorney-client privilege. Rather, some work-product materials are provided only qualified protection from disclosure.[28] In general terms, materials that would otherwise meet the criteria for work-product protection and are not the mental impressions of the lawyer, may nonetheless be subject to disclosure if the moving party can demonstrate (1) substantial need for the materials and (2) that the substantial equivalent cannot be obtained without undue hardship.[29]

"Substantial need" consists of "the relative importance of the information in the documents to the party's case and the ability of the party to obtain that information by other means."[30] Relevancy alone is insufficient to establish substantial need. Rather, substantial need may exist where the work-product material is central to the substantive litigation claim.[31] For example, a court found that substantial need existed with regard to attorney work product where the plaintiff sued his former attorney for malpractice and the work-product generated during the course of the representation was central to the plaintiff's claims.[32] Substantial need may also be found if the opposing party opens the door to an analysis of the work product itself. For example, "in a discrimination case where an employer defends on the basis of having made an adequate investigation of the charges, work-product showing the extent of the investigation is discoverable."[33]

Some courts also find that substantial need exists with respect to contemporaneous statements made immediately following an accident.[34] A witness' own statement may be subject to no protection from disclosure to that witness. The United States District Court for the District of Maryland explained, "statements of either the parties or witnesses taken immediately

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28 Davis v. Emery Air Freight Corp., 212 F.R.D. 432, 434 (D. Mc. 2003).

29 *In re* Cendant Corp. Sec. Litig., 343 F.3d 658, 663 (3d Cir. 2003).

30 Stampley v. State Farm Fire & Cas. Co. 23 F.App'x 467 (6th Cir. 2001).

31 Mandanes v. Mandanes, 199 F.R.D. 135, 150 (S.D.N.Y. 2001).

32 *Id*.

33 *Id*.

34 Coogan v. Cornet Transp. Co., 199 F.R.D. 166, 167–68 (D. Md. 2001).

after the accident and involving a material issue in an action arising out of that accident, constitute "unique catalysts in the search for truth" in the judicial process.[35] However, courts are less likely to find that there is a substantial need when such information is available through other means.[36]

In seeking to establish undue hardship, a party should be prepared to make a particularized showing that all other avenues of obtaining the sought-after material have been exhausted.[37] As a general rule, inconvenience and expense do not constitute undue hardship.[38] Courts have found undue hardship where a witness is unable to testify.[39] Courts have also found undue hardship in situations where: (1) the materials concern statements made contemporaneously with an event and a witness cannot provide a similar account at a later time;[40] (2) the passage of time has dulled the witness's memory;[41] (3) materials are exclusively in the opposing party's possession;[42] and (4) the person possessing the materials has refused to respond to discovery or deposition requests.[43]

Additionally, some courts have treated substantial need and undue hardship requirements as a single requirement, blurring the distinction between the two.[44]

Some jurisdictions also draw distinctions between core and non-core work-product. *'Core work-product,' includes "the attorney's or the attorney's representative's mental impressions, opinions, conclusions, or*

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35 *Id*.

36 Stampley v. State Farm Fire & Cas. Co., 23 F. App'x 467 (6th Cir. 2001).

37 Davis v. Emery Air Freight Corp., 212 F.R.D. 432, 436-37 (D. ME 2003).

38 *Stampley,* 23 F. App'x 467 (6th Cir. 2001).

39 *Mandanes, supra,* 199 F.R.D. at 150 (S.D. N.Y. 2001).

40 McDougal v. Dunn, 468 F.2d 468, 474–76 (4th Cir. 1972).

41 Xerox Corp. v. IBM Corp., 79 F.R.D. 7 (S.D.N.Y. 1977).

42 Loctite Corp. v. Fel-Pro, Inc., 667 F.2d 577, 582 (7th Cir. 1981).

43 *In re* Vitamins Antitrust Litig., 211 F.R.D. 1, 4 (D.D.C. 2002); U.S. v. Gallo, No.12-20630-CR-Lenard/Goodman, 2014 U.S. Dist. LEXIS 61835, at *8 (S.D. Fl. May 5, 2014) ("holding that to argue undue hardship a party could assert that "he or his counsel attempted to interview the three witnesses but that they refused to speak with him, or that the prosecutor instructed the witnesses not to answer his counsel's questions.").

44 Burlington Indus. v. Exxon Corp., 65 F.R.D. 26, 43 (D. Md. 1974).

legal theories" and normally receives near absolute protection, like privileged communications.[45] Non-core work product, by contrast, such as photos taken in anticipation of litigation or in some cases witness statements, items which deal more with or reflect on facts, rather than the mental impressions or work of the lawyer, are subject to the qualified protections described above and thus may be subject to disclosure in given circumstances.[46]

[3] — Self-Critical Analysis Privilege.

The self-critical analysis privilege is a newer concept, first gaining support in the 1970s. It developed in response to the increasingly complex regulatory and statutory framework in which corporations conduct business. Litigants, particularly corporate litigants, struggled with ensuring their compliance with the mandates of Congress and federal agencies, while avoiding simultaneously generating potentially adverse documents that could be damaging in subsequent litigation.

The purpose of the self-critical analysis privilege is to encourage organizations to conduct self-critical reviews regarding matters of importance to the public without being restricted by the possibility that the self-criticism will be discovered and then used against the organization in a later proceeding. A common test of the self-critical analysis privilege is that it applies when: (1) the information results from a critical self-evaluation undertaken by the party seeking protection; (2) the public has a strong interest in preserving the free flow of information sought; (3) the information is of the type for which flow would be curtailed if discovery were allowed; and (4) the document must have been created with the expectation that it would be kept confidential and must have remained so.[47]

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45 *In re* Bexar County Crim. Dist. Attorney's Office, 224 S.W.3d 182, 187–188 (Tex. 2007) (referring to core work-product as "sacrosanct.").

46 Honey Transp., Inc. v. Ruiz, 893 So. 2d 661 (4th Dist. 2005) (holding that photographs taken of two vehicles involved in an automobile accident could potentially qualify for work-product protection); Houdaille Indus., Inc. v. Cunningham, 502 S.W.2d 544, 549 (Tex. 1973) (allowing discovery of photographs).

47 Dowling v. Am. Hawaii Cruises, Inc., 971 F.2d 423 (9th Cir. 1992).

Most courts that recognize the privilege only apply the protections to the subjective portions of the self-critical reports and hold that the underlying data is discoverable.[48] Some courts even go so far as to restrict the privilege to post-accident analyses and have held that the privilege is inapplicable to pre-accident safety analyses.[49]

Caution is advised when attempting to apply the self-critical analysis privilege, however, as the circuit courts have not expressly adopted it,[50] and courts have taken opposing positions on the privilege.[51]

State law relating to privileges is often governed by statute and some states have statutes adopting forms of self-evaluative privilege in a very limited context, such as within medical settings.[52] A few states have specifically adopted a self-evaluative privilege including Alabama, Florida, and Georgia.[53]

[4] — The Common Interest Privilege.

The common interest doctrine extends the attorney-client privilege to certain communications with third parties made during the course of common or shared business transactions, or in the common course of preparing for or defending litigation. Thus, the common interest privilege *could* apply, for example, in cases where an operator and a contractor have a common or aligned interest in the conduct of an investigation of a well event, or with

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48 Bemer v. Carnival Corp., No. 08-22569-CIV, 2009 WL 982621, at *1 (S.D. Fla. April 10, 2009); *In re* Crazy Eddie Sec. Litig., 792 F. Supp. 197 (E.D.N.Y. 1992); Shipes v. BIC Corp., 154 F.R.D. 301, 308 (M.D. Ga. 1994).

49 Myers v. Uniroyal Chem. Co., Civ. A. No. 916716, 1992 WL 97822, at *4 (E.D. Pa. May 5, 1992).

50 ASARCO, Inc. v. NLRB, 805 F.2d 194 (6th Cir. 1986); Johnson v. United Parcel Serv., Inc., 206 F.R.D. 686, 689–90 (M.D. Fla. 2002) (stating that "[n]o circuit courts have adopted the self-critical analysis privilege.").

51 *Compare, In re* Salomon Inc., Sec. Litig., Nos. 91 Civ. 5442 & 5471, 1992 WL 350762 (S.D.N.Y. Nov. 13, 1992) (refusing to apply the privilege); and *In re Crazy Eddie Sec. Litig.*, 792 F. Supp. 197 (E.D.N.Y. 1992) (applying privilege to internal accounting audits).

52 Ala. Code § 22-21-8 (2010); Fla. Stat. Ann. § 766.101 (West 2010); Ga. Code Ann. §§ 31-7-133, 31070143 (West 2010).

53 Nearly all 50 states have adopted a different form of the privilege, the peer review privilege, which only applies for medical providers.

regard to subsequent litigation. [54] It is the authors' view, however, that the company should first conduct an independent internal investigation of the event, and to leave for later any consideration of information that might be shared with potential or actual co-defendants. This will better ensure the confidentiality of the underlying investigation.

[5] — Privilege Laws in the Appalachian Basin States.

While all states provide attorney-client and work product protections, state privilege laws differ. It is critical, therefore, to know the particular laws of each state, because what may be protected in one state may not be protected in another. The privilege laws in the Appalachian Basin states, Ohio, Pennsylvania, Kentucky, West Virginia, and New York, are discussed below. In Appendix B is a chart illustrating some of the differences in the privilege laws of states within the Appalachian Basin.

[a] — Ohio: Attorney-Client Privilege.

In Ohio, the attorney-client privilege is partially codified by statute and where the statute does not apply, the privilege is guided by common law.[55]

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54 For a comprehensive analysis of the common-interest privilege in the Appalachian Basin States, see presentation, *Loose Lips Sink Ships: The Perils of Inadvertent Waiver of the Attorney-Client Privilege in Oil and Gas Litigation*, Dylan E. Lewis and Michael C. Cardi, 36th Annual Institute, EMLF, Amelia Island Plantation, Florida, noting that several state and federal courts within the Application Basin have considered the common interest privilege. *See id., citing, In re:* Matthew R. Klein/Cabinet for Health and Family Servs., Op. Att'y Gen. (Ky.), 10-ORD-039, 2010 WL 1989593 (March 2, 2010); Calor v. Ashland Hosp. Corp., Nos. 2007-SC-000573-DG, 2008-SC-000317-DC, 2011 WL 4431143 (Ky. Sept. 22, 2011); Buckeye Corrugated, Inc. v. Cincinnati Ins. Co., No. 26634, 2013 WL 4153540 (Ohio Ct. App. (9th Dist.) Aug. 14, 2013); Zerner v. New Par, No. 1999-CA-00201, 2000 WL 222150 (Ohio Ct. App. (5th Dist.) Jan. 31, 2000); Libbey Glass, Inc. v. Oneida Ltd., 197 F.R.D. 342 (D. Ohio 1999); Executive Risk Indem., Inc. v. Cigna Corp., 2004 No. 1495, 2006 WL 2439733 (Pa. Commw. Court (1st Dist.) Aug. 18, 2006); Young v. Presbyterian Homes Inc., No. 2000-C-990, 2001 WL 753031 (Lehigh C.C. January 17, 2001); State ex rel. Brison v. Kaufman 584 S.E.2d 480 (W. Va. 2003); Baker v. PPG Indus., Inc., C.A. No. 12-C-229 (Marshall Cty. Cir. Ct. January 2, 2014). In the federal courts, *see* Katz v. AT&T Corp., 191 F.R.D. 433 (E.D. Pa. 2000); Andritz Sprout-Bauer, Inc. v. Beazer East, Inc., 174 F.R.D. 609 (M.D. Pa. 1997); Teleglobe Communications Corp. v. BCE Inc., 493 F.3d 345 (3d Cir. 2007); *In re* Grand Jury Subpoenas, 89-3 & 89-4, John Doe 89-129, 902 F.2d 244 (4th Cir. 1990).

55 Ohio Rev. Code R.C. § 2317.02(A)(1).

Ohio Revised Code § 2317.02 provides a testimonial privilege — *i.e.*, it prevents an attorney from testifying concerning communications made to the attorney by a client or the attorney's advice to a client[56] — while common law provides a broad protection against the dissemination of information obtained in the confidential attorney-client relationship.[57]

There is no material difference between Ohio's attorney-client privilege and the federal attorney-client privilege. Under the privilege, "(1) [w]here legal advice of any kind is sought, (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at this instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) unless that protection is waived."[58] And, as to corporate "clients," Ohio has suggested it follows the Subject Matter Test established in *Upjohn*.[59]

[b] — Ohio: Work-Product Doctrine.

Ohio Civil Rule 26(B)(3) describes the work-product doctrine as it applies in civil cases. "[A] party may obtain discovery documents, electronically stored information and tangible things prepared in anticipation of litigation or for trial by another party or by or for that other party's representative only upon a showing of good cause therefore."[60] Ohio Civil Rule 26(B)(3) protects "documents, electronically stored information, and tangible things" and also "**intangible work-product**."[61] The protection for intangible work-product, the lawyer's own thoughts and impressions, exists because "[o]therwise,

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56 *See* Jackson v. Greger, 854 N.E.2d 487 (Ohio 2006).

57 State ex rel. Dawson v. Bloom-Carroll Local Sch. Dist., 131 Ohio St. 3d 10, 2011-Ohio-6009 (2011).

58 State ex. rel. Leslie v. Ohio Hous. Fin. Agency, 105 Ohio St. 3d 261 (2005) (quoting Reed v. Baxter, 134 F.3d 351, 355–56 (6th Cir. 1998)).

59 *Id*.

60 Ohio R. Civ. P. 26(B)(3).

61 *Id*. (Emphasis added).

attorneys' files would be protected from discovery, but attorneys themselves would have no work-product objections to depositions."[62]

Application of the work-product doctrine requires a two-step analysis: (1) whether the document was prepared in "anticipation of litigation," and (2) whether there has been a showing of "good cause" to obtain the document.[63] Ohio courts have interpreted "anticipation of litigation" to mean that the threat of litigation must be "real and substantial,"[64] or "substantial and imminent."[65] The Sixth Circuit and several other U.S. Circuits apply the "because of test";[66] if the documents were prepared "because of the prospect of litigation" and the party has "the subjective belief that litigation was a real possibility" and that belief was "objectively reasonable," then the document meets the work-product doctrine requirements.[67]

In *Jackson v. Greger*,[68] the Ohio Supreme Court examined the meaning of "good cause," and held that "a showing of good cause under Civ. R. 26(B)(3) requires demonstration of need for the materials — *i.e.*, a showing that the materials, or the information they contain, are relevant and otherwise unavailable.

To that end, Civ. R. 26(B)(3) places a burden on the party seeking discovery to demonstrate good cause for the sought-after materials."[69]

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62 Sherwin-Williams Co. v. Motley Rice LLC, No. 96927, 2012 Ohio App. LEXIS 703, at *26 (8th Dist. 2012) (citing *In re* Seagate Tech., LLC, 497 F.3d 1360, 1376 (Fed. Cir. 2007); *see also* Squire, Sanders & Dempsey, L.L.P. v. Givaudan Flavors Corp., 127 Ohio St. 3d 161, 174 (Ohio 2010). (Internal citations omitted). ("[T]he work-product doctrine provides a qualified privilege protecting the attorney's mental processes in preparation of litigation, establishing 'a zone of privacy' in which lawyers can analyze and prepare their client's case free from scrutiny or interference by an adversary.").

63 Estate of Hohler v. Hohler, 185 Ohio App. 3d 420, 429, (7th Dist. 2009).

64 Perfection Corp. v. Travelers Cas. & Surety, 153 Ohio App. 3d 28, 36 (8th Dist. 2003).

65 Roggelin v. Auto-Owners, Ins., 6th Dist. Lucas No.L-02-1038, 2002-Ohio-7310 at *19 (6th Dist. 2002).

66 U.S. v. Roxworthy, 457 F.3d 590, 593 (6th Cir. 2006) (internal citations omitted).

67 *Id*. at 594.

68 Jackson v. Greger, 110 Ohio St. 3d 488 (2006).

69 *Id*.

In *Huntington Nat'l Bank v. Dixon,*[70] the court held that good cause existed to require production of an attorney's notes regarding attempts to serve the defendants because the notes reflected "ordinary fact" work and were not obtainable from another source. In *In re Estate of Hohler v. Hohler,*[71] the court held good cause existed to require production of handwritten notes memorializing opinions made by the attorney during a phone call with his client where the client was deceased and the information could not be obtained elsewhere.

[c] — Ohio: Self-Critical Analysis Privilege.

The self-critical analysis privilege has not been expressly adopted by Ohio Courts, but it has been discussed. In *State ex. rel. Celebresse v. CECOS Int'l, Inc.,*[72] CECOS, a hazardous waste disposal company, urged the court to find that it had a privilege of self-critical analysis with regard to internally generated performance evaluations. CECOS argued "that public policy favors such a privilege since it encourages candid introspection and improvement, as well as internal 'whistle blowing,' . . . [and that] . . . the self-evaluative privilege would have a positive environmental effect because it would encourage companies like itself to make changes in procedure and to frankly document mistakes without fear of prosecution by state and federal regulatory authorities."[73] The court noted that the generally accepted test for determining whether adoption of such privilege is appropriate involves consideration of three criteria: "[F]irst, the information must result from a critical self-analysis undertaken by the party seeking protection; second, the public must have a strong interest in preserving the free flow of the type of information sought; finally, the information must be of the type whose flow

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70 Huntington Nat'l Bank v. Dixon, 8th Dist. Cuyahoga No. 93604, 2010-Ohio-4668 at 18.

71 *In re* Estate of Hohler v. Hohler, 197 Ohio App. 3d 237, 246-47, 967 N.E.2d 219 (Ohio App. 7th Dist. 2011).

72 State ex. rel. Celebresse v. CECOS Int'l, Inc., 66 Ohio App. 3d 262, (Ohio App. 12th Dist. 1990).

73 *Id*. at 264.

would be curtailed if discovery were allowed."[74] The court held that the defendant met the first criterion, in that the information the state sought to discover derived from CECOS' critical self-analysis, but struggled with the second and third prongs of the test.[75] Ultimately, the court held the waste facility could not invoke the privilege because it was engaged in a potentially dangerous activity subject to strict scrutiny, including statutory obligations to disclose company records to public officials. The court concluded: "A self-evaluation privilege would allow CECOS to skirt obligations created by law. We may not ignore legislative intent by finding such privilege is present in the case at bar."[76]

The *Celebresse* opinion leaves open the question of whether Ohio state courts might apply the privilege in future disputes.

[d] — Pennsylvania: Attorney-Client Privilege.

In Pennsylvania, the attorney-client privilege is codified by statute and reads, "[i]n a civil matter counsel shall not be competent or permitted to testify to confidential communications made to him by his client, nor shall the client be compelled to disclose the same, unless in either case this privilege is waived upon trial by the client."[77] In 2011, the Pennsylvania Supreme Court further confirmed that "the attorney-client privilege operates in a two-way fashion to protect confidential client-to-attorney or attorney-to-client communications made for the purpose of obtaining or providing professional legal advice."[78] The courts have also noted that "[r]elevance is not the standard for determining whether or not evidence should be protected from disclosure as privileged, and that remains the case even if one might conclude the facts to be disclosed are vital, highly probative, directly relevant,

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74 *Id.*, at 255-256, *quoting,* Note, "The Privilege of Self-Critical Analysis" (1983), 96 *Harv. L. Rev.* 1083, 1086.

75 *Id*. at 266.

76 *Id*.

77 42 Pa. Stat. Ann. § 5928.

78 Gillard v. AIG Ins. Co., 15 A.3d 44 (Pa. 2011).

or even go to the heart of the issue."[79] Pennsylvania has adopted the Subject Matter Test established in *Upjohn*.[80]

[e] — Pennsylvania: Work-Product Doctrine.

Pennsylvania work-product doctrine distinguishes between core and non-core work product, providing protections against disclosure for the former, but not the latter. Work-product discovery in Pennsylvania is governed by Pennsylvania Rules of Civil Procedure 4003.[81] Under Pa. R. Civ. P. 4003.3:

> . . . a party may obtain discovery of any matter discoverable under Rule 4003.1 *even though prepared in anticipation of litigation or trial* or for another party or by or for that other party's representative, including his or her attorney, consultant, surety, indemnitor, insurer, or agent. The discovery shall not include disclosure of the mental impressions of a party's attorney or his or her conclusions, opinions, memoranda, notes or summaries, legal research, or legal theories. With respect to the representative of a party other than the party's attorney, discovery shall not include disclosure of his or her mental impressions, conclusions or opinions respecting the value or merit of a claim or defense or respecting strategy or tactics.[82]

Consequently, an attorney's analysis of his or her client's case is protected, similar to federal law's core work-product protection, but non-core work-product is subject to production.

[f] — Pennsylvania: Self-Critical Analysis Privilege.

No Pennsylvania appellate court has adopted the self-critical analysis privilege.[83] One court stated that "Pennsylvania has not recognized the self-

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79 Constand v. Cosby, 232 F.R.D. 494, 499–500 (E.D. Pa. 2006) (applying Pennsylvania state law).

80 Nat'l R.R. Passenger Corp. v. Fowler, 788 A.2d 1053 (Pa. Commw. Ct. 2001).

81 Comm. v. Noll, 662 A.2d 1123, 1126 (Pa. Super. Ct. 1995).

82 Pa. R. Civ. P. 4003.3 (emphasis added).

83 Drayton v. Pilgrim's Pride Corp., No. 03-2335, 2005 U.S. Dist. LEXIS 18571 at *4–5 (E.D. Pa. Aug. 30, 2005).

analysis privilege" and "in fact, the Pennsylvania Commonwealth Court has specifically noted that the privilege has not been recognized in this state."[84] Consequently, self-critical investigative reports may not be protected on that basis alone, though other privileges may still apply, depending on the facts.

[g] — Kentucky: Attorney-Client Privilege.

In Kentucky, Rule of Evidence 503 sets forth the parameters of the attorney-client privilege and provides that "[a] client has a privilege to refuse to disclose and to prevent any other person from disclosing a confidential communication made for the purpose of facilitating the rendition of professional legal services to the client."[85] Under Kentucky Rules of Evidence 503(a)(5), a "communication is confidential if not intended to be disclosed to third persons other than those to whom disclosure is made in furtherance of the rendition of professional legal services to the client or those reasonably necessary for the transmission of the communication." Kentucky has also adopted the Subject Matter Test established in *Upjohn*[86] for purposes of application of the privilege to corporate employees.

[h] — Kentucky: Work-Product Doctrine.

In Kentucky, the work-product doctrine provides that "a party may obtain discovery documents and tangible things otherwise discoverable under paragraph (1) of this rule and prepared in anticipation of litigation or for trial by or for another part or for that other party's representative only upon a showing that the party seeking discovery has a substantial need of the materials in the preparation of his case and that he is unable without undue hardship to obtain the substantial equivalent of the materials by other means."[87] The courts have also stated that Kentucky Rule 26.02(3)(a) tracks its federal counterpart, Fed. R. Civ. P. 26(b)(3).[88]

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84 *Id*. (citing Vanhime v. Dep't of State, 856 A.2d 204 (Pa. Commw. Ct. 2005)).

85 Ky. R. Evid. 503(b).

86 Lexington Pub. Library v. Clark, 90 S.W.3d 53, 59 (Ky. 2002); Ky. R. Evid. 503(a)(2) (West 2005).

87 Ky. R. Civ. P. 26.02(3)(a).

88 O'Connell v. Cowan, 332 S.W.3d 34, 40 (Ky. 2010) ("The work-product doctrine is designed to protect an adversary system of justice," Morrow v. Brown, Todd & Heyburn, 957

A two-step analysis is thus necessary to determine if particular documents are discoverable under Rule 26.02(3)(a). "First, the court must determine whether the document is work-product because it was prepared in *anticipation of litigation*. Second, if the document is work-product, the court must determine whether the requesting party has a substantial need of the document and is unable to obtain the *substantial equivalent* without *undue hardship*."[89]

The Kentucky Supreme Court has held that the test for determining whether a document was prepared "in anticipation of litigation" is "in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation."[90]

When evaluating whether to order disclosure of work product, Kentucky courts have also typically distinguished between primarily factual, non-opinion work product, and opinion work product or core work product.[91] "Work product which is primarily factual in nature is not absolutely immune from discovery under the rule. At best, it receives a qualified protection which is overcome if the opposing party shows substantial need of the material and inability to obtain it elsewhere without undue hardship."[92] The Kentucky Supreme Court has described core work product as having "complete protection."[93] However, opinion work product may be discovered if the material sought in discovery is directed to a pivotal issue in the litigation and the need for the material is compelling."[94]

S.W.2d 722, 724, 44 14 Ky. L. Summary 36 (Ky. 1997), and is rooted in the United States Supreme Court's decision in Hickman v. Taylor, 329 U.S. 495, 67 S. Ct. 385, 91 L. Ed. 451 (1947). C.R. 26.02(3)(a) is nearly identical to its federal counterpart, Fed. R. Civ. P. 26(b)(3). Thus, in addition to Kentucky case law, we shall look to other state and federal cases construing the rule for guidance on the issue.").

89 Duffy v. Wilson, 289 S.W.3d 555, 558–59 (Ky. 2009).

90 *Id*.

91 *Morrow*, 957 S.W.2d at 724 (quoting C.R. 26.02(3)(a)); *see also* United States ex rel. Yannacopoulos v. General Dynamics, 231 F.R.D. 378, 382 (N.D. Ill. 2005).

92 *Duffy*, 289 S.W.3d at 559 (Ky. 2009).

93 *Id*.

94 *Morrow*, 957 S.W.2d at 726. ("a far stronger showing of necessity and unavailability by other means . . . would be necessary to compel disclosure [of opinion work product])."

In *Morrow,* for example, a dentist who had successfully defended a dental malpractice suit filed against him, subsequently sued the plaintiff's attorneys who brought the malpractice case for wrongful use of civil proceedings.[95] The dentist sought discovery of the complete litigation file of the plaintiff's attorneys in the prior action, including opinion work product contained in the file.[96] The court held that the opinion work product was discoverable because the mental impressions of the attorneys and whether they believed there was a valid claim was the central issue in the wrongful use of civil proceedings claim.[97]

[i] — Kentucky: Self-Critical Analysis Privilege.

Kentucky courts have not adopted the self-critical analysis privilege.[98] In *Tibbs v. Bunnell*[99] the Kentucky Supreme Court refused to apply the self-critical analysis privilege to documents purportedly protected by the Patient Safety and Quality Improvement Act (the "Act") — a federal statute.[100] It remains to be seen if Kentucky courts will apply the self-critical privilege in other contexts. However, the court's refusal in *Tibbs*[101] to apply the privilege in the context of self-analysis of health care services — often protected by the privilege — suggests that Kentucky courts may be reluctant to apply the self-critical analysis privilege.

[j] — West Virginia: Attorney-Client Privilege.

In West Virginia, "the attorney client privilege is a common law privilege that protects communications between a client and an attorney during

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95 *Id*. at 723.

96 *Id*.

97 *Id*. at 726.

98 *See* Tibbs v. Bunnell, 448 S.W.3d 796, 802 (Ky. 2014) ("we therefore reverse the opinion of the Court of Appeals to the extent it limited the scope of the Act's privilege to documents containing a "'self-examining analysis.'"); *see also* Univ. of Ky. v. Courier-Journal & Louisville Times, Co., 830 S.W.2d 373 (Ky. 1992).

99 *Id*.

100 *Id*.

101 *Id*.

consultations."[102] "In order to assert an attorney-client privilege, three main elements must be present: (1) both parties must contemplate that the attorney-client relationship does or will exist; (2) the advice must be sought by the client from that attorney in his capacity as a legal advisor; and (3) the communication between the attorney and client must be identified to be confidential."[103] West Virginia has yet to state whether it follows the subject matter or control group test.

[k] — West Virginia: Work-Product Doctrine.

West Virginia Rules of Civil Procedure (26)(b) describes the work-product doctrine as it applies in civil cases. The work-product privilege "historically protects against disclosure of the fruits of an attorney's labor [and] is necessary to prevent one attorney from invading the files of another attorney."[104] The "work-product protection under the provisions of Rule 26 extends only to documents prepared in anticipation of litigation."[105]

The Supreme Court of West Virginia held that "to determine whether a document was prepared in anticipation of litigation and, is therefore, protected from disclosure under the work-product doctrine, the primary motivating purpose behind the creation of the document must have been to assist in pending or probable future litigation."[106] This is similar to the federal 'because of' test.

Ohio recognizes two categories of work-product: fact and opinion.[107] Although the West Virginia Supreme Court refers to the protection for both types of work-product as "qualified," opinion work-product requires the party requesting the materials to prove a higher level of necessity than the

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102 State ex rel. U.S. USF&G v. Canady, 194 W. Va. 431, 441 (W. Va. 1995).

103 State v. Burton, 163 W. Va. 40, 48 (W. Va. 1979).

104 *Canady, supra*, 194 W. Va. at 444 (W. Va. 1995).

105 State ex rel. Erie Ins. Prop. & Cas. Co. v. Mazzone, 220 W. Va. 525, 534 (W. Va. 2007).

106 State ex rel. United Hosp. v. Bedell, 199 W. Va. 316, 330 (W. Va. 1997).

107 *In re Markle,* 174 W. Va. 550, 556 (W. Va. 1984).

party would have to show to gain access to fact work-product materials.[108] Factual work-product is "information or materials gathered or assembled by a lawyer in anticipation of litigation not falling under the category of opinion work-product."[109] Opinion work-product "consists of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation."[110] Courts have either concluded that mental impressions are absolutely immune to discovery[111] or that they can be obtained only in rare and extraordinary circumstances.[112]

[l] — West Virginia: Self-Critical Analysis Privilege.

West Virginia has not adopted the self-critical analysis privilege.[113] In *In re Digitek*, Plaintiffs requested an order compelling defendants to produce documents and testimony relating to internal compliance audits.[114] Defendant requested that the court apply the self-critical analysis to the requested information.[115] The court found that the Fourth Circuit Court of Appeals had not adopted the self-critical analysis privilege and refused to apply it to the defendant's compliance audits.[116] The court further stated that "[e]ven if [it] were to acknowledge and accept the privilege, which it does not … Defendants have not shown that it applies."[117] Accordingly, the privilege may not apply in West Virginia.

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108 State ex rel. Montpelier US Ins. Co. v. Bloom, 233 W. Va. 258, 270 (W. Va. 2014) ("W. Va. R. Civ. P. 26(b)(3) makes the distinction between factual and opinion work-product with regard to the level of necessity that has to be shown to obtain their discovery.").

109 State ex rel. Med. Assur. of W. Va., Inc. v. Recht, 583 S.E.2d 80, 90 (W. Va. 2003).

110 *Id*.

111 Duplan Corp. v. Moulinage Et Retarderie de Chavanoz, 509 F.2d 730, 732-35 (4th Cir. 1974), cert. denied, 420 U.S. 997, 43 L. Ed. 2d 680, 95 S. Ct. 1438 (1975).

112 *In re Murphy,* 560 F.2d 326, 336 (8th Cir. 1997).

113 *In re* Digitek Prod. Liab. Litig., No. 1968, 2010 U.S. Dist. LEXIS 141012, at* 105–106 (S.D. W. Va. Feb. 10, 2010).

114 *Id*.

115 *Id*.

116 *Id*.

117 *Id*.

[m] — New York: Attorney-Client Privilege.

In New York, the attorney-client privilege is governed by C.P.L.R. 4503(a). "Unless the client waives the privilege, an attorney or his employee, or any person who obtains without the knowledge of the client evidence of a confidential communication made between the attorney or his employee and the client in the course of professional employment, shall not disclose, or be allowed to disclose such communication, nor shall the client be compelled to disclose such communication in any action . . . ."[118] "The attorney-client privilege in the corporate setting is governed by the Supreme Court's decision in *Upjohn v United States*, 449 U.S. 383, 101 S. Ct. 677, 66 L. Ed. 2d 584 (1981)."[119]

In *Rossi v. Blue Cross and Blue Shield of Greater New York*,[120] for example, the New York Court of Appeals, New York's highest court, held that there is no specific test to distinguish between protected legal communications and unprotected business communications. The court stated that the inquiry is fact-specific and listed several "guideposts" — similar to *Upjohn* — to be used to identify privileged communications: 1) the organizational responsibilities of the person giving the advice; 2) whether the document was clearly an internal, confidential document; 3) whether the communication occurred in a litigation related context; 4) whether the communication expressly concerned the client's legal rights and obligations; and 5) whether the communication dealt primarily with legal matters.[121] The case concerned an internal memorandum from the defendant insurance corporation's staff attorney to a corporate officer communicating advice, a company form that was the subject of an imminent defamation action.[122] Ultimately, the court found the document to be privileged because the author of the document functioned solely as a corporate attorney, that there was no

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118 C.P.L.R. § 4503(a).

119 Bernard v. Brookfield Props. Corp., 2012 NY Slip Op. 31654(U).

120 Rossi v. Blue Cross and Blue Shield of Greater New York, 73 N.Y.2d 588, 540 N.E.2d 703, 524 N.Y.S.2d 508 (1989).

121 *Id.*

122 *Id.*

evidence anyone outside the organization had access to the document, that the document concerned a defamation suit, which was imminent and that the communication was predominately of a legal character.[123]

[n] — New York: Work-Product Doctrine.

In New York, the work-product doctrine in civil cases is divided between two statutory provisions. First, C.P.L.R. § 3101(c) gives "attorney work-product" an absolute exemption from discovery by providing that it, "shall not be obtainable."[124] Although C.P.L.R. § 3101 does not, on its face, limit the privilege to work done in "anticipation of litigation," this requirement has often been imposed by the courts.[125] The immunity given to attorney work-product has been further restricted by the courts to only apply to "material prepared in an attorney's professional capacity and which necessarily involved professional skills."[126] Protected work-product includes "those materials which are uniquely the product of a lawyer's learning and professional skills, such as materials which reflect his legal research, analysis, conclusions, legal theory, or strategy."[127] New York courts have interpreted this to include "interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible [items]."[128]

Second, C.P.L.R. § 3101(d)(2) protects "materials . . . prepared in anticipation of litigation by or for another party, or by or for that other party's representative including an attorney, consultant, surety, indemnitor, insurer, or agent."[129] Unlike attorney work-product, the trial-preparation materials encompassed by C.P.L.R. § 3101(d)(2) are only conditionally immune from discovery. If an adversary shows "substantial need" for the material or that

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123 *Id*.
124 C.P.L.R. § 3101(c).
125 Lichtenberg v. Zinn, 243 A.D.2d 1045, 1045 (3d Dept. 1997).
126 Bloss v. Ford Motor Co., 126 A.D.2d 804, 805 (3d Dept. 1987).
127 Hoffman v. Ro-San Manor, 73 A.D.2d 207, 211 (1st Dept. 1980).
128 Charter One Bank, F.S.B. v. Midtown Rochester, LLC, 738 N.Y.S.2d 179, 185 (N.Y. 2002).
129 C.P.L.R. § 3101(d)(2).

he is, "unable without undue hardship to obtain the substantial equivalent materials by other means," then they may be discoverable.[130] Substantial need is subject to similar standards as applied in the federal courts.[131]

[o] — New York: Self-Critical Analysis Privilege.

New York state courts have a mixed history with the self-critical analysis privilege.[132] In *RKB Enters. v. Ernst & Young*, the court denied defendant's request to apply the self-analysis privilege to qualifications training and job performance evaluation of employees who worked on the plaintiff's project. In support of its decision, the court found that "the self-critical analysis . . . has no support in either New York statutes or case law. . . ."[133] However, in *In re Crazy Eddie* securities litigation, the court applied the self-critical analysis privilege because the production of materials requested would "chill" the company's attempt to monitor the quality of its work.[134] The court observed that "privilege of self-critical analysis" or a "self-evaluative privilege" serves the public interest by encouraging self-improvement through uninhibited self-analysis and evaluation.[135] The court held the privilege was not absolute, however, in that it applies only to the analysis or evaluation itself, not to the facts upon which the evaluation is based, balanced against the party's need for discovery fully and fairly to determine the issues.[136] Accordingly, parties may assert the privilege, but there are no assurances New York courts will apply the privilege.

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130 Spectrum Sys. Int'l Corp. v. Chem. Bank, 581 N.E.2d 1055, 1059 (N.Y. 1991).

131 *Id*.

132 RKB Enters. v. Ernst & Young, 195 A.D.2d 857, 858 (N.Y 1993).

133 *Id*.

134 Matter of Crazy Eddie Sec. Litig., 195 A.D.2d 857, 600 N.Y.S.2d 793 (App. Div. 1993).

135 *Id*., citing Lasky v. American Broadcasting Cos., Inc., 5 Fed. R. Serv. 3d 1366, 1986 WL 9223 (S.D.N.Y. 1986) (recognizing self-evaluative privilege in cases of violations of securities laws, medical malpractice, violations of civil rights and libel); New York Stock Exchange, Inc. v. Sloan, 22 Fed. R. Serv. 2d 500 (S.D.N.Y. 1976).

136 *Id*. (internal citations omitted).

§ 17.04. Conducting an Ethical Investigation.

This section addresses some of the more common ethical issues faced by lawyers handling well event investigations. Because the Appalachian Basin states addressed in this chapter have each adopted the ABA Model Rules of Professional Conduct (at least in significant part), the discussion below focuses on the language of the Model Rules. Lawyers are cautioned to review the specific language of the rules in their respective states, however.

[1] — Lawyers Should Exercise Caution Before Handling Well Site Investigations.

Model Rule 1.1 of the ABA Model Code states that "[a] lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation."[137]

The Rule and the Comments to the Rule require the lawyer to think carefully as to all aspects of the proposed engagement. The Comments to Rule 1.1 state:

> [1] In determining whether a lawyer employs the requisite knowledge and skill in a particular matter, relevant factors include the relative complexity and specialized nature of the matter, the lawyer's general experience, the lawyer's training and experience in the field in question, the preparation and study the lawyer is able to give the matter and whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question. In many instances, the required proficiency is that of a general practitioner. Expertise in a particular field of law may be required in some circumstances.[138]

As the Comments further caution, though a "lawyer need not necessarily have special training or prior experience to handle legal problems of a type with which the lawyer is unfamiliar,"[139] "ill-considered action under

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137 Model Code of Prof'l Responsibility 1.1.

138 Model Code of Prof'l Responsibility 1.1 cmt. 1 (emphasis added).

139 Model Code of Prof'l Responsibility 1.1 cmt. 2.

emergency conditions can jeopardize the client's interest."[140] The Comments also make clear that competent handling of a matter "is determined in part by *what is at stake*; major litigation and complex transactions ordinarily require more extensive treatment than matters of lesser complexity and consequence."[141] The rule thus highlights those very issues — specialized knowledge, emergency conditions and high stakes — that make well site event investigations particularly difficult to address properly. To be sure, a lawyer less experienced in a particular area may consult with another lawyer "of established competence in the field in question"[142] and, in an emergency "a lawyer may give advice or assistance in a matter in which the lawyer does not have the skill ordinarily required where referral to or consultation or association with another lawyer would be impractical."[143] However, lawyers should exercise real caution before taking these steps. The failure to heed these warnings can lead to disciplinary action or to malpractice claims.[144]

The rule also cautions experienced practitioners to address each potential representation individually and to not assume that prior experience necessarily qualifies the lawyer for the new engagement. As the comments to the rule provide, to maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology, engage in continuing study and education and comply with all continuing legal education requirements to which the lawyer is subject.[145] Accordingly, even experienced oil and gas lawyers should think carefully before undertaking a particular well event investigation.

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140 Model Code of Prof'l Responsibility 1.1 cmt. 3 (emphasis added).

141 Model Code of Prof'l Responsibility 1.1 cmt. 5.

142 Model Code of Prof'l Responsibility 1.1 cmt. 1.

143 Model Code of Prof'l Responsibility 1.1 cmt. 3.

144 Ky. Bar Ass'n v. Holton, 390 S.W.3d 789 (Ky. 2013) (finding that the attorney was not competent under Rule 1.1 to handle the lawsuit where he admitted that he "did not have the experience to handle the [landlord/tenant] matter before the court"); Disciplinary Counsel v. Bogdanski, 2013-Ohio-398, 985 N.E.2d 1251 (attorney violated Rule 1.1 by taking on a divorce case the lawyer was not qualified to handle) (lawyer did not practice in the area).

145 Model Code of Prof'l Responsibility 1.1 cmt. 8.

[2] — Ethical Issues in Dealing with Witnesses and Third Parties.

Well events routinely require lawyers to deal with third parties and the press. It is critical in this context that lawyers carefully adhere to ethical guidelines for contacts with third parties. Improper or careless exchanges with third parties could become the focus of the court or the jury, particularly if the lawyer is perceived to have been misrepresenting or even merely shading the facts in the investigation process. *Practice Point: Remember that witnesses may be asked at deposition or at trial about what you said or about how you acted during the investigation*.

[a] — Truthfulness in Statements to Others.

Model Rule, Rule 4.1, Truthfulness in Statements to Others provides:

> In the course of representing a client a lawyer shall not knowingly:
> (a) make a false statement of material fact or law to a third person; or
> (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.[146]

The Comment on Rule 4.1 provides that, though a lawyer "generally has no affirmative duty to inform an opposing party of relevant facts," he or she must be careful not to slant facts gathered from others, or to pass on as facts statements the lawyer knows to be false.[147] The lawyer must be mindful that generally true statements can be misleading and run afoul of the rule when offered out of context.[148] The lawyer must also be very careful not to aid the client in a lie."[149]

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[146] Model Code of Prof'l Responsibility 4.1.

[147] Model Code of Prof'l Responsibility 4.1 cmt. 1.

[148] Model Code of Prof'l Responsibility 4.1 cmt. 1 ("Misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false. Misrepresentations can also occur by partially true but misleading statements or omissions that are the equivalent of affirmative false statements.").

[149] Model Code of Prof'l Responsibility 4.1 cmt. 3.

Lawyers should also be careful not to misrepresent their role in the investigation. *In Matter of Hart*, for example, an attorney who used a false name and falsely identified herself as a journalist calling from a business journal for a story in the course of an investigation was found to have violated Rule 4.1 and was sanctioned.[150]

Lawyers, particularly good trial lawyers, are highly skilled at argument and at framing the facts in a manner that best serves their clients. Rule 4.1 cautions that such skills may prove problematic in the course of an investigation and are, perhaps, best reserved for the courtroom.[151]

[b] — Communication with Persons Represented by Counsel.

In the course of an investigation, lawyers are often asked to interview third parties who are or who may reasonably be expected to be represented by counsel, and/or who are reasonably expected to be adverse to the client. Consider, for example, a third party contractor and their employees, both high ranking and low level, who may have had a hand in causing the well event. Such third parties will likely need to be contacted or interviewed immediately after or even during the well event itself. There may also be eyewitnesses or persons who were injured or even just shaken up by the event who should be contacted and interviewed. Each of these interactions raises a host of ethical concerns.

Rule 4.2 states that, "[i]n representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order."[152] "[T]his Rule applies to communications with any person who is represented by counsel concerning the matter to which the communication

150 In Matter of Hart, 2014 NY Slip Op. 2864, 118 A.D.3d 13, 984 N.Y.S.2d 353 (App. Div. 2014).

151 Model Code of Prof'l Responsibility 4.1.

152 Model Code of Prof'l Responsibility 4.2.

relates," and "applies even though the represented person initiates or consents to the communication."[153]

Rule 4.2 and the Comments also address contacts with employees or representatives of organizations. Comment 7 states: "In the case of a represented organization, this Rule prohibits communications with a constituent of the organization who supervises, directs, or regularly consults with the organization's lawyer concerning the matter or has authority to obligate the organization with respect to the matter or whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability."[154] This Comment reads much like the Control Group Test under the law of attorney-client privilege. Application of this rule may be relatively easy in circumstances, such as when you are dealing with the CEO or high-level executive of a contractor or equipment provider, in which case the lawyer is clearly prohibited from discussing the matter with the third party. In other cases, however, such as when the lawyer is dealing with lower level employees, application of Rule 4.2 may prove more difficult, because it is harder to determine if the employee is part of the company's 'control group.'[155] In *Dent v. Kaufman*, for example, the West Virginia court adopted a test that restricts communications with corporate officers who have the legal power to bind the corporation, but permits contact with employees who were merely witnesses to an event for which the company is sued.

The Comments further provide that "[t]he prohibition on communications with a represented person only applies in circumstances where the lawyer knows that the person is in fact represented in the matter to be discussed." However, "such actual knowledge may be inferred from the circumstances."[156] "Thus, the lawyer cannot evade the requirement of obtaining the consent

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153 Model Code of Prof'l Responsibility 4.2 cmts. 2–3.

154 Model Code of Prof'l Responsibility 4.2 cmt. 7.

155 For a searching analysis of the no contact rule in the context of investigations, see *Dent v. Kaufman*, 406 S.E.2d 68 (W. Va. 1991) and *Neisig v. Team I,* 76 N.Y.2d 363 (N.Y. 1990). Both cases discuss at length the difficulty lawyers face when analyzing the no contact rule in the context of lower level current and former corporate employees.

156 *Id*.

of counsel by closing eyes to the obvious."[157] Consider the example of a contractor's field technician. The contractor and the technician might play a role in subsequent litigation. Consider further that the contractor, like the well operator, may have also engaged counsel at first word of the well event. Is it reasonable for a lawyer in such circumstances to reasonably conclude that the contractor's technician is not represented by counsel and therefore may be questioned or sought out for a statement? May the lawyer reasonably avoid asking the witness if he/she is represented by counsel and later claim that they didn't know the person was represented by counsel? Bear in mind that the potential ethical violation will necessarily be viewed *in hindsight*.[158]

This issue is further complicated where outside investigators are engaged. In *Damron v. CSX Transp. Inc.*,[159] the court held that the plaintiff's attorney did not violate Prof. Cond. R. 4.2 where his investigator questioned, without an attorney present, the defendant's former accident investigator about facts outside of the accident itself. The accident involved a train collision between a vehicle operated by the plaintiff and a train owned by the defendant. The court did not find a violation of the no contact rule because the issues discussed fell outside of the incident itself and the witness was a former employee.

[c] — Dealing with Unrepresented Persons.

Even if the lawyer knows the witness is not represented by counsel, ethical limitations still apply. Rule 4.3, dealing with unrepresented persons, states:

> In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding. The lawyer shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the

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157 *Id*.

158 *See, e.g.*, Neisig v. Team I, 76 N.Y.2d 363 (N.Y. 1990), and Dent v. Kaufman, 406 S.E.2d 68 (W. Va. 1991).

159 Damron v. CSX Transp. Inc., 184 Ohio App. 3d 183 (Oh. Ct. App. 2009).

> lawyer knows or reasonably should know that the interests of such a person are or have a reasonable possibility of being in conflict with the interests of the client.[160]

Lawyers investigating well site emergencies, particularly ones with significant property damage or personal injuries, may reasonably expect that third parties, eyewitnesses, and others, have a reasonable possibility of being adverse to the lawyer's client. Accordingly, full and frank disclosure of the lawyer's role and the lawyer's interest in the matter and advising witnesses they may wish to obtain their own counsel may be required. This does not mean the lawyer is barred from having dealings with unrepresented parties. In the absence of clear disclosures as to the lawyer's role, however, interactions with unrepresented parties may be subject to after-the-fact scrutiny, with the benefit of the doubt going to the unrepresented lay person.

[d] — Respecting the Rights of Third Persons.

The ethics rules also dictate courtesy, professionalism, fair play, and respect for third parties, as well as for the lawyer's role in the legal process.[161] And the rules apply at all times, even in the fog of an emergency.[162] Rule 4.4, for example, provides at subsection (a): "In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person, or use methods of obtaining evidence that violate the legal rights of such a person."

In *Lawyer Disciplinary Bd. v. Neely*,[163] the court held that an attorney violated Rule 4.4 when he sent a letter to a non-party stating that his firm "tends to be extraordinarily high-profile" and threatened to cause "substantial embarrassment," to the non-party if they did not cooperate. Though the court in *Neely* had the benefit of an unfortunate writing as evidence of the rule violation, the rule could apply equally to actual or even alleged verbal harassment. Accordingly, a potential ethics violation could turn on the

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160 Model Code of Prof'l Responsibility 4.3.

161 Model Code of Prof'l Responsibility 4.4.

162 *Id*.

163 Lawyer Disciplinary Bd. v. Neely, 528 S.E.2d 468 (W. Va. 1998).

outcome of a he said/she said, highlighting the importance of ethical and courteous conduct throughout the course of the investigation — and the importance of good interview notes.

[e] — Trial Publicity.

Well events, particularly significant ones, often garner press attention. Such attention will likely continue as the public takes an increasing interest in oil and gas development. Rule 3.6 discusses trial publicity and states:

(a) A lawyer who is participating or has participated in the investigation or litigation of a matter shall not make an extrajudicial statement that the lawyer knows or reasonably should know will be disseminated by means of public communication and will have a substantial likelihood of materially prejudicing an adjudicative proceeding in the matter.[164]

(b) Notwithstanding paragraph (a), a lawyer may state:

(1) the claim, offense or defense involved and, except when prohibited by law, the identity of the persons involved;

(2) information contained in a public record;

(3) that an investigation of a matter is in progress;

(4) the scheduling or result of any step in litigation;

(5) a warning of danger concerning the behavior of a person involved, when there is reason to believe that there exists the likelihood of substantial harm to an individual or to the public interest; and

(6) in a criminal case, in addition to subparagraphs (1) through (6):

(i) the identity, residence, occupation and family status of the accused;

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164 Model Code of Prof'l Responsibility 3.6.

(ii) if the accused has not been apprehended, information necessary to aid in apprehension of that person;

(iii) the fact, time and place of arrest; and

(iv) the identity of investigating and arresting officers or agencies and the length of the investigation.

(c) Notwithstanding paragraph (a), a lawyer may make a statement that a reasonable lawyer would believe is required to protect a client from the substantial undue prejudicial effect of recent publicity not initiated by the lawyer or the lawyer's client. A statement made pursuant to this paragraph shall be limited to such information as is necessary to mitigate the recent adverse publicity.

(d) No lawyer associated in a firm or government agency with a lawyer subject to paragraph (a) shall make a statement prohibited by paragraph (a).

The takeaway from Rule 3.6 is that statements to the press are significantly restricted and should be undertaken with the greatest of caution by counsel.[165]

[f] — Lawyers as Witnesses.

Lawyers may find themselves on site soon after an initial event and thus may be witness to events that speak to the preservation of evidence and the consequences of a well site emergency. Consequently, the lawyer could be called to testify in the matter as to what he or she witnessed.[166] Rule 3.7 addresses the circumstances under which lawyers may testify in cases where they are also being an advocate for their client:

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165 Lawyer Disciplinary Bd. v. Sims, 574 S.E.2d 795 (W. Va. 2002) (prosecutor's deliberate and repeated public comments about grand jury proceedings threatened to harm proceedings and thus violated Rule 3.6). *But compare*, CSX Transp., Inc. v. Williams, 2008 Ky. App. Unpub. LEXIS 1116, 2008 WL 2779303 (Ky. Ct. App. July 18, 2008) (attorney did not violate Rule 3.6 when he was interviewed by a local newspaper and merely stated the "existence of the pending lawsuits and the nature of those claims").

166 Model Code of Prof'l Responsibility 3.7.

(a) A lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness unless:

(1) the testimony relates to an uncontested issue;

(2) the testimony relates to the nature and value of legal services rendered in the case; or

(3) disqualification of the lawyer would work substantial hardship on the client.

(b) A lawyer may act as advocate in a trial in which another lawyer in the lawyer's firm is likely to be called as a witness unless precluded from doing so by Rule 1.7 or Rule 1.9.[167]

Rule 3.7 protects the tribunal from the potentially confusing and prejudicial effect of a lawyer acting as both a witness and as an advocate in the same proceeding. "Whether the tribunal is likely to be misled or the opposing party is likely to suffer prejudice depends on the nature of the case, the importance and probably [tenor] of the lawyer's testimony, and the probability that the lawyer's testimony will conflict with that of other witnesses. Even if there is risk of such prejudice, in determining whether a lawyer should be disqualified, due regard must be given to the effect of disqualification on the lawyer's client. It is relevant that one or both parties could reasonably foresee that the lawyer would probably be a witness."[168]

In *Fuller v. Collins*,[169] the plaintiff was terminated and filed a suit claiming she was discriminated against for taking medical leave. The plaintiff hired the defendant, a forensic psychiatrist, as an expert to testify on her behalf as to her medical condition. The defendant subsequently resigned after a conversation with the plaintiff and her attorney and the plaintiff filed suit for breach of contract and negligence. The court held that the plaintiff's attorney should be disqualified because she was the only other person besides

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167 *Id*.

168 Model Code of Prof'l Responsibility 3.7. cmt. 4.

169 Fuller v. Collins, 2014 NY Slip Op. 1149, 114 A.D.3d 827, 982 N.Y.S.2d 484 (App. Div. 2014).

the parties who witnessed the conduct that formed the basis of the plaintiff's complaint, and, therefore, was a key witness in the case.

Further, in "determining if it is permissible to act as an advocate in a trial in which the lawyer will be a necessary witness, the lawyer must also consider that the dual role may give rise to a conflict of interest that will require compliance with Rules 1.7 or 1.9." "[D]etermining whether or not such a conflict exists is primarily the responsibility of the lawyer involved. If there is a conflict of interest, the lawyer must secure the client's informed consent, confirmed in writing."[170] It is important to note that the responsibility is on the lawyer to determine (1) if there is a conflict and (2) to address the issue with the client. Once again, these issues are better addressed up front, rather than with the benefit of hindsight in an ethics proceeding.

§ 17.05. Practical Tips for Conducting the Internal Investigation of a Well Site Event.

Outside counsel are typically contacted immediately after a well site event. In some cases, counsel are contacted and engaged while the event is still taking place. In either case, it is important that outside counsel take immediate action to understand the situation and to start the investigation.

[1] — There Is an Emergency — Now What?

First things first — the lawyer should focus on the basics: who, what, when, where, why or how? Is anyone seriously injured? Is the location safe? The safety of employees, contractors, the public and the environment should be the lawyer's *first* consideration — in law as in life, first do the right thing.

[a] — Who Needs to Know?

Once the lawyer has a handle on the basics, the next question is who needs notice of the event? This analysis includes consideration of both persons inside the company and persons outside the company. Should counsel involve public relations, risk management, environmental health safety or security? To the extent there is an internal policy as to who should be notified in the event of

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170 Model Code of Prof'l Responsibility 3.7. cmt. 6.

an emergency, it should be followed. In the unlikely event in-house legal is not already involved, it should be. In-house legal should be included from the outset. It is the authors' view that lawyers just look at things differently than laypersons. They ask the big picture questions; how can this be used against me? Do we really need to say this? And, the lawyer will often be in the best position to see how actions or statements may be taken out of context or used against a company and to suggest ways to accomplish the goals of the company without saying more than has to be said.

There may also be local, state or federal governmental emergency personnel or agencies that require notice. Such personnel or agencies are typically identified in the company's emergency response plan (ERP). To the extent the lawyer handling the investigation assisted in the preparation of the ERP, he or she may already be familiar with the requirements of the ERP. If not, the lawyer should ask to be immediately provided with the ERP, or its equivalent, and should review it thoroughly and comply with it unless good cause warrants a deviation.

That said, an important distinction must be made between the company's emergency response plan, which the company implements in the immediate aftermath of a well site event or emergency, and the lawyer's plan for conducting the internal investigation of the well site event. Though a company's ERP and the manner in which the company implements the ERP will clearly inform the lawyer's work, the lawyer's investigation plan is distinct from the emergency response plan and serves a different purpose than the ERP; the ERP is directed to containing and mitigating any damage to persons, property or the environment that might be caused by a well site event, whereas the lawyer's investigation plan is directed to gaining an understanding of how the event occurred, who or what was responsible for the event, and how the company might defend against or mitigate its liability for the event going forward, including defending against later legal claims arising out of the event. The emergency response plan will help the lawyer know what certain questions to ask, including who needs to know of the event. It needs to be evaluated to see if the conduct complied with those standards and, if not, why there was no compliance, but the ERP is not the guide for the internal investigation.

In addition to public entities or authorities, there may be contractual or other reasons why the company may need to notify third parties of the event such as contractors, other lawyers, or insurance carriers. In-house counsel should be included in this analysis, and, when appropriate, so should risk management staff. Just who should be notified will depend on the nature of the incident and company policies. As noted, a well-conceived emergency response plan will identify in advance who should be contacted in each situation.

Whether additional third parties need to be contacted will also be driven by the nature and scope of the accident. The major question here is, is anyone interested in the incident? This could be a client or customer or contractor involved in the work, an equipment or vessel manufacturer, an equipment or vessel vendor or seller, an insurer (as soon as practical), or even a plaintiff's attorney. Such notice is important for, among other reasons, if equipment is going to be moved or the scene changed, it is important that interested parties have an opportunity to participate in what is going to be done with the equipment and when, so as to avoid potential spoliation claims in subsequent litigation.

[b] — Secure the Scene and Objects at Issue.

The scene should be secured as soon as practically possible. The "scene" is the general area where the incident occurred. The goal is to secure the area so further injury does not occur and so that a reasoned decision can be made about what to do. Such steps include limiting access, and advising the employees and retained consultants not to speak with investigators, surveyors or adjusters without a company representative present.

The same analysis applies to any objects at issue. The object at issue should be secured and, to the extent practicable, preserved in its original form. If a functioning part of the vessel or operation is not practically removed, preserve it until decisions can be made about how to document its condition, e.g. by photographs, operation, or testing, and/or how and when to involved third parties in this process, if applicable. As discussed in Section 17.06[3][a] and [b] below, an operator likely has a duty to preserve all evidence (documents and tangible things) relating to a well site event

upon the occurrence of the event itself, particularly in the cases of incidents resulting in personal injury, property damage or harm to the environment.

[c] — What Kind of Investigation Is Needed?

Another practical, but critical decision regards what kind of investigation is needed. This is a matter of common sense and good judgment. The principal reasons for doing investigations are to understand what happened to prevent a reoccurrence. For example, a minor housekeeping issue that causes a no-lost-time injury may require no more than the preparation of an accident report and a review of the circumstances by a supervisor. However, the fifth housekeeping issue in a week may suggest there are more deep-rooted systemic issues that need to be addressed and investigated as a whole. An explosion and fire, by contrast, will almost always require a full investigation team with a great deal more formality. The company ERP may also address the level of response or investigation required, depending on the nature or severity of the event.

[d] — Who Is Going to Conduct the Investigation?

A critical question is who is going to conduct the investigation. Investigations may be conducted by outside counsel, in-house counsel, a non-lawyer root cause team, or an adjuster. It is the authors' view that the investigation of any serious incident should be conducted under the direction of outside counsel. Use of outside counsel will maximize the chance that the investigation will not be subject to discovery, or subject only to limited discovery. Use of outside counsel also better assures that policies are followed and appropriate notifications are given in a timely manner. Use of outside counsel may also better facilitate timely, objective advice on the legal implications of any actions considered, including any contractual obligations that may exist. Some commentators have also suggested that in significant matters, the company should retain outside counsel that the company does not use on a regular basis in order to strengthen the appearance of impartiality of the investigation.[171]

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171 Mark J. Biros, "Anatomy of a Quality Internal Investigation," 33 *Energy & Min. L. Inst.*, Chapter 1, § 1.04 at p. 8, citing Andrew Longstreth, "Double Agent: In the New Era of

The use of in-house counsel, by contrast, presents potential problems. For example, most in house lawyers give both legal and business advice. Questions may arise as to what hat — the legal or business hat — the in-house lawyer was wearing at any given time. Consequently, communications thought to be privileged may turn out to be discoverable.[172] There is no similar risk if outside counsel is used. Bear in mind that the outside counsel's sole role is the rendering of legal advice, which advice is subject to near absolute protections, unless waived.

Another option is a root cause analysis, performed by a root cause team. A root cause analysis looks at the immediate and systemic causes of an incident and is typically conducted by root cause specialists.[173] There are many companies and consultants that provide root cause analysis services, and many are very good. The problem with a root cause analysis for resulting litigation, however, is that rarely does such an analysis find an absence of fault on anyone involved. For example, the methodology provides a host of reasons the analyst may select as causing an incident. Even if the incident is caused by an independent contractor and the contract says that the owner did not control the manner and method of the work, a root cause analysis may still find that an incident could have been avoided had the owner exercised control over the contractor's work. Further, a representative of the contractor is often part of the team. This makes it much more difficult to sustain a privilege claim in the litigation. To the extent a root cause is performed, a lawyer should participate.

Insurance adjusters are also often involved in investigations and, for the most part, should be included. The principal issue with regard to the adjuster is not whether an adjuster should be involved, but the role the adjuster should play. For example, should the adjuster direct the investigation? The question

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Internal Investigations, Defense Lawyers Have Become Deputy Prosecutors," 27 *American Lawyer* 2, 68 (Feb. 2005).

172 *In re* John Doe Corp. v. Unites States, 675 F.2d 482, 489 (2nd Cir. 1982) (privilege applies to in-house counsel only where requests for information and advice are used for designated legal purposes).

173 *Comparison of Common Root Cause Analysis Tools and Methods,* Appendix to Dean L. Gano, *Appollo Root Cause Analysis – A New Way of Thinking* (3rd Ed. 2007).

may be posed later about whether the adjuster's investigation was done in the ordinary course of business, as opposed to the adjuster preparing his/her report in anticipation of litigation, or to facilitate the rendering of legal advice, such that the attorney/client or work product privileges may apply. For example, application of the work-product doctrine to documents prepared by insurance companies has been particularly troublesome because it is the routine business of insurance companies to investigate and evaluate claims and to defend their insureds against third-party claims.[174] As a result, many courts have refused to grant work-product protection to investigative reports prepared as part of the routine process of adjusting a claim made by the insured.[175] The best strategy is for the adjuster to work under the direction of the outside attorney. This will provide the greatest level of confidentiality for the adjuster's work.

[2] — After You Decide Who Needs to Know, What Should You Tell Them?

Thought should also be given to when, how and what people will be told about the event, keeping in mind that what is said about the event is likely to be repeated in court, or in the press. People want to know about their friends and coworkers, so lawyers and staff should avoid premature statements about the cause of an event or the condition of the people involved. Sometimes all that needs to be said is that an incident occurred at "X" facility, the known condition of persons involved, and that an investigation is being conducted.

It is also important to timely and accurately advise the client, potential witnesses and possibly others of the schedule of the investigation. Big or small, an incident should be investigated quickly. People should be questioned as soon as possible, while their memories are fresh. And, whoever is directing

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174 Insurance Co. of N. Am. v. M/V Savannah, 1995 U.S. Dist. LEXIS 15247, *3, 94 Civ. 8846 (CSH), 1995 WL 608295, at *1 (S.D.N.Y. Oct. 17, 1995); *see also* Harper v. Auto-Owners Ins. Co., 138 F.R.D. 655, 662 (S.D. Ind. 1991); Fine v. Bellefonte Underwriters Ins. Co., 91 F.R.D. 420, 422 (S.D.N.Y. 1981).

175 Harper v. Auto-Owners Ins. Co., *supra*, 138 F.R.D. at 662 (citing cases); 6 Edward J. Brunet *et al., Moore's Federal Practice* § 26.70[3][c] at 26-213 (3d ed. 1998) ("*Moore's Federal Practice*").

the investigation should have a clear understanding of when the investigation is expected to be completed.

[3] — Remove the Decision Maker from the Investigation.

In the author's view, it is critical to remove any decision makers from the investigation team. Do not have on the investigation team someone who is potentially responsible (or has a conflict of interest) or someone who will have to make a decision about what will be done following an investigation. Those involved in the investigation need to be independent to assure the independence of the investigation, and the independence of any decision based upon the investigation.

[4] — Make a Plan.

Once the lawyer has a handle on what has happened, secured the scene and made an initial report on events to those who need to know, immediate attention should be given to drafting a more detailed plan for the investigation. The following are some of the key components of any investigation plan.

[a] — Identify the Law, Policies, Procedures and Issue.

The three most important things in real estate are location, location, and location. The same may be said of well event investigations. State laws differ in many and significant respects, including regulatory requirements, emergency response requirements, and issues of privilege and ethics. All such differences directly impact the course and conduct of internal investigations. Accordingly, lawyers must look to local laws and practices for guidance in developing an investigation plan. The plan tells you what questions to ask to evaluate if conduct complied with the applicable standards and requirements and if not, why not.

[b] — Identify the People Who May Have Knowledge of the Facts and Key Documents.

The best sources for information include witnesses, organizational charts, crew lists, internal reports, contractor records, and internal policies, procedures and rules. The lawyer will need to quickly identify key documents

and take immediate steps to ensure that such materials are preserved. As discussed in more detail below, the investigation plan must include provisions for a thorough analysis of document sources, types, review and document preservation.

Determining where the interview or investigation will take place is also important. It may take place on the rig or site, at a nearby hotel, the corporate office, or the lawyer's office. If it is important for the witnesses to view the scene, the scene is the best place. Otherwise, select a location that places the witnesses more at ease.

[c] — Determine Who Will Do the Interviewing.

There are a number of options as to who will conduct witness interviews. These options include outside counsel, in-house counsel, a company employee, a root cause analyst or an adjuster. There are pros and cons as to each (noted above), but the authors' view is that the witnesses be interviewed by outside counsel. There are several reasons why outside counsel is preferable. There is no better way for the lawyer who may be involved in any following lawsuit to get to know the people and to learn the facts. Second, lawyers are skilled in the art of asking questions and thus may be better suited to rooting out a full and complete picture of relevant events. Third, the lawyer is in the best position to know the issues that are raised by witness statements in the context of applicable law and to advise the client accordingly. And lastly, the notes of an outside lawyer regarding an interview of a witness will be privileged, unless there is a waiver. The same may not be said of an in-house lawyer, root cause analyst, company employee, or adjuster, depending on the circumstances.

[d] — Determine Who Should Be Interviewed and in What Order.

Get the big picture from the foreman or supervisor, if available. Talk to the complainant, if possible. Interview all the people who may have knowledge relevant to the occurrence. Talk to people who can verify or rebut accounts of relevant events. And, always follow up, as recollections of events may change once the emotional fog of the event clears.

[e] — Identify Any Issues Related to Interviewing Specific Witnesses.

In each instance, first consider the relationship of the witnesses or interviewee to the company and what, if any, steps can be taken to protect the conversation and/or the notes of the conversation from disclosure. A lawyer must consider, for example, what disclosures should be made to specific witnesses regarding the lawyer's role in the investigation; specifically, the lawyer's representation of the company.

A witness may also have a right to have a person of their choice sit in on an interview. For example, a union steward may need to be present for the interview. The witness may also be represented by counsel, or is or may reasonably be expected to be adverse to your client, in which case there may be additional ethical limitations on the lawyer's ability to question the witness.

[f] — Identify the Documents or Evidence that Will Be Shared with What Witness.

It is helpful to organize documents by witness or subject to get an idea of what he/she knows. Address the policy or procedures at issue, if any, and determine if their job is to follow the procedure or see that it was followed.

§ 17.06. Conducting the Investigation.

Once the plan has been developed and counsel has a strong knowledge of relevant law, privilege, and regulatory requirements, it is appropriate to start the actual investigation. The conduct of the investigation should adhere to the plan unless circumstances warrant change, in which event the change should be documented in the plan. Though slavish adherence to the original plan is ill advised — investigators need to remain nimble to respond to events as they develop — the plan will provide guidance and organization to what may be a complex undertaking. The plan, if followed, will aid in marshalling the many elements of the event and ultimately telling the story of the incident and how it was handled by the company to the court or jury.

[1] — Document the Scene and the Objects at Issue.

If the scene or the object at issue has not been secured already, this should be done immediately. Extreme care should be taken to photograph, mark, tag, and retain custody of the items in existing condition and to maintain a record of the chain of custody so that no one can ever legitimately claim that they were disadvantaged by the way the employer conducted the investigation. It is also important to remember that in Ohio, West Virginia, and Kentucky, any photographs taken at the scene by the attorney may not be protected as work-product, so careful consideration should be given to what to photograph.

Consider also inviting interested parties to observe the process of securing the scene and preserving physical evidence. If anything is going to be discarded, someone should always ask if there is any way an interested party could claim that its absence prejudiced their ability to reconstruct what occurred, prosecute a claim or advance a defense. Therefore, it is a good idea to seek consent and participation from any interested parties before items are changed or removed.

[2] — Interview Witnesses and Take Notes.

In all of the Appalachia Basin states discussed above, the notes of an outside attorney are generally considered privileged either under the attorney-client privilege or the work-product doctrine, so it is recommended that outside counsel conduct witness interviews.

In some cases, it makes sense to have a lawyer who is not questioning the witnesses take the notes during the interview. This allows the questioner to focus on the witness and the information as it is developed. This also allows the questioner to engage in a conversation with the witness without the interruption and distraction of taking notes, which might help to relax the witness.

Whoever is the note taker, however, should be complete and consistent, note the date and time of the interview and who was present, write down the substance of the discussion and if something is really important, place it in quotations. The note taker should also exercise care to capture any introductory cautionary statements, disclosures or closing comments. Such instructions may include information as to the role of counsel and other

interested parties. For example, what are called "*Upjohn* warnings" may be required when interviewing company employees. *Upjohn* warnings inform company employees that counsel represents the company, not the employee, but that the statements of the employees and their exchanges with counsel are privileged and should not be disclosed to anyone else. Such warnings operate to (1) prevent the formation of an attorney client relationship between outside counsel and the employee, and (2) ensure that the company — and not the employee — maintains control over the privilege.[176]

The note taker should also note any credibility issues like body language, a refusal to answer questions, crying, anger, and defensiveness. It may also be helpful to note the physical characteristics of the witness, for future identification. For example, "blue fire retardant clothing with the name Bob," and the company name, height, weight, hair color, build, hard hat, etc., could be noted. These details may prove invaluable later when trying to recall specific witnesses or for addressing the witness at deposition or trial. And, as noted above, detailed notes may assist the lawyer in defending against subsequent claims of unethical conduct or to foreclose claims that an attorney-client relationship was formed between the attorney and the witness.

[a] — Consider Taking Recorded Statements.

Another common but important consideration is, should statements be taken before a court reporter or be recorded? This has advantages and disadvantages. The advantage is that there is no question about what was said. It also frees the questioner to ask the questions without taking notes. The potential disadvantages include the recording of everything said, even if harmful to the entity conducting the investigation, the cost of having a reporter, and the dampening effect it may have on a witness's willingness to converse openly. As a general rule, interviews should be stenographically or tape recorded when it is likely to be helpful. Recording an interview may

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176 *See, e.g., The Benefits of a Miranda-Type Approach to Upjohn Warnings* (April 30, 2012), American Bar Association Section of Litigation at http://amricanbar.org/litigation/, citing *Upjohn Warnings, Recommended Best Practices When Corporate Counsel Interacts with Corporate Employee* (2009).

also be considered where an appearance of transparency is important due to some likely governmental investigation. If not, then the better practice would be to conduct the interview and then decide if written statements should be recorded.

[b] — Should You Take a Written Statement and What Do You Put In It?

Written statements serve a very important purpose. They record a person's recollection of events at a time when the events are the most fresh in their memory. Written statements tie a witness down to a story or a lack of knowledge. If taken, the statement should be signed by the witness, who should acknowledge that the statement has been freely given and the witness has been given the opportunity to change it in any way he or she saw fit. The challenge for the person taking a statement is always what to put in it. If there are bad and good facts, can the statement contain only the good? If the bad is omitted, how damaging will it be later if the bad information is asserted by the witness and it was not included? As a practical matter, it is likely that the witness will want the statement to be substantially correct. So, if harmful information is included, thought should be given to the level of detail necessary to make the statement complete. And, as with stenographically recorded statements, the better practice is to conduct the interviews first and then decide if a written statement should be drafted for the witness' signature.

[c] — Ask the Witness, "What Am I Missing?"

No matter how experienced a person is at investigating well site incidents, it is important to ask a witness, "What am I missing?" The investigator should also ask, "Anything you think I should know that we have not talked about?" Further, ask the witness if he or she is thinking, "Gee, I figured you would ask me about something, but you didn't do it." An investigator should also ask these kinds of questions about documents, people to interview, and questions or facts he or she ought to know.

[c] — Explain What Happens or May Happen Next.

What happens next may be a deposition, an interview by a government investigator, or returning to work with the likelihood that nothing else will

happen. The witness will appreciate knowing what to expect, which may help build a rapport that could be important later on in time.

[d] — Explain Possible Contact by Third Parties.

Always tell witnesses that they may be contacted by someone represented by another party. If they are contacted, they should be informed to let the company know of the contact and advise the person contacting them that the witness would prefer to have someone from the company present in any interview. In this way, there will not be any mistake or misunderstanding about what is said.

[e] — Confidentiality.

Counsel should also be wary of prohibitions against blanket requirements that employees keep confidential internal investigations. The Department of Labor, National Labor Relations Board, and the Securities and Exchange Commission prohibit confidentiality provisions that in word or effect limit the employees' rights to report wrongdoing to investigators. For example, KBR, Inc. (KBRR), a global technology and engineering firm, recently settled an enforcement action by the SEC related to charges that some of KBR's confidentiality agreements included language warning employees that they could face discipline or be fired if they discussed internal investigations with outside parties without first getting approval from KBR's legal department. The SEC said, "SEC rules prohibit employers from taking measures through confidentiality, employment, severance, or other type of agreements that may silence potential whistleblowers before they can reach out to the SEC."[177] What is permissible has not been fully developed by the courts, although the NLRB has issued guidance.[178] Consequently, employees who are within the protection of the attorney client privilege should be told that the interview is confidential and for the purpose of obtaining legal advice by the company. While they may not be prohibited from talking to federal or state agencies,

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177 *See also*, SEC Press Release, *Agency Announces First Whistleblower Protection Case Involving Restrictive Language*, http://www.sec.gov/news/pressrelease/2015-54.html.

178 *See, e.g.,* https//www.nlrb.gov/reports-guidance.

the company may request it be notified of any such request and have an opportunity to be present.

[3] — Identify and Preserve Required Documents and "Things."

[a] — Documents Tell the Story.

In learning the story from the witnesses, documents and things can play a key role. To the extent documents set forth the applicable standard of conduct, they are the guide to determining whether the conduct failed to comply with the standard in any material way. They may also establish who knew what and when and the contractual obligations of the parties. The same is true of key things, such as equipment parts or other items that may help to explain the cause or results of an accident. Accordingly, key documents must be identified, gathered and preserved as part of the investigative process.

In addition to helping the lawyer tell the story of the event, properly preserving documents and things is necessary to avoid spoliation claims. Spoliation of evidence is "the destruction or material alteration of evidence or . . . the failure to preserve property for another's use as evidence in pending or reasonably foreseeable litigation."[179] Under the spoliation doctrine, "parties have a duty to preserve (including a duty not to destroy) evidence when litigation is filed or becomes reasonably anticipated."[180] It is important to bear in mind that pending litigation or a formal discovery request is not necessary to trigger the duty to preserve evidence.[181] Rather, the common law "imposes the obligation to preserve evidence from the moment that litigation is reasonably anticipated."[182] The duty arises "at the point in time

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179 Victor Stanley, Inc. v. Creative Pipe, Inc., 269 F.R.D. 497, 515-16 (D. Md. 2010) (quoting Silvestri v. Gen. Motors Corp., 271 F.3d 583, 590 (4th Cir. 2001)).

180 Cheng v. Lakeforest Assocs., LLC, No. CBD-13-1365, 2014 U.S. Dist. LEXIS 88421, at *11 (D. Md. June 30, 2014).

181 *Victor Stanley, supra,* 269 F.R.D. at 52.

182 *Id*. (citing *Silvestri*, 271 F.3d at 591) ("The duty to preserve material evidence arises not only during litigation but also extends to that period before the litigation when a party reasonably should know that the evidence may be relevant to anticipated litigation.").

when litigation is reasonably anticipated whether the organization is the initiator or the target of litigation."[183]

In a given case, whether preservation or discovery conduct is acceptable depends on what is reasonable under the circumstances, which depends on whether what was done — or not done — was proportional to the case and consistent with clearly established applicable standards.[184] That is, "the scope of preservation should somehow be proportional to the amount in controversy and the costs and burdens of preservation."[185] And, where a failure to preserve and spoliation of evidence is found, the court may impose sanctions that range from dismissal or judgment by default, preclusion of evidence, imposition of an adverse inference, or assessment of attorney's fees and costs.[186] Accordingly, it is imperative that all reasonable steps be taken to preserve documents and other things relating to the incident.

[b] — Send a Legal Hold Email.

For these reasons, it is essential to send a legal hold letter to the client soon after the event or even immediately upon the engagement.

Such a letter should assign responsibility for:

(1) Identifying who needs notice to preserve documents;

(2) Placing the relevant group of individuals on notice that emails and other electronic data should not be destroyed;

(3) Taking the appropriate steps to assure that any automatic deletion of electronic data is suspended pending further notice; and

(4) The responsibility for retrieving the data.

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183 *Id.* at 521-22 ("Thus, the duty exists, for a defendant, at the latest, when the defendant is served with the complaint.") (citing Nucor Corp. v. Bell, 251 F.R.D. 191, 197 (D.S.C. 2009)).

184 *Id.*

185 *Id.* at 523 (quoting Paul W. Grimm, Michael D. Berman, Conor R. Crowley, Leslie Wharton, "Proportionality in the Post-Hoc Analysis of Pre-Litigation Preservation Decisions," 37 *U. Balt. L. Rev.* 381, 405 (2008)) ("Thus, an assessment of reasonableness and proportionality should be at the forefront of all inquiries into whether a party has fulfilled its duty to preserve relevant evidence.").

186 *In re* NTL, Inc. Secs. Litig., 244 F.R.D. 179, 191 (S.D.N.Y. 2007).

In this regard, it is also important to bear in mind that the work product doctrine and the duty to issue a legal hold notice both turn on whether a party reasonably anticipates litigation. A number of federal courts have acknowledged the relationship between the two doctrines and have held that once a party anticipates litigation, thus implicating work product protections, the party has an affirmative obligation to preserve evidence.[187] This suggests, fairly clearly, that the duty to preserve evidence — and to send a legal hold letter — may exist upon the very occurrence of most well incidents, particularly those involving serious personal injury or property damage where it may be reasonably anticipated that adverse claims [*i.e.*, litigation] will follow.

[c] — Be Prepared to Share.

All documents gathered are likely to be disclosed during the discovery process and should be reviewed and considered with this in mind. Merely attaching documents to an investigation report does not make the documents privileged. Further, though protections for communications with experts now enjoy greater protections from disclosure than previously provided, communications with experts retained to assist the client may not be protected from sharing.[188] Communications with experts and all sensitive documents, should be carefully drafted and marked privileged and confidential whenever appropriate so as to provide further protections against inadvertent or unwanted disclosure.

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[187] PacifiCorp v. Nw. Pipeline, 879 F. Supp. 2d 1171 (D. Or. 2012); Sinai v. State Univ. of N.Y. at Farmingdale, No. CV09-407, 2010 WL 3170664 (E.D.N.Y. Aug. 10, 2010); sanofi-aventis Deutschland GmbH v. Glenmark Pham. Inc., USA, No. 07-CV-5855, 2010 WL 2652412 (D. N.J. Jul. 1, 2010). *See also* Medeva Pharma Suisse A.G. v. Roxane Lab., Inc., No. 07-5165, 2011 WL 310697 (D. N.J. Jan. 28, 2011).

[188] *See, e.g., Increased Protection for Communications with Experts Under Amended Rule 26,* American Bar Association, Section of Litigation, Mass Torts (November 2011), http://apps.americanbar.org/litigation/committees.

[d] — The Investigator Must Determine What Exists and Should Be Reviewed.

The person investigating needs to make his or her own judgment about what documents exist and should be reviewed. Often, clients make judgments about what they believe is needed, and this may not cover all of the documents that should be considered. Counsel are cautioned not to leave the work of identifying and collecting documents to the client alone.[189]

The first step is identifying the existence of the documents. This is done by asking managers about people who may have relevant documents, asking witnesses what documents they maintain or know about, asking that electronic documents be preserved, and addressing how electronic documents will be searched, retrieved and preserved, and learning how records are kept and deleted within the organization, both formally in such places as the corporate records, working files, calendars, personal files, supervisor files, and personnel files. Then, the best practice is to go to where the documents are kept and look for yourself. And always ask everyone if they made notes, took pictures, or have any documents either in their work or *personal* file. Best practice is to draft a document identification and retrieval plan, akin to a plan to retrieve documents sought under civil discovery requests, and then to document compliance with the plan as the investigation proceeds.[190]

[e] — Maintain the Documents Received.

As noted above, once documents are obtained, their integrity <u>must</u> be maintained. Some key rules to follow are:

(1) Do not alter originals.

(2) Note the source.

(3) Make working copies for interviews and other files.

(4) Designate a person to keep the originals.

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189 Bratka v. Anheuser-Busch Co., 164 F.R.D. 448 (S.D. Ohio 1995) (chastising counsel for failing to diligently search for documents responsive to civil discovery requests and holding that outside counsel bears responsibility for document identification and collection, including preparation and execution of a plan to identify and collect responsive documents).

190 *Id*.

(5) Create a list of documents received.

Consider summarizing key documents so that key points are readily available.

[f] — What If Key Evidence Is Not Maintained?

As noted, if documents are not preserved, the consequences can be disastrous. Under the spoliation doctrine, a jury or judge might draw an inference that a document was destroyed because it was harmful. Pleadings may be stricken. The court may preclude the offering of proof. This may not only affect the specific issue, but it could taint the entire view of the case. Usually, the documents at issue would not be as harmful as the inference which might be drawn from their destruction. In order to avoid the document retention issue taking on a life of its own and becoming a central issue reflecting on the character of the company, care must be taken to identify and preserve relevant documents.

[g] — Document the Investigation.

If an investigation is documented, it allows someone else to pick up the file and understand what was done. An investigation file should include:

(1) Any written investigation plan;

(2) A document with the names and contact information for the investigators and persons interviewed;

(3) A record of the documents preserving and gathering process, including the notice sent to preserve documents and any response;

(4) One place for documents gathered, with a record of when documents were received, the name of the person(s) who provided the documents, the location found, and the date;

(5) A chronology of events;

(6) All interview notes in one place; and

(7) Any final report or memorandum with all references or attachments.

[4] — Create a Report or Memorandum.

The result of the investigation, *i.e.*, the facts found, should always be documented. The more complex question is how should documentation of the facts take place? Generally, this will be by a formal report or memorandum to the file. In each of the Appalachian Basin states, most memorandums to the file will be protected by the work-product doctrine. It is a good practice to mark these documents as "privileged" and/or "confidential."

If a priority is protecting the results from disclosure in subsequent litigation, an oral report to the company with a memo to the lawyer's file by the outside lawyer may be best. The company will have the benefit of the findings, with the highest likelihood of preserving the privilege, and the lawyer will have the benefit of the memorandum as the case progresses.

If a report is written, the writer and the company should have a clear understanding of what is expected in the report. Is it the job of the investigator to report the facts, to determine causation, or to make recommendations regarding future corrective actions?

Some companies and insurers have specific formats for reports. Topics which may be covered by the report include:

A description of the steps taken (people interviewed and documents reviewed).

(1) A description of the facts found.

(2) An analysis of the evidence.

(3) The opinions of consultants.

(4) A description of other incidents of a similar nature.

(5) A list of recommendations for corrective actions.

(6) The opinions or conclusions of counsel.

Consult with your clients as to the form of the required report. Remember, in-house counsel has to report to others inside the company.

§ 17.07. Conclusion.

There is no risk in being prepared. When an incident occurs, the investigation needs to be well planned. By utilizing good planning and

keeping all applicable privileges and ethical rules in mind, a lawyer can maximize the likelihood of maintaining the confidentiality of key points of the investigation. Furthermore, by conducting the investigation in an ethical and professional manner, the event, not the investigation, will be the focus of any subsequent lawsuits.

§ 17.08. Appendices

[1] — Appendix A

Preparing for Emergencies — A Checklist

The following is a list of items that might be considered when an employer is forming an emergency response procedure. In the oil and gas production setting, the crises that might arise include a fatality or catastrophic injury, an explosion or fire, a toxic release, terrorism or assault. When the telephone call advising of the problem arrives, there will likely be confusion and conflicting reports, inquiries from the media, calls from employees and their family members, questions about the next shift or continuing production, and the like. This list is offered to help organize a response plan.

Establish a team

- Representation across the entity
- Authority to develop a plan
- Schedule and budget
- Mission statement

Vulnerability analysis

- Who will be responsible
- Prioritizing the risks

Emergency Plan

- Purpose
- Identify responsibilities
- Identify types of emergencies
- Operation headquarters
- Core elements of managing an emergency
- Checklist
- Support documents
- Distribution of plan

Legal

- Who is to be notified
  - In-house counsel
  - Outside counsel

Communications

- Who will be responsible
- External
- Internal

Assisting the employees

- The role of the counselor
- Selection of the counselor/group
- Who should have input

Plans

- Evacuation
- Hazardous waste and emergency response operations
- Security
- Hazard communication
- Other OSHA programs

Identify local resources and how to contact them

- Fire department
- Police department
- Local emergency management
- Local medical care
- First responders

Governmental regulation and notice

- OSHA
- EPA
- Workers' compensation

Insurance review

- Coverage
- Employer liability
- Excess coverage

Implementing the plan

- Training
  - Identify the trainers
  - Decide how training will be accomplished
- Integration into company operations
- Audits and review

[2] — Appendix B

Materials Sought to be Protected	Ohio Work-Product Privilege	Pennsylvania Work-Product Privilege	West Virginia Work-Product Privilege
Attorney Notes and Impressions of Witness Interview	Protected as Core Work-Product	Protected as Core Work-Product	Protected as Core-Work Product
Attorney Dictaphone Tape of Mental Impressions of Accident	Protected as Core Work-Product	Protected as Core-Work Product	Protected as Core-Work Product
Photographs Taken by Attorney of Accident	Not Protected	Protected as Non-Core Work-Product (may be discoverable by showing substantial need and undue hardship	Not Protected
Investigation Reports	Mental impressions of attorney protected. Recitation of facts or witnesses may be discoverable by showing substantial need and undue hardship	Protected as Non-Core Work-Product (may be discoverable by showing substantial need and undue hardship)	Mental impressions of attorney protected Recitation of facts or witnesses may be discoverable by showing substantial need and undue hardship
Legal Research and Memos	Protected as Core Work-Product	Protected as Core Work-Product	Protected as Core Work-Product
Letters from Attorney to Client	Protected as Core Work-Product	Protected as Core Work-Product	Protected as Core Work-Product
Video Recording by Attorney Prepared in Anticipation of Litigation	Protected as Non-Core Work-Product (may be discoverable by showing substantial need and undue hardship)	Protected as Non-Core Work-Product (may be discoverable by showing substantial need and undue hardship	Protected as Non-Core Work-Product (may be discoverable by showing substantial need and undue hardship

Materials Sought to be Protected	Kentucky Work-Product Privilege	New York Work-Product Privilege	Federal Work-Product Priviilege
Attorney Notes and Impressions of Witness Interview	Protected as Core Work-Product	Protected as Core Work-Product	Protected as Core-Work Product
Attorney Dictaphone Tape of Mental Impressions of Accident	Protected as Core Work-Product	Protected as Core-Work Product	Protected as Core-Work Product
Photographs Taken by Attorney of Accident	Not Protected	Protected as Non-Core Work-Product (may be discovereable by showing substantial need and undue hardship	Protected as Non-Core Work-Product (may be diiscovered by showing substantial need and undue hardship
Investigation Reports	Mental impressions of attorney protected. Recitation of facts or witnesses may be discoverable by showing substantial need and undue hardship	Protected as Non-Core Work-Product (may be discoverable by showing substantial need and undue hardship)	Mental impressions of attorney protected Recitation of facts or witnesses may be discoverable by showing substantial need and undue hardship
Legal Resarch and Memos	Protected as Core Work-Product	Protected as Core Work-Product	Protected as Core Work-Product
Letters from Attorney to Client	Protected as Core Work-Product	Protected as Core Work-Product	Protected as Core Work-Product
Video Recording by Attorney Prepared in Anticipation of Litigation	Protected as Non-Core Work-Product (may be discoverable by showing substantial need and undue hardship)	Protected as Non-Core Work-Product (may be discoverable by showing substantial need and undue hardship	Protected as Non-Core Work-Product (may be discoverable by showing substantial need and undue hardship

Chapter 18

Can a Terminated Lease Be Cured?

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1 The authors wish to thank Attorneys Aletha Carver, Ian Hoke and Joseph Pasquarella for their significant contributions to this chapter.

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§ 18.01. Introduction.

This chapter reviews the different legal theories and trends currently being utilized by courts in the Appalachian Basin regarding the curing of a terminated lease. The chapter begins with a discussion of the different provisions of an oil and gas lease that may cause expiration or termination. Thereafter, the chapter will discuss the impacts of such expiration or termination and the resulting impact on Renewal and Right of First Refusal provisions and the legal theories of Ratification, Revivor, and Novation. Finally, the chapter will address recent decisions regarding tolling of the lease term during landowner challenges.

§ 18.02. Termination by Operation of Law.

An oil and gas lease can terminate by operation of law for various reasons. This section will provide a brief introduction of the concepts lease termination is based on: (1) the failure to timely develop a lease under the lease's habendum clause; (2) the failure to maintain production under a lease; (3) the failure to pay delay rentals; and (4) the failure to pay shut-in royalties. The termination of the lease by operation of law, rather than simply a breach of the lease, can impact the necessary curative steps, and impact the timeframe to exercise an extension or rights of first refusal under the lease.

[1] — Termination Based on the Failure to Timely Develop a Lease Under the Lease's Habendum Clause.

The habendum clause of virtually all contemporary leases provides for a relatively short primary term after which the lease will terminate unless certain conditions are met to extend the lease into its secondary term, such as the commencement of drilling operations or the production of oil or gas in paying quantities.[2] What constitutes sufficient development of a lease within its primary term will depend on the lease's specific habendum clause language. However, the general rule in the majority of jurisdictions is that actual drilling is not required, and substantial surface operations are sufficient to maintain the lease provided that such operations are continued in good faith and with due diligence.

Case law from the Appalachian Basin discussed herein follows the majority position and generally provides that to avoid a lease's termination by operation of law, there must be some activity necessary to the drilling of a well prior to the expiration of the primary term. If sufficient operations are not conducted within the primary term, the lease automatically terminates.

[a] — Ohio.

In *Henry v. Chesapeake Appalachia, LLC*,[3] the lease at issue provided that it could be extended beyond its primary term by the commencement

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2 *See, e.g.*, 4 Howard R. Williams and Charles J. Meyers, *Oil and Gas Law*, § 601.4 (2014).

3 Henry v. Chesapeake Appalachia, LLC, 739 F.3d 909 (6th Cir. 2014).

of operations. The lease defined commencement of operations as including "any acts in search for or in an endeavor to obtain, maintain or increase the production of oil and/or gas including, without limitation, inject substances into a well." The Sixth Circuit Court of Appeals, in relying upon prior Ohio case law discussed below, ruled the lessee's filing of a Declaration of Pooled Unit constituted a commencement of operations to extend the lease into its secondary term. The court ruled the recording of the Declaration was an act similar to or incidental to "acts 'in search for or in an endeavor to obtain, maintain or increase the production of oil and/or gas' from the Plaintiffs' property."[4]

In *Duffield v. Hall*,[5] the Ohio Supreme Court affirmed without comment the circuit court's holding that a lessee's acts on the last day of the primary term of a lease, including staking out a well and contracting to buy timber for the purpose of drilling a well, were sufficient to commence operations under the lease.

[b] — West Virginia.

Likewise, in *Braden v. Chesapeake Appalachia, Inc.*,[6] the Northern District of the United States District Court of West Virginia relied upon West Virginia law and *Henry v. Chesapeake Appalachia, LLC*, in finding that the lessee sufficiently commenced operations during the primary term of its lease. The court ruled that the lessee's acts of: (1) pooling the plaintiff lessor's property; (2) constructing a well pad and access road on the pooled unit; (3) obtaining well permits; and (4) commencing drilling of the wells were acts sufficient to extend the lease into its secondary term. *See also Fleming Oil & Gas Co. v. South Penn Oil Co.*[7] (holding lessee's acts of surveying, cutting timbers, and contracting to haul machinery for the drilling of a test well were sufficient acts to commence operations under the lease).

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4 *Id*. at 914.

5 Duffield v. Hall, 19 Ohio C.C. 266 (Ohio Cir. Ct. 1899).

6 Braden v. Chesapeake Appalachia, Inc., No. 5:13CV107, 2014 WL 6633231 (N.D. W. Va. Nov. 21, 2014), *appeal docketed*, No. 14-2384 (4th Cir. Dec. 19, 2014).

7 Fleming Oil & Gas Co. v. South Penn Oil Co., 17 S.E. 203 (W. Va. 1893).

[c] — Pennsylvania.

In *Good Will Hunting Club, Inc. v. Range Resources-Appalachia, LLC*,[8] the lease at issue could be extended beyond its primary term upon the commencement of a well. The Middle District of the United States District Court of Pennsylvania, relying upon Pennsylvania law, ruled that the lessee only had to commence operations and drill with due diligence to extend its lease into the secondary term. The court held the lessee's acts of staking a drill site, obtaining permits and easements, clearing timber, and constructing roads to the well site were sufficient to constitute the commencement of a well.[9]

Similarly, the court in *Pemco Gas, Inc. v. Bernardi*,[10] held a lessee's acts of surveying, contracting with a driller and excavator, and obtaining a drilling permit with the bona fide intent of drilling the well with due diligence were sufficient to commence operations under the lease. Likewise, the Supreme Court of Pennsylvania has held that the preparatory actions of staking the location of a well and attempting to unload lumber at the site on the final day of the primary term constituted drilling operations sufficient to extend the lease.[11]

However, in *Neuhard v. Range Resources-Appalachia, LLC*,[12] the Middle District of the United States District Court of Pennsylvania found that a lease expired by its own terms on June 21, 2011, despite the fact Range Resources — Appalachia, LLC ("Range") commenced a well before the expiration of the Lease's primary term. Range had filed a Designation of Unit prior to the expiration of the primary term of the lease creating an approximately 395-acre production unit that included the lessor's acreage. However, the court reasoned the well was neither "on the Leased Premises"

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8 Good Will Hunting Club, Inc. v. Range Resources-Appalachia, LLC, No. 4:11-CV-1152, 2013 WL 2297170 (M.D. Pa. May 24, 2013).

9 *See also* Roe v. Chief Exploration & Dev. LLC, No. 4:11-CV-00816, 2013 WL 4083326 (M.D. Pa. Aug. 13, 2013).

10 Pemco Gas, Inc. v. Bernardi, 5 Pa. D. & C.3d 85 (Pa. Ct. Comm. Pleas 1977).

11 Henderson v. Ferrell, 38 A. 1018 (Pa. 1898).

12 Neuhard v. Range Resources-Appalachia, LLC, 29 F. Supp. 3d 461 (M.D. Pa. 2014), *appeal docketed*, No. 14-2830 (3rd Cir. May 27, 2014).

nor "on a unit containing a portion of the Leased Premises," because it found Range had exceeded its unitization authority under the language in the Lease which was limited to 350 acres.

[d] — Kentucky.

In *Little v. Page*,[13] the lease at issue had a primary term for one year and as long thereafter as oil or gas were produced. A few days before expiration of the primary term, the lessor moved drilling equipment onto the leased premises and began drilling operations. Even though the lease did not contain a continuing operations clause that would keep the lease in force pending completion of a well, the Supreme Court of Kentucky held that a well commenced during the primary term may still be completed after expiration of the term. The court ruled that unless negated by contract terms or loss by abandonment, the right to commence a well during the primary term of a lease carries with it, by necessary legal implication, the right to complete the well after expiration of the primary term.

However, in *Yost Energy, LLC v. Gaines*,[14] the Court of Appeals of Kentucky upheld a jury verdict finding the lease at issue terminated because the lessee did not pursue production with reasonable diligence and good faith after commencing the well during the primary term. The court found there was sufficient evidence to support the verdict because there was no inclement weather preventing the operation of the well as demonstrated by the lessee's operation of several wells on adjacent properties, and evidence the lessee was financially unable to continue production. Note that notice is not required when a lease expires upon its own terms.[15]

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13 Little v. Page, 810 S.W.2d 339 (Ky. 1991).

14 Yost Energy, LLC v. Gaines, No. 2011–CA–000554–MR, 2012 WL 1649103 (Ky. Ct. App. May 11, 2012).

15 Hiroc Programs, Inc. v. Robertson, 40 S.W.3d 373, 378 (Ky. Ct. App. 2000). *See also* Swiss Oil Corp., v. Hupp, 22 S.W.2d 1029 (Ky. Ct. App. 1930), which suggests the oil and gas lease at issue in that case could have been automatically terminated during its primary term under the implied covenant to develop if the other joint tenants had confirmed the demand to develop.

[2] — Termination Based on the Failure to Maintain Production Under a Lease.

Termination by operation of law can also occur under the habendum clause of an oil and gas lease if there is not continuous production of oil or gas. The vast majority of courts have construed the word "produced" in the "thereafter" portion of a habendum clause to mean "produced in paying quantities."[16] Consequently, when production falls below this amount, the lease automatically terminates.[17] The basis of this position is that the parties to a lease intend that a lessee should not be permitted to hold a lease after the expiration of the primary term for speculative purposes only.[18] Ohio, West Virginia, and Pennsylvania generally require production to be in paying quantities, while some decisions in Kentucky have held that any amount of production would continue the lease into the secondary term.

[a] — Ohio.

In *Blausey v. Stein*,[19] the Supreme Court of Ohio held that "paying quantities" means quantities of oil or gas sufficient to yield a profit, even small, to the lessee over the operating expenses, even though the undertaking as a whole may thus result in a loss. Similarly, in *Bohlen v. Anadarko E & P Onshore, LLC*,[20] the Fourth District Court of Appeals of Ohio held the lessor produced gas in paying quantities so as to avoid expiration of its lease in the secondary term. The court found that the well at issue produced gas in paying quantities as it generated profits to the defendant lessee and resulted in royalty payments to the plaintiff lessors.[21]

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16 *See* 4 Howard R. Williams and Charles J. Meyers, *Oil and Gas Law*, § 604.5 (2014).

17 *Id*.

18 *Id*.

19 Blausey v. Stein, 400 N.E.2d 408 (Ohio 1980).

20 Bohlen v. Anadarko E & P Onshore, LLC, 26 N.E.3d 1176 (Ohio Ct. App. 2014).

21 *See also* Litton v. Geisler, 76 N.E.2d 741 (Ohio Ct. App. 1945) (Paying quantities is to be construed from the standpoint of the lessee, and by his judgment if exercised in good faith).

When production ceases to be in paying quantities, the lease will expire. See *Gardner v. Oxford Oil Co.*,[22] in which the Seventh District Court of Appeals of Ohio upheld the trial court's determination that a lease expired in 2001, the last date the well could have been produced in paying quantities.[23]

[b] — West Virginia.

In *Goodwin v. Wright*,[24] the Supreme Court of Appeals of West Virginia ruled that the term "production" when used in a mineral lease as the basis for continuation of the lease in force, means "production in paying quantities." The court ultimately cancelled the lease at issue because a gas well was not producing in paying quantities and no royalties or rentals were being received by the lessors as required by the terms of the lease as necessary to its continuation. The court also ruled receipt by the lessors of free gas from the well did not constitute consideration sufficient to keep the lessors bound by the lease, nor did it amount to production under the lease, which required production in paying quantities.[25] Additionally, in *McCullough Oil, Inc. v. Rezek*,[26] the Supreme Court of Appeals of West Virginia held an oil and gas lease terminated automatically upon failure of lessee or its assignee to resume operations within 60 days after production ceased during the secondary term of lease. The secondary term provided the lease would not terminate upon cessation of production for any cause during the secondary

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22 Gardner v. Oxford Oil Co., 7 N.E.3d 510, 516 (Ohio Ct. App. 2013).

23 *See also* Tedrow v. Shaffer, 155 N.E. 510 (Ohio Ct. App. 1926) (The court ruled the lease at issue expired where the lessee initially drilled a well, pumped a small amount of oil from it for seven years, and then paid delay rentals up until one month prior to the lease's expiration. The court ruled the lessee could not produce oil and gas in paying quantities on the last day of the primary term but must have been producing it in paying quantities for a substantial or reasonable time prior to the final day); *see also* Moore v. Adams, No. 2007AP090066, 2008 WL 4907590 (Ohio Ct. App. Nov. 17, 2008) (The court ruled the lease terminated due to the lessee's failure to operate the well at issue or pay shut-in royalties for more than six years).

24 Goodwin v. Wright, 255 S.E.2d 924 (W. Va. 1979).

25 *See also* Jolynne Corp. v. Michels, 446 S.E.2d 494 (W. Va. 1994) (*following id.*); Currey v. TNG, Inc., 410 S.E.2d 415 (W. Va. 1991) (*same*).

26 McCullough Oil, Inc. v. Rezek, 346 S.E.2d 788 (W. Va. 1986).

term if lessee resumed operations within 60 days of such cessation, and such automatic termination did not result in a default or forfeiture, so that lessee was not entitled to notice that production had ceased.

[c] — Pennsylvania.

In *T.W. Phillips Gas and Oil Co. v. Jedlicka*,[27] the Supreme Court of Pennsylvania held that where a well consistently pays a profit, however small, over operating expenses, it produces in "paying quantities." The court also held where production is marginal or sporadic, such that, over some period, the well's profits do not exceed its operating expenses, a determination of whether the well has produced in paying quantities requires consideration of the operator's good faith judgment in maintaining operation of the well. The court ruled that in assessing whether an operator has exercised his judgment in good faith, a court must consider the reasonableness of the period during which the operator has continued his operation of the well in an effort to reestablish the well's profitability.

Accordingly, in *T.W. Phillips Gas and Oil Co*., the court held the lease produced gas in paying quantities over a reasonable period of time regardless of a $40.00 loss over a one-year period 45 years earlier. The court noted that the well at issue paid a profit over operating expenses and no evidence suggested that the wells were not being operated by the lessee in its good faith judgment. The court noted the lessor was protected because if the well fails to pay a profit over operating expenses, and the evidence establishes that the lessee was not operating the wells for profit in good faith, the lease will terminate.[28]

[d] — Kentucky.

The Court of Appeals of Kentucky in *Swiss Oil Corp. v. Riggsby*,[29] acknowledged the term "paying quantities" as:

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27 T.W. Phillips Gas and Oil Co. v. Jedlicka, 42 A.3d 261, (Pa. 2012).

28 *Id*. at 227. The court also characterized the lease as a fee simple determinable that automatically reverts to the grantor upon the occurrence of a specific event. *Id*. at 267.

29 Swiss Oil Corp. v. Riggsby, 67 S.W.2d 30 (Ky. Ct. App. 1933).

> being such quantities as will pay a profit, but at least the cost of operating the well. The lessee is not required to market the gas at a loss, but only when there is a reasonable profit, and in determining whether it could be so marketed, the distance to the market, the expense of marketing, and every similar circumstance should be taken into consideration. In determining whether or not a gas or oil well is productive to this extent, the judgment of an experienced operator or lessee, if exercised in good faith, will prevail as against that of a lessor without experience.[30]

Thus, the court in *Swiss Oil* also found the good faith judgment of the lessee to be a relevant consideration in determining whether a well has produced in paying quantities. In *Hiroc Programs, Inc. v. Robertson*,[31] the Court of Appeals of Kentucky ruled that where the primary term of an oil and gas lease has run and the lease provides for an extension so long as oil or gas is produced in paying quantities, the lease will *ipso facto* terminate whenever production or development ceases for an unreasonable period of time.[32]

[3] — The Failure to Pay Delay Rentals.

Delay rentals may be provided for in an oil and gas lease as an alternative to commencing to drill a well. The failure to pay delay rentals may terminate a lease by operation of law. The delay rental provision of a lease has historically been used to postpone the drilling of a well during the primary term by permitting the lessee to pay the lessor for the postponement.[33] Delay rental

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30 *Id*.

31 Hiroc Programs, Inc. v. Robertson, 40 S.W.3d 373 (Ky. Ct. App. 2000).

32 However, there is some support in Kentucky that in the absence of lease language requiring production in paying quantities, any production may extend the lease into the secondary term. *See, e.g.,* Enfield v. Woods, 248 S.W. 842 (Ky. 1923) (holding lease which was to continue so long as oil was produced on the premises means the production of oil in such quantities as to be susceptible of division, so as to pay the landowner a royalty, even though small); *see also Hiroc*, 40 S.W.3d 373, at 379-80 (holding lease terminated in 1984 only after all commercial sales of gas ceased).

33 4 Howard R. Williams and Charles J. Meyers, *Oil and Gas Law*, § 601.5 (2014).

provisions have evolved into two general types, an "or" provision or an "unless" provision. An "or" delay rental provision provides in essence that a lessee will commence drilling operations "or" pay specified rentals to the lessor.[34] Thus, the nonpayment results in a breach of the lease.

Unlike an "or" lease, an "unless" delay rental provision does not contain any covenant by the lessee that it will pay the delay rental.[35] Instead, in an "unless" lease, if the lessee fails to engage in specified drilling operations during the primary term or, in the alternative, fails to pay specified rentals, then the lease will terminate by operation of law.[36]

[a] — Ohio.

In Ohio, for an "or" lease that does not provide for forfeiture, courts have ruled that it will not be forfeited for failing to pay delay rentals specified in the lease.[37] If an "or" lease does provide for forfeiture, courts have ruled that a lessor may forfeit the lease for failing to pay delay rentals.[38] Under an "unless" lease, courts have ruled that if there is a failure to pay delay rentals, the lease will automatically terminate by operation of law.[39]

[b] — Pennsylvania.

In Pennsylvania, if the lease at issue contains no provision for its automatic termination in the event of the failure of the lessee to drill or to pay the delay rental, nor any express reservation of the power of forfeiture, a lessor will be left with an action at law for the rentals owed.[40] The only way a lease may be terminated in such a situation is upon clear proof of

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34 *Id*.

35 *Id*.

36 *Id*.

37 Wohnhas v. Shepherd, 119 N.E.2d 861 (C.P. Monroe Cnty., Ohio Mar. 15, 1954).

38 Murdock-West Co. v. Logan, 69 N.E. 984 (Ohio 1904); Woodland Oil Co. v. Crawford, 44 N.E. 1093 (Ohio 1896).

39 Brown v. Fowler, 63 N.E. 76 (Ohio 1902); *see also* Van Etten v. Kelly, 64 N.E. 560 (Ohio 1902).

40 Girolami v. Peoples Natural Gas Co., 76 A.2d 375 (Pa. 1950).

the lease's abandonment by the lessee.[41] If an "or" lease does provide for forfeiture, the Supreme Court of Pennsylvania has held that the lessor must declare a forfeiture before the lease ends.[42] Just as in Ohio, Pennsylvania courts have ruled that under an "unless" lease it will terminate automatically by operation of law if there is a failure to pay delay rentals.[43]

[c] — Kentucky.

Unlike Ohio and Pennsylvania, Kentucky has enacted a statute that addresses a lessee's failure to pay delay rentals under a lease.[44] Kentucky's statute provides that if a lessee fails to pay delay rentals as specified in a lease, a lessor or landowner may avoid the lease, unless before executing a new lease he has accepted payment of the delay rental.[45] The Court of Appeals of Kentucky has ruled that Kentucky's delay rental statute applies to "or" and "unless" leases.[46]

[d] — West Virginia.

West Virginia has also enacted a statute addressing the failure to pay delay rentals. It provides that if the delay rental has not been paid when due according to the terms of such lease, or the terms of any other agreement between lessor and lessee, the lease shall be null and void unless payment thereof shall be made within 60 days from the date upon which demand for payment in full of such delay rental has been made by the lessor upon the lessee, except in such cases where there is a bona fide dispute between lessor and lessee as to the amount due or entitlement thereto.[47] However, unlike Kentucky, the West Virginia Supreme Court of Appeals has ruled its

41 *Id*.

42 McKean Natural Gas Co. v. Wolcott, 98 A. 955 (Pa. 1916).

43 Bertani v. Beck, 479 A.2d 534 (Pa. Super. Ct. 1984); see also Glasgow v. Chartiers, 25 A. 232 (Pa. 1892).

44 Ky. Rev. Stat. § 353.020.

45 Ky. Rev. Stat. Ann. § 353.020 (West 2015).

46 Walter v. Ashland Oil & Refining Co., 187 S.W.2d 425 (Ky. 1945).

47 W. Va. Code Ann. § 36-4-9a (West 2015).

delay rental statute does not apply to "unless" leases because "unless" leases terminate automatically upon operation of law.[48]

[4] — The Failure to Pay Shut-In Royalties.

Shut-in payments may be provided for in an oil and gas lease if a well has already been drilled and is capable of production but is shut-in. In some cases a lessee completes a well capable of paying production during the primary term of a lease, but is unable to produce the well for want of a market.[49] This problem arises most frequently in the case of a well that produces gaseous hydrocarbons that cannot be produced until a pipeline connection with the well is secured.[50] To address this situation, a lease may include "shut-in royalty" clauses, which enable lessees, under appropriate circumstances, to keep nonproducing leases in force by the payment of a sum of money described as a shut-in royalty.[51] The failure to pay shut-in royalties can terminate a lease by operation of law, depending on whether the payment was optional under the terms of the lease, or whether the provision places an obligation on the lessee to make a shut-in payment. When the shut-in payment is phrased as an obligation, the lessee is obligated to pay the shut-in and the lessor's apparent remedy for a failure to make such a payment is an action to recover the payment rather than for cancellation of the lease.

[a] — Ohio.

Ohio courts dealing with shut-in royalties have generally held that "a shut-in royalty clause modifies the habendum clause so that the lease may be preserved between the time of discovery of product and marketing of the same," but does not negate the duty to use due diligence to sell the production."[52]

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48 Warner v. Haught, Inc., 329 S.E.2d 88 (W. Va. 1985).

49 4 Howard R. Williams and Charles J. Meyers, *Oil and Gas Law*, § 631 (2014).

50 *Id*.

51 *Id*.

52 Curtis v. Hess Ohio Res. LLC, No. 2:13-CV-0453, 2014 WL 4249857 (S.D. Ohio Aug. 27, 2014) (Because the well at issue was drilled during the primary term and was flow tested, the court ruled it was capable of producing gas. As a result, the court ruled the well was

In *Moore v. Adams*,[53] the well at issue was shut-in by the lessee. The lease at issue contained a shut-in provision with an obligatory feature:

> Notwithstanding anything herein to the contrary, this lease shall continue in full force for so long as there is a well or wells on the leased premises capable of producing oil or gas, but in the event all such wells are shut-in for any reason, then on or before the end of each calendar year during which the well or wells are shut-in, Lessee shall pay to Lessor a shut-in royalty equal to the delay rental provided herein.[54]

For a period of five years after the shut-in, no shut-in royalties were paid by the lessee. Thereafter, the lessee attempted to send the lessors a check for shut-in royalties for the previous five years. Instead of accepting the check, the lessors sought forfeiture of the lease due to the lessee's failure to pay the shut-in royalties. The Fifth District Court of Appeals ruled that the lessee's attempted shut-in royalty payment after five years of non-payment was contrary to the express language of the shut-in clause, which required payment at the end of each calendar year. The Appeals Court upheld the trial court's determination that the failure terminated the lease by its express terms, and as a result, the lessee violated the implied covenants of the lease, forfeited the lease, and abandoned the leasehold premises by not operating the well for over six years without making payment and allowing the equipment to fall into disrepair.[55]

In *Morrison v. Petro Evaluation Serv., Inc.*,[56] the lessors claimed they weren't paid shut-in royalties pursuant to their lease. The lessee claimed that

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properly shut-in and was able to be treated as a producing well for purposes of extending the lease past its primary term); *see also* Am. Energy Services v. Lekan, 598 N.E.2d 1315 (Ohio Ct. App. 1992).

53 Moore v. Adams, No. 2007AP090006, 2008 WL 4907590 (Ohio Ct. App. Nov. 17, 2008).

54 *Id*.

55 *Id*. at ¶ 39.

56 Morrison v. Petro Evaluation Serv., Inc., No. 2004 CA 0004, 2005 WL 2715578 (Ohio Ct. App. Oct. 21, 2005).

the well drilled pursuant to the lease wasn't producing, wasn't capable of producing, had expired, and therefore no shut-in royalties were due to the lessors. The lessee argued the well at issue wasn't producing because it only produced sour gas. The Fifth District Court of Appeals affirmed the trial court's ruling that the well was in fact capable of producing gas in paying quantities because even sour gas is marketable. The court concluded that the lessors were entitled to shut in royalties under the lease.[57]

[b] — West Virginia.

West Virginia courts have yet to interpret the operation of a shut in clause in an oil and gas lease. One author has found that the Supreme Court of Appeals of West Virginia's decision in *Howell v. Appalachian Energy, Inc*.[58] implicitly stands for "the prospect that West Virginia courts would be prepared to evaluate the application of a shut-in clause to preserve a lease in the secondary term by appropriate payment under a shut in clause."[59]

[c] — Pennsylvania.

Recent decisions by Pennsylvania federal courts have upheld a lessee's extension of a lease by paying the lessor shut-in royalties in conformance with the shut-in royalty provision.[60]

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57 *See also* Wuenschel v. Northwood Energy Corp., No. 2008-A-0039, 2008 WL 5389710 (Ohio Ct. App. Dec. 26, 2008). (Court ruled the lessees' failure to pay shut-in royalties was not a breach of the lease because the wells were not shut in. The wells were not shut in because the problem was not with the wells themselves, but rather leaky pipelines, which were fixed. Production was only halted for reasonable repairs and the shut-in clause was never triggered).

58 Howell v. Appalachian Energy, Inc., 519 S.E.2d 423 (W. Va. 1991) (Lessee attempted to mail a shut-in check after eight years of non-production under the lease at issue. The court noted the lease did not contain a shut-in clause and ruled that eight years of non-production and non-payment showed an abandonment of the lessee's leasehold interest).

59 R. Neal Pierce, *et al*., "The Quick and the Dead: Cessation of Production and Shut-Ins During the Secondary Term of an Oil and Gas Lease," 88 *N.D. L. Rev*. 727, 810 (2012).

60 Messner v. Swepi, LP, No. 4:13-CV-00014, 2013 WL 4417723 (M.D. Pa. Aug. 14, 2013), *aff'd*, 574 Fed. App'x 96 (3d Cir. 2014) (shut-in payment paid under the lease extended the lease); Zupp v. Cabot Oil & Gas Corp., No. 3:CV-12-2333, 2013 WL 1935358 (M.D. Pa. May 9, 2013) (*same*).

Additionally, in *Smith v. Steckman Ridge, LP*,[61] the lease contained an obligatory shut-in provision. The lessee did not paid the rental as required under the shut-in clause, but rather paid the amount necessary to convert the lease to storage, as provided under a separate provision of the lease. The storage payment was made within the time frame for the shut-in royalty. Under those facts, the court found the offer of payment for gas storage was sufficient to avoid forfeiture under the lease, but the lessor was still entitled to the unpaid shut-in amount.[62]

[d] — Kentucky.

Two recent Kentucky court decisions have briefly discussed the effect on a lease when shut-in royalties are not paid pursuant to a lease. In *P & J Res., Inc.,*[63] the Eastern District of the United States Bankruptcy Court of Kentucky noted that the leases at issue required the payment of a shut-in royalty to the landowner if production temporarily ceased from wells located on the leased premises. Said shut-in royalty payments would then keep the leases in effect. The bankruptcy court noted that the leases at issue terminated due to the lessee's absolute failure to make the shut-in royalty payments as required by the leases. In *Bailey v. Endeavor Energy Res., LP*,[64] the Court of Appeals of Kentucky noted that the lease at issue required the payment of a shut-in royalty to keep the lease in effect. Just as the lessee in *P & J Res., Inc*., the lessee in *Bailey* wholly failed to pay the yearly shut-in royalty as required by the terms of its lease. As a result, the court held the lease terminated.

§ 18.03. Statutory Requirements to Record a Release of Lease.

In some states there is a statutory requirement imposed on a lessee to record a release of an oil and gas lease after it has terminated or expired.

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61 Smith v. Steckman Ridge, LP, 38 F. Supp. 3d 644 (W.D. Pa. 2014), *aff'd*, 590 Fed. App'x 189 (3d Cir. 2014). This case is discussed more fully in Section 18.04[2][d].

62 *Id*. at 655.

63 *In re* P & J Res., Inc., 475 B.R. 838 (Bankr. E.D. Ky. 2012).

64 Bailey v. Endeavor Energy Res., LP, No. 2012-CA-001584-MR, 2013 WL 6730740 (Ky. Ct. App. Dec. 20, 2013).

Besides the state statutory requirements discussed below, the duty of a lessee to release a lease may also be based upon provisions contained within the lease.

In both Ohio and Pennsylvania, there is a statutory requirement imposed upon a lessee to record a release of the lease after it has terminated or expired. In Ohio, R.C. § 5301.09 provides in relevant part:

> Whenever any such lease is forfeited for failure of the lessee, the lessee's successors or assigns to abide by specifically described covenants provided for in the lease, or because the term of the lease has expired, the lessee, the lessee's successors or assigns, shall have such lease released of record in the county where such land is situated without cost to the owner thereof.[65]

To date, there are no Ohio Appellate Court or Supreme Court cases that interpret the release requirement language of Ohio R.C. § 5301.09 and whether liability could be imposed on a lessee for failing to record a release of lease pursuant to R.C. § 5301.09.

In Pennsylvania, 58 P.S. § 903(a) requires that "not more than 30 days after the termination, expiration or cancellation of an oil or natural gas lease, the lessee shall deliver to the lessor, without cost to the lessor, a surrender document in recordable form." This statute, effective December 22, 2014, was intended to "provide a process for addressing situations where a lease has expired, contains no renewal clause, and the landowner would like to sign a lease with a new natural gas development company."[66]

If the lessee fails to provide the surrender document, the lessor can proceed as discussed below in Section 18.03[2] — Statutory Requirements for Forfeiture of Lease.

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65 Ohio, R.C. § 5301.09.

66 House Co-Sponsorship Memoranda, Recording of Release from Oil and Natural Gas Lease Act, Former HB 2320, 2013-2014 Sess. (Pa. 2013) http://www.legis.state.pa.us/cfdocs/Legis/CSM/show/MemoPublic.cfm? chamber=H&SPick=20_/30&cosponld= 10800 (Jan. 11, 2013).

§ 18.04. Statutory Requirements for Forfeiture of Lease.

While some states impose a statutory duty upon a lessee to file a release of an oil and gas lease of record upon its expiration, termination or forfeiture, some states[67] provide landowners with a statutory mechanism to clear title to their oil and gas rights in the event a lessee fails to do so. The purpose of these statutes is not to provide landowners with the ability to challenge the validity of an oil and gas lease, but is instead intended to promote development by allowing a landowner to clear title to their oil and gas rights by removing the cloud upon their title created by an unreleased lease.

[1] — Ohio.

In Ohio, a landowner seeking to clear title to its oil and gas rights may attempt to declare a lease forfeited (of record) by complying with the procedure set forth in Ohio Rev. Code § 5301.332. However, two conditions precedent must exist before a landowner can employ this statute — specifically, (1) there can be no *producing* or *drilling* oil or gas wells on the property at issue, and (2) a specific covenant of the lease must have been breached or the term of the lease must have expired.[68] "This is consistent with the forfeiture statute's purpose, which is to clear title to leases that have *clearly* been forfeited, and not to attempt to force certain parties to forfeit their interests."[69]

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67 See Ohio Rev. Code Ann. § 5301.332 (West 2015) (providing Ohio's forfeiture mechanism); 58 Pa. Cons. Stat. Ann. §§ 904-905 (West 2015) (providing Pennsylvania's forfeiture mechanism).

68 Ohio Rev. Code Ann. § 5301.332 (A)(1) (West 2015); *see* Blausey v. Stein, No. OT–78–3, 1978 WL 214959, at *5 (Ohio Ct. App. Dec. 8, 1978), *aff'd*, 400 N.E.2d 408 (Ohio 1980); Popa v. CNX Gas Co. LLC, No. 4:14CV143, 2014 WL 3749415, at *8 (N.D. Ohio July 30, 2014) ("The Court finds no merit in Plaintiffs' forfeiture claim brought pursuant to R.C. § 5301.332. R.C. § 5301.332 applies to lands 'upon which there are *no* producing or drilling oil or gas wells . . . [and] failure of the lessee, his successors or assigns, to abide by specifically described covenants provided for in the lease, or because the term of the lease has expired.' (Emphasis added.) Because the Court finds production within the development unit that holds the entire lease, via the Everflow well, there is no lack of production. Plaintiffs' forfeiture claim is dismissed.").

69 Baile-Bairead, LLC v. Magnum Land Servs., LLC, No. 2:12-CV-00957, 2014 WL 1917527 (S.D. Ohio May 13, 2014).

Although a landowner may be unhappy with nominal production from an oil or gas well on its property, Ohio Rev. Code § 5301.332 only contemplates production, and does not appear to delve into the factual determination of whether there is production in paying quantities. In *Blausey v. Stein*, the Sixth District Court of Appeals found that as a matter of law it was improper to apply Ohio Rev. Code § 5301.332 because there was a producing well on the property at the time the landowner initiated the process.[70] The court held that contrary to the landowner's assertion that a specific covenant of the lease had been broken due to nonpayment of royalties, "the trial court properly found as a matter of law that absent specific language in the lease, nonpayment of royalties is not grounds for cancellation of an oil and gas lease."[71] Additionally, it has also been held by a federal court applying Ohio law that this condition precedent extends to production from a well within a development unit that holds the lease in question,[72] but not located on the lease or the landowner's property.

In *Wuenschel v. Northwood Energy Corp.*,[73] the landowners successfully completed the forfeiture process, but in doing so they failed to comply with a savings provision in the lease that mandated they provide the lessee with 90-days' notice of a default before pursuing forfeiture. The appellate court held that before addressing the statutory forfeiture, "dismissal should have been granted based on the [lessors'] failure to declare a default pursuant to the unambiguous lease provision[.]"[74]

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70 *Blausey*, 1978 WL 214959, at *6.

71 *Id*. *citing generally to* Cannon v. Cassidy, 542 P.2d 514 (Okla. 1975); Kelley v. Ivyton Oil and Gas Co., 265 S.W. 309 (Ky. Ct. App. 1924).

72 *Popa*, 2014 WL 3749415, at *8 ("The Court finds no merit in Plaintiffs' forfeiture claim brought pursuant to R.C. § 5301.332. R.C. § 5301.332 applies to lands 'upon which there are no producing or drilling oil or gas wells ... [and] failure of the lessee, his successors or assigns, to abide by specifically described covenants provided for in the lease, or because the term of the lease has expired.' (Emphasis added.) Because the Court finds *production within the development unit* that holds the entire lease, *via* the Everflow well, there is no lack of production. Plaintiffs' forfeiture claim is dismissed."). (Emphasis added.)

73 Wuenschel v. Northwood Energy Corp., No. 2008-A-0039, 2008 WL 5389710 (Ohio Ct. App. Dec. 26, 2008).

74 *Id*. at ¶ 35.

[2] — Pennsylvania.

Pennsylvania has recently enacted a forfeiture statute[75] similar to that of Ohio, entitled the "Recording of Surrender Documents from Oil and Natural Gas Lease Act" (the "Act"). It provides a landowner the ability to clear title to its oil and gas rights in the event the lease expires and the lessee fails to provide the landowner with the required "surrender document." Because the Act only recently took effect on December 22, 2014, no cases interpreting its application have been decided by the Superior or Supreme Court of Pennsylvania. Notwithstanding that fact, a plain reading of the Act reveals that a condition precedent to its application is that the lease in question must have actually terminated, expired, or been cancelled.[76] It also provides that the "surrender document," *i.e.*, release of lease, be delivered to the lessor "without cost to the lessor[.]"[77]

[3] — Kentucky and West Virginia.

While Ohio and Pennsylvania have expressly adopted statutes that allow lessors to clear title to their oil and gas rights, to date Kentucky and West Virginia have not followed that approach. However, as discuss in Section 18.02[3][c], Kentucky provides that a landowner may avoid a lease or contract where delay rentals are provided for in the lease and they are not timely paid or tendered.[78] Additionally, the Kentucky statute codifies what is often asserted by lessees as a defense to a lease termination action under the doctrines of ratification, estoppel, or waiver—namely, that the "the lessor or landowner may avoid the lease or contract *unless* before executing a new lease or contract he has accepted payment of the rental."[79] Thus, by acceptance of the rental payment the landowner may no longer avoid the lease or contract.

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75 58 Pa. Cons. Stat. Ann. §§ 901-905 (West 2015).

76 *Id*. § 903(a).

77 *Id*. (presumably the costs referred to contemplate the surrender document's preparation, however, this provision may be subject to future litigation where a lessor expends money in the process of declaring the lease forfeited.).

78 Ky. Rev. Stat. Ann. § 353.020 (West 2015).

79 *Id*.

West Virginia has taken a similar approach to that of Kentucky in adopting legislation that provides for the termination of a lease due to a lessees failure to pay delay rentals.[80] Additionally, West Virginia's legislature has codified a legal presumption that the lessee intended to abandon an oil and gas lease upon the nonoccurrence of certain events.[81] Specifically, West Virginia Code, 36-4-9a, creates a rebuttable legal presumption that if a lessee fails to produce and sell (or use for the lessee's own purposes) oil or gas from the leasehold, for a period in excess of 24 months, the lessee shall be deemed to have intended to abandon any oil or gas well situated on the premises.[82]

> This rebuttable presumption shall not be created in instances (i) of leases for gas storage purposes, or (ii) where any shut-in royalty, flat rate well rental, delay rental or other similar payment designed to keep an oil or gas lease in effect or to extend its term has been paid or tendered, or (iii) where the failure to produce and sell is the direct result of the interference or action of the owner of such oil and/or gas or his subsequent lessee or assignee.[83]

The statute goes on to state that "no such presumption is created when a delay in excess of twenty-four months occurs because of any inability to sell any oil and/or gas produced or because of any inability to deliver or otherwise tender such oil and/or gas produced to any person, firm, corporation, partnership or association."[84]

In applying this rebuttable legal presumption, the Supreme Court of West Virginia has held that the presumption of abandonment may only be rebutted if a lessee can demonstrate the existence of one of the foregoing instances identified where the rebuttable presumption shall not be created.[85] However,

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80 W. Va. Code Ann. § 36-4-9a (West 2015).

81 *Id.*

82 *Id.*

83 *Id.*

84 *Id.*

85 Howell v. Appalachian Energy, Inc., 519 S.E.2d 423, 431 (W. Va. 1999) ("We therefore conclude that the legal presumption that a lessee has abandoned an oil or gas well, or abandoned any equipment used in the production of any oil or gas from such a well, set

the Supreme Court of West Virginia has also held that where "a lessor and a lessee have entered into a lease for the purpose of 'exploring and operating for' and 'producing and marketing' oil and gas, and a well has been drilled by the lessee and gas discovered, the payment or tender by the lessee of delay rental for the leased premises does not relieve the lessee from an implied obligation to exercise reasonable diligence in marketing gas from the leased premises."[86] The Supreme Court has further held on several occasions that a lessor's use of free gas does not constitute "production" which would render W. Va. Code, 36-4-9a, inapplicable.[87]

§ 18.05. Ratification and Revivor.

[1] — Generally.

The doctrines of ratification and revivor are often confused and referenced interchangeably, however, they are separate and distinct doctrines.[88] Williams and Meyers in their treatise, *Oil and Gas Law,* describe the distinction between these doctrines as they have been applied by various courts:

> The courts seem to take the position that if there was intent to pass the interest originally and there is a dispute as to the necessary formalities, a later reference by the grantor to the instrument as a valid grant is sufficient to ratify it. In other words, there is a waiver

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forth in W. Va. Code, 36–4–9a [1994], may only be rebutted in instances where the lessee demonstrates: (1) that the lease is for gas storage purposes; (2) that a shut-in royalty, flat rate well rental, delay rental or other similar payment, agreed to by the lessor and lessee and designed to keep the oil or gas lease in effect or extend its term, has been paid or tendered; (3) that the failure to produce or sell gas or oil from the leased premises is the direct result of interference or other actions of the owner of the oil or gas or his subsequent lessee or assignee; or (4) an inability to sell the oil or gas produced from the leased premises, or an inability to deliver or otherwise tender the oil or gas produced to any person, firm, corporation, partnership or association.").

86 Berry Energy Consultants and Managers, Inc. v. Bennett, 331 S.E.2d 823, 829 (W. Va. 1985).

87 *See generally* Goodwin v. Wright, 255 S.E.2d 924 (W. Va. 1979); Currey v. TNG, Inc., 410 S.E.2d 415, 416-18 (W. Va. 1991).

88 *See* Bradley v. Avery, 746 S.W.2d 341, 342 (Tex. App. 1988) (discussing the confusion over ratification versus revivor as applied by various Texas courts).

of the defense as to the lack of necessary formalities in the execution and delivery of the instrument.

On the other hand, where the original grant was concededly effective, but the interest granted has terminated by reason of the limitation in the grant itself, application of the doctrine of revivor involves the granting of a new estate in the land.[89]

Thus, ratification is a reaffirmation or confirmation of a prior defective grant, whereas revivor breathes life into, or grants a new estate, where the prior grant was valid, but ceased to continue in force and effect by operation of its own terms. In addition to the often interchangeable use of ratification and revivor, courts have frequently found that a party is estopped from denying, or has waived its right to challenge, the validity of an oil and gas lease due to some form of conduct which in many cases amounts to a ratification or revivor of the underlying lease.

[2] — Ratification.

[a] — Ohio.

Ohio courts often apply ratification under the guise of estoppel. However, when ratification is asserted due to the lessors continued receipt of some benefit under the lease, Ohio courts look to whether the lessor/landowner would be entitled to that benefit regardless of the lease's existence. For example, in *Quadrant Exploration, Inc. v. Estate of Greenwood*,[90] the Fourth District Court of Appeals held that the remaindermen had ratified the oil and gas lease at issue by their acceptance of delay rentals and therefore were estopped from denying the lease's existence. In upholding the trial court's decision, the court of appeals noted that a life tenant "has no right to exploit the gas and oil resources or to authorize such by others under a lease, in that exploitation of such resources amounts to waste,"[91] and thus, the lease

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89 2 Howard R. Williams and Charles J. Meyers, *Oil and Gas Law*, § 340.04 (1986).

90 Quadrant Exploration, Inc. v. Estate of Greenwood, No. 82 X 29, 1983 WL 3260 (Ohio Ct. App. Aug. 16, 1983).

91 *Id*. at *3.

was defective. But, the court went on to reiterate the trial court's statement that "one who accepts benefits under an agreement to which he would not be entitled if not a party to the agreement will be viewed as having ratified the agreement. Thus, acceptance of royalties by a non-leasing concurrent owner of land and minerals has been held to constitute a ratification of the lease."[92] The court also pointed out that the remaindermen did not return, or attempt to return the rentals.[93]

However, the Fourth District Court of Appeals in a footnote in a later decision concerning an assignment provision in an oil and gas lease pointed out that "[t]here are just as many cases, however, that hold that acceptance of a benefit that a lessor is entitled to, such as royalty payments from the production of minerals from the lessor's property, does not result in a landowner being estopped from asserting breach under a lease."[94] The distinction in the Fourth District's holding in *Quadrant* from the latter decision is that a lessor would not be entitled to delay rentals absent a valid oil and gas lease, whereas that same landowner is entitled to all of the production from his property absent a valid lease.

The Seventh District Court of Appeals decision in *Price v. K.A. Brown Oil & Gas, L.L.C.*,[95] is another Ohio case in support of the proposition that there can be no ratification (or estoppel) preventing a landowner from denying a lease's validity where the landowner would be entitled to the payment regardless. In *Price* the court held that the doctrine of ratification did not apply to lessors where the lessee asserted that the lessors had ratified the

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92 *Id*. (internal citation omitted).

93 *Id*. at *7

94 Harding v. Viking Int'l Res. Co., Inc., 1 N.E.3d 872 (Ohio Ct. App. 2013); *see also* Bonner Farms, Ltd. v. Thomas A. Fritz, Deborah D. Weise, and Exco–North Coast Energy, Inc., 355 Fed. App'x 10 (6th Cir. 2009) (holding estoppel inapplicable where landowner cashed royalty checks, based in part upon fact that landowners had a claim to the payments in absence of the lease); Stitzlein v. Willey and Columbia Gas Transmission Corp., No. CA–318, 1979 WL 209691 (Ohio Ct. App. Dec. 12, 1979) (holding estoppel inapplicable because landowners were entitled to royalties regardless of lease); Yoder v. Artex Oil Co., No. 14 CA 4, 2014 WL 646744 (Ohio Ct. App. Nov. 13, 2014).

95 Price v. K.A. Brown Oil & Gas, L.L.C. No. 13 MO 13, 2014 WL 2466360 (Ohio Ct. App. May 27, 2014).

lease by acceptance of royalty payments and were therefore estopped from claiming the lease had terminated. While the decision in *Price* is in line with the Fourth District, the underlying reasoning propounded by the court appears to be an outlier — namely, that "[t]he doctrine of ratification does not apply in this case [because] [t]his doctrine refers to actions taken by a corporation to validate an unauthorized contract."[96] Thus, the court affirmed the trial court's holding that the lease had terminated and that acceptance of royalties did not estop a landowner from asserting a breach of said lease.

While the foregoing examples involved ratification by acceptance of certain benefits under the lease, at least one Ohio court has held that a lease was ratified by virtue of a reference to the lease at issue in a subsequent deed. In *Mossgrove v. All States Oil & Producing Co.*,[97] the Fifth District Court of Appeals held that the lessors under an oil and gas lease were estopped from denying the lease's validity where they acquired title to the property encumbered by the lease by virtue of a deed that stated it was "subject to" that lease. The lease at issue was not properly executed because only one of the two attesting witnesses was actually present to witness its execution.[98] The court held that both the grantor and grantee under the deed were "estopped by the recitals of their deed to show the latent defect of the prior lease."[99] While the court's decision is proffered under the doctrine of estoppel by deed, the form and effect mirror that of the doctrine of ratification. Thus, in accepting the property "subject to" the lease, the lessors ratified, or reconfirmed the lease's validity. The "subject to" clause in deeds has frequently been found to ratify, and in some instances revive oil and gas leases.[100]

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96 *Id*. In reaching its decision, the court focused on the Supreme Court of Ohio's decision in *Campbell v. Hospitality Motor Inns, Inc*., 493 N.E.2d 239 (Ohio 1986), which the lessee/appellant primarily cited to in their assertion that the oil and gas lease at issue had been ratified. The *Campbell* decision hinged upon a dispute over whether Harley Hotels, Inc. was bound by an employment agreement that was not expressly authorized by the hotel's board of directors.

97 Mossgrove v. All States Oil & Producing Co., 265 N.E.2d 299 (Ohio Ct. App. 1970).

98 *Id*. at 300.

99 *Id*.

100 *Id*.

[b] — West Virginia.

West Virginia courts have taken a similar approach to that of Ohio, however, with some distinctions. In *Wellman v. Bobcat Oil & Gas, Inc.,*[101] the Fourth Circuit, applying West Virginia law, held that the landowners had ratified any defects in the oil and gas lease at issue and may not assert those defects now to justify cancellation of the lease. The lease in question provided for a quarterly flat-rate payment, in advance, for any natural gas produced from the lease. The court noted that the landowners sought rescission of the lease based on late or missing checks between 1995 and 2006, but the landowners had cashed many checks during and after such periods. Reciting West Virginia law, the court stated that "ratification occurs, and there is no breach justifying rescission, 'so long as the injured party elects to treat the contract as continuing.'"[102] Further, "West Virginia law specifically prohibits a lessor from accepting imperfect performance under a lease on an ongoing basis, then complaining of the accepted breach."[103]

While at first glance the *Wellman* decision may not appear to be in line with the various Ohio decisions, an important distinction which alters that appearance should be noted. The lease in *Wellman* involved a flat-rate rental payment, which under West Virginia law does not require production in paying quantities, but only that the flat-rate rental payment is made on time.[104]

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101 Wellman v. Bobcat Oil & Gas, Inc., 524 Fed. App'x 26, 31-32 (4th Cir. 2013) (unpublished); *see* Hamilton v. McCall Drilling Co., 50 S.E.2d 482, 484-85 (W. Va. 1948).

102 *Id., citing* Atl. Bitulithic Co. v. Town of Edgewood, 137 S.E. 223, 225 (W. Va. 1927) (internal citations omitted).

103 *Id., citing generally* Ohio Fuel Oil Co. v. Greenleaf, 99 S.E. 274, 279–80 (W. Va. 1919) ("It has been held repeatedly that, where the continuance of a lease such as this depends upon the payment of money by a certain time, any conduct upon the part of the lessor which would indicate that the time of payment might be extended, or conduct on his part indulging the lessee in making such payment, would estop him from claiming that the lessee's rights had ceased.").

104 *See* Bruen v. Columbia Gas Transmission Corp., 426 S.E.2d 522, 522 (W. Va. 1992) (If an oil and gas lease contains a clause to continue the lease for a term "so long thereafter as oil or gas is produced," but also provides for "flat-rate" rental payments, then quantity of production is not relevant to the expiration of the term of the lease if such "flat-rate" rental payments have been made by the lessee.)

This distinction is important because under the Ohio line of cases acceptance of benefits under the lease will not operate as a ratification where the lessor would be entitled to those benefits regardless, *i.e.*, where a landowner would be entitled to the royalty payment whether the lease existed or not because it held title to the oil and gas rights. However, the flat-rate rental payments in *Wellman* appear to be more akin to a true rental payment than a royalty since they have no relation to the quantity of production.[105]

[c] — Kentucky.

Kentucky appears, at least in part, to have codified one instance where the doctrine of ratification, estoppel and waiver generally apply. Kentucky Revised Statute § 353.020 provides in pertinent part that a "lessor or landowner may avoid the lease or contract *unless* before executing a new lease or contract he has accepted payment of the rental."[106]

In *United Fuel Gas Company v. Jude*,[107] the Court of Appeals of Kentucky held that a landowner was estopped from renouncing an oil and gas lease where it was executed by his son without his knowledge, but the landowner remained silent while the lessee invested money in drilling a producing well on the property. The court went on to note that "[w]here a party has the right to disavow, he can not delay the exercise of the right to determine whether avoidance or affirmance of an act would be more profitable to him."[108] While the landowner was held to be estopped from denying the lease's validity, a correlation can be drawn with the doctrine of ratification as the underlying lease was clearly defective due to the son's execution, but by virtue of the landowner's subsequent actions he affirmed or ratified its validity, thus resulting in an estoppel to deny the same. Conversely, in *Lykins*

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105 *See id*.

106 Ky. Rev. Stat. Ann. § 353.020; s*ee* Walter v. Ashland Oil & Refining Co., 187 S.W.2d 425, 428-29 (Ky. Ct. App. 1945) (providing a discussion of Ky. Rev. Stat. Ann. § 353.020 (predecessor), Chapter 24 of the Acts of 1920, § 3766b-4, and its application to both "or" and "unless" leases.).

107 United Fuel Gas Co. v. Jude, 355 S.W.2d 664 (Ky. Ct. App. 1962).

108 *Id*. at 666.

v. Oaks, the Court of Appeals of Kentucky held that a lease which was void as it had expired automatically could not be ratified.[109]

In another Kentucky case, *Union Gas & Oil Co. v. Gillem*, a lease was held to be ratified where two of three tenants-in-common ratified and confirmed the lease by execution of division orders without reservation, and where in a conveyance between them of a portion of the oil and gas rights under the property the deed specifically referenced the lease.[110] The lessor in *Gillem* executed an oil and gas lease and then conveyed a portion of its oil and gas rights to the Moores who then conveyed a portion of the same to the Swopes. Prior to the lessor's conveyance to the Moores, it demanded that the lessee develop the lease at once and further provided notice that no further delay rentals would be accepted. After that demand, but before development, Moore conveyed a portion of the oil and gas rights to the Swopes and both executed division orders. Subsequently, the lessor entered into a second lease, but the initial lessee had already begun development of the property — eventually drilling two wells. The lessor filed suit to enjoin the original lessee from further development. The court noted that "[t]he general rule with regard to forfeitures of leases, where the lessors are tenants in common, is that all tenants in common must concur and unite in an action on account of the breach of entire and indivisible covenants. Such is the implied covenant in oil leases like the one before us to develop the lease on notice."[111] The court further stated that "[t]he breach of the covenant makes the lease voidable . . . and any act on the part of the lessor, by word or deed, with knowledge of what has been done, which signifies his intention to affirm the lease, is conclusive evidence of a waiver of the forfeiture,"[112] or stated another way, a ratification.

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109 Lykins v. Oaks, 150 S.W.2d 231, 232 (Ky. Ct. App. 1941).

110 Union Gas & Oil Co. v. Gillem, 279 S.W. 626, 627 (Ky. Ct. App. 1925).

111 *Id*. at 628, *citing* Cadillac Oil & Gas Co. v. Harrison, 244 S.W. 669 (Ky. Ct. App. 1922).

112 *Id*. at 629.

[d] — Pennsylvania.

Pennsylvania courts have also utilized estoppel to confirm otherwise voidable agreements. "[A] person may be estopped by his conduct, his statements, or even his silence, if another has thereby been induced to act to his detriment."[113]

In *Smith v. Steckman Ridge, LP*,[114] the court stated the general rule that "a person who accepts the benefits of a transaction should remain bound by its obligations."[115] The lessors in Smith asserted that the lease in question terminated in 2007, but accepted approximately $387,000 two years later from the lessee as a gas storage rental. The court noted that "[t]his sum was indisputably intended as payment for the delay rental and for the estimated recoverable gas reserves in Well 1663, as required under the conversion-to-storage provision."[116] The court further noted it could hardly find a better situation suited to estoppel, stating that "even if the lease was forfeited in 2007, it is now enforceable against the Smiths because they are estopped from contesting the lease's validity."

In their appeal to the Third Circuit, the Smiths argued that the District Court erred in holding them estopped from arguing forfeiture of the lease because of the acceptance of the gas storage payment. In upholding the district court's decision, the Third Circuit held by accepting payments under the lease the Smiths relinquished any right to assert forfeiture of the lease.[117] The Third Circuit found the lessor confirmed the leases continued existence by virtue of accepting the payment, but that the lessor was not estopped from challenging the valuation of that payment had it been properly raised at the lower court.[118]

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113 Fried v. Fisher, 196 A. 39, 41 (Pa. 1938).

114 Smith v. Steckman Ridge, LP, No. 3:09-268, 2014 WL 1278120 (W.D. Pa. Mar. 27, 2014), *aff'd*, 590 Fed. App'x 189 (3d Cir. 2014) (unpublished).

115 *Id., citing generally* 31 C.J.S. Estoppel and Waiver § 163 (2013); Laurel Mobile Health Servs. Ltd. v. Commonwealth, Dep't of Health, 550 A.2d 616, 621 (Pa. Commw. Ct. 1988).

116 *Smith*, 2014 WL 1278120, at *9.

117 *See* McCausland v. Wagner, 78 A.3d 1093, 1104–05 (Pa. Super. Ct. 2013).

118 *Id*. at 1104-05.

[3] — Revivor.

The doctrine of revivor comes into play when a previously effective grant, such as an oil and gas lease, terminates. Once the lease has terminated, it may be revived under certain circumstances.[119] Cases finding an expired lease has been revived *generally* require the existence of some variation of the following after a lease terminates, expires or is otherwise forfeited: (a) the subsequent execution of a formal document; and (b) the express recognition in clear language that the lifeless lease is valid.[120] Stated another way, there must be a new document and that document must "clearly evince an intent to grant a new estate in land *or* to revive the old one."[121] Because revivor involves a new grant, intent to grant such an estate must be shown. While numerous cases in multiple jurisdictions hold that a lifeless lease may be revived, it should be pointed out that there are also numerous cases to the contrary.[122] Additionally, much like ratification, many cases dealing with revivor do not actually mention that the lease at hand has been "revived" because courts often consider the issue in the context of the equitable

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[119] *See, e.g.*, Mossgrove v. All States Oil & Producing Co., 265 N.E.2d 299 (Ohio Ct. App. 1970); Nat'l Bank of Commerce of Houston v. Dunn, 361 S.W.2d 654 (Tex. Civ. App. 1962); Loeffler v. King, 236 S.W.2d 772, 773 (Tex. 1952); Morgan v. Fox, 536 S.W.2d 644 (Tex. Civ. App. 1976).

[120] Westbrook v. Atl. Richfield Co., 502 S.W.2d 551 (Tex. 1973); Cannon v. Sun-Key Oil Co., 117 S.W.3d 416, 419-20 (Tex. App. 2003) (*citing* Westbrook at 555)

[121] Anadarko Petroleum Corp. v. Thompson, 60 S.W.3d 134 (Tex. App. 2000); *Id.*, 94 S.W.3d 550 (Tex. 2002), *citing* Bruce Kramer, "The Temporary Cessation Doctrine: A Practical Response to an Ideological Dilemma," 43 *Baylor L. Rev.* 519, 543 (1991); 2 Howard R. Williams and Charles J. Meyers, *Oil and Gas Law*, § 340.04 at p. 256.

[122] *See* L & L Energy Co. v. Chesapeake Exploration, LLC, 379 S.W.3d 42, 47 (Ark. App. 2010); Ladd Petroleum Corp. v. Eagle Oil and Gas Co., 695 S.W.2d 99, 109 (Tex. App. 1985) ("once a lease terminates by its own terms, it cannot be ratified or revived."); Freeman v. Samedan Oil Corp., 78 S.W.3d 1, 11 (Tex. App. 2001) (once a lease has expired life cannot be breathed back into the lease by principles of estoppel, waiver and laches — once a lease terminates by its own terms, it cannot be ratified or revived.); Stitzlein v. Willey, No. CA-318, 1979 WL 209691, at *3 (Ohio Ct. App. Dec. 12, 1979) (holding acceptance of royalty payments did not prejudice lessors claim of lease termination because, as owners of the land, they were entitled to at least the royalties, no matter what the outcome in this case, and noting in the court's view that R.C. 5301.01 precludes the concept that a lease may be " 'reborn by estoppel' "[.]).

doctrine of estoppel, either holding that a landowner cannot, under the respective circumstances, now deny the leases validity, or the lessee should not be punished for developing the lease after termination in the absence of objections from the lessor.

Ohio, West Virginia, Pennsylvania and Kentucky do not appear to have well-developed bodies of case law concerning the doctrine of revivor as it is traditionally applied. However, there are various cases that present examples of conduct that will or will not suffice to revive an expired lease. Generally, execution of a document by the parties to a lease following termination can revive the lease. However, mere tender of a late rental payment is insufficient to revive as lease, as is the acceptance of royalties.

[a] — Ohio.

In *Stitzlein v. Wiley*, Ohio's Fifth District Court of Appeals held that where a lease expired of its own terms upon the cessation of production after the primary term, it does not follow that the lease has been revived because of the actions of the lessors' acceptance of royalty payments for production occurring after the lease had expired.[123] The court further noted in dicta that it believed Ohio Rev. Code § 5301.01 "precludes the concept that a lease may be "reborn by estoppel."[124] Ohio Rev. Code § 5301.01 governs acknowledgment of interests conveying real property, and the court's reference was likely due to the fact that the concept of rebirth by estoppel implicitly violates the statute's requirement for a written acknowledgment.

[b] — West Virginia.

In *Trees v. Eclipse Oil Co.*, the Supreme Court of Appeals of West Virginia held the lease in question was invalid and the lessee's rental payment "could not revive its defunct lease."[125] However, it is important to note this lease was found to be an executory lease, which provided for its surrender at any time, thereby creating a mere right of entry at will that could

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123 *Stitzlein*, 1979 WL 209691, at *3.

124 *Id*.

125 Trees v. Eclipse Oil Co., 34 S.E. 933, 934 (W. Va. 1899).

be terminated by either party prior to executing on its terms.[126] Further, the lessor had died prior to the attempted payment, and the court held the executory contract terminated by the death of lessor.

The Supreme Court of Appeals of West Virginia has also held on multiple occasions that the lessee cannot unilaterally revive an expired lease.[127] Notably, in one of those decisions, *Jolynne Corp. v. Michels*, the court was also faced with an estoppel claim by the lessee who asserted that the lessor was estopped from claiming the lease at issue was abandoned prior to lessor purchasing the property because the lessor acquired title to the property "subject to" the lease.[128] However, the court made a distinction between reservations and exceptions within a deed and recitations of other instruments, *i.e.*, the lease, which involve third parties.[129] Thus, although the lease was recited in the deed, because it was not set forth as an exception or reservation therein, the court held estoppel by deed could not validate the expired lease.[130]

Equitable estoppel in the context of an oil and gas lease was addressed in *Wilson v. Xander*.[131] In *Wilson*, the original lessees, Wilson and Lockhart, claimed that the value of the leasehold was destroyed because of a failure to deliver clear title to the property. The lessees alleged that the defendants' action should estop the defendants from denying the lessees' lease. The court held while the courts will normally honor the letter of the lease, if the lessor himself hinders the lessee's performance, precipitating the special limitation and defeasance of the lessee's estate, the doctrine of equitable estoppel effectively extends the lease for the reasonable time that justice may require for the lessee to begin production unhindered and avoid the special limitation. Additionally, "[f]or the lessee in an oil and gas lease to make out a

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126 *See* Eclipse Oil Co. v. S. Penn Oil Co., 34 S.E. 923, 924 (W. Va. 1899).

127 See Bryan v. Big Two Mile Gas Co., 577 S.E.2d 258, 269 (W. Va. 2001); Jolynne Corp. v. Michels, 446 S.E.2d 494, 501 (W. Va. 1994).

128 *Jolynne Corp.*, 446 S.E.2d 494, at 502.

129 *Id*. at 502-503.

130 *Id*. at 503.

131 Wilson v. Xander, 387 S.E.2d 809 (W. Va. 1989).

theory of estoppel to prevent defeasance of his estate because of misconduct by the lessor, the lessee is required to use due diligence toward production; however, the lessee's degree of diligence is a factual question."[132]

[c] — Pennsylvania.

In *Bertani v. C. E. Beck*, the Superior Court of Pennsylvania addressed a lessee's attempt to revive a lease by tendering delay rentals.[133] The action was brought by the lessors under assumpsit to recover prior years' delay rental payments. The court held the lessee was not required to tender delay rental payments under the lease and it was free to forfeit the now defunct lease. It further noted that the lessee's subsequent tender to the lessor, which the lessee offered as compromise for the monies owed "did not constitute either a promise to pay or an estoppel requiring future payment of monies under the defunct lease agreement."[134] As the court further stated the tender was rejected and "the attempted revival of the lease was unsuccessful."[135] This seems to suggest revivor may have occurred it the lessor accepted the tender, which would be in accord with cases from other jurisdictions, however, the court concluded that once the lease terminated "it could be revived only by mutual agreement."[136]

[d] — Kentucky.

In *Walter v. Ashland Oil & Refining Co.*,[137] the Court of Appeals of Kentucky found the acceptance of a late payment by the lessor revived the lease. The court noted that to its knowledge "in every instance in which the lessee has accepted the past due rental, or in which he has suffered the lessee to drill after the time had expired within which the lessee was required to drill, we have accepted the construction adopted by the parties

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132 *Id*. at 811.

133 Bertani v. C. E. Beck, 479 A.2d 534 (Pa. Super. Ct. 1984).

134 *Id*. at 536.

135 *Id*.

136 *Id*. at 537.

137 Walter v. Ashland Oil & Refining Co., 187 S.W.2d 425 (Ky. Ct. App. 1945).

and applied the rules of waiver and estoppel."[138] This "well-established rule of construction received legislative recognition and approval," when codified by the legislature as current Kentucky Revised Statute 353.020.[139] The court clarified application of K.R.S. 353.020 in holding that it applied to both "or" and "unless" delay rental provisions, and therefore, acceptance of the delay rentals in the present matter had the effect of avoiding the automatic termination of the lease under its "unless" delay rental provision by allowing the lessee to avail itself of the doctrines of waiver and estoppel."[140]

However, in *Jenkins v. Williams*,[141] the Court of Appeals of Kentucky held that where the lease at issue became null and void, the lessor's "widow did not, either as executrix, life tenant, or doweress, have power to revive the void contract by any act whatsoever of hers, much less by merely receiving past-due rentals."[142] The court relied on its finding the widow owned and claimed no interest in the land at the time of the making of the lease in question except a potential right of dower, and she could not then have made a binding oil lease on the property, nor could she have done so at the time she received the money as rentals.[143]

§ 18.06. The Renewal or Extension of the Lease.

Generally, in the absence of some condition allowing for extension of an oil and gas lease, such as the continuing production of oil or gas in producing quantities or payment of rentals, there cannot be an extension of an oil and gas lease without the agreement of the parties. To preserve the ability to keep

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138 *Id*. at 426, 427.

139 *Id*. at 428; *see* § 18.04 [3][d] above for a brief discussion of Ky. Rev. Stat. Ann. § 353.020.

140 *Id*. at 429; *see id*., at 430 (in addition to the court's clarification of Ky. Rev. Stat. Ann. § 353.020 in holding it applies to "unless" delay rental provisions as well as "or" provisions, the court also held that the lessor waived a subsequent hand written provision in the lease providing that the lease shall terminate if a well was not commenced within 60 days, noting that if the lessor may waive the forfeiture provision in one instance (the delay rental provision), he may also waive it in the other (the subsequent requirement to commence a well within 60 days)).

141 Jenkins v. Williams, 229 S.W. 94 (Ky. Ct. App. 1921).

142 *Id*.

143 *Id*. at 95.

their leasehold interests before expiration or termination, lessees can include renewal or extension provisions within their leases. Based on the specific language contained within the oil and gas lease, these renewal or extension provisions can, among other things, give a lessee the option to automatically extend their lease pursuant to the terms of the provision. When, or if, the lease has terminated can impact the appropriate time frame to exercise such a right. As shown by the case snapshots below, the interpretation of renewal and extension provisions have been a trending topic among courts in the Appalachian states.

[1] — Ohio.

Recently, the Sixth Circuit Court of Appeals affirmed that a lessee had the unilateral right to extend an oil and gas lease. In *Eastham v. Chesapeake Appalachia, LLC*,[144] the lessor and lessee argued over the interpretation of a renewal provision in their lease. The provision of the lease at issue stated:

> In consideration of the acceptance of this lease by the Lessee, the Lessor agrees for himself and his heirs, successors and assigns, that no other lease for the minerals covered by this lease shall be granted by the Lessor during the term of this lease or any extension or renewal thereof granted to the Lessee herein. Upon the expiration of this lease and within sixty (60) days thereinafter, Lessor grants to Lessee an option to extend or renew under similar terms a like lease.[145]

The dispute between the lessor and lessee was whether the above provision allowed for the lessee to exercise a unilateral renewal of the lease or if it required a renegotiation of the lease, and whether the lessee's exercise of its option to extend the lease was premature and it was required to let the original lease expire before it could exercise its option. The court, in relying on an Ohio Supreme Court case,[146] distinguished the terms "renew" and "extend". The court stated the option to renew grants a right to a like lease with

144 Eastham v. Chesapeake Appalachia, LLC, 754 F.3d 356 (6th Cir. 2014).

145 *Id.*

146 State ex rel. Preston v. Ferguson, 166 N.E.2d 365 (Ohio 1960).

similar terms, while the option to extend grants the right to simply lengthen the existing lease for a new period of time. Thus, the court ruled because "renew" and "extend" have different meanings, it followed that the lessee had the unilateral option to extend the lease.[147] Further, the Sixth Circuit noted that neither the court nor the lessors have identified any authority or case where an option under a contract was invalidated because the option was exercised early, and under such an interpretation the lessee could never extend the lease because if it waited until after expiration, the lease would have expired. Therefore, the court rejected the lessors' timeliness argument, and found the early extension nonmaterial.[148]

In *Kelich v. Hess Corp.* and *Griffith v. Hess Corp.*,[149] the Sixth Circuit Court of Appeals reversed decisions from two United States District Courts of Ohio finding the subject oil and gas leases expired by their own terms. The leases at issue provided for primary terms of five years. In addition, in exchange for an extension payment before expiration of the primary terms, the leases gave the lessee the option to extend the lease for an "additional term" of five years "or as long thereafter as oil or gas . . . is produced" on the property. The leases also contained a delay rental provision, which required the lessee to make annual payments to extend the leases for 12-month periods during the primary terms.

The Sixth Circuit reversed the district court, finding the lessee may continue to delay drilling during the second five-year period of the primary terms by making the annual delay rental payments. However, the court found that a delay rental payment was to be paid at the end of the fifth year (to delay

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[147] Courts throughout Ohio and West Virginia interpreting the identical "extend or renew" provision in *Eastham* have come to the same conclusion. *See* Brown v. Chesapeake Appalachia, LLC, No. 5:12-CV-71, 2013 Lexis 118827 (N.D. W. Va. Aug. 21, 2013); Bissett v. Chesapeake Appalachia, LLC, No. 5:13-CV-20, 2014 WL 1689928 (N.D. W. Va. Apr. 29, 2014); Benzel v. Chesapeake Exploration, LLC, No. 2:13-CV-00280, 2014 WL 4915566 (S.D. Ohio Sept. 30, 2014); Kenny v. Chesapeake Appalachia, LLC, No. 14 CO 24, 2015 WL 1453099 (Ohio Ct. App. Mar. 30, 2015).

[148] *Eastham*, 754 F.3d 356, at 364.

[149] Kelich v. Hess Corp., Nos. 14-3411, 14-3431, 2014 WL 7331014 (6th Cir. 2014).

the drilling during the sixth year) in addition to the extension payment for the second five-year period.

In its analysis of the apparent failure of the lessee to tender a delay-rental at the end of the fifth year of the primary terms, the court found such failure to be insufficient to terminate the leases. The court stated "this apparent 'error in paying' cannot result in 'forfeiture' until [the lessee] receives notice and has an opportunity to correct the error," based on the 30-day savings clause included in the leases.[150]

In *Phillips Exploration, Inc. v. Reitz*,[151] the Southern District of the United States District Court of Ohio held that a lessor could not prevent the lessee from renewing its oil and gas lease by refusing to accept a renewal check tendered in accordance with the lease. The lease at issue provided that it could be extended for an additional primary term if the lessee paid or tendered $40.00 per acre prior to the lease's expiration date. The lessee attempted to tender the extension payment by sending it to the same address it sent the royalty payments to, but the lessor declined the certified mail containing the check. Thereafter, the lessor filed an Affidavit of Non-Production and re-leased the mineral rights to another company. On summary judgment, the court held that because the lessee timely tendered the extension check, it complied with the renewal provision and the lessor could not therefore prevent the renewal by refusing to accept the payment.[152]

[2] — Pennsylvania.

In *Danko Holdings, L.P. v. EXCO Resources (PA), LLC*,[153] the Middle District of the United States District Court of Pennsylvania held

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150 *Id*. at *2.

151 Phillips Exploration, Inc. v. Reitz, No. 2:11-CV-920, 2012 WL 6594915 (S.D. Ohio Dec. 18, 2012).

152 *See also* Baile-Bairead, LLC v. Magnum Land Servs., LLC, 19 F. Supp. 3d 760 (S.D. Ohio 2014) (The court found that, in timely tendering an extension payment to the lessor, the lessee substantially performed under the terms of the leases, despite evidence the lessee improperly tendered payment to the wrong party under the plain language of the leases, and sent the check to the wrong address.).

153 Danko Holdings, L.P. v. EXCO Res. (PA), LLC, No. 4:14-CV-00274, 2014 WL 4828878 (M.D. Pa. Sept. 29, 2014), *appeal docketed*, No. 14-4283 (3rd Cir. Oct. 30, 2014).

that an extension payment made by the lessees' predecessor to the lessor's predecessor extended the oil and gas lease at issue, even though at the time of payment, the lessor's predecessor had already sold their interest in the lease to the plaintiff lessor. The lease at issue contained a primary term of five years and the following two provisions:

> EXTENSION OF TERM: Lessee may extend the primary term for one additional period equal to the primary term by paying to Lessor, at any time within the primary term, proportionate to Lessor's percentage of ownership an Extension Payment equal in amount to the annual Delay Rental as herein described, or by drilling a well on the Leasehold which is not capable of commercial production.
>
> CHANGE OF OWNERSHIP: Lessee shall not be bound by any change in the ownership of the Leasehold until furnished with such documentation as Lessee may reasonably require. Pending the receipt of documentation, Lessee may elect either to continue to make or withhold payments as if such a change had not occurred.[154]

Neither the plaintiff lessor nor the lessor's predecessor-in-interest provided notice of the change of ownership as required by the lease. Accordingly, when the lessees' predecessor sought to extend the lease, it made the extension payment to the lessor's predecessor.

The court dismissed the plaintiff lessor's complaint ruling that it did not comply with the plain language of the change in ownership clause. As a result of the plaintiff lessor's noncompliance with the change in ownership clause, the court ruled the extension payment to the lessor's predecessor extended the term of the Lease. The court stated it was irrelevant whether the defendant lessees or its predecessors had any actual or constructive notice of the ownership change because the plaintiff lessor did not provide documentation of the ownership change.[155]

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154 *Id*.

155 S*ee also* Shedden v. Anadarko E & P Co., L.P., 88 A.3d 228 (Pa. Super. Ct. 2014), *appeal accepted*, 97 A.3d 741 (Pa. Aug. 14, 2014) (The superior court found that lease extension payment was timely made and constituted a valid exercise of the defendant lessor's

§ 18.07. The First Right of Refusal Provision.

Third party companies, hoping that an existing oil and gas lease will expire, often offer a new lease to a landowner, referred to as "top lease." A "top lease" is a lease acquired on a mineral interest, which is subject to a valid, existing prior lease. A "top lease" is meant to take effect upon the existing lease's termination. In order to avoid the possibility of being top leased, lessees sometimes will include a Right of First Refusal provision in their leases. Generally, this provision provides that before a lessor is able to enter into another lease, the lessee shall first be notified of the lease and be given the opportunity to match the third party company's offer. Generally, such provisions specify the timeframe during which the right of first refusal exists and may be limited to the term of the lease or include up to one year thereafter. As shown by the case snapshots below, right of first refusal provisions have been interpreted in a wide variety of contexts within oil and gas leases.

[1] — Ohio.

There has been a recent line of cases interpreting Ohio contract law and right of first refusal provisions within oil and gas leases. In *Chesapeake Exploration, LLC v. Catlett Quality Plumbing & Heating, Inc.*,[156] the lessors received offers from third parties to lease their properties currently under lease. The lease included the following "preferential right to renew" clause:

> If, any time during the primary term hereof, or within one (1) year from the expiration, cancellation or termination of this Lease, Lessor receives an acceptable, bona fide third-party offer to lease the Leasehold, in whole or part, Lessor shall promptly provide the Lessee, in writing, of all of the verifiable particulars of such offer.

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contractual option to extend the lease for an additional term of five years); *see also* Route v. East Res. Mgmt., LLC, No. 1:12-CV-00776, 2014 WL 4977354 (M.D. Pa. Oct. 6, 2014) (The court found that defendant lessor validly exercised an option to extend its lease for an additional five years.).

[156] Chesapeake Exploration, LLC v. Catlett Quality Plumbing & Heating, Inc., No. 5:12CV188, 2012 WL 5364259 (N.D. Ohio Oct. 30, 2012), *aff'd by* Stewart v. Chesapeake Exploration, L.L.C., 542 Fed. App'x 468 (6th Cir. 2013).

> Lessee shall have thirty (30) days from the receipt thereof to advise Lessor, in writing, of its agreement to match said third-party offer as to all terms and consideration; immediately thereafter, Lessor and Lessee shall take all cooperative steps necessary to effectuate the consummation of said transaction and the survival of said transaction through any statutorily mandated right of cancellation thereof. Any lease or option to lease the Leasehold, in whole or part, granted by Lessor in contravention of the purposes of this paragraph shall be deemed null and void.[157]

The lessors in *Catlett* attempted to use this provision as a "right of first refusal" to terminate their current lease before expiration of the primary term, and immediately enter into the offers from the third parties. The court in *Catlett* held that the preferential right-to-renew clause allowed the lessor to present an offer to the lessee, that the lessee then had a chance to match that offer, and that the lessee's failure to do so did not terminate the pre-existing lease. The court concluded that the lessors could accept third-party offers while the current lease remained valid; however, they could not deprive the lessee of its current rights in its lease.[158]

[2] — West Virginia.

The Northern District of the United States District Court of West Virginia has recently interpreted a right of first refusal provision within an oil and gas lease. In *Cunningham Energy LLC*,[159] the lessor attempted to terminate its oil and gas lease due to the lessee's alleged failure to drill horizontal Marcellus Shale wells pursuant to the lease terms. Because the lessor believed its

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157 *Id*.

158 The identical "preferential right to renew" provision in *Catlett* has been interpreted in similar fashion in Cain v. Chesapeake Exploration, LLC, No. 5:12CV1699, 2012 WL 5996910 (N.D. Ohio Nov. 30, 2012), Wiley v. Triad Hunter, LLC, No. 2:12-CV-00605, 2013 WL 4041772 (S.D. Ohio Aug. 8, 2013), Egnot v. Triad Hunter, LLC, No. 2:12-cv-1008, 2013 WL 5487059 (S.D. Ohio Sept. 30, 2013), and Stewart v. Chesapeake Exploration, LLC, 542 Fed. App'x 468 (6th Cir. 2013).

159 Cunningham Energy LLC v. Ridgetop Capital II, LP, No. 5:13-CV-78, 2014 WL 4385875 (N.D. W. Va. Sept. 4, 2014).

lease would terminate due to the failure to drill wells pursuant to the lease, the lessor executed a top lease. The lease between the lessor and the lessee contained the following provision governing top leases:

> ***RIGHT OF FIRST REFUSAL:*** If at any time within 30 days of the expiration of the Lease's primary term . . . Lessor should receive a bona fide, acceptable offer to grant an additional lease ("Top Lease") for all or part of the subject premises, Lessor shall grant Lessee the option of meeting terms and conditions of said offer . . . Any Top Lease granted by Lessor in violation of this provision shall be null and void.

In violation of the right of first refusal provision, the lessor neither informed the lessee of the top lease nor offered the lessee the option of meeting the terms and conditions of the top lease. The court noted that both notice and a right of first refusal were required by the right of first refusal provision. Thus, in accord with the lease's terms, the court rendered the top lease null and void.

[3] — Pennsylvania.

The Western District of the United States District Court of Pennsylvania has also recently interpreted a right of first refusal provision within an oil and gas lease. In *U.S. Energy Development Corp. v. L.E. Mallory*,[160] the parties entered into an oil and gas lease which granted the lessee the rights to develop the shallow oil and gas deposits on property owned by the lessors. The lease at issue also granted the lessee a right of first refusal with respect to the deep rights on the property:

> The lessee shall have the right of first refusal to lease the horizons below the base of the Bradford Third Sandstone upon the terms and conditions of any bona fide written offer made for them. Said right to be exercised by notifying the Lessor by registered mail within

160 U.S. Energy Dev. Corp. v. L.E. Mallory, No. 12-235, 2014 WL 4659659 (W.D. Pa. Aug. 13, 2014).

ten (10) days of its receiving written notice that such bona fide offer has been made.

The lessors subsequently entered into two new leases with respect to the deep rights. It was undisputed that the lessors did not notify the lessee before having entered into the leases, as required by the right of first refusal provision. The lessors made numerous arguments, including that the lessee already indicated to the lessors that it was not interested in the deep rights. The lessors also argued that plaintiff already declined to exercise its right of first refusal in 2007 for a previous lease entered into by the lessors and that the right of first refusal was therefore a one-time right.

The court ruled that all of the lessors' arguments went beyond the terms of the unambiguous oil and gas lease. The court noted that the unambiguous language of the right of first refusal provision required the lessors to notify the lessee of any bona fide written offer made for the deep rights. The court ruled that the finder of fact at trial could determine whether the lessee was entitled to compensatory damages measured by the difference between the contract and the fair market value of the deep horizon rights at the time of the breach.[161]

§ 18.08. The Doctrine of Novation.

Novation is a legal doctrine that could come into play where parties to an oil or gas lease enter into a new agreement. Novation is essentially the substitution of a new contract for an old one, whereby the new agreement extinguishes the rights and obligations that were in effect under the prior agreement. Novation may be argued by lessors or lessees to uphold the validity of a subsequently executed agreement. Top leasing by the existing lessee has occasionally given rise to a claim the new lease supersedes or is substituted for the original lease, even though original lease had not yet expired according to its terms.[162]

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161 *Id*.

162 *See* Placid Oil Co. v. Taylor, 325 So. 2d 313 (La. App., 1976), *writ denied* 329 So. 2d 455 (La. 1976) (ruling that an oil and gas lease entered into by a lessor as to mineral rights subject to prior leases with the same lessee effected a novation of the prior leases,

Generally, a contract of novation is created where a previous valid obligation is extinguished by a new valid contract, accomplished by substitution of parties or of the undertaking, with the consent of all the parties, and based on valid consideration.[163] A novation can never be presumed but must be shown by a clear and definite intention on the part of all the parties to the original contract to completely negate the original contract and enter into the second contract.[164] Because a novation is a new contract, it must also meet all the elements of a contract.[165] In the context of oil and gas leases, novation has not been discussed and interpreted by many court in the Appalachian Basin.

In *Strahler v. Alliance Petroleum Corp.*,[166] the court rejected a claim of novation. The lessees were the successor owners of two oil and gas leases covering the same 400-acre tract of land. The question before the court was whether the second lease was a top lease, or alternatively, a novation that terminated the first lease. The common pleas court in *Strahler* found that the second lease was not a novation. The court noted: (1) there was no discharge of the obligations of the parties or obligations in the first lease contained in the second lease; and (2) there was no clear and definite intent expressed in the second lease that it would negate the first lease. The court concluded that the second lease was a top lease granted by a landowner during the existence of the first lease that would become effective if and when the existing lease expires or is terminated, and because there was continuous production of oil and/or gas under the first lease, it controlled.[167]

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extinguishing those leases as to the affected mineral interest and substituting the latest lease in their place).

163 The same elements required for a novation are present in Ohio, West Virginia, Pennsylvania, and Kentucky. *See* Williams v. Ormsby, 966 N.E.2d 255 (Ohio 2012); Perlick and Co. v. Lakeview Creditor's Trustee Comm., 298 S.E.2d 228 (W. Va. 1982); Yoder v. T.F. Scholes, Inc., 173 A.2d 120 (Pa. 1961); Ranger Natural Gas, LLC v. Burns, No. 07-202-ART, 2010 WL 2573501 (E.D. Ky. June 21, 2010).

164 *Id*.

165 *Id*.

166 Strahler v. Alliance Petroleum Corp., No. 13 OT 174 (C.P. Washington Cnty., Ohio Oct. 7, 2014).

167 Note, however, in Placid Oil Co. v. Taylor, 325 So. 2d 313, 317 (La. App., 1976), the Third Circuit Court of Appeals of Louisiana found the silence as to the prior existing lease

Courts who address the issue, have routinely ruled an assignment of certain rights under an oil and gas lease did not constitute a novation of the lease. For instance, in *Gardner v. Oxford Oil Co.*,[168] the lessee drilled one well pursuant to its lease with the lessor. After determining the well was no longer productive, the lessee sold and assigned the well production equipment to the lessor, who thereafter used the well only for domestic gas. The assignment from the lessee to the lessor conveyed all of the lessee's interest in the lease, but retained all deep rights from the bottom of the producing zone to the center of the earth.

Shortly after selling a majority of the well equipment, the lessor demanded a release of the lease from the lessee as to the deep rights, due to non-production of oil and gas. One of the lessee's arguments against termination of the lease was that the assignment constituted a novation because it was a new, separate agreement not subject to the terms of the lease.

In rejecting the lessee's novation argument, the court noted that because a novation is a new contract, it too must meet all the elements of a contract. The court stated that none of the documentation between the parties showed that the lessor gave his mutual assent to sell the deep rights in the lease, and thus the required elements of a novation were not present.[169] The lessee's retention of the deep rights thus remained subject to the terms of the lease agreement, which terminated due to the non-production of oil and gas.

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showed the intent to extinguish the prior lease, stating, "[i]t is inconceivable, we think, that the parties would omit a reference to the 1964 leases, if they actually intended that the lessee was to pay only a one-eighth royalty on the production from the Watson and Pap C. Taylor mineral interests instead of the One-fourth royalty provided in the 1965 lease covering the same interests."

168 Gardner v. Oxford Oil Co., 7 N.E.3d 510 (Ohio Ct. App. 2013).

169 *See also* Ranger Natural Gas, LLC, 2010 WL 2573501 (holding that while defendants may be correct that a 2004 assignment was a novation of the prior 1998 operating agreement, summary judgment was inappropriate based on material issues of fact, including defendants alterative argument that the 2004 assignment never came into existence).

Similar court rulings in *Popa v. CNX Gas Co. LLC*,[170] and *Marshall v. Beekay Co*.[171] relied upon the rationale in *Gardner*.[172] In *Papa* and *Marshall*, the court found that a partial assignment of rights in an oil and gas lease does not constitute a new, separate conveyance or contract and thus the deep rights will remain subject to the terms of the original lease agreement. Both the *Popa* and *Marshall* courts ruled the production from shallow depths were sufficient to hold and sustain the nonproducing deep rights.[173] See also *Kelley v. Reed*,[174] rejecting a claim of novation where the new leases were signed by the appellant who had received only a life estate in the leases because the consent and understanding of the remaindermen was also required.

§ 18.09. Tolling.

With increased litigation in the Appalachian Basin challenging the validity of existing oil and gas leases, the ability to toll the term of the lease becomes critical for lessees. Such challenges place the lessee in the difficult position of foregoing development of the challenged leasehold and risk losing the lease through expiration, or proceeding with development in light of the challenge to the lease's validity. To protect its interest in such a situation, lessees should seek equitable tolling of the challenged oil and gas lease during the pendency of the litigation. Many jurisdictions have been willing to grant the lessee additional time to meet its obligation in such situations.[175] Williams

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170 Popa v. CNX Gas Co. LLC, No. 4:14CV143, 2014 WL 3749415 (N.D. Ohio July 30, 2014).

171 Marshall v. Beekay Co., 27 N.E.3d 1 (Ohio Ct. App. 2015).

172 *Gardner,* 7 N.E.2d at 519.

173 *See also* Rice v. Chesapeake Energy Corp., No. 2:12-cv-00392, 2012 WL 3144318, at *2 (W.D. Pa.) (noting an assignment standing alone does not ordinarily work a novation of the lease relationship, and keeps the original lessee in the game, vis-à-vis the lessor).

174 Kelley v. Reed, Ninth District Case No. 2194-M, 1993 WL 280419 (Ohio App. 9 Dist.).

175 *See generally* Rougon v. Chevron, U.S.A. Inc., 575 F. Supp. 95, 100 (M.D. La. 1983) (stating "where a lessor questions the validity of a lease, the term of the lease is suspended, the logic being that the lessee has been deprived of the exercise of the rights granted to him by the lease by the act of the lessor and he is therefore granted an extension beyond the primary term for the period during the primary term when the lease was placed in jeopardy"); Sw. Energy Prod. Co. v. Elkins, 374 S.W.3d 678, 685 (Ark. 2010) (tolling Southwestern Energy's drilling obligations effective as of October 13, 2009, the date the complaint was filed); Greer

and Meyers states, "courts have almost universally held that when the lessor has brought a suit during the *primary term* claiming the termination of the lessee's interest, the lessee, should he prevail in such action, will be entitled to a period of time extending beyond the expiration of the primary term to gain production."[176]

While West Virginia[177] and Kentucky have not addressed the appropriateness of equitable tolling in the context of lessor challenges to the lease's validity, Ohio and Pennsylvania have come to differing results.

[1] — Pennsylvania.

Recently, in *Harrison v. Cabot Oil & Gas Corp.*,[178] the Supreme Court of Pennsylvania addressed whether equitable tolling of an oil and gas lease was appropriate whena lessor challenges the validity of a lease by virtue of a declaratory judgment action. Prior to *Harrison*, the Superior Court of Pennsylvania[179] and the United States District Court for the Middle District of Pennsylvania[180] held that equitable tolling was not appropriate in similar circumstances.

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v. Carter Oil Co., 25 N.E.2d 805, 810 (Ill. 1940) (extending the time of drilling for a period of six months from the date the affirming order of the court is filed with the clerk of the circuit court); Kothmann v. Boley, 308 S.W.2d 1, 4 (Tex. 1957) (holding the lease shall remain in full force and effect for a term of eight months from the date of the judgment, and that the end of such period of eight months shall be deemed the end of the primary term for all purposes); Bingham v. Stevenson, 420 P.2d 839, 842 (Mont. 1966) (finding the lessee was entitled to have the lease extended for a period of seven years and nine months from date of judgment).

176 3 Howard R. Williams and Charles J. Meyers, *Oil and Gas Law* § 604.7 (2009).

177 *But see* Wilson v. Xander, 387 S.E.2d 809 (W. Va. 1989), discussed in § XX.04[3][b].

178 Harrison v. Cabot Oil & Gas Corp., 110 A.3d 178 (Pa. 2015).

179 Derrickheim Co. v. Brown, 451 A.2d 477 (Pa. Super. Ct. 1982) (the Superior Court reversed the lower court's extending of the lease term from the date of the title issue identified by the lessee, noting that "[while] we agree with the trial court's conclusion that the cloud on the title relieved [lessee] of any affirmative duty it may have under the lease to drill for oil or make rental payments . . . we cannot agree that the cloud on the title stopped the running of the lease term.").

180 *Lauchle*, 768 F. Supp. 2d 757 (following the Superior Court of Pennsylvania's decision in *Derrickheim* in holding that lessors did not repudiate their lease by filing declaratory action to terminate the lease and thus, lessee is not entitled to equitable extension of lease.).

In *Harrison*, the Supreme Court of Pennsylvania addressed whether the primary term of an oil and gas lease should be equitably extended where the lessor unsuccessfully challenged the lease's validity.[181] Notwithstanding the majority view, the court held that the lessor, in pursuing a declaratory judgment challenging the validity of the oil and gas lease, did not repudiate the lease thereby necessitating equitable relief.

Cabot Oil & Gas Corp. (Cabot) argued that by challenging the lease, the lessors had repudiated the lease. Cabot further argued Harrison's declaratory action was the equivalent of a statement that the lessor would not perform in accordance with the agreement.[182] Cabot's position was based on the principle that a party to a contract is entitled to the benefit of its bargain, and the landowner's challenge to the validity of the oil and gas lease forestalls drilling and "[i]t would be essentially impossible for a producer to place such an investment at risk while there remains pending a lawsuit seeking to invalidate the producer's interest in the property."[183] Cabot also sought to distinguish *Derrickheim* by calling the court's attention to the fact that the lessee there had commenced the lawsuit, whereas in the instant matter the lessor brought suit.[184]

In holding that equitable tolling was inappropriate, the court focused on the lessor's action in seeking a declaratory judgment as to the lease's termination. It noted that "[t]he difficulty with Cabot's position, however, is that this court has required more than the mere assertion of a challenge to the validity of an agreement to demonstrate such repudiation. Under Pennsylvania law, anticipatory repudiation or breach requires an "absolute and unequivocal refusal to perform or a distinct and positive statement of an inability to do so."[185] The court went on to state that it is widely recognized, beyond the

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181 The action in *Harrison* was initially commenced by the lessors in federal court, however, upon motion from Cabot, the Third Circuit certified the issue of whether the primary term of an oil and gas lease should be equitably extended by the court where the lessor has pursued an unsuccessful lawsuit challenging the validity of the lease.

182 *Id*. at 182-83.

183 *Id*. at 182, citing Brief for Appellant at 16 (Cabot).

184 *Id*. at 183.

185 *Id*. (citation omitted).

sphere of oil and gas, that a declaratory action contesting the validity of an agreement does not amount to a refusal to perform, *i.e.*, a repudiation, and the court declines to adopt a special approach for oil and gas leases, "as a substantial number of other jurisdictions would appear to have done."[186]

Notably, however, the court stated "[w]e do not foreclose that equitable relief may be available to oil-and-gas-producing companies — subject to applicable requirements governing recourse to equity — where there is an affirmative repudiation of a lease."[187] Thus, equitable tolling may be found appropriate where there has been conduct by the lessor above and beyond merely seeking declaratory relief.

[2] — Ohio.

Ohio law, contrary to the minority view embraced by the Supreme Court of Pennsylvania in *Harrison v. Cabot Oil & Gas Corp.*, discussed below, generally favors equitable tolling, with few exceptions, where the oil and gas lease in question is found to be valid despite the lessor's assertion otherwise.[188]

In *Three Waters, LLC v. Northwood Energy Corp.*, the lessor challenged the validity of the oil and gas lease at issue during its primary term alleging the lease was invalid because the lessor's signature was not notarized. The Monroe County Court of Common Pleas, upon finding the lease valid, held that "[lessor's] action of challenging the validity of the Leases makes

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186 *Id.* at 184-185.

187 *Id.* at 186 (in a footnote the court noted that several decisions cited by *Cabot* did involve some level of refusal by the lessor to surrender possession of the leasehold.)

188 *See generally* Three Waters, LLC v. Northwood Energy Corp., No. 2012–042 (C.P. Monroe Cnty., Ohio, June 12, 2012); Yoskey v. Eric Petroleum Corp., No. 12CV808 (C.P. Columbiana Cnty., Ohio) (*reversed on other grounds and remanded for further proceedings* in Yoskey v. Eric Petroleum Corp., No. 13 CO 42, 2014 WL 4291629 (Ohio Ct. App. Aug. 29, 2014); Allton v. Chesapeake Exploration, LLC, No. 2:14-CV-1685, 2015 WL 1396439, at *2 (S.D. Ohio Mar. 25, 2015) (applying Ohio law); Cameron v. Hess Corp., No. 2:12-CV-00168, 2014 WL 1653119, at *4-5 (S.D. Ohio Apr. 23, 2014) (applying Ohio law); Griffith v. Hess Corp., No. 2:14-CV-00337, 2014 WL 1407953, at *5 (S.D. Ohio Apr. 11, 2014) (applying Ohio law); Wiley v. Triad Hunter LLC, No. 2:12–CV–00605 (S.D. Ohio Sept. 27, 2013) (Magis. Opinion and Order) (applying Ohio law).

Defendant's claim for tolling of the Leases ripe and justiciable at the present time."[189] The court found that because the lawsuit directly affected the lessee's rights under the leases during the primary term that the "[lessee] is entitled as [a] matter of law to judgment tolling the five-year term of the Leases from the date of service of [lessor's] Complaint until final disposition of Plaintiff's claims, including the pendency of any appeal."[190]

Since the decision in *Three Waters*, there have been a string of decisions out of the United States District Court, Southern District of Ohio concerning equitable tolling under Ohio law.[191] In *Allton v. Chesapeake Exploration, LLC*, the court held it would be inappropriate to toll the term of the lease at a preliminary stage in the proceedings prior to determining the validity of the underlying lease. The court noted with the exception of two decisions, the prior decisions holding equitable tolling appropriate under Ohio law have "involved motions to toll that courts decided either in conjunction with, or after deciding the validity of the underlying lease."[192] Thus, under Ohio law

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189 Three Waters, LLC, No. 2012-042 (C.P. Monroe Cnty.).

190 *Id*.

191 *See Allton,* 2015 WL 1396439, at *2 (applying Ohio law); *Cameron v. Hess Corp*., 2014 WL 1653119, at *4-5 (applying Ohio law); *Griffith,* 2014 WL 1407953, at *5 (applying Ohio law); *Wiley,* No. 2:12-CV-00605 (S.D. Ohio) (applying Ohio law).

192 *Allton*, 2015 WL 1396439, at *3; *see also* Feisley Farms Family, L.P. v. Hess Ohio Res., LLC, No. 2:14–cv–146, 2014 WL 4306487 at *4 (S.D.Ohio Aug. 25, 2014) (declining to toll the term of a lease, finding that the motion was premature because the underlying merits of the plaintiff's claims were not yet resolved); Egnot v. Triad Hunter, LLC, No. 2:12–cv–1008, 2013 WL 5487059 (S.D.Ohio Sept.30, 2013) (finding the lease was valid and then tolling the term of the lease); Wiley v. Triad Hunter, LLC, No. 2:12–cv–605 (S.D. Ohio) (noting that the court had previously denied the defendants' motion to toll as "premature given that the underlying merits of the case remained unresolved," but after finding the lease valid found that tolling was equitable based on the reasoning in Three Waters); *but see* Kelich v. Hess Corp., No. 13–cv–140 (S.D. Ohio April 15, 2014) (noting that "should the Sixth Circuit overturn the court's decision and find that the Lease did not terminate, Hess may very well have already lost the time under the Lease for which it bargained and paid for, which is the very justification under Ohio law for tolling a Lease."); and Chesapeake Exploration, L.L.C. v. McClain, No. 2:13–cv–0445 (S.D.Ohio July 30, 2013) (granting the motion to toll "at a highly preliminary stage" of the lawsuit, the court found that the defendant "need not prove its entire case now," and "[i]t suffices . . . to show that the [plaintiffs] have challenged the validity of the Lease and that such as challenge has prevented [the defendant] from developing its leasehold interest.").

it appears that a possible condition precedent to such a tolling order may be the establishment of the challenged lease's validity.

Recently, the Ohio Supreme Court granted an alternative writ in a mandamus action filed by the Claugus Family Limited Partnership against Beck Energy Corporation.[193] At issue is whether putative class members' due process rights were violated when the Ohio Seventh District Court of Appeals extended a tolling order to Civ.R. 23(B)(2) class members, without giving class members notice or the ability to opt out.

The underlying lawsuit giving rise to this original action commenced when four Plaintiffs filed a declaratory judgment/quiet title action against Beck Energy Corporation.[194] Plaintiffs asked the Monroe County Court of Common Pleas to find their GT83 leases with Beck Energy void.[195] The trial court granted summary judgment, declaring the GT83 leases void *ab initio*.[196] Beck Energy appealed the trial court's decision to the Seventh District Court of Appeals.

Following the trial court's decision on the merits, these same plaintiffs moved to certify a class action under Civ.R. 23(B)(2). Beck Energy filed a motion to toll the leases of the named plaintiffs, but the trial court never ruled on the pending motion. The trial court eventually certified a (B)(2) class action consisting of all Ohio lessors who executed a GT83 lease with Beck Energy, where Beck Energy had neither drilled nor prepared to drill a well, nor included the property in a drilling unit. Following class certification, Beck Energy filed a second motion to toll, this time asking the trial court to toll the leases of the named Plaintiffs and class members. The trial court declined to do so and tolled only the leases of the named Plaintiffs.

Thereafter, Beck Energy requested tolling in the Seventh District Court of Appeals, asking the court to toll the leases of all class members while

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193 Entry, State of Ohio ex rel. Claugus Family Farm, L.P. v. Seventh District Court of Appeals, No. 2014-0423 (Ohio Supreme Ct. Sept. 3, 2014).

194 Complaint, Hupp v. Beck Energy Corp., No. CVH2011-345 (C.P. Monroe Cnty., Ohio Sept. 14, 2011).

195 *Id*.

196 Decision, Hupp v. Beck Energy Corp., No. CVH2011-345 (C.P. Monroe Cnty., Ohio July 12, 2012).

the appeal remained pending. The Court of Appeals granted Beck Energy's request and tolled the class members' leases until the court decided the pending appeal and, in case of an appeal to the Ohio Supreme Court, until the Ohio Supreme Court accepted or declined jurisdiction.[197]

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[197] Judgment Entry, Hupp v. Beck Energy Corp., Nos. 12 MO 6, 13 MO 13, 13 MO 11, (Ohio Ct. App. Sept. 26, 2013).

Chapter 19

Recent Decisions in Oil and Gas Jurisprudence

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§ 19.01. Introduction.

The past year has been a time of transition for the oil and gas industry. Prior to 2014, domestic oil and gas production was the impetus of one of the largest energy booms in American history. Chiefly due to the advent and success of hydraulic fracturing, American energy production expanded at a breakneck pace and countless individuals and organizations sought to share in the bounty of this revolutionary industry. While the industry's success and rate of expansion was nothing short of remarkable, it also had the unintended effect of contributing to a considerable drop in the price of crude oil and natural gas. In turn, this shift in the global energy markets finally managed to curb domestic oil and gas development. In addition to forcing many operators to drastically reduce rig counts, implement steep reductions in drilling budgets and generally rethink their operational strategies, these economic happenings also had a significant impact on many ancillary businesses that relied on domestic energy production.

The oil and gas industry's abrupt shift was also felt in the judiciary, as courts across the country were faced with a number of novel legal issues impacting oil and gas development. By recounting some of the most important oil-and-gas-related judicial developments of the past year from Appalachia and beyond, this chapter will assist oil and gas practitioners in staying abreast of the industry's constantly changing legal landscape. This chapter opens with a discussion of issues related to leasing and conveyancing in Louisiana, Texas and New York. It proceeds with an examination of decisions concerning the calculation of royalties in Texas. Next, this chapter addresses local and state preemption in New York, North Dakota and Pennsylvania. It continues with a review of important decisions from Ohio regarding the State's Dormant

Mineral Act. It then recounts an array of important judicial decisions which address unique legal issues from several jurisdictions. Finally, this chapter concludes with an eye to the future, predicting which legal issues will rise to the forefront in years to come and providing guidance to oil and gas practitioners as to how to best protect client interests in a rapidly shifting legal environment.

§ 19.02. Land, Leasing and Conveyancing.

With many operators focusing on already-producing wells and slowing expansion to a fraction of what it was just a year ago, numerous lessors have become dissatisfied that their leases are not as profitable as they had hoped they would be. As a result, many lessors have moved to try to avoid their leases, in the (largely misguided) hopes of signing a more advantageous lease with another operator. Courts across the country have been tasked with assessing the validity of these leases. The following decisions are several of the most interesting and impactful cases to deal with leasing and conveyancing in 2014.

[1] — *Questar Exploration & Prod. Co. v. Woodard Villa, Inc.*[4]

Decided in late 2013, this decision addressed the novel issue of whether a well drilled off-lease, but reaching horizontally into a formation under the lease, can maintain operations as to all or part of the lease.

The lease at issue contained a standard Pugh clause[5] and horizontal Pugh clause,[6] both of which proved determinative in construing the effect of the lease itself.[7] During the lease's primary term, Questar Exploration

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4 Questar Exploration & Prod. Co. v. Woodard Villa, Inc., 48,401 (La. App. 2 Cir. 8/7/13), 123 So. 3d 734, 736, *reh'g denied* (Sept. 19, 2013), *writ denied*, 2013-2467 (La. 2/21/14), 133 So. 3d 682.

5 A clause designed to sever the pooled and the non-pooled portions of the leasehold in the event of a partial pooling by the lessee. 4-6 Williams & Meyers, *Oil and Gas Law* § 670.4.

6 Severing a leasehold on the basis of horizontal planes, as opposed to a typical Pugh clause which severs the leasehold on the basis of vertical planes only. *Id*.

7 *Questar Exploration*, 123 So. 3d at 736.

and Production Company (QEP) drilled at least one well into the Cotton Valley shale formation[8] (the "Cotton Valley formation") on each of the five units encompassing the leased premises, but did not drill any wells into the Haynesville shale formation[9] (the "Haynesville formation").[10] While the lease was still in effect QEP also began drilling on a surface location not part of the leased premises and not in a unit containing any part of the leased premises.[11] Prior to the expiration of the subject lease's primary term, this horizontal off-lease well reached into the Haynesville formation underlying one of the units which included the leased premises, but was not completed until after the lease expired.[12]

After the expiration of the primary term, the lessors demanded that QEP execute a release as to all depths below the Cotton Valley formation, including the Haynesville formation.[13] QEP refused to release any depths above the Haynesville formation and filed suit seeking declaratory judgment, arguing that the entire lease had been maintained to the bottom of the Haynesville formation by virtue of the off-lease well that reached horizontally into a unit encompassing the leased premises.[14] The lessor argued that, once the Pugh clause was triggered, a well producing from one unit would only apply to satisfy the maintenance requirement of that unit.[15] Additionally, the lessor argued that to allow QEP to maintain the entire acreage via a producing well

8 Located approximately 7,800-10,000 feet below Northeast Texas and Northwest Louisiana and just above the Haynesville/Bossier Shale, the Cotton Valley subsurface formation is mainly a natural gas play, but has produced some oil. "Cotton Valley Tight Gas," *Oil & Gas Journal*, http://www.ogj.com/unconventional-resources/cotton-valley.html (accessed 4-15-15).

9 Running through northwestern Louisiana, northeastern Texas and the southwestern tip of Arkansas, the Haynesville formation is believed to contain up to 30-40 trillion cubic feet of natural gas. "Haynesville," *Oil & Gas Journal*, http://www.ogj.com/unconventional-resources/haynesville-shale.html (accessed 4-15-15).

10 *Questar Exploration,* 123 So. 3d at 736.

11 *Id*.

12 *Id*.

13 *Id*.

14 *Id*. at 737.

15 *Id*.

outside of the unit would create a loophole whereby the whole lease could be maintained by dividing the leased premises into several units and only drilling one well on one unit.[16]

In response to the lessor's argument, the court noted that the main purpose of a Pugh clause is to protect the lessor "from the anomaly of having the entire property held under lease by production from a very small portion."[17] The court also focused on the language of the Pugh clause itself: "[t]his lease may be maintained as to acreage not included in such unit or units in any other manner provided for herein, including continuous development."[18] Because the Pugh clause specifically mentioned "this lease" and did not reference any separate leases or division of the lease, the clause demonstrated that the parties did not intend for the clause to separate or divide the lease.[19] Therefore, there was no absurd consequence in holding that the entire acreage was maintained by the operation of the off-lease well because, pursuant to the language of the parties' agreement, operations on all five units clearly maintained the entire lease beyond the primary term.[20]

Additionally, the lessors tried to convince the court that, because the well in question was off-lease and was not drilled on, completed or producing from land within a unit embracing some part of the leased premises prior to the expiration of the primary term, the horizontal Pugh clause ceased to affect depths below the Cotton Valley formation.[21] The court disagreed, focusing on how the horizontal Pugh clause did not specifically require actual production to maintain depths, as well as the fact that the off-lease well was spudded and had entered into a formation on the leased premises prior to the expiration of the primary term.[22]

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16 *Id*.

17 *Id*. (citing small Will-Drill Res., Inc. v. Huggs Inc., 32,179 ((La. App. 2 Cir. 8/18/99)), 738 So. 2d 1196, 1200 *writ denied*, 99-2957 ((La. 12/17/99)), 751 So. 2d 885).

18 *Id*. at 739.

19 *Id*.

20 *Id*.

21 *Id*.

22 *Id*.

Practice Point: Pugh clauses can be drafted so as to permit a well drilled off-lease, but reaching into a formation located under the leased premises, to maintain operations as to all of the subject lease.

[2] — *Key Operating & Equip., Inc. v. Hegar.*[23]

This case tasked the Texas Supreme Court with determining whether, when two mineral leases have been pooled but production is only from one lease, the lessee has the right to utilize the surface of the non-producing lease in order to access the producing lease.[24]

Key Operating Equipment, Inc. (Key) began operating the Richardson No. 1 Well on the 60-acre Richardson Tract in 1987.[25] In 1994, Key acquired multiple oil and gas leases on the contiguous Curbo-Rosenbaum Tract, and reworked the Rosenbaum No. 2 well, which already existed on that acreage.[26] Also in 1994, Key built an access road across the Curbo-Rosenbaum Tract that enabled it to access both that tract and the Richardson Tract.[27] When the Rosenbaum No. 2 well stopped producing in 2000, Key's lease on the Curbo-Rosenbaum Tract expired and its owners purchased an undivided fractional mineral interest in the Curbo-Rosenbaum Tract.[28] Key's owners promptly leased this fractional interest to Key, and the terms of the lease permitted Key to pool a portion of the acreage from the Curbo-Rosenbaum Tract with a portion of the acreage from the adjacent Richardson Tract.[29] In 2002, Will and Loree Hegar (the Hegars) bought a portion of the Curbo-Richardson Tract (the "Hegar Tract"), including a portion of the road used by Key to access the Richardson No. 1 well.[30] The Hegars were aware when they purchased the acreage that Key used the road to access its existing operations on the

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23 Key Operating & Equip., Inc. v. Hegar, 435 S.W.3d 794 (Tex. 2014).
24 *Id*. at 796.
25 *Id*.
26 *Id*.
27 *Id*.
28 *Id*.
29 *Id*.
30 *Id*.

Richardson Tract, but they did not object to this usage until 2004 when Key drilled the Richardson No. 4 well and traffic on the road increased.[31]

The Hegars brought suit alleging that Key's use of the road was trespassory, and sought declaratory judgment "that Key had no legal right to 'access or use the surface of the Hegar Tract in order to produce minerals from the Richardson Tract.'"[32] After hearing evidence that Key's only producing well was drawing from a reservoir that did not underlie the Hegar Tract, the trial court enjoined Key from using the section of road on the Hegar Tract.[33] The court reasoned that, because no minerals were being extracted from beneath the Hegar Tract by wells on the Richardson Tract, Key's use of the surface of the Curbo-Richardson Tract was not reasonably necessary.[34] The court of appeals initially reversed, but on rehearing determined that evidence supported the trial court's finding that Key was only producing oil from the adjacent Richardson Tract and therefore had no right to use the Hegars' surface for production exclusively from the Richardson Tract.[35] The court also held that Key could not contractually expand its right to use the Hegars' surface because Key's lease and pooling agreement were not part of the Hegars' chain of title.[36]

However, the Texas Supreme Court reversed, holding that Key had a right to use the surface of the Hegar Tract due to both its status as a partial mineral owner and the fact that both the Curbo-Rosenbaum and Richardson leases permitted pooling.[37] Because it owned a portion of the minerals underlying the Hegar Tract, the accommodation doctrine[38] granted Key

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31 *Id*.
32 *Id*.
33 *Id*. at 796-797.
34 *Id*.
35 *Id*. at 797.
36 *Id*.
37 *Id*. at 799.
38 *See* Merriman v. XTO Energy, Inc., 407 S.W.3d 244, 248–49 (Tex.2013) (holding that the owner of the dominant mineral estate in a tract has the right to go upon the surface of that land to produce and remove the minerals).

implied property rights in the Hegars' surface.[39] Additionally, the court cited to Texas' longstanding policy of encouraging pooling to avoid waste and stated that the primary legal consequence of pooling is that "'production and operations anywhere on the pooled unit are treated as if they have taken place on each tract within the unit.'"[40] Once pooling occurred, the pooled parts of the Richardson and Hegar Tracts no longer maintained separate identities as to where production from the pooled interests was located.[41] And because production from the pooled portion of the Richardson Tract was legally considered to be production from the pooled portion of the Hegar Tract, Key had a right to use the road passing over the Hegar Tract to access the Richardson Tract.[42] Therefore, Key was permitted the right of ingress and egress over the Hegar Tract because its owners did not increase the burden on the surface estate by leasing their minerals to Key or by pooling the two tracts at issue.[43]

Practice Point: Through its mineral lease, Key had the right of ingress and egress over the surface in order to develop and remove minerals from the tract, as well as a right to pool. And because the right of ingress and egress included the right to access the surface of any pooled acreage for the purpose of producing minerals, Key was permitted to utilize a non-producing tract to access a producing tract in that same unit.

[3] — *Sabella v. Appalachian Dev. Corp.*[44]

Dennis Sabella purchased the mineral rights underlying 66 acres of land at a sheriff's sale in 1997.[45] Sabella properly recorded his deed and drove the public road adjacent to the land under which his mineral estate

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39 *Key Operating*, 435 S.W.3d at 799.

40 *Id*. at 798 (*citing* Pipe Line Co. v. Tichacek, 997 S.W.2d 166, 170 (Tex.1999)).

41 *Id*. at 799.

42 *Id*.

43 *Id*. at 800.

44 Sabella v. Appalachian Dev. Corp., 103 A.3d 83 (Pa. Super. 2014), *reargument denied* (Dec. 10, 2014).

45 *Id*. at 86.

was located to look for any signs of oil and gas development.[46] Finding that the property was secluded and observing no activity from the road, Sabella assumed (incorrectly, but seemingly in good faith) that there was no oil and gas production occurring on the property.[47] In 2001, Mark and Virginia Harvey (the "Harveys"), who owned 104 surface acres above the 66 mineral acres owned by Sabella, signed an oil and gas lease (the "Harvey Lease") with Appalachian Development Corp. ("Appalachian").[48] Although the Harvey Lease was duly recorded, neither the Harveys nor Appalachian were aware that 66 of the subsurface acres were already owned by Sabella.[49] Appalachian eventually sold some of its holdings, including the Harvey Lease, to Brian Haner, warranting good, marketable title.[50] In finalizing the purchase from Appalachian, Haner elected to perform only a "bring down" title search[51] of his newly acquired properties.[52]

At the time of the sale to Haner there existed two producing oil and natural gas wells on the property, and Haner proceeded to drill seven more.[53] In connection with other operations, Haner eventually met Sabella and the two men reviewed a map depicting the Harveys' acreage and Sabella's mineral estate.[54] Despite conflicting testimony about what exactly the two men said during this meeting, the evidence demonstrated Haner concluded that he was operating on Sabella's land.[55] Despite this realization, Haner failed to disclose his operations to Sabella and even implied that there was no oil and gas activity occurring on Sabella's property.[56] After realizing he was producing minerals owned by Sabella, Haner conferred only with

46 *Id*.
47 *Id*.
48 *Id*. at 87.
49 *Id*.
50 *Id*.
51 A search of the applicable records only from the date of the conveyance to Haner.
52 *Id*.
53 *Id*.
54 *Id*.
55 *Id*. at 88.
56 *Id*.

Appalachian's partners, who assured Haner that he had good title.[57] Instead of performing a full title search on the property or placing royalty funds in escrow, Haner proceeded to continue operating on Sabella's land, even going so far as to engage in further development of the property.[58] After discovering the full extent of Haner's operations, Sabella brought suit and the trial court found Haner liable for trespass and conversion.[59]

On review, the Pennsylvania Superior Court addressed several procedural issues in addition to the substantive claims. Regarding subject matter jurisdiction, Haner argued that the Harveys were indispensable parties to the action because they had an interest in the outcome of the litigation.[60] Both the trial court and the superior court disagreed, holding that the Harveys had no interest in the litigation because they only ever owned an interest in the surface estate and a mistaken belief regarding the ownership of the minerals was insufficient to confer a justiciable interest.[61]

Additionally, the trial court and the superior court agreed that the discovery rule[62] functioned to toll the applicable two-year statute of limitations.[63] Sabella purchased the oil and gas rights at a tax sale, properly recorded the deed and observed no oil and gas development when he examined the surface of the parcel.[64] Because Pennsylvania has strong protections as a "race-notice"[65] state, it was reasonable for Sabella to assume that his right would be protected by both his recordation of the deed and

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57 *Id*.
58 *Id*.
59 *Id*. at 89.
60 *Id*. at 90-91.
61 *Id*. at 91-92.
62 *See* Lewey v. Fricke Coke Co., 31 A. 261 (Pa. 1895) (holding that "the start of the statutory limitation on an action in tort may be delayed by plaintiff's ignorance of his injury and its cause, until such time as he could or should have discovered it by the exercise of reasonable diligence.").
63 *Sabella*, 103 A.3d at 92.
64 *Id*. at 94.
65 Giving priority of title to the party that records first, but only if the recording party also lacked notice of prior unrecorded claims on the same property.

subsequent inspection.[66] Furthermore, even though Sabella's examination of the premises did not uncover the fact that oil and gas development was occurring on the property at the time of his purchase, the existing wells were secluded and almost impossible to see from the public road without binoculars.[67] And although Sabella was a mineral owner who had the right to enter onto the surface to aid in development of his interest pursuant to the accommodation doctrine, he did not have a right to enter onto the surface with impunity merely to investigate whether development was occurring.[68] Therefore, a reasonably prudent landowner exercising reasonable efforts would not have discovered oil and gas development on the land at issue and the discovery rule function to toll the applicable statute of limitations.[69]

After resolving these procedural issues, the superior court then focused on the substantive issue of good faith vs. bad faith trespass.[70] Generally, when a good-faith trespasser makes improvements to land, the injured party is entitled to the trespasser's net profits, *i.e.*, the revenues generated upon the land minus the money expended in facilitating the profitable activity.[71] Yet when a party trespasses in bad faith, the injured party is entitled to all moneys derived from the trespass without any offset.[72] The trial court held that Haner was a good faith trespasser until meeting with Sabella and a bad faith trespasser thereafter because, after meeting Sabella, Haner knew or should have known that he was trespassing upon Sabella's property yet chose to

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66 *Id*.

67 *Id*. at 95.

68 *Id*. at 97.

69 *Id*.

70 *Id*. at 98.

71 *Id*. at 98-99 (citing Matthews v. Rush,105 A. 817, 818 (Pa. 1919); Crawford v. Forest Oil Co., 57 A. 47 (Pa. 1904); Appeal of Coleman, 62 Pa. 252, 278–79 (Pa. 1869); Herdic v. Young, 55 Pa. 176, 178-79 (Pa. 1867); *see also* United States v. Wyoming, 331 U.S. 440, 458, 67 S. Ct. 1319, 91 L. Ed. 1590 (1947) ("[O]ne who 'willfully' or 'in bad faith' trespasses on the land of another, and removes minerals, is liable to the owner for their full value computed as of the time the trespasser converted them to his own use, by sale or otherwise, but . . . an 'innocent' trespasser, who has acted 'in good faith,' may deduct from such value the expenses of extraction.")).

72 *Id*. (internal citations omitted).

expand production without making any effort to determine Sabella's potential interest in the minerals underlying the property or to compensate him.[73]

However, the superior court disagreed, stating that Haner was a bad faith trespasser for the duration of his drilling operations because Sabella's recordation of his deed put Haner on constructive notice of Sabella's interest in the property.[74] After discussing the relevant Pennsylvania statutes regarding notice and restitution, as well as reviewing the nature of an oil and gas lease and how such a lease functions to convey a defeasible fee in the property, the superior court held that Haner lost his *bona fide* purchaser status when he neglected to perform a full title search of the property.[75] By failing to perform a relatively simple search that would have uncovered Sabella's interest, Haner also failed to act in good faith and was not entitled to any offsets whatsoever.[76]

Practice Points: In certain situations, the discovery rule can function to toll the statute of limitations regarding knowledge of oil and gas development occurring on property. Also, due to the unique nature of the rights conveyed by an oil and gas lease, the failure to perform a full title search before proceeding with development can qualify an operator's actions as bad faith for the duration of the drilling activity.

[4] — *Cade v. Cosgrove*.[77]

In 2006, Michael and Billie Cade (the Cades) sold property subject to an oil, gas and mineral lease to Barbara Cosgrove.[78] Although the sales contract stated that the Cades were to retain the mineral rights, the parties inadvertently failed to include a mineral reservation in the warranty deed.[79] Although the parties subsequently took actions consistent with the belief that the Cades owned the minerals, the operator eventually determined that the

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73 *Id*. at 99.

74 *Id*.

75 *Id*. at 104.

76 *Id*.

77 Cade v. Cosgrove, 430 S.W.3d 488 (Tex. App. 2014), *review granted* (Jan. 30, 2015).

78 *Id*. at 492.

79 *Id*.

warranty deed actually conveyed the mineral rights to Cosgrove and notified the Cades.[80] Realizing the mistake, the Cades asked Cosgrove to execute a correction deed, but she refused.[81] After the Cades sought declaratory judgment that they owned the minerals, the trial court granted summary judgment for Cosgrove based on the merger doctrine and the statute of limitations.[82]

Pursuant to the common law merger doctrine, the deed is considered the final expression of the parties' agreement because the terms of the sales contract ultimately merge into those of the deed.[83] Yet the application of this doctrine can be avoided if a party alleges or proves a mistake in the execution of the deed.[84] Importantly, mutual mistake can be used as grounds to reform a deed, and the common law treats knowledge by one party of a unilateral mistake by another party as the equivalent of mutual mistake.[85] In this situation, the contract between the Cades and Cosgrove reflected that the Cades would retain their mineral rights, and Cosgrove neither disputed this fact nor offered any evidence to contradict the contract.[86] Therefore, the deed's mistaken omission of mineral reservation on behalf of the Cades constituted a mutual mistake that permitted reformation of the deed despite the merger doctrine.[87]

Addressing a related issue, the court held that, although a grantor is presumed to know the contents of the deed immediately upon executing it, mutual mistake can toll the statute of limitations until such time as the claimant knows or with reasonable diligence should have known of the

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80 *Id*.

81 *Id*.

82 *Id*.

83 *Id*. at 493 (citing Harris v. Rowe, 593 S.W.2d 303, 306 (Tex.1979); Munawar v. Cadle Co., 2 S.W.3d 12, 16–17 (Tex. App.-Corpus Christi 1999, pet. denied)).

84 *Id*. (citing *Harris*, 593 S.W.2d at 306; Turberville v. Upper Valley Farms, Inc., 616 S.W.2d 676, 678 (Tex. Civ. App.-Corpus Christi 1981)).

85 *Id*. (citing Davis v. Grammer, 750 S.W.2d 766, 768 (Tex. 1988)).

86 *Id*.

87 *Id*.

mistake.[88] And after exhaustively assessing established precedent on the statute of limitations and accrual of claims to reform a deed, the court reversed the trial court's order of summary judgment and remanded the case for further proceedings because there was a question of fact as to when the Cades knew or should have known of the mistake.[89]

Practice Point: Regardless of the merger doctrine, mutual mistake can function to reform a deed and determine which party owns the mineral rights, as well as toll the applicable statute of limitations. Yet a court decision to reform the deed will likely hinge on the factual issue of when the parties knew or should have known of the mistake, making this situation inappropriate for resolution via summary judgment.

[5] — *Hess Corp. v. ENI Petroleum US, LLC.*[90]

ENI Petroleum (ENI) agreed to "sell and deliver" natural gas to Hess Corporation (Hess) pursuant to a Base Contract that contained only basic provisions applicable only to subsequent sales of natural gas between the parties.[91] The details of each successive sale were memorialized in Transaction Confirmations which specified that the parties' obligations were "firm," meaning that performance was interruptible only be *force majeure*.[92] Notably, the Transaction Confirmations did not specify a particular source from which the gas would be sold or which transporter would be utilized.[93] During one such sale, a pipeline leak prevented ENI from delivering natural gas from its preferred transporter to the pool specified in the Transaction Confirmation.[94] ENI then informed Hess that it was claiming *force majeure* under the terms of the Base Agreement and would not be delivering any gas.[95]

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88 *Id*. at 501.
89 *Id*. at 508.
90 Hess Corp. v. ENI Petroleum US, LLC, 435 N.J. Super. 39 (App. Div. 2014).
91 *Id*. at 41-42.
92 *Id*. at 42.
93 *Id*. at 43.
94 *Id*. at 44.
95 *Id*.

In pertinent part, the *force majeure* clause stated that

> [n]either party shall be liable to the other for failure to perform . . . to the extent such failure was caused by a Force Majeure. The term "Force Majeure" as employed herein means any cause not reasonably within the control of the party claiming suspension[.]
>
> ....
>
> Force Majeure shall include, but not be limited to ... interruption and/or curtailment of Firm transportation and/or storage by Transporters[.][96]

Hess rejected ENI's declaration of *force majeure* on the grounds that the Transaction Confirmation did not identify a particular transporter.[97] Hess also denied *force majeure* because the pool at which ENI was supposed to deliver the gas was fed by several different transporters and pipelines controlled by ENI, meaning that the pipeline leak would merely require ENI to allocate identical gas delivered by a different transporter in order to fulfill its obligations to Hess.[98] ENI still refused to deliver the gas and Hess filed suit for breach of contract after being forced to purchase replacement gas for $300,000 over the contract price.[99]

Focusing on how neither the Base Contract nor the Transaction Agreement specified the source of the natural gas ENI would sell to Hess or the specific transporter or pipeline that would be used to deliver the gas, the court held in favor of Hess.[100] Because other pipelines were available and capable of fulfilling ENI's obligations under the contract, ENI could not claim *force majeure* as a defense based purely on the fact that its preferred transporter was unable to deliver the gas.[101]

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96 *Id*.
97 *Id*. at 44-45.
98 *Id*.
99 *Id*. at 45.
100 *Id*. at 47-48.
101 *Id*. at 48.

Practice Point: A *force majeure* clause may not function to negate a party's obligations under a contract where other methods of performance are available and are not specifically prohibited by the parties' agreement.

[6] — *Kennedy v. Consol Energy Inc.*[102]

Issued April 22, 2015, this opinion concluded that methane gas contained in coal belongs to the owner of the coal estate when the severance deed is silent.

The plaintiff–appellants (the "Kennedys") owned oil and gas rights underlying a 790-acre tract of land.[103] However, Consol Energy Inc. (Consol) owned the coal underlying that tract and drilled several wells to extract coalbed methane gas from the coal seam.[104] The Kennedys sought to quiet title to the coalbed methane gas and filed suit against Consol for trespass, conversion, unjust enrichment and replevin based on Consol's alleged intrusion into the adjacent strata owned by the Kennedys (the oil and gas estate) during its degasification of the coal seam in preparation for mining.[105] The trial court granted judgment on the pleadings in favor of Consol on all claims, and the superior court affirmed.[106]

The superior court stated that the facts of the instant case were essentially indistinguishable from the 1983 Pennsylvania Supreme Court ruling in *U.S. Steel Corp. v. Hoge,*[107] which established that, when a coal severance deed is silent or does not expressly reserve the ownership of the coalbed methane, the gas contained in the coal belongs to the owner of the coal.[108] Specifically, both cases involved a situation where different parties owned the oil and gas and coal estates underlying a single tract, and neither of the coal severance deeds mentioned ownership of the coalbed methane.[109]

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102 Kennedy v. Consol Energy Inc., 2015 Pa. Super. 93 (Apr. 22, 2015).
103 *Id*. at 1.
104 *Id*.
105 *Id*.
106 *Id*.
107 U.S. Steel Corp. v. Hoge, 468 A.2d 1380 (Pa. 1983).
108 2015 Pa. Super. at 3-6.
109 *Id*. at 6.

Looking to the intent of the grantors at the time of the severance, the superior court stated that the reservation of oil and gas did not include coalbed methane (which was actually regarded as a nuisance at the time of the conveyance) and the severance deeds expressly reserved the right to drill for natural gas.[110] This demonstrated that the grantor only intended to reserve natural gas and that the coalbed methane was conveyed with the coal.[111]

In resolving the other claims brought by the Kennedys, the superior court ruled that the Kennedys' claim of trespass against Consol was refuted by the language of the reservation in the deed which permitted the holder to "dig, mine, ventilate, drain and carry away the coal on the land."[112] Despite the Kennedys' argument that the right-of-way granted to Consol did not permit commercial production of the coalbed methane, the language in the deed directly refuted this claim and rendered immaterial the fact that the operation of degasification is often a profitable enterprise.[113]

Finally, the superior court also refused to validate any of the Kennedys' claims that Consol has possibly converted any of the natural gas belonging to the Kennedys when Consol entered the adjacent strata to ventilate the coalbed methane.[114] Although the evidence could lead to the conclusion that Consol's operations caused some of the Kennedys' natural gas to migrate to Consol's wells and was produced, the court refused to entertain this argument because the Kennedys were unable to offer any evidence establishing the value of the gas lost or show that Consol acted in bad faith or with fraudulent intent.[115]

Practice Point: The owner of the coal estate owns the coalbed methane in Pennsylvania and claims of conversion premised on an operator's entrance into an adjacent strata require evidence of bad faith or fraudulent intent.

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110 *Id*.

111 *Id*.

112 *Id*. at 8.

113 *Id*.

114 *Id*. at 638.

115 *Id*. at 638-39.

§ 19.03. Calculating Royalties.

As the technology driving modern oil and gas development continues to advance by leaps and bounds, many lessors are implementing innovative new methods of extraction and production that function to minimize waste and increase profits. In an effort to share the costs associated with these new techniques, many lessees have attempted to classify these operations as post-production activities that are deductible from the lessor's royalties. But many lessors are still unfamiliar with these cutting-edge processes and the current oil and gas market has made many lessors increasingly wary of unexpected deductions from their royalty checks. Disputes have now arisen over how best to equitably allocate these new expenses, requiring courts to reestablish the distinction between production and post-production activities.

[1] — *French v. Occidental Permian Ltd.*[116]

A royalty is generally "free of the expenses of production, [but]" is often subject to certain post-production costs.[117] These post-production costs usually include the cost of treatment "'to render [production] marketable,' but the parties may modify this general rule by agreement.'"[118] In this case, the subject leases allowed for enhanced oil recovery via the injection of carbon dioxide (CO_2)) into a reservoir "to sweep [ ]oil to the production wells."[119] The CO_2 eventually returned to the surface entrained in casinghead gas,[120] and the operator contracted with a third party to separate the CO_2 from the other casinghead compounds so that the CO_2 could be reused.[121] The operator

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116 French v. Occidental Permian Ltd., 440 S.W.3d 1 (Tex. 2014), reh'g denied (Oct. 3, 2014).

117 *Id*. at 3 (citing Heritage Res., Inc. v. NationsBank, 939 S.W.2d 118, 121–122, 123 (Tex. 1996)).

118 *Id*.

119 *French*, 440 S.W.3d at 2.

120 *See Railroad Comm'n of Tex. v. Lone Star Gas Co.*, 844 S.W.2d 679, 684 n. 5 (Tex.1992) (quoting 8 H. Williams & C. Meyers, Oil and Gas Law: Manual of Oil and Gas Terms 156 (1991)) (defining "casinghead gas" as '[g]as produced with oil in oil wells, the gas being taken from the well through the casinghead at the top of the well, as distinguished from gas produced from a gas well'").

121 *French*, 440 S.W. 3d at 2.

deducted the cost of separating the CO_2 from the lessor's royalty.[122] The lessor claimed that, under the terms of the parties' agreement, the "royalty due on the casinghead gas . . . must be determined as if the injected CO_2 were not present," and that the working interest owners were not required to share in the "expense of removing the CO_2 from the gas."[123]

Pursuant to the parties' unitization agreement, no royalty was due – and none was paid – on casinghead gas.[124] Although the operator had the option of simply reinjecting the casinghead gas back into the field without any type of refinement or separation, it chose not to do so because the recovered casinghead gas did not have an optimal CO_2 concentration and also contained natural gas liquids (NGLs) and other valuable compounds that could be sold after the CO_2 was extracted.[125] In order to achieve an adequate CO_2 concentration for reinjection and to realize the value of the NGLs contained in the casinghead gas, the operator paid a third party to process the gas and separate the CO_2 from the NGLs.[126] Although neither party objected to sharing in the cost of removing the NGLs and other contaminants from the casinghead gas, the lessor sued the operator for underpayment of royalties due to the operator's inclusion of the cost of removing the CO_2 as part of post-production expenses to be shared by both parties.[127]

Looking to precedent for guidance, the court noted that, although royalty owners are typically required to share in the cost of removing contaminants indigenous to the production field, no cases involved the allocation of cost for the separation of extraneous substances injected in the field.[128] The court ultimately compared the CO_2 separation process to that of separating water from oil when production occurs via waterflooding,[129] but noted

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122 *Id*.
123 *Id*.
124 *Id*. at 6.
125 *Id*.
126 *Id*.
127 *Id*. at 7.
128 *Id*. at 9.
129 The injection of water into an oil reservoir in order to increase pressure and stimulate production.

that separating the CO_2 from the casinghead gas was not necessary for the continued production of oil or to render the oil marketable.[130] However, the separation of the gases did lead to more efficient production and prevented waste in that both parties shared in the value of the NGLs and the operator obtained a concentrated strain of CO_2 for reinjection.[131] Furthermore, the parties' Unitization Agreement gave the lessee the option of reinjecting the casinghead gas directly into the field, but the operator chose to process the gas instead.[132] Had the operator chosen to reinject the entire production of casinghead gas, the lessor would not be entitled to any royalty on the casinghead gas.[133] Therefore, because the parties' agreement gave the operator the "right and discretion to decide whether to reinject or process the casinghead gas," and because the decision to separate the CO_2 allowed for more efficient production and granted the lessor a royalty that it would not otherwise have received, the court held that the lessor must share in the cost of CO_2 extraction.[134]

Practice Point: A lessor may be required to share in the post-production cost of removing extraneous substances from oil or gas if the lessor realizes some additional benefit as a result of the extraction process that it would not have realized otherwise.

[2] — *Warren v. Chesapeake Exploration, L.L.C.*[135]

Also addressing the deduction of post-production expenses from the lessor's royalty, this case focuses on whether the lease's royalty clause permitted the deduction of costs incurred in delivering the marketable natural gas from the mouth of the well to the actual point of sale.

The oil and gas leases at issue provided that the lessors were entitled to 22.5 percent "of the amount realized by Lessee, computed at the mouth of

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130 *Id*. at 10.
131 *Id*.
132 *Id*.
133 *Id*.
134 *Id*.
135 Warren v. Chesapeake Exploration, L.L.C., 759 F.3d 413 (5th Cir. 2014).

the well."[136] The term "amount realized" typically require[s] measurement of the royalty based on the amount the lessee [] receives under its sales contract for the gas.[137] However, the addition of the language "at the mouth of the well" means that the royalty is calculated "based on net proceeds, and the physical point to be used as the basis for [this] calculation . . . is the mouth of the well.[138] Therefore, based on this language alone, the lessees were permitted to deduct the cost of delivering marketable gas from the mouth of the well to the point of sale.[139]

However, the leases also contained an addendum that provided that it was to supersede any inconsistent portion of the original lease, including the royalty clause.[140] Yet when the court compared the addendum's royalty clause to that of the original lease, it determined that the language of the two clauses had the same effect.[141] The original lease stated that all royalties, regardless of where the gas sales occurred, were to be free of post-production costs, including transportation.[142] The addendum provided that all royalties paid to the lessors would be free of costs and expenses, including costs of transportation.[143] Yet the addendum did not alter the point at which the royalty was computed: the mouth of the well.[144] The court also noted that, if the parties wanted the lessors to receive 22.5 percent of the proceeds of sales regardless of where the sales occurred, they could have accomplished that in a number of ways, the most obvious of which being to delete the phrase "at the mouth of the well."[145] Therefore, the language of the royalty clause permitted deduction of post-production costs incurred by the lessees

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136 *Id*. at 416.
137 *Id*. at 417.
138 *Id*.
139 *Id*.
140 *Id*. at 418.
141 *Id*.
142 *Id*.
143 *Id*.
144 *Id*.
145 *Id*.

in delivering marketable gas from the mouth of the well to the actual point of sale.[146]

[3] — *Chesapeake Exploration, L.L.C. v. Hyder*.[147]

Functioning as the inverse of the *Warren* decision, this case involves an operator seeking to recover overpaid royalties on the grounds that the royalty clause permitted the operator to deduct from the lessor's royalty certain post-production costs incurred between the point of delivery and the point of sale.[148]

The lease at issue stated that the royalty was to be "free and clear of all production and post-production costs and expenses," including transporting and delivering the gas, along "with any other costs and expenses incurred between the wellhead and the [lessee's] point of delivery or sale."[149] While acknowledging that the lease excluded production costs and expenses, the lessee argued that the royalty clause permitted deduction of post-production costs and expenses, including third-party transportation costs incurred between the point of delivery and the point of sale.[150] The lessees argued that the disjunctive nature of the language regarding expenses "incurred between the wellhead and [appellants] point of delivery *or* sale," allowed them to choose either the point of delivery or sale to determine whether to deduct post-production costs and expenses.[151] The court disagreed, stating that this interpretation ignored the "free and clear" provision of the royalty clause.[152] Specifically, the court interpreted the parties' agreement as "excluding all costs and expenses of production and post-production" from the royalty,

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146 *Id*.
147 Chesapeake Exploration, L.L.C. v. Hyder, 427 S.W.3d 472 (Tex. App. 2014), *review granted* (Jan. 30, 2015).
148 *Id*. at 476.
149 *Id*.
150 *Id*. at 477.
151 *Id*. at 476 (emphasis added).
152 *Id*. at 477.

including post-production costs and expenses incurred between the point of delivery and the point of sale."[153]

Additionally, the court assessed whether the operator was entitled to an overriding royalty free from all production and post-production costs when the parties' agreement stated that lessees were entitled to a "cost-free overriding royalty."[154] Examining the four corners of the instrument, the court held that to adopt the lessor's position in regards to the lease would require it to "render the term 'cost-free' meaningless and determine whether the parties true intent was to provide a traditional overriding royalty interest (ORI) or a cost-free ORI (except only to its portion of production taxes and post-production costs).[155] Because such an interpretation would require the court "to rewrite the lease and alter the parties' contract," the court concluded that the parties had expressly excluded the ORI from deductions for post-production costs.[156]

§ 19.04. State Preemption vs. Local Control.

The debate as to whether federal, state or local governments are better equipped to regulate oil and gas development is as old as the industry itself. Those who favor federal oversight argue that pre-existing federal acts regulating air, water and federal lands present the best framework for oil and gas regulation. Proponents of state regulation cite to the benefits of statewide permitting, reporting and bonding controls, as well as taxes for severance, road use and permitting fees. Finally, supporters of local control focus on a local government's familiarity with zoning and setbacks, along with regulations governing road use, hours of operation and noise. A number of recent decisions demonstrate how courts are still attempting to find an acceptable mechanism for allocating power and control among these factions.

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153 *Id*.
154 *Id*. at 478.
155 *Id*. at 480.
156 *Id*.

[1] — *ONEOK, Inc. v. Learjet, Inc.*[157]

In a 7-2 decision on April 21, 2015, the U.S. Supreme Court ruled that state and federal lawsuits brought under state antitrust laws by retail customers against interstate pipeline companies were not preempted by the Natural Gas Act (NGA)[158] and, therefore, may proceed.

In 2005, a plaintiffs' group composed of manufacturers buying natural gas directly from interstate pipelines (collectively the "Traders") filed claims under both federal and state law alleging that various natural gas pipelines (collectively the "Pipelines") engaged in "wash sales"[159] and misrepresented price figures to trade publications, thereby distorting the market for natural gas and inflating gas prices.[160]

In 2007, the case was consolidated and the Nevada District Court granted the Pipelines' motion for summary judgment on the grounds that the NGA preempted the Traders' state-law antitrust claims.[161] The Ninth Circuit reversed, emphasizing that the price manipulation complained of "affected not only jurisdictional (*i.e.*, wholesale)[], but also nonjurisdictional (*i.e.*, retail) sales."[162] The Ninth Circuit construed the NGA's preemptive scope as only preserving the states' authority to regulate nonjurisdictional sales, and held that the NGA did not preempt state law claims aimed at price manipulation, "even if the manipulation also raised wholesale rates."[163]

The Supreme Court granted certiorari and the Pipelines argued that the Traders' state antitrust lawsuits were within the field that the NGA preempts and that the "claims target anticompetitive activities that affected wholesale as well as retail rates."[164] They also noted that the NGA "expressly grants the [Federal Energy Regulatory Commission] (FERC) the authority to

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157 ONEOK, Inc. v. Learjet, Inc., 135 S. Ct. 1591 (U.S. Apr. 21, 2015).

158 15 U.S.C. § 717.

159 A wash sale occurs when a party sells a security at a loss and then purchases the same or substantially similar security shortly after.

160 *ONEOK, Inc.*, 135 S. Ct. at 1598.

161 *Id*.

162 *Id*. at 1599.

163 *Id*.

164 *Id*.

keep wholesale rates at reasonable levels" and, in exercising its authority, "FERC has prohibited the very kind of anticompetitive conduct that the state actions attack."[165] The Pipelines contended that allowing these lawsuits to proceed "would "permit state antitrust courts to reach conclusions" regarding pipeline conduct that differ from those reached by the FERC.[166]

The court rejected the Pipelines' argument, stating that the NGA "was drawn with meticulous regard for the continued exercise of state power, not to handicap or dilute it in any way."[167] "Accordingly, where [] state law can be applied to nonjurisdictional as well as jurisdictional sales, [the court must proceed cautiously, finding preemption only where detailed examination convinces [it] that a matter falls within the preempted field as defined by [] precedent [].[168] Furthermore, "the target at which the state law *aims*" is important in "determining whether that law is preempted."[169] The Supreme Court noted that here, as well as in several precedential decisions, the state lawsuits were directed at practices affecting retail rates — which are "firmly on the States' side of that dividing line."[170]

Therefore, because the NGA was carefully drawn so as to not dilute state power, the NGA can only be held to preempt a claim when that claim falls

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165 *Id*.

166 *Id*.

167 *Id*. (citing Panhandle Eastern Pipe Line Co. v. Public Serv. Comm'n of Ind., 332 U.S. 507, 517–518, 68 S. Ct. 190, 92 L. Ed. 128 (1947)*; see also* Northwest Central, 489 U.S. at 511, 109 S. Ct. 1262 (the "legislative history of the [Act] is replete with assurances that the Act 'takes nothing from the State [regulatory] commissions'" (quoting 81 Cong. Rec. 6721 (1937)))).

168 *Id*. (citing *Panhandle Eastern, supra,* at 516–518, 68 S. Ct. 190; Interstate Natural Gas Co. v. FPC, 331 U.S. 682, 689–693, 67 S. Ct. 1482, 91 L. Ed. 1742 (1947)).

169 *Id*. *See* also Northern Natural Gas Co. v. State Corp. Comm'n of Kan., 372 U. S. 84 (1963) (holding that the Supreme Court has "consistently recognized" that the "significant distinction" for purposes of preemption in the natural gas context is the distinction between "measures *aimed directly at* interstate purchasers and wholesales for resale and those aimed at" subjects left to the states to regulate).

170 *ONEOK, Inc*., 135 S. Ct. at 1600 (citing Nw. Cent. Pipeline Corp. v. State Corp. Comm'n of Kansas, 489 U.S. 493, 513 (1989) (*quoting* N. Natural Gas Co. v. State Corp. Comm'n of Kan., 372 U.S. 84, 92 (1963))).

within established precedent.[171] Because Traders raised claims premised on state laws regulating the retail rates of natural gas prices, state laws control and the NGA cannot preempt these claims. However, the Supreme Court noted that, to the extent any conflicts arise between state antitrust law proceedings and the federal rate setting process, the doctrine of conflict preemption would likely prove sufficient to address them.[172] But since the parties did not argue conflict preemption, the court expressly left open the possibility that conflict preemption questions may become ripe for the lower courts to resolve in the first instance.[173]

[2] — *Norse Energy Corp. USA v. Town of Dryden*.[174]

The fact that many oil and gas practitioners are already aware of the widespread impacts of this decision warrants its inclusion in any discussion of the issue of state preemption of local regulation of oil and gas development.

Due to local concern over the proposed use of high-volume hydraulic fracturing, the New York town of Dryden amended its zoning ordinance in August of 2011 to ban all activities related to the exploration for and the production or storage of natural gas and petroleum.[175] Anschutz Exploration Corporation, predecessor in interest to Petitioner Norse Energy Corp. U.S.A. (Norse Energy), an oil and natural gas driller and developer who owned leases covering approximately 22,000 acres in Dryden, sought to invalidate the amendment to the grounds that it was preempted by New York's Oil, Gas and Solution Mining Law (the OGSML).[176]

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171 *Id*. at 1601.

172 *Id*. at 1602.

173 *Id*.

174 Norse Energy Corp. USA v. Town of Dryden, 108 A.D.3d 25, 964 N.Y.S.2d 714 *leave to appeal granted*, 21 N.Y.3d 863, 995 N.E.2d 851 (2013) and *aff'd sub nom*. Wallach v. Town of Dryden, 23 N.Y.3d 728, 992 N.Y.S.2d 710 (2014) *reargument denied,* 24 N.Y.3d 981, 995 N.Y.S.2d 704 (2014). *See also* Cooperstown Holstein Corp. v. Town of Middlefield, 35 Misc. 3d 767, 943 N.Y.S.2d 722 (Sup. Ct. 2012) *aff'd*, 106 A.D.3d 1170, 964 N.Y.S.2d 431 (2013) *aff'd sub nom*. *Wallach*, 23 N.Y.3d 728, 992 N.Y.S.2d 710 (2014) (upholding a local zoning ordinance banning all oil and gas drilling).

175 *Id*. at 27-28.

176 *Id*. at 28.

Under the New York Constitution, every local government has the power to "amend local laws not inconsistent with the provisions of [the] constitution or any general law relating to its property, affairs or government."[177] However, the OGSML also grants the Legislature the power to expressly or impliedly preempt local regulation despite the fact that one of the most significant functions of local government is to foster productive land use by enacting zoning ordinances.[178] Because the OGSML contains an express preemption clause, the court's primary function in this instance was to determine whether the legislature intended to reserve to itself the power to preempt ordinances similar to Dryden's.[179]

The New York Supreme Court determined that the OGSML's express preemption clause prohibited municipalities from enacting laws or ordinances "relating to the regulation of the oil, gas and solution mining industries."[180] However, the OGSML did not define the word "regulation," prompting the court to determine that the word's ordinary meaning is "an authoritative rule dealing with details or procedure."[181] Applying this definition to determine the scope of the OGSML's express preemption clause, the court concluded that the legislature designed the OGSML to preempt local ordinances regulating the details or procedure of the oil, gas and solution mining industries.[182] But instead of attempting to regulate the details or procedure of the oil and gas industry, Dryden's ordinance instead functioned to establish permissible and prohibited uses for the purpose of regulating land within the town.[183] And although Dryden's exercise of its right to enact ordinances regulating land use through zoning would "inevitably have an incidental effect upon the oil, gas and solution mining industries," zoning ordinances were "not the type

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177 *Id*. at 30 (citing N.Y. Const. art. IX, § 2c).

178 *Id*. at 31.

179 *Id*. at 32.

180 *Id*. at 31(citing N.Y. Envtl. Conserv. Law § 23-0303 (McKinney)).

181 *Id*. at 31-32 (citing Merriam-Webster On-line Dictionary, http://www.merriam-webster.com/dictionary/regulation).

182 *Id*. at 32.

183 *Id*. at 33.

of regulatory provision that the Legislature intended" to expressly preempt via the OGSML.[184]

Yet despite the fact that the ordinance was not expressly preempted by the OGSML, the court noted that the mere existence of an express preemption clause does not entirely foreclose the possibility of implied preemption.[185] In a final effort to overcome the local ordinance, Norse Energy argued that the OGSML specifically directs where drilling is to occur in order to maximize resource recovery and minimize waste, and that operators cannot comply with this directive if municipalities are permitted to enact a blanket ban on drilling within their jurisdictions.[186] The court was similarly unconvinced by this argument, stating that the "well-spacing provisions of the OGSML concern[ed] technical, operational aspects of drilling [that] are separate and distinct from a municipality's zoning authority."[187] The court also claimed that these two functions can properly coexist because zoning laws dictate in which districts, if any, drilling may occur, "while the OGSML instructs operators as to the proper spacing of the units within those districts in order to prevent waste."[188]

Therefore, New York's OGSML did not preempt Dryden's ordinance, and municipalities have the authority to enact zoning regulations either relating to or outright banning the exploration for, and the production or storage of, natural gas and petroleum.[189]

[3] — *Pennsylvania Environmental Defense Foundation v. Commonwealth*.[190]

Decided in the first week of 2015, Pennsylvania's Commonwealth Court determined that the state Supreme Court's analysis of the Pennsylvania

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184 *Id*.
185 *Id*. at 36.
186 *Id*.
187 *Id*. at 37.
188 *Id*.
189 *Id*. at 38.
190 Pennsylvania Envtl. Def. Found. v. Commw., 108 A.3d 140 (Pa. Commw. Ct. 2015), *reargument denied* (Feb. 3, 2015).

Constitution's Environmental Rights Amendment (the "Amendment") in the landmark *Robinson Twp. v. Commonwealth*[191] decision is nonbinding on the Commonwealth Court.[192]

Generally, Pennsylvania's Department of Conservation and Natural Resources (the DCNR) is responsible for the management and care of state lands, including state owned parks.[193] Under Pennsylvania's Oil and Gas Lease Fund Act (the "Lease Fund Act"), all rents and royalties from gas leases on state land are to be placed into a specific fund called the Oil and Gas Lease Fund (the "Lease Fund").[194] The monies in the Lease Fund are to be used solely for conservation purposes and the DCNR has the authority to determine whether a given project can be subsidized by the Lease Fund.[195]

Although the leasing activities on state lands had netted the Commonwealth approximately $150 million since approximately 1947, all of that changed in 2008 when the DCNR began leasing state land for unconventional drilling.[196] After only one month of DCNR-sanctioned unconventional drilling on state lands, the Commonwealth netted over $160 million — more than the prior 60 years of leasing activity.[197] Yet despite the 2008 lease sale's obvious profitability, the DCNR decided to forgo additional unconventional leasing of state lands pending its study of the Marcellus play and the development of the land currently leased for unconventional drilling.[198] However, the Pennsylvania General Assembly was hesitant to lose this newly-acquired source of income and pressured the DCNR into executing more unconventional leases.[199] In order to further capitalize on unconventional drilling, the General Assembly also passed legislation in

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191 Robinson Twp. v. Commonwealth, 83 A.3d 901 (Pa. 2013).

192 Due to the length and detail of this opinion, this summary is intended to function as merely an overview of some of the most important issues addressed by the court.

193 *Pennsylvania Envtl. Def.*, 108 A.3d at 143.

194 *Id*.

195 *Id*.

196 *Id*.

197 *Id*. at 144.

198 *Id*.

199 *Id*. at 145.

2009 appropriating money from the Lease Fund and transferring additional Lease Fund monies to the state's General Fund.[200]

Over the next several years, the General Assembly continued to appropriate more money from the Lease Fund and pressure the DCNR to execute additional leases on state land.[201] Ultimately, former Pennsylvania Governor Ed Rendell curtailed the General Assembly's influence over the DCNR and placed a moratorium on further leasing.[202] However, this moratorium was quickly modified by Rendell's successor, former Governor Tom Corbett, to ban only further leasing that would result in additional surface disturbance on forest or state park lands.[203] The instant litigation was instituted when a public interest group called the Pennsylvania Environmental Defense Foundation (the "PEDF") brought a variety of claims against both the Commonwealth and Governor Corbett, challenging the General Assembly's ability to reorganize and limit the DNCR's access to the Lease Fund.[204] Similar to *Robinson Twp*., the PEDF's challenges were premised on the Amendment.[205]

In assessing this challenge, a unanimous en banc panel of the Commonwealth Court ruled that a three-part test established decades ago

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200 *Id*. at 146.

201 *Id*.

202 *Id*. at 148.

203 *Id*. at 149-50. Current Governor Tom Wolf has since restored the complete moratorium on drilling on state lands. *Id*. at 149-50.

204 *Id*. at 154.

205 Pa. Const. art. I, § 27. The Environmental Rights Amendment provides:

> The people have a right to clean air, pure water, and to the preservation of the natural, scenic, historic, and esthetic values of the environment. Pennsylvania's public natural resources are the common property of all the people, including generations yet to come. As trustee of these resources, the Commonwealth shall conserve and maintain them for the benefit of all the people.

In order to balance the rights conferred on the people by the Amendment, the Court in *Robinson Twp*. held that "economic development cannot take place at the expense of an unreasonable degradation of the environment" and that the police power to promote the economic welfare of the citizens "must be exercised in a manner that promotes sustainable property use and economic development." *Robinson Twp*., 83 A.3d at 954.

in *Payne v. Kassab*[206] remains the controlling standard when reviewing challenges to state action under the Amendment regardless of the plurality's determination in *Robinson Twp*. that the *Payne* test should only be applied in the "narrowest of cases."[207] The Commonwealth Court disagreed with the plurality's dismissal of the *Payne* test and held that the conclusions contained in *Robinson Twp*. are nonbinding precedent on the Commonwealth Court because the ruling is not consistent with other binding precedent from both the Commonwealth and state Supreme Court on the same subject.[208] Applying the *Payne* test, the Commonwealth Court found that the state's budgetary decisions with regard to leasing state land and appropriating money from the Lease Fund were consistent with the Commonwealth's obligations to its citizens under the Amendment.[209]

Importantly, because many appeals from both lower courts and the Pennsylvania Environmental Hearing Board are directed to the Commonwealth Court, this decision functions to revitalize the *Payne* test and further decrease the precedential value of the *Robinson Twp*. decision. This is an important victory for Pennsylvania's oil and gas industry because, since *Robinson Twp*. was decided, almost every challenge to state action with even the remotest of environmental connections has been premised on the Amendment. Furthermore, the Commonwealth Court's ruling in this case is likely to stand the test of time, as any appeal of this decision will

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206 312 A.2d 86 (Pa. Commw. 1973), aff'd, 361 A.2d 263 (Pa. 1976).
The *Payne* test is as follows:

> (1) Was there compliance with all applicable statutes and regulations relevant to the protection of the Commonwealth's public natural resources?
> (2) Does the record demonstrate a reasonable effort to reduce the environmental incursion to a minimum?
> (3) Does the environmental harm which will result from the challenged decision or action so clearly outweigh the benefits to be derived therefrom that to proceed further would be an abuse of discretion?

207 *Pennsylvania Envtl. Def. Found.*, 108 A.3d at 159 (citing *Robinson Twp.,* 83 A.3d at 967).

208 *Id*. at 156, fn 37.

209 *Id*. at 172-73.

be reviewed by an entirely different Pennsylvania Supreme Court than that which decided *Robinson Twp*.[210]

[4] — *Alliance Pipeline L.P. v. 4.360 Acres of Land, More or Less, in S/2 of Section 29, Twp. 163 N., Range 85 W., Renville Cnty., N.D.*[211]

After beginning plans to construct a 79-mile pipeline in Tioga, North Dakota, Alliance Pipeline, L.P. ("Alliance") applied to the Federal Energy Regulatory Commission (the FERC) for a certification of public convenience and necessity (the "Certificate") as required by federal law.[212] In addition to being mandatory step in constructing a natural gas pipeline in the United States, the "[C]ertificate also gives the recipient the authority to condemn land along the route of its pipeline under the power of eminent domain."[213] While the application for the Certificate was pending, Alliance attempted to purchase a pipeline easement from Leonard and Ione Smith (the Smiths), but the Smiths refused.[214] Alliance then filed a petition with the court requesting permission to enter and survey the Smiths' property as a necessary part of its application for the Certificate.[215] The court granted Alliance's petition and the FERC subsequently issued the Certificate to Alliance.[216] Less than one month later, Alliance succeeded in condemning the Smiths' land and acquiring an order for immediate use and possession.[217]

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210 Justice Todd is the only justice still on the bench who participated in the plurality opinion. Justice Saylor (now Chief Justice) wrote a dissenting opinion while the plurality, penned by former Chief Justice Castille, was joined by Justices Todd and McCaffrey. Both Justices Castille and McCaffrey have since retired from the bench.

211 Alliance Pipeline L.P. v. 4.360 Acres of Land, More or Less, in S/2 of Section 29, Twp. 163 N., Range 85 W., Renville Cnty., N.D., 746 F.3d 362 (8th Cir.) *cert. denied sub nom*. 4.360 Acres of Land, More or Less, in the S/2 of Section 29, Twp. 163 N., Range 85 W., Renville Cnty., N. Dakota v. Alliance Pipeline L.P., 135 S. Ct. 245, 190 L. Ed. 2d 136 (2014).

212 *Id*. at 364.

213 *Id*.

214 *Id*. at 365.

215 *Id*.

216 *Id*.

217 *Id*.

The Smiths then brought suit alleging, among other things, that Alliance violated several state procedural rules in bringing its condemnation action.[218] In support of this contention, the Smiths cited to 15 U.S.C. § 717f(h), which requires that "[t]he practice and procedure [in a condemnation proceeding under this section] shall conform as nearly as may be with the practice and procedure in similar action or proceeding in the courts of the State where the property is situated."[219] The Smiths contended that the language of Section 717f(h) requires a party who brings a condemnation action pursuant to a FERC certificate to comply with relevant state procedural law in bringing that action.[220] Specifically, the Smiths argued that the North Dakota Code permitted them a jury trial in eminent domain proceedings and that Alliance's invocation of state law in its petition to enter and survey the Smiths' land estopped Alliance from arguing that state law did not apply to the condemnation action.[221]

However, the court made short work of the Smiths' argument that it was entitled to a jury trial by noting that United States Supreme Court determined that "there is no right to a jury in eminent domain proceedings."[222] The court also quickly dispatched the Smiths' argument regarding the applicability of state law to condemnation proceedings, stating that, because "there is no federal law that deals specifically with entries to survey property, there is nothing to preempt state law in such a proceeding."[223] Furthermore, the advisory committee notes to Rule 71.1 (which "govern[s] proceedings to condemn real and personal property by eminent domain") state that the rule "affords a uniform procedure for all cases of condemnation invoking the national power of eminent domain" and "supplants all statutes prescribing a different procedure."[224] The court refused to apply state law and, after also

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218 *Id*. at 366.
219 *Id*. at 366-67.
220 *Id*. at 367.
221 *Id*.
222 *Id*. (citing United States v. Reynolds, 397 U.S. 14, 18 (1970)).
223 *Id*.
224 *Id*. (citing Fed. R. Civ. P. 71.1).

deciding for Alliance on the other issues raised by the Smiths, the Eighth Circuit affirmed the district court's grant of summary judgment in favor of Alliance.[225]

§19.05. Ohio's Dormant Mineral Act.

The 1989 Ohio Dormant Mineral Act (1989 ODMA) and its 2006 amendment ("2006 ODMA") have emerged as the preeminent sources of uncertainty surrounding title to oil and gas interests in Ohio since the energy industry began flocking to the state in 2010 in pursuit of the Utica Shale's vast hydrocarbon reserves. Ambiguity permeates the ODMA, forcing prudent title attorneys to couch their legal opinions in contingencies while speculating about how the Ohio Supreme Court will interpret the law's most perplexing provisions. A flood of ODMA litigation in 2014 has finally set the stage for Ohio's highest court to answer many questions regarding the act's validity and application.

The 1989 ODMA, effective March 22, 1989, provided that a mineral interest held by a person other than the surface owner "shall be deemed abandoned and vested in the owner of the surface" if no "savings event" occurred within the preceding 20 years. O.R.C. § 5301.56. The 1989 ODMA described six savings events: (i) the mineral interest was the subject of a *title transaction* that has been field or recorded in the recorder's office, (ii) there was actual production or withdrawal by the holder, (iii) the holder used the mineral interest for underground gas storage, (iv) a mining permit has been issued to the holder, (v) a claim to preserve the mineral interest was filed, or (vi) a separately listed tax parcel number was created. O.R.C. § 5301.56(B)(1)(c) (emphasis added). The 1989 ODMA provided for a three year grace period from the effective date of the act, ending on March 22, 1992, during which dormant mineral interest owners whose interests would otherwise be deemed abandoned and vested in the surface owner could file a claim of preservation of record and retain the interest absent a savings event.

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225 *Id*. at 369.

The 2006 ODMA requires the surface owner to give notice to the dormant mineral interest holder and file an affidavit of abandonment before the severed mineral estate will be reunited with the surface estate. O.R.C. § 5301.56(E). The 2006 ODMA also provides that a mineral interest holder who claims an interest that has not been abandoned may file with the recorder (a) a claim to preserve the interest or (b) an affidavit containing a savings event within 60 days after notice of abandonment is served or published. If the mineral interest holder fails to timely file either document, the surface owner must file with the recorder a notice of the failure to file a preservation document, at which point the mineral interest vests in the surface owner. O.R.C. § 5301.56(H).

While the Ohio Supreme Court has yet to rule on the validity and application of the ODMA, it has accepted appeals of five state court cases, all on appeal from decisions of the Ohio Seventh District Court of Appeals (the Seventh District).[226] The Supreme Court has also accepted certified questions of law in two federal court cases filed in the U.S. District Court for the Southern District of Ohio (the "Federal District Court"). The Ohio Supreme Court now has the opportunity to rule on the definition of a "title transaction," the effects of the self-executing nature of the 1989 ODMA, and the continued applicability of the 1989 ODMA after the enactment of the 2006 ODMA. The seven ODMA cases pending before the Ohio Supreme Court present the following questions:

(1) Does a transfer of the surface estate that specifically references the severed mineral interest qualify as a title transaction?

(2) Does the recording of a lease of a severed mineral estate qualify as a title transaction?

(3) Does the expiration of a recorded lease of a mineral estate and reversion of the rights granted under the lease qualify as a title transaction?

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226 The Seventh District is the only appellate court in Ohio to address the issues discussed below to date. Therefore, until the Ohio Supreme Court rules on these appeals, the Seventh District's decisions are binding on common pleas courts in Belmont, Carroll, Columbiana, Harrison, Jefferson, Mahoning, Monroe and Noble counties.

(4) Is the 1989 ODMA self-executing, automatically vesting a surface owner with the severed mineral interest absent any affirmative act on the part of the surface owner?

(5) Is the 1989 ODMA's 20-year look-back period fixed at the effective date of the act fixed or rolling?

(6) Does the affirmative process by which a surface owner may acquire title to a dormant mineral interest established by the 2006 ODMA apply to interests automatically vested in the surface owner pursuant to the 1989 ODMA absent a formal recording of the event prior to 2006.

[1] — Title Transaction.

The Seventh District has held that a reference to the instrument which severed minerals from the surface estate in a subsequent deed conveying only the surface is not a "title transaction" that would operate as a savings event under the ODMA because in order for the mineral interest to be the subject of a title transaction the grantor must be conveying or retaining the interest.[227] It has also held that the recording of a valid oil and gas lease is a title transaction operating as a savings event.[228]

The Federal District Court has also certified that latter question of state law to the Ohio Supreme Court, along with the question of whether the expiration of a recorded oil and gas lease and reversion of the rights granted under the lease is a title transaction.[229] The Ohio Supreme Court has also accepted the Federal District Court's certification of the question of whether the payment of a delay rental during the primary term of an oil and gas lease is a title transaction.[230]

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227 *See* Dodd v. Crosky, 2013 WL 5437365 (Ohio App. 7th Dist. 2013); *Walker v. Shondrick-Nau*, 2014 WL 1407942 (Ohio App. 7th Dist. 2014).

228 Eisenbarth v. Reusser, 18 N.E.3d 477 (Ohio App. 7th Dist. 2014).

229 Chesapeake Exploration, L.L.C. v. Buell, 138 Ohio St.3d 1446 (2014).

230 Corban v. Chesapeake Exploration, L.L.C., 139 Ohio.St. 1482 (2014).

[2] — The 1989 ODMA.

The Ohio Supreme Court will soon weigh in on some of the nagging questions regarding the application of the 1989 ODMA specifically. The Seventh District has held that the 1989 ODMA is self-executing, and that an interest abandoned under the act automatically vests in the surface owner, even absent a formal memorialization of the event on the record.[231] The Seventh District also held that the twenty year look-back period applied to determine whether abandonment has occurred is fixed from the date of enactment of the 1989 ODMA (March 22, 1989).[232] This means that any interest abandoned under the 1989 ODMA must have vested in the surface owner, if at all, on March 22, 1992, upon the expiration of the three year window to preserve those interests. The Ohio Supreme Court will now decide whether the Seventh District's interpretation is correct, or whether the twenty year look back period is rolling, meaning that an abandoned interest could have vested in a surface owner at any point prior to the enactment of the 2006 ODMA, if twenty years had lapsed without a savings event at any point since the law took effect.

[3] — The 2006 ODMA.

The Ohio Supreme Court will also bring clarity to the process for abandonment and preservation of dormant mineral interests provided in the 2006 ODMA. It will review the Seventh District's holding that, while an affidavit of title transaction described in R.C. 5301.56(H)(1)(b) requires the mineral interest holder to identify a title transaction occurring during the twenty years prior to the surface owner's filing of a notice of abandonment, a claim of preservation pursuant to R.C. 5201.56 (H)(1)(a) need not be filed in the twenty years preceding the filing of a notice of abandonment, but may

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231 *See* Walker v. Shondrick-Nau, 2014-Ohio-1499 *appeal allowed*, 2014-Ohio-3785, 140 Ohio St. 3d 1414; Swartz v. Householder, 12 N.E.3d 1243 (Ohio App. 7th Dist. 2014): Dahlgren v. Brown Farm Properties L.L.C., 19 N.E.3d 926 (Ohio App. 7th Dist 2014).

232 *Eisenbarth*, 18 N.E.3d 477 (Ohio App. 7 Dist. 2014).

be filed with 60 days of the notice of abandonment in order to preserve the mineral interest.[233]

[4] — The Continued Applicability of the 1989 ODMA

Finally, the Ohio Supreme Court will weigh in on how the 2006 ODMA affects interests abandoned and automatically vested in surface owners pursuant to the 1989 ODMA, but not formally memorialized of record. The Seventh District held that the 1989 ODMA may still be applied for mineral interests that were deemed vested thereunder (though never formally memorialized) even after the enactment of the 2006 ODMA because those mineral interest automatically vested prior to the effective date of the 2006 ODMA, which contains no provisions eliminating property rights that have already vested.[234] Hence, the 2006 ODMA cannot be applied retroactively so as to permit a "claim to preserve" to revive the abandoned mineral interest, regardless of whether the automatic reunification with the surface estate under the 1989 ODMA had been formally recorded.[235] The Ohio Supreme Court will review the Seventh District's holding, and will also address a similar certified question of state law from the Federal District Court.[236]

§ 19.06. Litigation and Miscellaneous Issues – Bankruptcy, Trade Secrets and *Lone Pine* Orders.

The following cases do not fit squarely into any category, but address a variety of miscellaneous issues that required judicial interpretation and guidance. Dealing with issues involving ownership of a debtor's working interest, whether certain seismic maps qualify as trade secrets and the applicability of Lone Pine case management orders in toxic tort cases, these

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233 *Dodd*, 2013 WL 5437365.

234 *Swartz,* 12 N.E.3d 1243.

235 *See Walker*, 2014 WL 1407942; *Dahlgren,* 19 N.E.3d 926.

236 *Corban,* 139 OhioSt.3d 1482 (Addressing whether "the 2006 version or the 1989 version of the ODMA appl[ies] to claims asserted after 2006 alleging that the rights to oil, gas, and other minerals automatically vested in the surface land holder prior to the 2006 amendment as a result of abandonment").

decisions offer unique insight into the diverse and sometimes eclectic world of oil and gas litigation.

[1] — *Breton Energy, L.L.C. v. Mariner Energy Res., Inc.*[237]

Here, Conn Energy, Inc. (Conn) executed an agreement with Breton Energy, LLC (Breton) by which Breton would explore Conn's mineral lease in the Gulf of Mexico.[238] This lease, referred to as the WC 171, shared a hydrocarbon reservoir named the "K-1 sands" with an adjacent lease, the WC 172.[239] Breton and Conn specifically sought to develop WC 171's K-1 sands and, before beginning production, determined that a well had previously been drilled into a lower formation (called the K-2 sands) on WC 171, but that no production had occurred within the K-1 sands.[240] After spending over $6 million to drill a well, Breton and Conn were dissatisfied with the results and brought suit against Mariner Energy Resources, Inc. and its successors and predecessors in interest (collectively the "Mariner Group") alleging that the Mariner Group's operations on WC 172 had depleted WC 171's K-1 sands reservoir.[241]

Previously, the Mariner Group had sought approval from the Minerals Management Service (MMS) to drill into gas reserves located in both the K-1 and K-2 sands on WC 172.[242] MMS approved the Mariner Group's operations over Conn's objections, but specifically stated that the Mariner Group was not authorized to proceed with dual completions – *i.e.*, the Mariner Group had to select one zone for its first completion and then obtain approval from MMS for any subsequent completions.[243] After completing a well into the K-2 sands, the Mariner Group reported to MMS that its production exceeded expectations by almost 30 percent.[244] Breton and Conn alleged that this

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237 Breton Energy, L.L.C. v. Mariner Energy Res., Inc., 764 F.3d 394 (5th Cir. 2014).
238 *Id*. at 396.
239 *Id*.
240 *Id*. at 397.
241 *Id*.
242 *Id*.
243 *Id*.
244 *Id*.

overproduction evidenced that the Mariner Group actually completed the shared K-1 reserve at the same time it completed WC 172's isolated K-2 reserve.[245]

In determining whether the district court properly dismissed Breton and Conn's claims, the Fifth Circuit first reviewed the Rule of Capture and noted that Louisiana law only provides for recovery for drainage in situations involving intentional or negligent waste that deprives a landowner of their rights in a common reservoir.[246] After relying on factual statements made by a representative of the Mariner Group, the court ultimately concluded that dismissal was improper because Breton and Conn had adequately stated a claim.[247] Specifically, the facts demonstrated that the Mariner Group's operations on WC 172 encountered lower than expected bottom-hole pressure when developing the K-2 sands.[248] Taking this below-average bottom-hole pressure in conjunction with Breton and Conn's unexpected and disappointing return on the K-1 sands from WC 171, the Mariner Group's representative claimed that the only plausible explanation for the drainage was the perforation of the shared K-1 reservoir.[249] The Mariner Group's representative also stated a commingling of the K-1 and K-2 reservoirs was almost certain based on the significant overproduction from the first completion and the fact that the pressure in both reservoirs was virtually equal.[250] Finally, the Mariner Group's representative also demonstrated to the court that commingling causes waste because, after two zones that are not naturally in communication are commingled, it is unlikely that an operator will be able to recover the same amount of hydrocarbons that would have been possible had the formations been developed separately and independently.[251]

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245 *Breton*, 764 F.3d 394.

246 *Id*. at 398 (citing La. Rev. Stat. Ann. 31:10).

247 *Id*. at 400.

248 *Id*.

249 *Id*.

250 *Id*. at 401.

251 *Id*. at 401-02.

Furthermore, the court noted that the MMS permit expressly stated that the two reservoirs were to be produced separately in order to prevent waste, maximize oil and gas recovery and protect Conn's correlative rights.[252] And while the Mariner Group's violation of the MMS permit via its apparent perforation of WC 171's K-1 sands was insufficient to constitute waste by itself, the violation served as evidence that the Mariner Group's actions had reduced the total amount of recoverable oil and gas.[253] Based on this evidence, the Fifth Circuit held that Breton and Conn plausibly stated a claim against the Mariner Group for intentional and negligent production of oil and gas.[254] And because this manner of production drastically reduced the quantity of oil and gas ultimately recoverable from the pool, Breton and Conn had adequately alleged that the Mariner Group committed waste and harmed Breton and Conn's correlative rights.[255]

Practice Point: Commingling of adjacent oil and gas reservoirs could potentially subject an operator to liability for drainage if the evidence suggests that the commingling occurred as a result of intentional or negligent operations.

[2] — *In re Johnson*.[256]

The dispute in this case involves whether a debtor's working interest in an oil well, and the revenue received upon sale of the extracted oil, is property of the bankruptcy estate that must be turned over to the trustee or considered income to the debtors.[257] Due to a number of assignments, Jerry Johnson (the "Debtor") acquired an 11/32nds working interest in an oil and gas lease.[258] Based on the documents memorializing the assignments, the Debtor was not a lessee or an operator under the oil and gas lease, but held a true working interest that made him responsible for a portion of the costs associated with

252 *Id*. at 402.
253 *Id*.
254 *Id*.
255 *Id*. at 404.
256 *In re* Johnson, 513 B.R. 333 (Bankr. S.D. Ill. 2014).
257 *Id*. at 335
258 *Id*. at 336.

drilling a well.[259] In June of 2012, the Debtor voluntarily filed for Chapter 13 under the Bankruptcy Code, [260] only to have the district court dismiss the case without a confirmed plan.[261] In May of 2013, the Debtor then filed for bankruptcy under Chapter 7 of the Bankruptcy Code[262] and a Chapter 7 trustee was appointed to administer the case.[263]

The trustee sought to classify the Debtor's working interest and the proceeds derived therefrom as part of the bankruptcy estate, but the Debtor argued that these interests should be considered part of the Debtor's income and therefore be excluded from the definition of property of the estate.[264] Specifically, the trustee argued that the working interest should be considered an interest in real estate and that both the extracted oil and the funds produced from that oil are proceeds of the real estate interest.[265] The Debtor was willing to concede that the working interest was personal property, but adopted the position that the working interest constitutes a contractual right to payment that should be considered income that may not be touched by the trustee.[266]

Although the Bankruptcy Code[267] sets the parameters for what property is included in the bankruptcy estate, state law determines the nature of an interest in property and Illinois treats oil and gas interests as having a hybrid character involving both real and personal property components.[268] In Illinois, oil and gas in place constitutes land or real estate belonging to the owner of the land so long as it remains under the land.[269] Conversely, an oil

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259 *Id*. at 335-36.

260 Chapter 11 U.S.C. § 1321. A section of the United States Bankruptcy Code that allows an individual to propose a plan of financial reorganization while under the protection of the bankruptcy court.

261 *In re Johnson*, at 336.

262 11. U.S.C. § 721. This section of the Bankruptcy Code governs the process of liquidation.

263 *Id*.

264 *In re Johnson*, at 337.

265 *Id*. at 335.

266 *Id*.

267 11 U.S.C. § 541(a).

268 *In re Johnson*, 513 B.R. at 336 (internal citations omitted).

269 *Id*. (citing Miller v. Ridgley, 117 N.E.2d 759 (Ill. 1954)).

and gas lease constitutes a freehold estate or real estate interest because it grants the lessee the right to enter onto the surface to attempt to reduce the oil and gas to possession.[270] Furthermore, once the oil reaches the surface it is considered personalty and its disposition is governed by personal property law.[271]

The court noted that determining the true nature of a working interest is difficult because, in some situations, a "working interest" includes the right to enter onto the land, while in others the term has a narrower meaning.[272] In this situation, the Debtor did not receive a freehold interest because none of the documents conveying his interest also purported to convey the right to enter onto the property in order to reduce the oil and gas to his possession.[273] Therefore, the Debtor's working interest was to be considered a personal property interest because it lacked a real property component.[274]

However, the nature of the Debtor's personal property interest in the lease itself was complicated by the fact that oil and gas leases, as well as assignments of fractional interests in those leases, are contracts.[275] Here, the assignments to the Debtor also constituted an interest in personal property under Illinois law because those assignments conveyed a contractual right to payment for oil extracted in the future.[276] This meant that the Debtor's personal property interest included oil extracted pre-petition and its profits as

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270 *Id*. (citing Ohio Oil Co. v. Daughetee, 88 N.E. 818 (Ill. 1909); *In re* Hanson Oil Co., Inc., 97 B.R. 468 (Bankr. S.D. Ill. 1989)).

271 *Id*. (citing Palumbo v. Harry M. Quinn, Inc., 55 N.E.2d 825 (Ill. App. 1944); Nation Oil Co. v. R.C. Davoust Co., 201 N.E.2d 260 (Ill. App. 1964)).

272 *Id*.

273 *Id*.

274 *Id*. at 338.

275 *Id*. (citing Bi–County Properties v. Wampler, 378 N.E.2d 311, 314 (1978); Carter Oil Co. v. Dees, 92 N.E.2d 519, 522 (Ill. App. 1950); Hein v. Shell Oil Co., 42 N.E.2d 949, 951 (Ill. App. 1942)).

276 *Id*. (citing *In re* Classic Coach Interiors, Inc., 290 B.R. 631, 635–36 (Bankr. C.D. Ill.2002); Marquette Nat'l Bank v. B.J. Dodge Fiat, Inc., 475 N.E.2d 1057, 1061–62 (Ill. App.1985)).

well as contractual rights to post-petition oil production and accounts under the oil and gas assignments.[277]

Having established the Debtor's property interest also included post-petition oil production and accounts, the court had to then determine whether this interest was property of the bankruptcy estate.[278] The court ultimately held that a post-petition payment on a pre-petition contractual interest belonged to the bankruptcy estate so long as the payment was not attributed to or conditioned upon the Debtor's post-petition services.[279] Therefore, in situations where the mineral rights are considered to be part of the bankruptcy estate, the Bankruptcy Code considers an oil and gas lease, together with any present or future payments received thereunder, to also be property of the bankruptcy estate.[280]

Practice Point: A debtor's entire working interest in an oil and gas lease, including the profits earned from the sale of the extracted oil, can be considered property of the bankruptcy estate where a payment on post-petition production of oil is not attributed to the debtor's post-production services.

[3] — *Lightning Oil Co. v. Anadarko E & P Onshore, LLC*.[281]

Texas Briscoe Ranch, Inc. (Briscoe) owns the surface estate above several mineral leases held by Lightning Oil Co. (Lightning).[282] The Texas Parks and Wildlife Department (the Department) operates and manages the Chaparral Wildlife Management Area (Chaparral Area), a wildlife sanctuary and public hunting area that is located directly south of Lighting's leases.[283] Anadarko

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277 *Id*.

278 *Id*.

279 *Id*.

280 *Id*. (citing *In re* Resource Tech. Corp., 254 B.R. 215, 220 (Bankr. N.D. Ill.2000) (property of the estate includes any contract rights that a debtor possesses at the time of the bankruptcy filing)).

281 Lightning Oil Co. v. Anadarko E & P Onshore, LLC, No. 04-14-00152-CV, 2014 WL 5463956 (Tex. App. Oct. 29, 2014).

282 *Id*. at 1.

283 *Id*.

E&P Offshore, LLC (Anadarko) obtained leases to mineral interests below the Chaparral Area, but was unable to work out an agreement for surface use with the Department.[284] Anadarko then entered into a surface use agreement with Briscoe that would allow it to establish well sites on Briscoe's property that would reach into the Eagle Ford Shale underlying the Chaparral Area without requiring Anadarko to access or disturb the surface overlying the Chaparral Area.[285] Yet Anadarko's development strategy hit a snag when Lightning was understandably hesitant to allow Anadarko's well to pass through its leasehold (even though those wells would not be producing from Lightning's interests) and refused to enter into an agreement sanctioning Anadarko's proposed activities.[286] Lightning then sued Anadarko for trespass and tortious interference with contract and sought declaratory and injunctive relief.[287] Lightning pursued a temporary injunction on the grounds that Anadarko's operations would require Lightning to drill additional offset wells to prevent drainage from Anadarko's wells, Anadarko's wellbore would interfere with Lightning's drilling plans and drilling or fracing fluid would damage Lightning's mineral interests if Anadarko failed to properly case its wells.[288]

The trial court denied the temporary injunction and the appellate court ultimately agreed, focusing on how Lightning's own witnesses were unable to demonstrate that it would suffer immediate and irreparable harm as a result of Anadarko's operations.[289] Specifically, Lightning's own witnesses demonstrated that Lightning's allegations were groundless because Lighting's proposed wellbore would never encounter Anadarko's wellbore, Lightning would have to drill additional offset wells even if Anadarko were able to reach its lease from a different location, and, although a casing failure was

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284 *Id*.
285 *Lightning Oil Co.,* 2014 WL 5463956.
286 *Id*. at 2.
287 *Id*.
288 *Id*. at 4.
289 *Id*. at 3, 5.

unlikely, any loss resulting from such an occurrence was easily quantifiable and compensable based on reserve estimates.[290]

Additionally, although both parties raised arguments relating to the issues of whether Briscoe had the right to consent to drilling activities through Lightning's leasehold as owner of the surface estate only, and whether those drilling activities would actually constitute a trespass, the court refused to discuss those arguments, stating that they were outside the scope of the interlocutory appeal.[291]

Practice Point: Courts are unlikely to enjoin drilling activity without specific proof of irreparable harm.

[4] — *Lamont v. Vaquillas Energy Lopeno Ltd., LLP.*[292]

In 1996, Ricochet Energy, Inc. (Ricochet), an oil and gas development company, was created by Jerry Hamblin and Thomas Lamont.[293] Ricochet entered into Prospect Generation Agreements ("PGAs") with Vaquillas Energy Lopeno Ltd., LLP (Vaquillas) and JOB Energy Partners II, Ltd. (JOB), whereby Ricochet agreed to generate oil and gas prospects.[294] Under the terms of the PGAs, Vaquillas and JOB were to pay for Ricochet's overhead costs while Ricochet identified oil and gas prospects in Texas and presented prospects with seismic maps to Vaquillas and JOB for their first right of refusal for exploration and development.[295] Importantly, the PGAs also vested Vaquillas and JOB with a proprietary interest in all acquired or generated data and interpretations of any accepted prospects.[296] Ricochet eventually identified the Lopeno Prospect gas reservoir and prepared a seismic map —

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290 *Id*. at 4-5.

291 *Id*. at 3.

292 Lamont v. Vaquillas Energy Lopeno Ltd., LLP., 421 S.W.3d 198 (Tex. App. 2013), *review denied* (Mar. 13, 2015).

293 *Id*. at 205.

294 *Id*.

295 *Id*.

296 *Lamont*, 421 S.W. 3d 198.

referred to by the parties as the "Treasure Map" — detailing the size and potential of the gas reservoir.[297]

In 2006, Lamont left Ricochet, but retained a 29 percent working interest in the Lopeno Prospect and was permitted to continue participating in Ricochet PGA prospects and reviewing any associated seismic data.[298] In 2007, Lamont offered CPA and experienced oil and gas investor Rosendo Carranco 10 percent of his working interest in the Lopeno Prospect.[299] After showing Carranco seismic maps for four different prospects, including the Lopeno Prospect, Carranco purchased 10 percent of Lamont's interest in the Lopeno Prospect.[300] Carranco accepted the offer and Lamont and Carranco began jointly attempting to lease a portion of the Lopeno Prospect.[301] Ricochet contemporaneously undertook efforts to lease the same portion of the Lopeno Prospect, but was unaware of Lamont's involvement with Carranco in this matter.[302] Lamont and Carranco eventually succeeded in developing the Lopeno Prospect, thereby depleting the reservoir and preventing Ricochet from developing that portion of the Lopeno Prospect.[303] Vaquillas and JOB sued Carranco, Lamont and their associated organizations for, among other things, misappropriation of the Lopeno Prospect Treasure Map.[304] The jury returned a verdict for Vaquillas and JOB, awarding them $4.9 million in damages.[305]

On appeal, both sides agreed that the Treasure Map was a trade secret, but disagreed as to the extent and duration of that protection.[306] Lamont argued that the Treasure Map's trade secret status was destroyed because Ricochet did not require individuals to sign confidentiality agreements

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297 *Id*. at 206.
298 *Id*. at 207.
299 *Id*.
300 *Id*. at 208.
301 *Id*.
302 *Id*.
303 *Id*.
304 *Id*.
305 *Id*. at 209.
306 *Id*. at 210.

before viewing the Treasure Map and because Lamont was allowed to view the Treasure Map after leaving the company.[307] Vaquillas argued that the trade secret status of the Treasure Map was never compromised because Ricochet only showed the Treasure Map to Lamont for the limited purpose of negotiating his agreement and electing his working interest percentage in the Lopeno Prospect, and that the Treasure Map was only ever shown to potential Lopeno Prospect working interest investors.[308]

The court ultimately sided with Vaquillas, citing longstanding Texas law forbidding employees from using trade secret information acquired during the course of employment against former employers, even after employment is terminated.[309] And although Ricochet showed the Treasure Map to prospective buyers, customers and licensees, this was insufficient to destroy the Treasure Map's protected status.[310]

Practice Point: Although the common law may protect trade secrets from disclosure in certain situations, the best policy for protecting proprietary information is still to require all parties involved to execute a confidentiality agreement.

[5] — *Antero Resources v. Strudley*.[311]

Also decided April of 2015, the *Strudley* decision resolved a division between the Colorado district court and court of appeals regarding whether the Colorado Rules of Civil Procedure (CRCP) allow a district court to issue a specialized type of modified case management order called a "Lone Pine" order. Named for an unpublished New Jersey opinion entitled *Lore v. Lone Pine Corp.*,[312] where homeowners sued 464 operators of a nearby landfill for personal injury and property damage, the term "Lone Pine" order refers

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307 *Id*. at 210-211.

308 *Id*. at 211.

309 *Id*. at 211 (citing Reliant Hosp. Partners, LLC v. Cornerstone Healthcare Grp. Holdings, Inc., 374 S.W.3d 488, 499 (Tex.App.-Dallas 2012, pet. filed)).

310 *Id*. at 212 (citing Reinstatement ((Third)) of Unfair Competition § 41 cmt. b (1995)).

311 Antero Resources v. Strudley, 2015 CO 26.

312 Lore v. Lone Pine Corp., No. L-33606-85, 1986 WL 637507 (N.J. Super. Ct. Law Div. Nov. 18, 1986).

to a case management order requiring the plaintiffs to produce expert reports providing sufficient factual support for their claims or else face dismissal.[313] After the plaintiffs in *Lone Pine* failed to meet the burden established by the case management order, the court dismissed their case with prejudice.[314] Now, other courts utilize Lone Pine orders to manage the difficult issues that often arise in mass toxic tort litigation.

In *Antero*, William G. Strudley and Beth E. Strudley sued Antero Resources Corporation and several of its subsidiaries (collectively Antero), both individually and as the parents of two minor children (collectively the Strudleys), alleging that they suffered physical injuries and property damages as a result of Antero's natural gas drilling operations near their home.[315] Although the complaint stated that several specific chemicals had polluted the Strudleys' property, it did not causally connect the alleged pollutants to the health issues purportedly suffered by the Strudleys.[316] After exchanging initial disclosures pursuant to the case management order, Antero requested that the trial court issue a Lone Pine order requiring the Strudleys to present prima facie evidence to support their claims before discovery could continue.[317] In support of its request, Antero offered evidence in support of its claims that the Strudleys could not make a prima facie showing of exposure, injury and causation, and also expressed concern that discovery would be unduly burdensome and costly.[318] The trial court agreed with Antero and, seeking to promote efficiency in a "complex toxic tort action involving numerous claims," issued a modified case management order requiring the Strudleys to provide a prima facie showing of each plaintiff's exposure to toxic chemicals through expert reports or medical records, and to identify and quantify the contamination on their property attributable to

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313 *Id*.

314 *Id*.

315 *Antero*, 2015 CO at 2.

316 *Id*.

317 *Id*.

318 *Id*.

Antero's operations.[319] Just as in *Lone Pine*, the Strudleys were prohibited from conducting discovery until this burden was met.[320] Despite producing several expert reports, the trial court held that the Strudleys did not provide sufficient evidence suggesting that they had been exposed to dangerous chemicals or that Antero's conduct caused the alleged injuries and harm to the property.[321] The trial court subsequently dismissed the action with prejudice, and the court of appeals reversed.[322]

In reviewing this division between the trial court and the court of appeals, the Colorado Supreme Court observed that the authority for issuing such orders is derived from Fed. R. Civ. P. 16(c), which grants the court authority to "adopt[ ] special procedures for managing potentially difficult or protracted actions that may involve complex issues, multiple parties, difficult legal questions, or unusual proof problems."[323] However, Colorado appellate courts have never explicitly authorized the use of Lone Pine orders, and Federal Rule 16 contains distinct differences from the equivalent CRCP 16.[324] Specifically, when CRCP 16 was revised in 2002, the drafters failed to include a grant affording trial courts the authority to condition discovery on the plaintiff establishing a prima facie case.[325] Instead of including this language and making CRCP 16 the functional equivalent of Federal Rule 16, the drafters instead chose to utilize CRCP 16 to primarily address basic scheduling matters.[326] Furthermore, although trial judges are expected to assertively lead the management of cases to ensure that justice is served, the provisions of the CRCP conferring the powers of such leadership do not

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319 *Id*.

320 *Id*. at 3.

321 *Id*.

322 *Id*.

323 *Id*. at 4 (citing *In re* Digitek Prod. Liab. Litig., 264 F.R.D. 249, 255 (S.D.W. Va.2010)*; In re* Vioxx Prods. Liab. Litig., 388 F. App'x 391, 397 (5th Cir. 2010); McMunn v. Babcock & Wilcox Generation Grp., Inc., 896 F. Supp. 2d 347, 351 (W.D. Pa. 2012); McManaway v. KBR, Inc., 265 F.R.D. 384, 385 (S.D. Ind. 2009)).

324 *Id*. 4.

325 *Id*. at 6-7.

326 *Id*. at 7.

include the same explicit authorization included in the Federal Rules that provides for the issuance of Lone Pine orders.[327]

Additionally, the court reviewed a number of decisions assessing the applicable sections of the CRCP and failed to uncover any obligation for the plaintiffs to establish a prima facie case before exercising rights to discovery.[328] To the contrary, precedent demonstrated that the court had actually issued opinions limiting a trial court's ability to require a plaintiff to present prima facie evidence of a claim prior to compelling a defendant to engage in discovery.[329] The *Antero* court reiterated the message of these decisions and stated that requiring a plaintiff to produce prima facie evidence before discovery undermined the general policy that discovery disputes should be resolved in favor of disclosure and held that, had CRCP 16 intended to permit courts to require a prima facie case showing akin to *Lone Pine*, it would have been explicitly patterned after Federal Rule 16.[330] The court held that case management orders under CRCP 16 should be employed to streamline litigation and ensure the just progression of the case, and not to arbitrarily dismiss cases or eliminate claims.[331] Therefore, Lone Pine orders are now impermissible in Colorado because such orders allow courts the means to ignore existing rules and procedural safeguards while severely limiting the litigant's right to discovery.[332]

This decision was not unanimous, with one justice dissenting on the grounds that active case management by the judge is essential to running an efficient docket and administering justice.[333] Justice Boatright assessed

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327 *Id*. at 11-12.

328 *Id*. at 8. *See* DCP Midstream, LP v. Anadarko Petroleum Corp., 2013 CO 36, 303 P.3d 1187 (holding that the trial court may institute judicial management to tailor and manage discovery in a way that balances competing goals, but not condition discovery on the plaintiffs' proving a prima facie case).

329 *Id*. *See* Curtis, Inc. v. Dist. Court In & For City & Cnty. of Denver, 526 P.2d 1335 (Colo. 1974); Direct Sales Tire Co. v. Dist. Court In & For Jefferson Cnty., 686 P.2d 1316 (Colo. 1984).

330 *Id*.

331 *Id*. at 9.

332 *Id*.

333 *Id*. at 10 (dissent of Justice Boatright).

the same factors as the majority, but came to the conclusion that CRCP 16 allows for Lone Pine orders because such an order functions to effectuate the purpose of the rule itself: allowing courts to adjust the timelines for discovery.[334] Perhaps the most important element of Justice Boatright's dissent was the fact that the trial court's order only required the Strudleys to produce information that was entirely within their possession or control.[335] Because the Strudleys already had all of the information necessary to prove their case, Justice Boatright believed that the trial court's order fulfilled the explicit purpose of CRCP 16 and simply accelerated the timeline for the Strudleys to disclose records and expert testimony and delayed the timeline for when the Strudleys could engage in full discovery.[336]

Practice Point: State courts may be increasingly hesitant to utilize Lone Pine orders as a method of case management if the state's rules of civil procedure do not explicitly allow for such action.

§ 19.07. Conclusion — What the Future Holds.

As a result of the tumult surrounding the oil and gas industry in 2014, courts across the nation saw an influx of novel oil and gas-related disputes. In addition to the unprecedented issues discussed by this chapter, the industry as a whole also experienced more claims involving now-familiar issues such as the partition of mineral interests, construction contract disputes and collection claims. Moving forward into 2015, it is safe to assume that the legal framework supporting the oil and gas industry will continue to evolve and adapt to reflect the constantly changing political and economic landscape.

Based on the number and type of oil and gas-related claims brought in 2014, it is possible to offer predications as to what causes of action will arise in the years to come. For example, the market downturn has rendered many once-profitable joint ventures economically challenged. These changing conditions may drive a wedge between investors, operators and non-operators.

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334 *Id*.

335 *Id*. at 11.

336 *Id*. at 10.

Similarly, 2015 will likely see a greater number of disputes relating to the cancellation of oilfield equipment contracts. During the height of the oil and gas boom, many operators placed large orders for many complex pieces of equipment. Due to high demand, these equipment contracts could only be fulfilled by delivering each piece of equipment as it became available over the course of several years. Much of this equipment is highly leveraged. Lenders may seek to foreclose and repossess. Furthermore, employment discrimination suits may become more prevalent as companies downsize in an effort to cut costs.

Royalty owners could potentially implement a comparable strategy and allege that they should be permitted to avoid their obligations under a lease that has failed to produce in paying quantities. These allegations will likely include claims that the royalty owner should be permitted to recoup lost profits for gas produced after oil prices have dropped, making the outcome of these suits much more important than ever before.

Yet as many of the cases discussed in this chapter demonstrate, the oil and gas industry is nothing if not adaptable. Because many industry participants have utilized proper business practices since their inception, the industry as a whole has set itself up for success in many of these novel legal situations. The fact remains that domestic oil and gas are commodities whose value is subject to market fluctuations tied to political and economic machinations occurring both in our backyards and half a world away. Yet the industry is resilient. The debate is not "if the industry rebounds," but "when the rebound will occur." In the meantime, the cases discussed in this chapter serve to demonstrate that attorneys and industry professionals alike will continue to meet and overcome obstacles with the ingenuity and determination that built the oil and gas industry from the ground up.

Chapter 20

The Common Interest Doctrine and Protecting Against Inadvertent Waiver of the Attorney-Client Privilege in Oil and Gas Litigation

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§ 20.01. Introduction.

The common interest doctrine (also referred to and/or conceptually confused with the "community of interests doctrine," "joint defense privilege," and "allied lawyer doctrine") is based on the underlying principles of the attorney-client privilege. As Model Rule of Professional Conduct 1.6 — Confidentiality of Information Client-Lawyer Relationship states, "[a] lawyer shall not reveal information relating to the representation of a client . . . [and a] lawyer shall make reasonable efforts to prevent the inadvertent or

unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client."[1] Accordingly, the common interest doctrine has been developed through the common law to extend the attorney-client privilege to situations concerning communications between parties sharing common legal, and sometimes business, interests. While this area of law is in no way specific to the oil and gas industry, it does present unique scenarios in which attorney-client privilege becomes an issue because of the manner in which the oil and gas industry conducts business.

Unlike many other industries, the oil and gas industry often participates in collaborative-type business endeavors. These endeavors can occur between and among entities in their effort to develop leased acreage; between and among entities who elect to swap properties in an effort to organize more efficient units; between and among entities and third-party financiers and/or banks who can either be legitimate silent partners or simply loan sources; and countless other scenarios in which separate business entities and/or individuals enter into business relationships for the exploration, development and production of minerals, oil and/or gas.

Ultimately, the scenarios above, as well as many scenarios not specifically set forth in this chapter, result in the exchange of substantial amounts of information and documentation. Moreover, in an effort to maximize efficiencies, often times collaborating entities will elect to share costs for certain services and share certain information that is common to the business endeavor, or even as a precursor to entering into a long-term, business relationship. While often these relationships are memorialized either by a Joint Operating Agreement or a Joint Venture Agreement, these agreements are usually silent as to the treatment of attorney-client privileged materials and shared legal resources. Frequent examples of attorney-client privileged materials that are inadvertently disclosed in these relationships include: title opinions; e-mails from one entity's in-house counsel; and, legal opinions regarding risk/liability with regard to the endeavor.

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1 Model Rules of Prof'l Conduct R. 1.6 (a), (c) (2014).

The danger in not being able to adequately assess these risks are real. It is further complicated by the disconnect in time between when the disclosure(s) that may occur and the litigation in which the disclosure(s) becomes an issue. The waiver of the attorney-client privilege is a serious issue containing both ethical components and practical components. While the ethical implications are clear, the practical components can manifest themselves in varying ways depending on the complexity of the litigation, the amount at issue in the litigation, and the sophistication of the litigators on either side. At the end of the day, however, the most critical thing to remember is that there is no partial waiver of the attorney-client privilege.[2]

In the event of an inadvertent disclosure of attorney-client privilege during a cooperative business endeavor, the common interest doctrine may become one's last defense, although these authors would note that the common interest doctrine may not be a desirable default position. Unfortunately, the common interest doctrine is not applied or interpreted uniformly across the country, and, specifically, not in the jurisdictions, both state and federal, comprising the Appalachian Basin. This chapter seeks to provide a summary of the law as it currently exists in the jurisdictions comprising this specific geographic region.[3]

§ 20.02. Litigation on the Rise.

Before exploring the current state of the law on the common interest doctrine in the jurisdiction comprising the Appalachian Basin, it is important to note why these issues are becoming a concern for the industry. According to Fulbright's 9th Annual Litigation Trends Survey Report, the following trends were noted in the energy sector:

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2 *See* Nguyen v. Excel Corp., 197 F.3d 200 (5th Cir. 1999).

3 While these authors sought merely to discuss the present state of the law in the Appalachian Basin concerning the Common Interests Doctrine, these authors would briefly note that protecting oneself from these issues can potentially be achieved by incorporating sufficient language into partnering documentation and, certainly, by entering into a Joint Defense Agreement at the start of litigation, or even prior if the parties are on notice of the same.

- Of the industries which most frequently faced more than 20 lawsuits in the past 12 months, energy was second;
- Energy reported a rise of 6 percent in facing at least one lawsuit which was valued in excess of $20 million or more; and
- Energy reported almost 100 percent increase in facing at least one arbitration which was valued in excess of $20 million or more.

When one reads between the lines, it is clear that litigation in the energy sector is substantially increasing and the nature of those lawsuits is "bet the company" type litigation. Because there is so much at stake financially, the occasion to litigate niche issues, like attorney-client privilege/common interest doctrine, becomes more frequent since each litigant is using all available tactics to gain an advantage. Moreover, while in a lawsuit with a lesser value these issues may be present but not litigated, litigants in high-stakes litigation tend to authorize expenditures for more robust and complex litigation tactics.

It is the opinion of these authors that the common interest doctrine provides a ripe area for litigation. First, the law is not uniform and, in certain states, not even very clear. This increases the likelihood of litigation regardless of which position the client takes on the issue. Second, the industry as a whole lends itself to the type of business relationships in which inadvertent disclosure of attorney-client privileged materials regularly occur. And, last, often times entities involved in oil and gas litigation find themselves conceptually or factually aligned with other parties who they have had substantial communications with prior to litigation concerning the very issue(s) which is subject to the litigation.

§ 20.03. The Common Interest Doctrine.

The common interest doctrine is an extension of the attorney client privilege.[4] There are often times when two parties, each with separate counsel, have aligned interests with relation to certain litigation or business

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4 Katharine T. Schaffzin, "An Uncertain Privilege: Why the Common Interest Doctrine Does Not Work and How Uniformity Can Fix It," 15 *B.U. Pub. Int. L.J.* 49, 54 (2005).

transactions. These parties may benefit from cooperating in the endeavor, whether it be sharing privileged information or discussing strategy. In so doing, the parties risk waiving the attorney-client privilege they hold in their distinct attorney-client relationships. The common interest doctrine is an extension of the attorney-client privilege that prevents waiver of the attorney-client privilege when otherwise privileged communications are disclosed in the presence of or to certain third parties with a "common interest" in a legal matter.[5] As an exception to waiver, common interest doctrine presupposes the existence of an otherwise valid privilege, and the rule applies not only to communications subject to the attorney-client privilege, but also to communications protected by the work-product doctrine.[6]

The common interest doctrine applies when: 1) a communication is made by separate parties in the course of a matter of common interest; 2) that communication is designed to further the matter of common interest; and 3) the privilege has not been waived. Consider the following illustration:[7] Plaintiff A (an oil and gas company) and plaintiff B (a landowner) filed lawsuits in West Virginia and Pennsylvania, respectively, against a common defendant — another oil and gas company — for damages related to defendant's assertion of a valid and subsisting lease covering the oil and gas underlying plaintiff B's property, which spans West Virginia, Pennsylvania and Maryland. Plaintiff C, seeking similar relief, is considering filing a similar lawsuit against defendant in Maryland. Under this example, plaintiffs A, B, and C may decide to share otherwise privileged information with one another to facilitate their own claims. They may also elect to pool resources to save money and increase the efficiency of their claims. In theory, the common interest doctrine would allow plaintiffs A, B, and C to share, through or in the presence of counsel, privileged information related to their common interests against defendant without waiving the attorney-client privilege.

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5 Edna Selan Epstein, "The Attorney-Client Privilege and the Work-Product Doctrine," Vol. I, at 274-324 (5th ed., American Bar Association 2007).

6 Transmirra Prods. Corp. v. Monsanto Chem. Co., 26 F.R.D. 572, 578 (S.D.N.Y. 1960).

7 Schaffzin, *supra* note 4, at 50-51.

[1] — Common Applications.

The common interest doctrine has been recognized in the United States since 1971.[8] Its first application was to permit criminal co-defendants to share counsel.[9] As of 2005, some form of the doctrine had been favorably recognized or adopted in a handful of states and nearly all of the federal circuits: Arizona, California, Delaware, Florida, Georgia, Massachusetts, Missouri, Montana, New Jersey, New York, Texas, Tennessee and Virginia; and the First, Second, Third, Fourth, Sixth, Seventh, Eighth, Ninth, Federal, and District of Columbia Circuits.[10] Federal courts have expanded the privilege to apply to the following relationships:[11]

- two or more criminal co-defendants with the same attorney (and different attorneys);[12]
- two or more respondents in a grand jury investigation;[13]
- two or more parties made co-defendants by formal indictment;[14]
- two or more civil co-defendants with the same attorney (or different attorneys);[15]
- two or more co-plaintiffs in a civil suit;[16]
- two or more prospective clients in a joint consultation;[17]

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8 *See* Chahoon v. Commonwealth, 62 Va. 822, 1871 WL 4931 (1871).

9 Robert W. Higgason, "The Attorney-Client Privilege in Joint Defense and Common Interest Cases," 34 *Hous. Law.* 20, 20-21 (1996).

10 Schaffzin, *supra* note 4, at 49-51.

11 *See* Higgason, *supra* note 9, at 20.

12 *See, e.g.*, *In re* Grand Jury Proceedings, 156 F.3d 1038 (10th Cir. 1998); United States v. Schwimmer, 892 F.2d 237, 243-44 (2d Cir. 1989).

13 *See In re* LTV Security Litig., 89 F.R.D. 595, 604 (N.D. Tex. 1981).

14 *Id*.

15 *See* Wilson P. Abraham Constr. Co. v. Armco Steel Corp., 559 S.F.2d 250, 253 (5th Cir. 1977) (same attorney); *In re* Bevill, 805 F.2d 120, 126 (3d Cir. 1986) (different attorney).

16 *See* Schachar v. Am. Academy of Ophthalmology, Inc., 106 F.R.D. 187, 189 (N.D. Ill. 1985).

17 *See In re* Auclair, 961 F.2d 65, 70 (5th Cir. 1992).

- two or more non-parties;[18]
- threatened litigation;[19]
- potential co-parties;[20]
- counsel of potential co-parties;[21]
- communications to attorneys' agents;[22]
- corporations as well as individuals;[23]
- tangible objects;[24] and
- attorney work product.[25]

Not all federal and state courts apply the doctrine in all of these scenarios. Indeed, most jurisdictions have not precisely defined the doctrine's parameters and attributes.

The common interest doctrine is also referred to and/or conceptualized in alternate forms as the "community of interests doctrine" and the "joint defense privilege," and is often confused with other privilege doctrines. In this chapter, we use "common interest doctrine" to describe the extension of the attorney-client privilege to information exchanged by parties with a common interest, each with separately retained counsel, and with or without pending or anticipated litigation. Another situation, commonly known as the joint defense privilege and often affirmatively created by a "joint defense agreement," allows separate attorneys representing distinct clients with a common interest to communicate with one another without waiving the

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18 *See* Seadlcek v. Morgan Whitney Trading Group, Inc., 795 F. Supp. 329, 331 (C.D. Cal. 1992) (internal citations omitted).

19 *See In re* LTV Security Lit., 89 F.R.D. at 604.

20 *See id*.

21 *See* Leybold-Heraeus Tech's, Inc. v. Midwest Instrument Co., 118 F.R.D. 609, 613 (E.D. Wis. 1987).

22 *See Schwimmer*, 892 F.2d at 243.

23 *See In re Bevill*, 805 F.2d at 124.

24 *See* Haines v. Liggett Group, Inc., 975 F.2d 81, 90 (3d Cir. 1992).

25 *See* United States v. Am. Tel. & Tel. Co., 642 F.2d 1285, 1299 (D.C. Cir. 1980).

attorney-client privilege *during litigation*.[26] The common interest doctrine is more expansive than the joint defense privilege because it may apply absent pending or anticipated litigation.

[2] — Purpose and Policy.

One purpose of the common interest doctrine is to promote fairness by protecting the free flow of information, thereby facilitating litigation of the clients' best possible case.[27] "The [common interest doctrine] fulfills the social goal of encouraging inter-party communications by preserving their confidentiality. When several clients retain separate counsel, the litigation often requires cooperation among the clients and their respective counsel if the clients are going to receive effective legal representation."[28]

The benefit of free communication between a client and his attorney and between parties with a common interest must be balanced against the benefit of full discovery between adversaries. Courts must determine how much weight to give the presumption of disclosure. For this reason, courts enforce the doctrine, if at all, with divergent application, coverage and effectiveness. This uncertainty presents a danger in relying on the common interest doctrine. As the United States Supreme Court stated: "An uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all."[29] Attorneys must examine the law of the doctrine in the relevant jurisdiction or risk waiving the attorney-client privilege.

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26 *See, e.g.*, Slider v. State Farm Mut. Auto. Ins. Co., 557 S.E.2d 883, 887 (W. Va. 2001); *see also* Selan Epstein, *supra* note 5, at 286 (for a discussion on this form of the common interest privilege).

27 United States v. Schwimmer, 892 F.2d 237, 243-44 (2d Cir. 1989) ("The need to protect the free flow of information from client to attorney logically exists whenever multiple clients share a common interest about a legal matter . . .") (internal citations omitted).

28 Susan K. Rushing, Note, "Separating the Joint-Defense Doctrine from the Attorney-Client Privilege," 68 *Tex. L. Rev.* 1273, 1274 (1990).

29 Upjohn v. United States, 449 U.S. 383, 393 (1981).

§ 20.04. Uncertain Application of the Common Interest Doctrine.

Certain characteristics of the common interest doctrine are widely accepted. For example, one party may intervene and assert the privilege that another party in the common interest relationship is prepared to waive.[30] And if parties in a common interest relationship subsequently enter adverse litigation, neither party may assert the privilege to preclude testimony against the other. However, the common interest doctrine is otherwise applied sporadically and inconsistently throughout the United States. Indeed, the fundamental requirement that the parties share a common interest is difficult to define. Generally, *identical* interests are not required,[31] but courts disagree on the precise level of common interests required. Though courts disagree, it is clear that when total alignment is not required, the privilege only applies to matters of common interest.

Entities and individuals interested in common interest protection should consider how, and if, the relevant jurisdiction addresses the following questions:

- Is contemplated or actual litigation required?
- Must the parties take steps to preserve confidentiality?
- Is an underlying privilege always required?
- Is the presence of an attorney required?
- Is the presence of a party required (in the case of communications between attorneys)?
- Is a written agreement required?
- Does waiver by one party affect the privilege as to other party?

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30 *See, e.g.*, *In re* Grand Jury Proceedings, 156 F.3d 1038 (10th Cir. 1998).

31 *See, e.g.,* Visual Scene, Inc. v. Pilkington Brothers, PLC, 508 So. 2d 437, 439 (Fla. Dist. Ct. App. 1987) (extending the doctrine to a plaintiff and defendant in the same case because the parties had a common interest in defending against a cross-claim and counterclaim brought by a common co-defendant).

- What is the degree of aligned interests required?
- When is the agreement terminated?
- May the doctrine be asserted against the other party in the absence of litigation?
- Does the doctrine apply in the commercial/transactional context?

A couple of these considerations will be addressed in further detail to follow.

[1] — Legal v. Commercial Interests.

Most courts require a common legal, rather than merely commercial, interest. For example, in *Duplan Corporation v. Deering Milliken, Inc*., the Unites States District Court for the District of South Carolina declined to extend the common interest doctrine to communications between counsel for the plaintiff, a patent owner, and counsel for a non-party, the exclusive licensee under that patent, because the parties did not share a legal interest.[32] Other courts have determined that patent owners and licensees do have a common *legal*, rather than merely commercial, interest.[33]

This application of the doctrine has been established by the courts for concerns of abuse, highlighted particularly in antitrust cases, where corporate entities attempt to shield evidence of their collusive behavior with the common interest doctrine. Thus it is clear that when a common legal interest is present, but the common interest is predominately of a business nature, relying on the common interest creates the risk of privilege waiver.

[2] — Pending Litigation Requirement.

Most jurisdictions require actual or threatened[34] litigation for common interest protection. This concept correlates with the legal, versus commercial,

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32 Duplan Corp. v. Deering Milliken, Inc., 397 F. Supp. 1146, 1175 (D.S.C. 1975).

33 *See* Hewlett-Packard Co. v. Bausch & Lomb, Inc., 115 F.R.D. 308, 310, 312 (N.D. Cal. 1987).

34 Though case law addressing the concept of "threatened" litigation is scarce in the common interest context, the case law is well-developed in the context of work-product protection and courts often look to the same.

interest requirement. Thus, in jurisdictions that require a common legal interest, courts reason that no common legal interest can exist without threatened litigation. For example, in *Niagara Mohawk Power Corp. v. Megan-Racine Associates, Inc.*, a purchaser from a debtor during Chapter 11 bankruptcy alleged that the debtor violated provisions of a power purchase agreement by falling below certain standards under the Public Utility Regulatory Policies Act, and moved to compel discovery of certain documents.[35] Debtor and receiver, the FDIC, asserted protection under the common interest doctrine (referred to as the joint defense privilege). The court acknowledged that bankruptcy cases, by their nature, involve common commercial interests. The court, therefore, rejected the argument that a common commercial interest is enough, and directed the parties to determine if any of the documents sought to be produced were prepared in anticipation of litigation.[36]

Other jurisdictions have held that no pending or anticipated litigation is necessary for protection. The reasoning behind this point of view is well-stated by the United States District Court for the District of Connecticut:

> Corporations should be encouraged to seek legal advice in planning their affairs to avoid litigation as well as in pursuing it. The timing and setting of the communications are important indicators of the measure of common interest; the shared interest necessary to justify extending the privilege to encompass intercorporate communications appears most clearly in cases of co-defendants and impending litigations but is not necessarily limited to those situations.[37]

[3] — Uncertainty Is Discouraged by the Supreme Court.

Though some state and federal courts have definitively addressed the parameters and applications of the common interest doctrine, most have not.

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35 Niagara Mohawk Power Corp. v. Megan-Racine Assocs., Inc., 189 B.R. 562 , 567 (Bankr. N.D.N.Y. 1995).

36 *Id*. at 573.

37 SCM Corp. v. Xerox Corp., 70 F.R.D. 508, 513 (D. Conn. 1976).

In federal court, parties face the additional uncertainty of whether to apply state or federal law and, if state law applies, which state's law. If parties are to rely on the common interest doctrine, they often cannot foresee the nature of the eventual legal action, or to jurisdiction in which that legal action will be brought. As such, it is dangerous to rely on the common interest doctrine when parties share a mere commercial interest with no litigation in sight. The risk of waiving the attorney-client privilege, particularly when waiver can be absolute, discourages the free flow of information in contradiction to the goals of the common interest doctrine and the underlying attorney-client privilege.[38]

In *Upjohn Co. v. United States*, the Supreme Court of the United States acknowledged that corporations, as opposed to the average individual, require the protection of the attorney-client privilege in planning their everyday affairs, not just in responding to legal challenges.[39] One author extends the policy expounded in *Upjohn* to the common interest doctrine, suggesting that courts should uniformly reject limitations on the common interest doctrine to pending or anticipated litigation.[40] Such a limitation is unnecessary, particularly in light of other safeguards such as the requirement that the communication is used for the purpose of giving or receiving legal advice, and the requirement that the parties have a common *legal* interest.[41] This author advocates application of the doctrine in the due diligence phase of substantial transactions, *e.g.*, mergers, substantial asset sales, subsidiary divestitures, and succession to liabilities in general, because in these instances the parties' interests are aligned.[42]

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38 *See* Schaffzin, *supra* note 4, at 76.

39 Upjohn Co. v. United States, 449 U.S. 383, 392 (1981).

40 Schaffzin, *supra* note 4, at 76.

41 *Id*.

42 Anne King, "The Common Interest Doctrine and Disclosures During Negotiations for Substantial Transactions," 74 *U. Chi. L. Rev*. 1411 (2007).

§ 20.05. Application by Jurisdiction.

[1] — Kentucky.

The common interest doctrine has not been adopted by courts in the Commonwealth of Kentucky. However, support can be found in Kentucky Rule of Evidence 503(b):

> A client has a privilege to refuse to disclose and to prevent any other person from disclosing a confidential communication made for the purpose of facilitating the rendition of professional legal services to the client:
>
> > (3) By the client or a representative of the client or the client's lawyer or a representative of the lawyer to a lawyer or a representative of a lawyer representing another party in a pending action and concerning a matter of common interest therein.[43]

Rule 503(b) was cited in the context of the common interest doctrine by the Kentucky Attorney General Jack Conway in *In re: Matthew R. Klein/Cabinet for Health and Family Services*.[44] In this matter, Conway considered whether communications between attorneys for the Cabinet of Health and Family Services (the "Cabinet"), and attorneys for a transitional care facility seeking reconsideration of a final order of the Cabinet, retained the attorney-client privilege. Conway discussed the common interest doctrine in relation to Rule 503(b), noting that "[a]lthough the federal cases 'suggest that the litigation at issue could be prospective, . . . Kentucky's rule requires the litigation be pending.'"[45] Conway also found that efforts to maintain confidentiality is a prerequisite to protection: "Thus, the privilege consists of three elements: The relationship of attorney and client, communication by or to the client relating to the subject matter upon which professional advice is

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43 Ky. R. Evid. 503(b).

44 *In re*: Matthew R. Klein/Cabinet for Health and Family Services, Op. Att'y Gen. (Ky.), 10-ORD-039, 2010 WL 1989593 (March 2, 2010).

45 *Id*. at *2 (internal quotations omitted).

sought, and the confidentiality of the expression for which the protection is claimed.'"[46] Conway continued to find communications between the agency and the administrative appellant privileged.

[2] — Ohio.

The common interest doctrine has not been expressly adopted in Ohio, but it has been recognized by several courts in some form. For example, in *Buckeye Corrugated, Inc. v. Cincinnati Insurance Co.*, the court held that a party to a joint defense arrangement was not required to disclose any matter related to the common interest of the parties to the joint defense agreement.[47]

Libbey Glass, Inc. v. Oneida Ltd.,[48] although a federal district court case, is worth mentioning because privilege law is often characterized as "substantive" in diversity cases for purposes of the Erie Doctrine and, therefore, state law is applied.[49] In *Libbey Glass*, the Northern District of Ohio considered whether the common interest doctrine applied when parties have a common commercial interest. The court acknowledged *Hewlitt-Packard v. Bausch & Lomb*,[50] in which Northern District of California held that no waiver of the attorney-client privileged occurred when a patent owner

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46 *Id*. at *3 (also noting that the purpose of the common interest doctrine is to "ensure that confidences exchanged by an attorney and client are protected, thereby encouraging them to freely communicate") (internal citations omitted).

47 No. 26634, 2013 WL 4153540 (Ohio Ct. App. (9th Dist.) Aug. 14, 2014). *See also* Zerner v. New Par, No. 1999-CA-00201, 2000 WL 222150 (Ohio Ct. App. (5th Dist.) Jan. 31, 2000) (recognizing the joint representation privilege).

48 Libbey Glass, Inc. v. Oneida Ltd., 197 F.R.D. 342 (N. D. Ohio 1999).

49 *See, e.g.,* Hyde Constr. Co. v. Koehring Co., 455 F.2d 337 (5th Cir. 1972); Erie R.R. v. Tompkins, 304 U.S. 64, 58 S. Ct. 817 (1938). *But see* Wm. T. Thompson Co. v. Gen. Nutrition Corp., 671 F.2d 100, 104 (3d. Cir. 1982) (holding "that when there are federal law claims in a case also presenting state law claims, the federal rule favoring admissibility . . . is the controlling rule."); Tucker v. United States, 143 F. Supp. 2d 619, 622–25 (S.D. W. Va. 2001) (finding federal privilege law, not state privilege law, applied to both FTCA and pendent state law claims in medical malpractice case); Syposs v. United States, 179 F.R.D. 406, 411 (W.D.N.Y. 1998) (finding medical malpractice claim under the FTCA is a federal question case and therefore the federal common law of privileges applies).

50 Hewlitt-Packard v. Bausch & Lomb, 115 F.R.D. 308, 309-11 (N.D. Cal. 1987).

disclosed its patent attorney's opinion letter to a prospective purchaser.[51] However, the *Libbey Glass* court was persuaded by the narrower view set forth in *Bank Brussels Lambert v. Credit Lyonnais*,[52] that confidential communications can be shared only if the parties have a common *legal*, rather than merely commercial, interest.[53]

[3] — Pennsylvania.

The Pennsylvania Supreme Court has not expressly adopted the common interest doctrine, though it has been recognized by several courts.[54] In *Young v. Presbyterian Homes, Inc*., plaintiff sued defendant Lisa Quinby for assault and battery and defendant Presbyterian Homes, Inc., for negligently hiring and retaining Quinby.[55] The defendants entered into a joint defense and confidentiality agreement because they had a common interest in defending against plaintiff's allegations. The Leigh County Court of Common Pleas noted that the common interest privilege only applies if the parties asserting it shared a common legal, rather than commercial, interest.[56] The court held that statements made by employees of Presbyterian Homes in an interview conducted by its counsel and counsel for Quinby were protected by the common interest privilege.[57] The court reasoned:

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51 *Libbey Glass*, 197 F.R.D. at 348.

52 Bank Brussels Lambert v. Credit Lyonnais, 160 F.R.D. 437, 447 (S.D.N.Y. 1995).

53 *Libbey Glass*, 197 F.R.D. at 348.

54 "The "joint defense" or "common interest" privilege "essentially is an extension of the attorney-client privilege."); Executive Risk Indem., Inc. v. Cigna Corp, 2004 No. 1495, 2006 WL 2439733 at *7 (Pa. Commw. Ct. 2006) (a shared business interest is insufficient for common interest protection); Commonwealth v. Scarfo, 611 A.2d 242, (Pa. Commw. Ct. 1992) (extending the privilege to criminal defendants and their right to prepare a group defense).

55 50 Pa. D.&C. 4th 190, 198 (C.P. 2001) ("Frequently, co-defendants with essentially the same interest must retain separate counsel to avoid potential conflicts over contingency or subsidiary issues in the case. To avoid duplication of efforts, such defendants should be able to pool their resources on matters of common interest.").

56 *In re* Condemnation of City of Philadelphia in 16.2626 Acre Area, 981 A.2d 391, 396 (Pa. Commw. Ct. 2009).

57 197 F.R.D. at 199-200.

> Frequently, co-defendants with essentially the same interests must retain separate counsel to avoid potential conflicts over contingent or subsidiary issues in the case. To avoid duplication of efforts, such defendants should be able to pool their resources on matters of common interest. This can be done most effectively if both counsel can attend and participate in interviews with each other's clients and with employees of their client .... In this situation it makes a great deal of sense for both defense counsel to work together in providing a joint defense. So long as the defendants and their counsel wish to do so, the courts should not impede their efforts by withdrawing the protection of the attorney-client privilege for statements made in the presence of both counsel.[58]

In *Executive Risk Indemnification, Inc. v. Cigna Corp.*, the Philadelphia Court of Common Pleas cited the common interest doctrine to shield from production certain communications between Executive Risk Indemnification, Inc., and other insurers which were made as a part of a joint defense against Cigna Corp.'s claim for coverage.[59] The court stated with regard to the common interest doctrine:

> Of course the privilege extends only to counsel and parties who have entered into a joint defense agreement and share a common interest in legal strategy. A shared common business interest is insufficient to afford protection. Most importantly, unless an individual attorney-client privilege independently shields material from discovery, the otherwise common interest among the parties is of no consequence.[60]

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58 *Id*. at *198.

59 Executive Risk Indem., Inc. v. Cigna Corp, 2004 No. 1495, 2006 WL 2439733 at *7 (Pa. Commw. Ct. 2006).

60 *Id*.

[4] — West Virginia.

West Virginia has yet to formally adopt a version of the common interest privilege. Yet, most attorneys assume such protection exists and commonly enter into and rely on joint defense agreements. The following cases illustrate the uncertainty of the doctrine in West Virginia.

In *State ex rel. Brison v. Kaufman,*[61] an automobile insurer, its former claims representative, and two former attorneys for the insurer petitioned for a writ of prohibition against discovery of a litigation file and redacted portions of a claim file in a bad faith action in the Circuit Court of Kanawha County. Cledith Lee Falls, Jr., had been killed in a car accident while riding as a passenger in a car driven by April D. Knight. Deborah K. Falls (Falls), Administratrix of the Estate of Cledith Falls, filed a wrongful death action against Knight and others, and sought underinsurance coverage from Nationwide Mutual Insurance Company (Nationwide). Nationwide paid Falls the policy limits, but Falls filed bad faith and unfair trade practice claims against Nationwide for Nationwide's alleged delay in paying the underinsurance benefits. Falls sought discovery of the litigation file and redacted portions of the claim file that were created and maintained during the earlier wrongful death action, and Nationwide sought protection from this disclosure under attorney-client privilege and the work-product doctrine.

After determining that Nationwide's former attorneys did in fact represent Nationwide in the wrongful death action, the court applied the attorney-client privilege and the work-product doctrine to prohibit production and disclosure of the documents. However, only Chief Justice Robin Jean Davis, in her concurring opinion, discussed the common interest privilege.[62] She explained that there are two contexts in which first-party bad faith actions against the insurer arise. In the first scenario, an insurer fails to use good faith in resolving a "loss claim" filed by the insured. In loss claim actions, the insurer and insured are generally in an adversarial relationship because the insured has filed a claim for a loss sustained and the insurer has denied coverage,

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61 State ex rel. Brison v. Kaufman, 584 S.E.2d 480 (W. Va. 2003).

62 *Id*. at 635 (Davis, J. concurring).

delayed payment, or offered an amount the insured deems insufficient to cover the loss.[63] This is the basic fact pattern in *Kaufman*, and Chief Justice Davis concluded that it was properly resolved under traditional principles of attorney-client privilege and the work-product doctrine.[64]

The second scenario results from the insurer's failure to use good faith in settling a lawsuit brought by a third-party against the insured, resulting in an "excess judgment" against the insured.[65] This scenario is distinct for purposes of the common interest privilege because when an insured is sued by a third-party and the insurance company provides representation, the insurer employs the attorney to represent the common interests of both the insured and the insurer.[66]

Thus, in this setting the common interest privilege allows counsel to share with the insured privileged communications with the insurer without losing the privilege. However, in a subsequent bad faith litigation between the insurer and the insured, the privilege will not apply to prevent disclosure of his or her claim file and the litigation file because their interests are no longer aligned:

> The common interest privilege is usually cited as the reason for not allowing the attorney-client privilege and work product rule to apply in first-party bad faith litigation arising from a prior mutual interest litigation. "[U]nder the common interest privilege, when an attorney acts for two different parties who each have a common interest, communications by either party to the attorney are not necessarily privileged in a subsequent controversy between the two parties. . . ." [And] the interests of the insured and insurer in defeating the third-party claim against the insured are so close that 'no reasonable expectation of confidentiality is said to exist.[67]

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63 *Id*. (Davis, J. concurring).
64 *Id*. (Davis, J., concurring).
65 *Id*. (Davis, J., concurring).
66 *Id*. (Davis, J., concurring).
67 *Id*. at 636 (Davis, J. concurring) (citation omitted).

Despite recognizing that *Kaufman* concerned a first-party bad faith "loss claim" action, Chief Justice Davis went out of her way to address the common interest privilege in the context of first-party "excess judgment" bad faith litigation. Thus, it is seems clear that Chief Justice Davis, at the very least, would be willing to apply the common interest privilege if the right case arose.

Judge David W. Hummel of the Circuit Court of Marshall County took a contrary view and rejected an application of the common interest doctrine in *Baker v. PPG Industries, Inc*.[68] In *Baker*, plaintiff filed suit against co-employee David Wayne Wade and her employer, PPG Industries, Inc. (PPG), alleging sexual harassment. During discovery, plaintiff sought production of documents exchanged by the co-defendants, including agreements between them. PPG filed a motion for protective order, requesting that the court prohibit production of the requested documents on the basis that they were protected from disclosure by the common interest doctrine. The defendants acknowledged that West Virginia has not yet formally adopted the common interest privilege, but cited two West Virginia cases "that support[] the proposition that such privileges would be recognized as a logical extension of the attorney-client privilege and work product doctrines."[69] Defendants also discussed at length the Fourth Circuit's support for the doctrine.

Despite the Fourth Circuit's support for, and West Virginia's acknowledgement of, the common interest doctrine, Judge Hummel roundly rejected the common interest privilege for its uneven application in jurisdictions which have affirmatively adopted it: "An uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all."[70] Finally, Judge Hummel

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68 C.A. No. 12-C-229 (Marshall Cty January 2, 2014).

69 Joint Alternative Motions of Defendants PPG Indus. Inc. and David Wayne Wade for Reconsideration, for Certification of Question, for Findings of Fact and Conclusions of Law and for Stay of Execution of Order at 3, Baker v. PPG Indus. Inc., C.A. No. 12-C-229 (Marshall Cty Sept. 18, 2013) (citing State ex rel. Medical Assurance of W. Va., Inc. v. Recht, 583 S.E.2d 80, 88 (2003) and Kirchner v. Smith, 58 S.E. 614, 620 (W. Va. 1907)).

70 Order at 2, Baker v. PPG Indus., Inc., C.A. No. 12-C-229 (Marshall Cty. Sept. 4, 2013) (quoting Upjohn v. United States, 449 U.S. 383, 393 (1981)).

recognized, not wrongly-so, that if the doctrine were to be adopted, "a hot-mess of details need to be ironed out":

1. Is an express agreement necessary or will the courts be able to presume that communications are intended to be in furtherance of a joint defense based upon the parties' actions?
2. Would the doctrine or privilege apply where litigation is not threatened or anticipated or will the "palpable threat of litigation" at the time of the communications be required?
3. Will the doctrine or privilege be limited to where the parties have common shared legal interests rather than only a common shared economic, financial or commercial interests?
4. What would constitute "waiver" and who could be found to have "waived the application of the doctrine or privilege as well as how and to what extent?[71]

[5] — Third Circuit Court of Appeals.

The seminal case on the common interest doctrine in the Third Circuit Court of Appeals is *Teleglobe Communications Corp. v. BCE Inc.*[72] In *Teleglobe*, Chapter 11 debtor subsidiaries alleged breach of contract, breach of fiduciary duties, estoppel, and misrepresentation relating to the manner in which a controlling corporation, Bell Canada Enterprises, Inc. ("BCE"), ceased funding debtors' corporate parent, Teleglobe Communications Corp. ("Teleglobe"). Pre-suit creditors had sought production of documents from the BCE, but BCE claimed that certain documents were protected by the common interest doctrine because BCE had consulted with attorneys of Teleglobe, which shared common legal interest with BCE.[73] The Third Circuit discussed the common interest doctrine at length, describing several characteristics of the doctrine:

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71 *Id*. at 3.

72 Teleglobe Communications Corp. v. BCE Inc., 493 F.3d 345 (3d Cir. 2007).

73 *Id*. at 354.

- Written agreements are preferable, but not required.[74]
- Waiver of the privilege requires consent of all joint clients.[75]
- "[The common interest privilege] applies in civil and criminal litigation, and even in purely transactional contexts."[76]
- "[T]he communications must be shared with the *attorney* of the member of the community of interest."[77]

Several federal district courts in the Third Circuit's jurisdiction applied the common interest doctrine differently. In *Katz v AT&T Corp.*,[78] the Eastern District of Pennsylvania held that documents related to negotiations between a patentee and potential licensee prior to the final licensing agreement were not protected under the common interest doctrine: "The nature of the interest . . . must be identical, not similar, and be legal, not solely commercial."[79] However, the Middle District of Maryland held that the interests of the parties need not be identical, and may even be adverse in some respects.[80]

[6] — Fourth Circuit Court of Appeals.

The Fourth Circuit Court of Appeals has consistently applied the common interest doctrine. For example, in *In re Grand Jury Subpoenas*, the Fourth Circuit applied the common interest doctrine to protect communications between attorneys for a civil plaintiff and a non-party who did not contemplate litigation.[81]

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74 *Id*. at 362-63.

75 *Id*. at 363.

76 *Id*. at 364 (The court cites to the Restatement (Third) of the Law Governing Lawyers, but acknowledges that the leading approach is that the common interest must be legal in nature.).

77 *Id*. at 363-64.

78 Katz v. AT&T Corp., 191 F.R.D. 433 (E.D. Pa. 2000).

79 *Id*. at 437 (internal citations omitted).

80 Andritz Sprout-Bauer, Inc. v. Beazer East, Inc., 174 F.R.D. 609, 634 (M.D. Pa. 1997).

81 *In re* Grand Jury Subpoenas, 89-3 & 89-4, John Doe 89-129, 902 F.2d 244, 249 (4th Cir. 1990) (The privilege does not depend on a joint defense agreement, but "must rest in the first instance on the existence of some common interest about a legal matter.").

Whether an action is ongoing or contemplated, whether the jointly interested persons are defendants or plaintiffs, and whether the litigation or potential litigation is civil or criminal, the rationale for the joint defense rule remains unchanged: persons who share a common interest in litigation should be able to communicate with their respective attorneys and with each other to more effectively prosecute or defend their claims. The district court's ruling, apparently based on the notion that the joint defense privilege is limited to codefendants, was in error.[82]

In *United States v. Aramony*, several criminal defendants were convicted of conspiracy to defraud the United Way of America (UWA).[83] Aramony appealed, claiming attorney-client privilege with regard to his communications with UWA attorneys. The court considered the common interest doctrine, explaining that parties must first share a common interest in a *legal* matter to be entitled to protection, but that it is unnecessary that there be actual litigation in progress of the privilege to apply.[84] The Fourth Circuit ultimately rejected Aramony's contention, finding that Aramony and the UWA attorneys did not share a common interest about a legal matter.[85]

Finally, in *Hunton & Williams v. U.S. Department of Justice*, Hunton, a requester under the Freedom of Information Act (FOIA), appealed an adverse ruling to his claim for records related to communications between the United States Department of Justice (DOJ) and a telecommunications company, Research in Motion, Ltd. ("RIM").[86] Hunton argued that communications between the RIM and the DOJ were not protected because RIM is a private party.[87] The district court disagreed, reasoning that "communications between a government agency and a party possessing *common and unitary*

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82 *Id*. at 249.

83 United States v. Aramony, 88 F.3d 1369, 1392 (4th Cir. 1996).

84 *Id., see also* Hanson v. U.S. Agency for Int'l Devel., 372 F.3d 286, 292 (4th Cir. 2004).

85 88 F.3d at 1392.

86 Hunton & Williams v. U.S. Dept. of Justice, 590 F.3d 272, 277-78 (4th Cir. 2010).

87 *Id*. at 277.

litigation interests should be understood as 'intra-agency' for purposes of [the FOIA]."[88] The Fourth Circuit sided with the district court on this point:

> The common interest doctrine permits parties whose legal interests coincide to share privileged materials with one another in order to more effectively prosecute or defend their claims. Under Hunton's reading, however, the decision of a party, here the government, to partner with others in the conduct of litigation would somehow subject that party to the loss of its most basic civil discovery privileges-namely, the attorney-client and attorney work product privileges.
>
> This is a sweeping view, and its impact on the government's ability to conduct complex and multi-faceted litigation would be staggering.[89]

Thus, the Fourth Circuit analogizes the interests of common civil parties in preserving the attorney-client privilege to the need of federal agencies to protect communications with private parties in discharging their duties:

> It is that convergence of interests that entitles the government to communicate within the terms of the [FOIA] and to do so in a manner that does not strip it of those deliberative privileges that other litigants enjoy and that are widely recognized as necessary to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. What is sometimes termed the common interest doctrine is in this sense simply a matter of evenhandedness.[90]

[7] — Sixth Circuit Court of Appeals.

The Sixth Circuit Court of Appeals, unlike the other federal circuits covered in this chapter, has not explicitly adopted the common interest

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88 *Id*. (emphasis added).

89 *Id*. at 277-78.

90 *Id*. at 278.

doctrine.[91] In *Reed v. Baxter*, the court recognized the doctrine in dicta, but refused to apply it because it found a disparity of interests between the entities.[92] In *Baxter*, white firefighters alleged that the City of Murfreesboro violated Title VII by promoting an African-American firefighter to the rank of captain without regard to the candidates' qualifications. In the United States District Court for the Middle District of Tennessee, plaintiffs had sought evidence of statements made during a meeting between the city attorney and city council members, but the court granted a motion in limine to exclude deposition testimony regarding the same. On appeal, the Sixth Circuit discussed the common interest doctrine, noting that the common interest may be "either legal, factual, or strategic in character."[93] However, the court found that the common interest doctrine did not apply because no attorney-client privilege existed — the city council members participated in the meeting as third-parties, not as clients of the city attorney.[94] The Sixth Circuit held that the district court's pretrial ruling rested on a misapplication of the attorney-client privilege and vacated the judgment.

§ 20.06. Conclusion.

Due to the fact intensive analysis by the courts on a case-by-case basis and the lack of uniformity in application throughout the courts, state and federal, in the Appalachian Basin, it is difficult to rely on the common interest doctrine as a primary defense for preserving the attorney-client privilege. While the prudent litigator must certainly be aware of this doctrine's application in the jurisdiction in which litigation is pending, he or she should seriously consider the limitations the courts place on a party's right to exercise this extension of the attorney-client privilege. Even when used offensively to attack allegedly privileged documents, the same uncertainty is present. Ultimately, these authors anticipate that issues concerning the common interest doctrine will

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91 *But see Libbey Glass, Inc.*, *supra* § 20.05 [2].

92 Reed v. Baxter, 134 F.3d 351, 358 (6th Cir. 1998).

93 *Id*. at 357 (internal citations omitted).

94 *Id*. at 357-58.

become more frequent "litigation within litigation" in oil and gas cases due to the collaborative nature of the business relationships in the industry coupled with the vast and diverse landscape of the law.

Chapter 21

Title Traps

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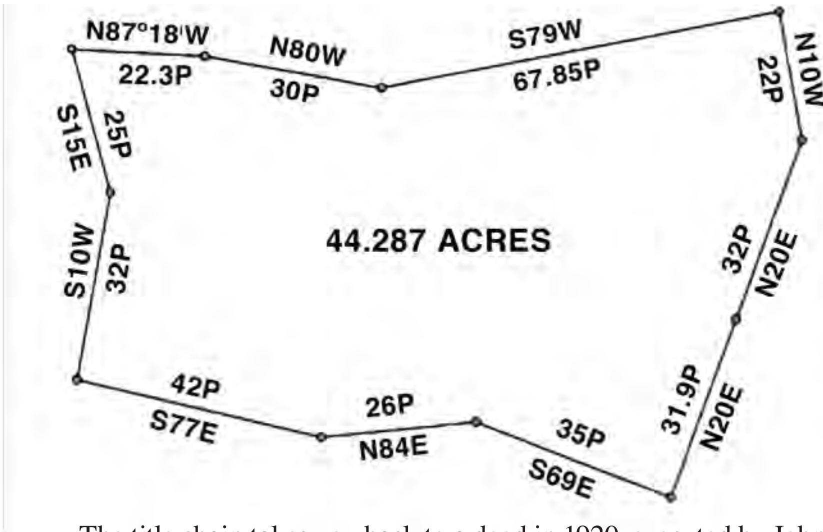
§ 21.01. Introduction.

There are numerous traps in title examinations that can create problems for the unsuspecting abstractor or title attorney. This chapter presents a review of some of the more common title traps in order that the title searcher or attorney may be aware of problems lurking in the title chain, which could otherwise be overlooked.

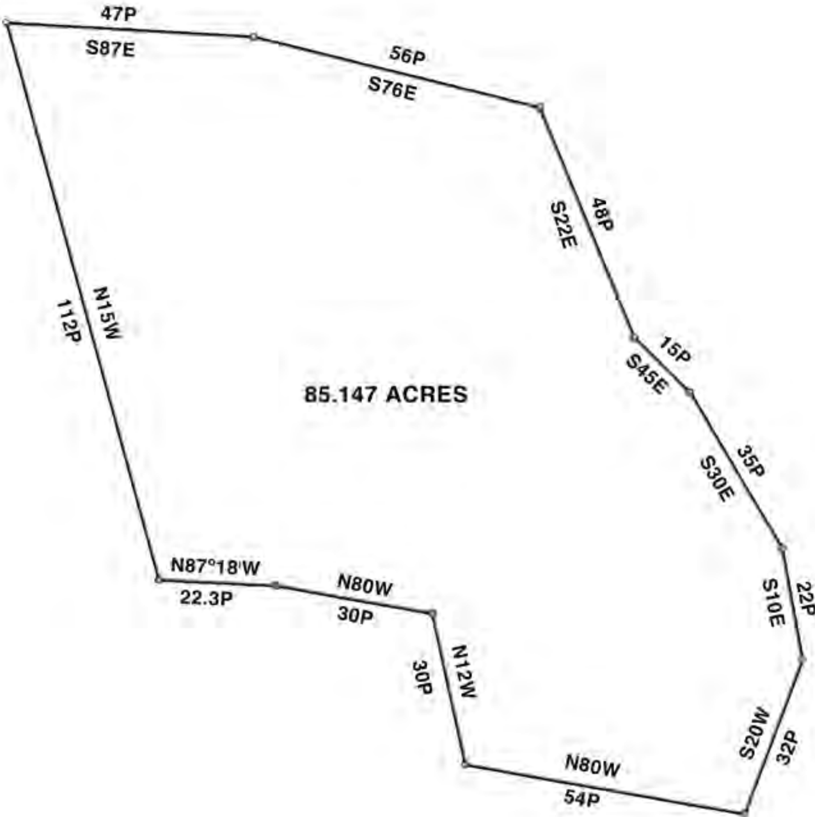
§ 21.02. Trap No. 1: Property Descriptions – Reliance on Recitals.

The title examination is for a lease covering 44.287 acres. A computer plat for the subject 44.287 acres tract is shown below.

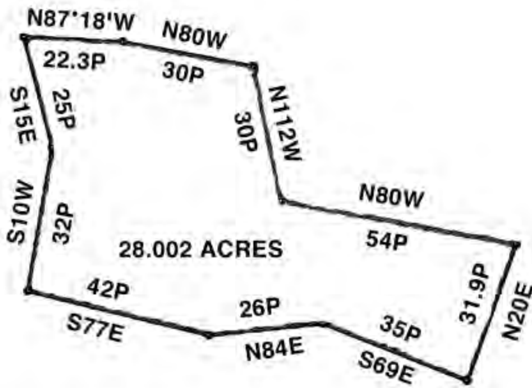


The title chain takes you back to a deed in 1920, executed by John Doe which includes a recital of "being part of a larger tract conveyed by William Smith to John Doe by deed dated April 12, 1911, recorded April 17, 1911, in Deed Book 147, page 58." You locate that deed, which conveys a tract containing 85.147 acres, and you continue examining the chain of title from 1911 back to a deed executed in 1852.

If you relied upon the recital in the 1920 deed and issued a title certificate accordingly, you would be caught in a title trap. The 85.147 acres conveyed by the 1911 deed is shown below. If you simply relied on the recital and did not make a computer plat of the 44.287 acres tract and the 85.147 acres tract, you would not realize that something is amiss. By comparing the 44.287 acres tract and the 85.147 acres tract you will soon realize that only a portion of the 44.287 acres tract is included within the 85.147 acres tract. By comparing the descriptions of the two tracts utilizing the adjoinders and specific corner points, you realize that only a portion of the 44.287 acres is located within the 85.147 acres.

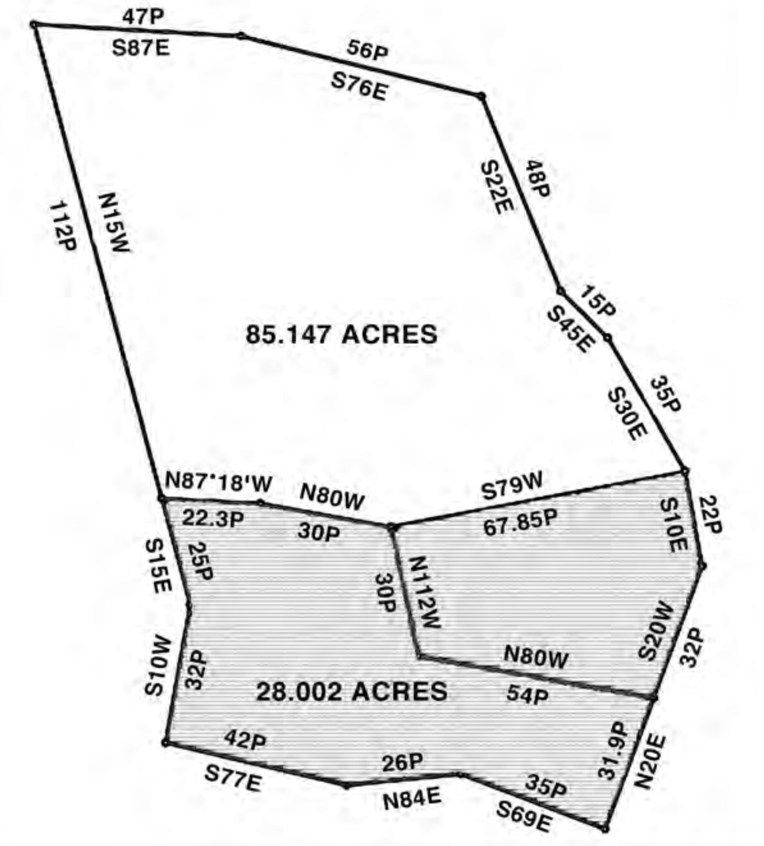


You are now presented with the problems of locating the source of the title into John Doe for the remaining portion of the 44.287 acres. Upon examining the grantee index, you find that there are no additional deeds into John Doe indexed in the Recorder's Index. However, the description of the 85.147 acres tract describes the Southern adjoinder as property now or formerly of Henry Jackson. By examining records of Henry Jackson, you locate a deed from Henry Jackson to William Doe conveying a 28.002 acres tract, which is shown on the following page.



This then leads you to an estate file whereby all the property of William Doe was devised to his son, John Doe. The 85.147 acres tract and 28.002 acres tract, which became vested in John Doe, are shown below.

The above two tracts are shown below with the subject 44.287 acres tract shown as the interlined area.



Your title examination now includes a complete examination of both the 28.002 acres chain of title and the 85.147 acres chain of title resulting in a complete and accurate title certificate. Had you not conducted the examination of the 28.002 acres tract, this failure could have lead to dire results. For example, let's assume that in the 1870 deed from Henry Jackson to William Doe, Henry Jackson excepted and reserved title to the oil and gas which would then result in title failure as to the portion of the subject tract which is included within the 28.002 acres tract. Then, according to Murphy's

Law, your client might locate a well site on the portion of the subject tract, which is included in the 28.002 acres tract resulting in a trespass claim by the heirs of Henry Jackson.

§ 21.03. Trap No. 2: Race-Notice . . . Head Start in the Race.

Most states are Race-Notice jurisdictions. Ordinarily, in determining priority of recorded deeds, mortgages, oil and gas leases, liens, etc., the first item recorded, regardless of date, has priority over a subsequently recorded item regardless of which item was executed first.[1] One exception to the Race is Notice; if a party has actual notice of a previously executed document, even though not recorded, the previously executed document will have priority.[2] Another exception can be found in early recording statutes which allowed for a period of time to record an instrument due to the difficulty in getting to the county courthouse.

Early recording statutes provided for priority as of the date of the instrument if recorded during the permissible time period. In Pennsylvania, an Act of March 18, 1775, allowed six months for recording a deed, or 12 months if executed outside of the commonwealth.[3] This Act was amended by the Act of May 19, 1893, P.L.108 to provide that constructive notice of deeds executed in Pennsylvania and recorded within 90 days related back to the date of execution; constructive notice of deeds executed from out-of-state and recorded within six months related back to the date of execution. Following passage of the Act of May 12, 1925, P.L. 613 No. 327, effective January 1, 1926, a deed does not constitute constructive notice in Pennsylvania until recorded.

For example, if John Doe executed a deed in Maryland for property in Pennsylvania to William Smith on May 1, 1910, which was not recorded until October 31, 1910, and in the meantime John Doe executed a deed for the

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1 21 Pa. Cons. Stat. § 351.

2 *Id*.

3 Act of March 18, 1775, § 1, Purd. Dig. 583, pl. 94.

same property to Henry Jones on September 30, 1910, which Henry Jones promptly recorded on October 3, 1910, the deed from John Doe to William Smith prevails over the deed from John Doe to Henry Jones because William Smith recorded his deed within the 6 month grace period allowed under the recording statute in effect at that time. However, had the deed to William Smith not been recorded until November 2, 1910, then the deed from John Doe to Henry Jones prevails due to Race-Notice.

The above example illustrates only one of the situations where a search of the early grantor indices against the owner of record ending with the date of recordation of the first recorded deed executed by the grantor would fail to discover a superior chain of title of record derived from an earlier executed, but later recorded deed from that same grantor. Consequently, the title searcher must examine the early grantor indices beyond the date of recordation of the chain deed until the latest date within which an earlier executed, but subsequently recorded deed constitutes notice under the recording statute in effect as of the date of recordation of the chain deed.

§ 21.04. Trap No. 3: Heirship Interests — Tenancy by the Entireties.

Assume that you are examining title to a 50 acres tract devised by the Will of Robert Johnson to his four children: Mary, Alice, Robert Jr. and Henry. Subsequently, a deed is executed by Mary, Alice and Robert Jr. to Henry and his wife, Donna, as tenants by the entireties. Henry subsequently dies and title to said tract is conveyed by Donna reciting that title was acquired as surviving tenant by the entireties. However, the aforesaid deed from Mary, Alice and Robert Jr. conveyed only an undivided 3/4 interest to Henry and Donna. The remaining 1/4 interest remained vested solely in Henry. Further, assume that Henry died, intestate, in 1990 survived by his wife, Donna, and their three children. In Pennsylvania, Donna would acquire only 1/2 of the 1/4 interest owned solely by Henry at the time of his death.[4] The remaining 1/2 of the 1/4 interest would vest in his three surviving children, vesting each

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4 20 Pa. Stat. § 2102.

child with an undivided 1/24 interest.[5] Consequently, title to the 3/24 interest needs to be examined and may be outstanding

§ 21.05. Trap No. 4: Unseated Tax Sales.

This is a problem unique to Pennsylvania. Previously, real estate was assessed as either seated property (developed or occupied) or unseated (vacant land). A tax sale of seated property conveyed only the real estate interest owned by the assessed owner. However, an unseated tax sale conveyed the entire interest in the property, excepting and reserving only interests which were separately assessed. For example, John Doe conveys a 100 acres tract to William Smith, excepting and reserving the oil and gas. Said property is assessed as unseated property to William Smith. Said property is subsequently conveyed at an unseated tax sale. The purchaser at the tax sale will acquire title to the entire property, including oil and gas, unless the oil and gas excepted and reserved by John Doe is separately assessed.

This chapter will not address the numerous legal issues created by unseated tax sales, which have been the subject of prior litigation in addition to several pending cases. Instead, this chapter will address only the title trap created by unseated tax sales.

Ordinarily, title to severed oil and gas can be examined by establishing a chain of title for the severed oil and gas to the present and examining all relevant indices to date. However, reliance on such an examination in Pennsylvania can result in title failure if the surface of the property was the subject of an unseated tax sale.

For example, take the severed oil and gas owned by John Doe by virtue of his exception and reservation of oil and gas. John Doe, not having knowledge of the unseated tax sale, conveys the oil and gas to Henry Jones which is followed by a complete chain of title ending with a 2015 deed conveying the same oil and gas. An examination of the entire chain of title for said oil and gas will not reveal any information concerning the unseated tax sale which effectively divested the separate oil and gas ownership resulting in title to

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5 *Id*.

the oil and gas being vested in the surface owner, assuming no subsequent severances of oil and gas by owners in the surface chain of title.

In order to eliminate the possible consequences of an unseated tax sale when examining title to severed oil and gas, there are two steps that should be taken by the title searcher if the tract being examined was assessed as unseated. First, an examination of the assessment records should be conducted to determine whether the severed oil and gas was separately assessed prior to the unseated tax sale. If the severed oil and gas was separately assessed, the second step is not necessary since an unseated tax sale does not divest any interest that is separately assessed. Second, if the severed oil and gas was not separately assessed, an examination of the surface chain of title will be necessary to verify that the surface tract was not conveyed by an unseated tax sale.

§ 21.06. Trap No. 5: Marriage Subsequent to Co-Tenancy.

Title to a tract is conveyed to John Doe and Mary Smith as tenants in common. Subsequently, John Doe and Mary Smith get married and execute rights of way as John Doe and Mary Doe, his wife. Title to said property is subsequently conveyed by deed executed by John Doe, widower, reciting that Mary Doe died, vesting title in John Doe by right of survivorship. However, marriage does not create a tenancy by the entireties. Unless John Doe and Mary Doe would execute a deed to themselves as tenants by the entireties, title continues to be held as tenants in common. Upon the death of Mary Doe, her 1/2 interest would vest in her surviving heirs.

§ 21.07. Trap No. 6: Effect of Divorce on Tenancy By the Entireties.

In Pennsylvania, prior to 1949, a divorce did not terminate the right of survivorship in a tenancy by entireties, although either party had a statutory right to file a partition proceeding.[6] However, subsequent to a statute enacted by Pennsylvania Law No. 412 of 1949, all real estate acquired subsequent to

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6 Act of May 10, 1927, P.L. §84, 68 P.S. § 501.

1949 as tenants by the entireties is converted to a tenancy in common upon divorce.[7] Although it would have probably made more sense to change the law concerning any divorce filed subsequent to 1949, this statute specifically applies only to property acquired subsequent to 1949. Therefore, if title was acquired in 1948, a subsequent divorce does not terminate the right of survivorship.

§ 21.08. Trap No. 7: Exception and Reservation of Oil and Gas in a Conveyance of a Portion of a Larger Tract.

Assume that John and Mary Doe own fee title to 100 acres. John and Mary Doe convey a tract containing 30 acres, excepting and reserving the oil and gas, to William Smith by deed recorded February 28, 2000. John and Mary Doe then convey the remaining 70 acres to Tom Jones by a deed dated April 15, 2005. Said conveyance could be made in one of the following methods:

(A) Deed describes 100 acres, but includes an exception and reservation stating "Excepting and reserving therefrom, all that 30 acres tract as conveyed to William Smith by deed recorded February 28, 2000, at Deed Book 2950, page 973."

The above deed only excepts and reserves what was conveyed in the prior deed. Since the prior deed did not convey the oil and gas, the oil and gas underlying the 30 acres is effectively conveyed to Tom Jones.

(B) The deed to Tom Jones conveys a separately surveyed tract containing 70 acres, which does not include any portion of the 30 acres tract.

Said deed conveys only the 70 acres and does not convey any interest in the 30 acres tract previously conveyed. Consequently, title to said oil and gas remains vested in John and Mary Doe.

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7 Act of May 17, 1949, P.L. §1394, 68 P.S. § 501.

(C) Deed conveys the 100 acres tract, but includes an exception and reservation stating "Excepting and reserving the following described tract":

"Beginning at a point" . . . (Deed includes the same metes and bounds description for the 30 acres in the deed to William Smith).

The deed excepts and reserves all interests in the specifically described 30 acres tract. Consequently, title to the oil and gas underlying the 30 acres remains vested in John Doe.

§ 21.09. Trap No. 8: Reacquisition of an Heirship Interest.

Title to a tract is vested in John Doe who dies survived by his three children, James, William and Mary. Subsequently, James executes a quitclaim deed to William and Mary conveying all of his right, title and interest in the property. Subsequently, William dies and is survived by his siblings, James and Mary as his sole heirs. A deed purporting to convey the property is subsequently executed by Mary, reciting the death of her father, the quitclaim deed by James, and the death of William. However, the death of William resulted in his 1/2 interest being vested in James 1/4 interest and Mary 1/4 interest. Consequently, the deed executed by Mary conveys only a 3/4 interest in the property and title to a 1/4 interest remains outstanding in James.

§ 21.10. Trap No. 9: Hidden Reservations.

Typically, when a deed contains an exception and reservation of oil and gas or other minerals, the exception and reservation is located after the description and before the Recital or Habendum. In some situations, however, the reservation is located somewhere else in the deed. In some rare cases, the reservation can be "hidden" within the deed. For example, an exception and reservation could be contained within the granting clause, following the addendum, inserted in the margin, or even following the grantor's signature. Consequently, care should be taken in reviewing the entire content of each deed in the chain of title.

§ 21.11. Trap No. 10: *Idem Sonans* Quandary.

Idem Sonans is a Latin term which means sounding the same or similar; having the same sound. However, there is an established legal doctrine in which a person's identity is presumed known despite the spelling of his or her name. In the context of title examinations, it is applied to deeds and indices, which contain a different spelling or misspelling of a party's name. In Pennsylvania, prior to computerized indexing, most counties utilized either an alphabetical index or a Russell Index. The Russell Index is based upon key letters L, M, N, R and T following the first letter in a person's last name or in a corporation's first name. If a name was sufficiently similar, although incorrect, it was afforded record notice if it was included in the same portion of the index that the correct spelling would occur.[8] For example, a deed indexed as Smith would afford record notice even though the actual name is Smyth. Other similar names might be Siebert/Sibert or Reed/Reid but the doctrine would not apply to Kane/Cain.

The advent of computerized recording systems would seemingly eliminate the doctrine of *Idem Sonans*. A computerized system requires more precision in the preparation and execution of recorded instruments. Documents should be captioned and executed with exactly the same name and spelling utilized in the prior vesting instrument. If the prior vesting instrument included an erroneous spelling, the current instrument should utilize the correct spelling but also include an "also known as" name utilizing the misspelling. Following recordation, the computerized index should be examined to verify that the Recorder of Deeds has properly indexed the instrument.

In some counties, all of the prior indices have been replaced by computerized indices. This raises an issue not yet addressed by the courts. For example, a prior document may have been entitled to record notice under the doctrine of *Idem Sonans* because it was located in the proper section of the Russell Index. However, a computer search utilizing the correct name will not reveal the document that was indexed with a misspelling. Theoretically,

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8 *See generally* 21 Pa. Stat § 357.

you could have a situation where William Smyth conveyed title to the oil and gas underlying his property by a deed that was mis-indexed as William Smith. Subsequent purchasers of the severed oil and gas could rely on record title under the doctrine of *Idem Sonans*. However, let's assume that current surface owner executes a deed conveying the oil and gas underlying the same property. The search of the computerized indices in the record chain of title will not reveal the instrument misspelled as Smith in the prior indices. Although there are no reported cases in Pennsylvania addressing this issue, at some point, the courts will have to rule on the priority of two such competing claims of title. A current owner, whose record title is based on the application of *Idem Sonans*, could protect himself by filing an affidavit concerning his chain of title to the oil and gas and have it indexed against the name of the current competing claimant. This might not protect his title against the current owner, but it would protect his title against successors to the current owner.

§ 21.12. Trap No. 11: "Boilerplate" Exception and Reservation.

A common exception and reservation found in deeds states "EXCEPTING AND RESERVING from First Tract and Second Tract all the coal and mining rights and the oil and gas as fully as the same have been excepted and reserved or conveyed by former owners". Ordinarily, this exception and reservation is included to protect the grantor from any general warranty claims in the event that there was a prior exception and reservation or conveyance of coal. Generally, it has no effect when there was no prior severance of title to the coal, oil and gas. However, what if there was a prior severance which has become revested in the grantor who then executes a deed including the aforesaid exception and reservation?

This issue was addressed by the Pennsylvania Supreme Court in *Sheaffer v. Caruso*.[9] In *Sheaffer*, there was an exception and reservation of oil and gas in a 1918 deed.[10] The surface followed a separate chain of title than the oil

9 Sheaffer v. Caruso, 676 A.2d 204 (Pa. 1996).
10 *Id*. at 206.

and gas for forty-seven (47) years.[11] However, after forty-seven (47) years, the surface owner acquired title to the oil and gas by virtue of a separate deed and the above quoted language was then included in a deed executed by said owner of surface, oil and gas. The issue raised was whether the above language was an effective exception and reservation of title to the oil and gas.[12] The trial court ruled that the exception and reservation was valid since the oil and gas was previously excepted and reserved.[13] The Superior Court of Pennsylvania reversed this holding ruling that the reservation clause did not clearly express an intention to limit the fee, and must, therefore by construed against the grantor.[14] The court further concluded that the above reservation clause was included in the deed in order to protect the grantor against liability which might arise under the general warranty deed and not to reserve an interest in the oil and gas to the grantor.

However, the Supreme Court ruled in the *Sheaffer* case that the exception and reservation language did effectively except and reserve title to the oil and gas. In justifying its ruling, the Supreme Court focused on the terms "excepting and reserving." The court stated

> By using the term 'excepting', the grantor excluded from the conveyance interests in the land or minerals which she did not own, thus protecting herself from liability under the warranty of the deed. By using the term 'reserving', she created in herself an estate in the oil and gas. Had the grantor intended only to exclude oil and gas interests which had been conveyed previously to persons other than the grantor, the usual way to do that would be to use only the term 'excepting'. By using both terms, she protected herself from liability under the general warranty deed and created in herself an estate in the oil and gas.[15]

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11 *Id*. at note 1.
12 *Id*. at 205.
13 *Id*. at 204.
14 *Id*. at 206.
15 *Id*.

§ 21.13. Trap No. 12: The Sherwood Dilemma.

In most jurisdictions (if not all) an instrument that is properly recorded but incorrectly indexed is not entitled to constructive notice. (However, see related issue discussed at Title Trap No. 10, *Idem Sonans*, discussed above, Section 21.11).

In 2005, the Supreme Court of Pennsylvania came down with a decision that left all title attorneys and title insurance companies shaking their heads in utter disbelief: *First Citizens National Bank v. Sherwood*.[16]

First Citizens National Bank bought a tract of land at a Sheriff's sale which was sold as the property of J. Joel Turrell, as Trustee for Genevieve VanNoy.[17] Prior to the purchase, First Citizens National Bank conducted a title search and discovered no encumbrances.[18] However, a mortgage was previously executed by J. Joel Turrell, as Trustee for Genevieve VanNoy, to Arthur W. Sherwood.[19] The Bradford County Recorder of Deeds properly recorded said mortgage but failed to properly index the mortgage.[20] Instead of indexing the mortgage under the name of J. Joel Turrell, Trustee, the Recorder's office indexed the mortgage under the name Genevieve VanNoy. The trial court granted summary judgment in favor of First Citizens National Bank holding that the mortgage was not entitled to constructive notice due to the improper indexing.[21] The Superior Court ordered the case remanded for a determination as to whether a diligent search would have discovered the lien.[22] (Apparently, on the issue as whether the title should have also been searched under the name of the beneficiary in addition to the Trustee.) First Citizens National Bank then filed a petition for allowance of appeal and the Supreme Court granted allocatur.[23] The Supreme Court's review focused on two statutes. In Statute 21 P.S. § 357 it states that when a written agreement

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16 First Citizens Nat'l Bank v. Sherwood, 879 A.2d 178 (Pa. 2005).

17 *Id*. at 179.

18 *Id*.

19 *Id*.

20 *Id*.

21 *Id*.

22 *Id*. at 180.

23 *Id*.

relating to real property is recorded, "the legal effect of the recording of such agreements shall be to give constructive notice to subsequent purchasers," and also states "the rights of the subsequent purchasers shall be limited thereby with the same force and effect as if said subsequent purchasers had actually joined in the execution of the (mortgage)." The second statute, 16 P.S. § 9853, applies in those instances when a mortgage is properly indexed and provides that such proper indexing "shall be notice to all persons of recording of the same."

First Citizens argued that if proper indexing is notice to all persons, then a subsequent purchaser presumptively has no notice where a mortgage is improperly indexed.[24] First Citizens argued that the proper recordation of a mortgage should include proper indexing and that the mortgagee should be duty bound to assure that said mortgage was properly indexed.[25] The Supreme Court ruled that 16 P.S. § 9853 does not create a negative inference that "a subsequent purchaser *per se* lacks notice where a mortgage is improperly indexed."[26] The court reasoned that such an interpretation would be "squarely at odds with 21 P.S. § 357," which dictates that "proper recordation of a mortgage constitutes constructive notice."[27] In conclusion, the Supreme Court ruled in favor of Sherwood and ruled that since the mortgage was properly recorded, all subsequent purchasers are deemed to have constructive notice of it.[28]

Needless to say, this decision sent shock waves through the legal community. Almost immediately, lobbying efforts led to the enactment by the legislature of 21 P.S. § 358 which specified that for a document to be entitled to constructive notice it must meet the condition that it is properly indexed. Furthermore, addressing the issue raised in *First Citizens National Bank v. Sherwood*, the amendment also stated "in the case of a document affecting

24 *Id*. at 181.
25 *Id*. at 181-82.
26 *Id* at 182.
27 *Id*.
28 *Id*.

title to trust property, the document need not be indexed to the beneficiary in order to give constructive notice of the trust."[29]

Even though the legislature corrected the seemingly blunderous opinion of the Supreme Court, a dilemma remains. The corrective act was not enacted until 2006. Are documents recorded prior to 2006 but improperly indexed entitled to constructive notice in accordance with the Supreme Court decision in *First Citizens National Bank v. Sherwood*? Of course, the whole problem with the decision is that a title searcher has no way of knowing whether there was an improperly indexed document, unless there is some subsequent recital concerning said document.

§ 21.14. Trap No. 13: Re-recorded and Corrective Deeds.

Example 1: Title to Lot 5 in Plan of Lots is being searched. X owns 2 lots, Lot No. 5 and Lot No. 15. X conveys Lot 5 to Y. X executes a Corrective Deed to Y, purporting to convey Lot 15 *instead* of Lot 5.

Example 2: Title to 20 acres residue of a larger 100 acres tract is being searched. X conveys 100 acres Tract to Y, but X only intended to convey 80 acres out of larger 100 acres tract, excepting and reserving the 20 acres search tract. X also intended to reserve an easement over the 80 acres intended to be conveyed in order to access the 20 acres residue. X executes and records a Corrective Deed from X to Y conveying 100 acres, excepting and reserving 20 acres, and reserving an easement over 80 acres.

Example 3: X conveys a 100 acres tract to Y, excepting and reserving the oil and gas. X then executes a corrective deed to Y conveying the same 100 acres tract. Said corrective deed states " this is a corrective deed being executed to correct a description error in the original deed." The corrective deed does not include the exception and reservation of oil and gas.

In example 1, title to Lot 5 became vested in Y by virtue of the first deed from X, and Y's title was not divested by the subsequent re-recorded or corrective deed. Y should execute a deed re-conveying Lot 5 to X in order to cure the defect in X's title to Lot 5.

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29 21 P.S. § 358.

In example 2, title to the entire 100 acres tract is vested Y, free of any easement. The Corrective Deed from X to Y is ineffective to diminish the grant from 100 acres to 80 acres, and is also ineffective to create an easement over land conveyed to Y. In order to cure the defect in X's title to 20 acres, Y should execute a deed to X conveying title to the 20 acres tract together with an appurtenant easement over 80 acres. (Other solutions are possible.)

In example 3, the corrective deed operates to convey title to the oil and gas which was previously excepted and reserved. However, this probably, but not necessarily, was not intended by X. In order to correct this defect, Y should execute a quitclaim deed to X conveying title to the oil and gas underlying the 100 acres tract.

In the above three examples, if X and Y do not agree to take the curative actions stated above, an action to quiet title would be necessary to obtain a judicial determination of title.

§ 21.15. Trap No. 14: Wills and Estates.

In conducting a title examination which includes a Will or an Estate in the chain of title, it is essential that the entire Estate file be reviewed. For example, a Will probated in the Estate of John Doe might devise his entire property to his son, Henry Doe. However, a review of the Estate file could alter the effect of this devise. In Pennsylvania, as in most states, a wife has the right to file an election to take against the Will.[30] This right allows the wife to take her intestate share in the Estate regardless of the Will.[31] Another matter that could alter the effect of the Will is a Family Settlement Agreement. If all potential heirs agree, they may enter into a Family Settlement Agreement, which will alter the specific devises made by the Will. In cases of intestacy, a Family Settlement Agreement could likewise alter the intestate succession provided by statute. Of course, in either testacy or intestacy, a final Decree of Distribution by the Orphan's Court will clearly transfer the property.[32] However, not all Estates have a final Decree of Distribution. If an abstract

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30 20 P.S. § 2201 *et seq*.

31 *Id*.

32 20 P.S. § 781.

includes only a copy of the Will or a list of the intestate heirs, further review of the entire Estate file needs to be completed to avoid the consequences that an election by the wife or a Family Settlement Agreement might create.[33]

§ 21.16. Trap No. 15: Reliance on Tax Maps.

In conducting title searches, the accuracy of tax maps should not be assumed. Different counties have different degrees of accuracy in their tax maps, but I do not believe any county has tax maps that are 100 percent accurate.

Plotting of deeds is essential in order to check the accuracy of tax maps. You might be examining title to a 100 acres tract and encounter a five acres deed while adversing and the tax map indicates that the five acres tract adjoins the 100 acres tract. However, the tax map may erroneously locate the five acres tract, which is actually located within the 100 acres tract and therefore should be reported in the title certificate as an adverse conveyance.

§ 21.17. Trap No. 16: Incorporation of Unrecorded Matters Recited in Deeds.

Under certain circumstances, recitals in deeds, or stray deeds from grantors with no interest in the title of record, can constitute constructive notice of adverse claims and create a duty of further inquiry on the part of the grantee. The following example comes from an actual case.

Record title was vested solely in The Aloe Company, Inc., and was conveyed by deed executed by Jeffrey Ankrom and The Aloe Company, Inc. to Timothy Zyra and Kimberly Zyra. Note that Jeffrey Ankrom had no record interest in the title prior to the deed to Zyras. Also, note that the deed to Zyras was made subject to the following relevant provisions:

> UNDER AND SUBJECT to the exceptions, reservations, easements, rights-of-way, etc. as contained in the deed hereinafter recited or visible upon an inspection of the premises.

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33 20 P.S. § 2101.

> BEING the same tract of land conveyed to the Aloe Company, Inc. by deed of Robert Glasser, et ux., dated March 10, 1978, and recorded in the Office of the Recorder of Deeds Office of Washington County, Pennsylvania, in Deed Book 1824, page 205.
>
> And the Jeffrey J. Ankrom and The Aloe Company, Inc. Grantors, will warrant generally the property hereby conveyed. Jeffery Ankrom joins in this deed in order to convey all of his rights as purchaser in that certain unrecorded Agreement of Sale from The Aloe Company, Inc. dated May 17, 1985.[34]

There was actually an unrecorded deed (not an Agreement of Sale) from The Aloe Company, Inc. to Jeffrey Ankrom which excepted and reserved the oil and gas. In an action to Quiet Title, The Aloe Company successfully claimed that the exception and reservation of oil and gas contained in the unrecorded deed to Ankrom was incorporated by reference into the recorded deed to Zyras. The trial court determined the recital to the "unrecorded Agreement of Sale" was sufficient to put Zyras on notice of the possibility of the oil and gas exception and reservation contained in the unrecorded deed, and quieted title to the oil and gas in *Zyra v. Aloe Company*[35] (affirmed on appeal in a non-published opinion).

In the trial court decision, the court cited a prior case, *Jennings v. Bloomfield*.[36] In *Jennings*, Edward Jones was the owner in fee of 46 acres and executed a deed conveying 1/2 of all the oil and minerals to James B. Jennings.[37] The deed was dated June 15, 1871, but was not recorded until January 31, 1899.[38] In 1876, Jones conveyed his entire interest in the tract with a deed stating "Subject however to certain leases, for oil and other purposes given at different times by the aforesaid Edward Jones."[39] Two (2)

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34 On file with author.

35 Zyra v. Aloe Co., 981 A.2d 919 (Pa. Super. 2009).

36 Jennings v. Bloomfield, 49 A. 135 (Pa. 1901).

37 *Id*. at 135.

38 *Id*.

39 *Id*.

subsequent deeds executed in 1881 and 1893 included language "This deed is subject to the oil lease given by Edward Jones to James B. Jennings." The court ruled that the language in these deeds created a duty of further inquiry, which would have resulted in determining that there was a deed conveying the 1/2 interest in the oil and not a lease.[40]

In conclusion, when encountering deeds reciting or referring to unrecorded items, such recital creates a duty to make further inquiry which must be conducted with due diligence to determine the effect of the unrecorded item on title.

§ 21.18. Trap No. 17: Condemnation Proceedings.

In Washington County, there is a public park known as Mingo Park owned by Washington County comprised of numerous tracts of land, which were acquired by deed or eminent domain. Washington County filed a Declaration of Taking for 19.1452 acres, which was taken as the property of John Doerfler and Barbara Doerfler, his wife, at No. 403 September Term 1974. Washington County filed a Notice of Filing of Declaration of Taking which was recorded in the Recorder of Deeds Office on October 9, 1974, in Deed Book 1551, page 6 of the Recorder of Deeds Office. The Declaration of Taking described the nature of the title acquired in and to said property as an Estate in Fee Simple. Neither the Declaration of Taking nor the recorded Notice included any exception and reservation of oil and gas.

If the title searcher would rely on the Declaration of Taking and the recorded Notice, this would lead to the conclusion that Washington County acquired title to the oil and gas.

However, a complete examination of the eminent domain file at No. 403 September Term 1974, indicates that a settlement agreement was filed by and between Washington County and John Doerfler and Barbara Doerfler which stipulated that "All minerals including gas and oil but excluding the Waynesburg seam of coal and all rights to exploration for same, shall remain the properties of the condemnees." (The stipulation agreement did include restrictions concerning the surface operating rights of the condemnees.)

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40 *Id*. at 136.

In conclusion, if condemnations, or other legal proceedings involving title to real estate are encountered, it is essential that the entire case file be reviewed. In the aforesaid example, reliance on a Declaration of Taking and recorded Notice, resulting in oil and gas operations by the lessee of Washington County, would have resulted in title failure.

§ 21.19. Trap No. 18: In Pennsylvania, Oil and Gas Is Not a "Mineral."

With the advent of the Marcellus Shale frenzy in Pennsylvania, a number of landmen or companies from the Southwest became the victim of this title trap. In most jurisdictions, a conveyance or exception and reservation of "minerals" includes oil and gas. Even in Pennsylvania, lawyers have prepared deeds excepting and reserving "all minerals" which they mistakenly thought were retaining oil and gas rights for their clients.

Pennsylvania applies the "Dunham Rule,"[41] which simply states that there is a rebuttable presumption that in connection with a conveyance of land, if there is a conveyance or a reservation or exception of "minerals" without any specific mention of natural gas or oil, then the word "minerals" was not intended by the parties to include natural gas or oil. The presumption may be rebutted only by clear and convincing evidence that the intent of the parties was to include natural gas and/or oil. If the disputed language is between parties to a current transaction, the presumption could theoretically be overcome with parole evidence. However, in the case of past deeds in the chain of title, the presumption can only be rebutted by items of record indicating a contrary intent to include oil and gas.

The Dunham Rule in Pennsylvania was most recently upheld in the Supreme Court decision in *Butler v. Charles Powers Estate*,[42] which ruled that the reservation of minerals does not include oil and gas within the Marcellus Shale Formation, due to the long established Dunham Rule.

As an example of overcoming the rebuttable presumption, a deed might include an exception and reservation of all minerals, together with the right

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41 Established in Dunham & Shortt v. Kirkpatrick, 101 Pa. 366 (1882).

42 Butler v. Charles Powers Estate, 63 A.3d (Pa. 2013).

to locate wells upon the property and to construct pipelines for transportation of the same. This should be apparent to indicate an intent to include oil and gas in the exception and reservation of minerals. Another example would be a deed from John Doe to William Smith conveying 100 acres and excepting and reserving all minerals. A subsequent deed is executed by William Smith to Henry Jones conveying the same 100 acres tract stating "Subject to the exception and reservation of all minerals including oil and gas as excepted and reserved by John Doe in the deed to William Smith."

Chapter 22

Deduction of Post-Production Costs – An Analysis of Royalty Calculation Issues Across the Appalachian Basin

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§ 22.01. Introduction.

Traditional royalty calculation analysis involved a determination of the physical point at which natural gas was to be valued for royalty purposes. Historically, a lease calling for a royalty based upon the value of production "at the wellhead" allowed the lessee to deduct the cost of transporting, compressing, treating, and processing natural gas to arrive at a wellhead value for purposes of calculating royalties. A minority view began to develop, however, which held that the lessee's implied covenant to market the gas requires the lessee to bear the costs of placing natural gas production in a marketable condition and thus to bear at least some post-production costs.[2]

In this chapter, these differing approaches have been analyzed in terms of whether the jurisdiction in question follows the "at the well" rule or the "marketable product" rule. The "at the well" rule holds that under most

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2 Patrick H. Martin and Bruce M. Kramer, 3-6 Williams & Meyers, *Oil and Gas Law*, § 645 (LexisNexis 2015) ("Williams & Meyers").

standard lease provisions, a royalty is only owed on "production," and production occurs when gas is captured at the wellhead. The lessee-operator is permitted to net-back all expenses incurred in processing, gathering, compressing, and transporting the gas to a marketplace, and the lessee can recoup all or its proportionate share of the commercial value the lessee adds to the gas after it is produced at the wellhead.[3]

Under the marketable-product rule, "production" is not viewed as being complete until the gas has been placed in the condition in which it can be sold (*i.e.*, "marketable"). Since "production" is the responsibility of the lessee, these costs fall to the lessee alone. Some jurisdictions hold that it is the lessee's obligation to bear all expenses necessary to put the natural gas in a marketable condition (such as dehydration, purification, and compression and gathering on the leasehold premises), but it is the obligation of the royalty owner to bear a proportionate share of the cost to transport the gas from the leasehold premises to the marketplace.[4] Additionally, some jurisdictions have read an implied covenant to market into every lease, regardless of its express terms, and hold that lessees have the obligation to bear not only all expenses required to put the gas in a marketable condition,[5] but also all expenses of transporting the gas to a viable marketplace.[6]

This chapter surveys the law governing royalty calculations within the Appalachian Basin states of Kentucky, Ohio, Pennsylvania and West Virginia. It addresses the majority "at the well" and minority "marketable product" rules, the origins and reasoning behind each rule, how each state has addressed the two rules to date, and how the issue might play out in states, like Ohio, that have yet to formally adopt one of the rules.

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3 *See*, *e.g.*, Ramming v. Natural Gas Pipeline Co., 390 F.3d 366, 372 (5th Cir. 2004) (interpreting Texas law); Heritage Res., Inc. v. Nationsbank, 939 S.W.2d 118, 122 (Tex. 1996).

4 *See*, *e.g.*, Mittelstaedt v. Santa Fe Minerals, Inc., 954 P.2d 1203 (Okla. 1998); Sternberger v. Marathon Oil Co., 894 P.2d 788 (Kan. 1995).

5 *See* Garman v. Conoco, Inc., 886 P.2d 652 (Colo. 1994).

6 *See*, *e.g.*, Rogers v. Westerman Farm Co., 29 P.3d 887 (Colo. 2001); Savage v. Williams Prod. RMT Co., 140 P.3d 67 (Colo. Ct. App. 2005); Wellman v. Energy Res., Inc., 557 S.E.2d 254 (W. Va. 2001); Estate of Tawney v. Columbia Nat. Res., L.L.C., 633 S.E.2d 22 (W. Va. 2006).

§ 22.02. Royalty Valuation and Post-Production Costs: The Competing Rules.

[1] — "At the Well" Rule.

A majority of oil and gas jurisdictions have adopted the "at the well" rule, determining that oil and gas leases that are either silent on the point at which royalty calculations are to occur, or provide for royalties "at the wellhead," authorize lessees to apportion post-production costs in determining the value of the lessor's royalty.

States that have given effect to "at the well" language in oil and gas leases include traditional oil and gas states:

- Texas[7]
- Louisiana[8]
- Mississippi[9]

States more recently affected:

- California[10]
- Kentucky[11]
- New Mexico[12]

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7 Danciger Oil & Refineries, Inc. v. Hamill Drilling Co., 171 S.W.2d 321 (Tex. 1943); *Heritage*, 939 S.W.2d 118.

8 Wall v. United Gas Public Serv. Co., 152 So. 561 (La. 1934); Merritt v. Sw. Elec. Power Co., 499 So. 2d 210 (La. Ct. App. 1986).

9 Piney Woods Country Life School v. Shell Oil Co., 726 F.2d 225 (5th Cir. 1984).

10 Atl. Richfield Co. v. State of Cal., 214 Cal. App. 3d 533 (Cal. Ct. App. 1989).

11 Baker v. Magnum Hunter Prod., No. 2012-CA-001016-MR, 2013 Ky. App. Unpub. LEXIS 545 (Ky. Ct. App. June 28, 2013); *see also* Poplar Creek Dev. Co. v. Chesapeake Appalachia, L.L.C., 636 F.3d 235 (6th Cir. 2011).

12 Creson v. Amoco Prod. Co., 10 P.3d 853 (N.M. Ct. App. 2000); ConocoPhillips Co. v. Lyons, 299 P.3d 844 (N.M. 2012). Recent federal decisions, however, have called into question whether the Supreme Court of New Mexico would adopt the "at the well" rule. At least one federal court has made an "Erie guess" that New Mexico would adopt the marketable product rule. *See* Anderson Living Trust v. WPX Energy Prod. LLC, No. CIV 12-0040 JB/LFG, 2015 U.S. Dist. LEXIS 37256, at *369 (D.N.M. Mar. 19, 2015) ("The Court believes that, if and when the Supreme Court of New Mexico determines that the existence of the marketable condition rule is ripe for review, it will find that the rule is included in oil-and-gas contracts as part of the implied duty to market."). The New Mexico Supreme Court has expressly declined to reject or adopt the marketable product rule on several occasions. The most recent decision to address the issue, however, suggests that even if New Mexico were to

- North Dakota[13]
- Michigan[14]
- Montana[15]
- Pennsylvania.[16]

[a] — Origin and History of the "At the Well" Rule.

Until the 1960s, the law governing the calculation of royalty payments was uniform — it was well recognized that a lessee would bear all the costs necessary to achieve "production," which occurred when the oil and gas was extracted at the wellhead, and the royalty paid to lessors would be based on the value of the price of production at the wellhead.[17] Likewise, it

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adopt the "marketable product" rule in some form, it would still give effect to "at the well" language as allocating post-production costs. ConocoPhillips Co., 10 P.3d at 850-51 ("In oil and gas leases it is typical for the royalty clause to specify the calculation of net proceeds "*at the well*." When the *well* is specified as the point of valuation, it is generally understood that the 'lessee is entitled to deduct all costs that are incurred subsequent to production, including those necessary to transport the gas to a downstream market and those costs, such as dehydrating, treating, and processing the gas, that are either necessary to make the gas saleable in that market or that increase the value of the gas.' . . . New Mexico courts have endorsed this approach to interpreting a royalty obligation when the language provides that such payments are to be payable on net proceeds *at the well*. . . . Thus, if the 1931 and 1947 statutory lease forms provided for royalty on net proceeds at the well, there would be little controversy because such language typically entitles the lessee to deduct all post-production expenses.") (citations omitted, emphasis in original).

[13] Bice v. Petro-Hunt, L.L.C., 768 N.W.2d 496 (N.D. 2009).

[14] Schroeder v. Terra Energy, 565 N.W.2d 887 (Mich. Ct. App. 1997). The "at the well" rule, however, only applies to leases signed before March 28, 2000. By statute, leases after this date in Michigan are not subject to deduction for postproduction costs in calculating the lessor's royalty, unless explicitly provided for in the parties' lease. Mich. Comp. Laws § 324.61503b ("A person who enters into a gas lease as a lessee after March 28, 2000 shall not deduct from the lessor's royalty any portion of postproduction costs unless the lease explicitly allows for the deduction of postproduction costs.").

[15] Montana Power Co. v. Kravik, 586 P.2d 298 (Mont. 1978).

[16] Kilmer v. Elexco Land Servs., 990 A.2d 1147 (Pa. 2009).

[17] David E. Pierce, "The First Marketable Product Doctrine: Just What Is the "Product"?," 37 *St. Mary's L. J.* 1, 30 (2005) ("*The First Marketable Product Doctrine*") ("The general rule establishing that a lessee could properly calculate its royalty payments at the wellhead was 'a well recognized, basic concept of oil and gas law for many decades.'") (quoting La Fitte Co. v. United Fuel Gas Co., 284 F.2d 845, 849 (6th Cir. 1960)). *See also* Williams &

was also generally accepted that a lessee could calculate royalty payments at the wellhead even when the lease was silent concerning the place of determination, unless there was express language in the lease to the contrary.[18] In fact, until around 1992 — when the United States deregulated the gas industry with the promulgation of various orders from the Federal Energy Regulatory Commission[19] — Kansas and Arkansas were the only states to hold otherwise.[20]

Although natural gas has been produced in the United States since 1815,[21] natural gas production did not become a major player until the large natural gas reservoirs in the mid-continental U.S. — located primarily in

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Meyers, § 645 (noting that that a contrary view did not arise until the 1960s). Even in states that have adopted the marketable product rule, such as Kansas and Oklahoma, early cases had previously permitted a lessee to use the workback method as calculating the value of the lessor's royalty. *See e.g.* Matzen v. Hugoton Prod. Co., 321 P.2d 576, 581 (Kan. 1958); Molter v. Lewis, 134 P.2d 404, 407 (Kan. 1943); Scott v. Steinberger, 213 P. 646, 647 (Kan. 1923); Harding v. Cameron, 220 F. Supp. 466, 471 (W.D. Okla. 1963); Johnson v. Jernigan, 475 P.2d 396, 398 (Okla. 1970); Cimarron Utils. Co. v. Safranko, 101 P.2d 258, 260 (Okla. 1940).

18 *See e.g.*, La Fitte Co. v. United Fuel Gas Co., 284 F.2d 845, 849 (6th Cir. 1960) (holding that the market value of gas was to be determined at the wellhead); Warfield Natural Gas Co. v. Allen, 88 S.W.2d 989, 992 (Ky. 1935) (royalty was to be determined by gross proceeds, as determined at the well, when the lease was silent as to the place of valuation). *See also* Brief of *Amicus Curiae* of Bruce M. Kramer, Kilmer v. Elexco Land Servs, Doc #114-10, filed August 6, 2014, at 16 ("Amicus Brief") ("In 1979, there was an almost universal understanding in the oil-and-gas industry that royalties were to be measured at the wellhead in the absence of express language to the contrary.").

19 Bruce M. Kramer credits the deregulation of the natural gas industry to Order No. 636, promulgated by the Federal Energy Regulation Commission in 1992, which de-coupled the interstate pipeline companies' roles as *both* merchants and transporters of natural gas. Amicus Brief, at 10.

20 *See*, *e.g*., Gilmore v. Superior Oil Co., 388 P.2d 602 (Kan. 1964); Schupbach v. Continental Oil Co., 394 P.2d 1 (Kan. 1964); Hanna Oil & Gas Co. v. Taylor, 759 S.W.2d 563 (Ark. 1988). *See also* Wood v. TXO Prod. Corp., 854 P.2d 880 (Okla. 1992) (noting that the "Kansas and Arkansas approach of burdening the lessee with post-production compression costs originated in a trilogy of cases," citing *Gilmore*, *Schupbach*, and *Hanna Oil*) (dissenting opinion).

21 Amicus Brief, at 4 (citing Eugene Kuntz, *Law of Oil and Gas* § 1.10 (1987) (noting that the first known natural gas production was in connection with a salt well located in Charleston, West Virginia)).

Texas, Louisiana, Kansas and Oklahoma — were discovered.[22] Initially, due to the capital-intensive requirements of pipeline construction, most natural gas production was sold at the well to interstate pipeline companies — akin to "common carriers" such as railroads — and then resold by these companies to local distribution companies or end users along the pipeline.[23] Because this practice tended to create a "monopoly or oligopoly pricing power,"[24] in 1938 Congress enacted the Natural Gas Act of 1938 (NGA), which restrained the practices of lessees related to the production, sale, transportation and marketing of natural gas throughout the United States.[25] Some of the requirements under the NGA included federal price regulation, applications for certificates of public convenience and necessity to enter the industry or construct a facility, adequate reserve requirements, and other restrictions on lessees.[26]

The NGA, however, still retained the existing system of producers selling to pipeline companies, who then re-sold the gas to local distribution companies or end users. Because the new laws and regulations demanded adequate reserves, pipeline companies similarly demanded long-term contracts for the sale of natural gas at the wellhead.[27] As a result, "the near-universal method by which natural gas was sold in the United States was through long-term contracts with the sale taking place at the wellhead[.]"[28]

Accordingly, consistent with the predominant method by which gas was sold during this time frame, many oil and gas leases pre-dating 1990 provided for royalties to be based on their price or value of gas "at the well."[29] Because gas was typically sold at the well, calculating royalties

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22 Amicus Brief, at 4.
23 *Id*. at 5.
24 *Id*.
25 *Id*.
26 *Id*.
27 *Id*. at 6.
28 *Id*. at 7.
29 *Id*. at 12. *See also* Matzen v. Hugton Prod. Co., 321 P.2d 576, 581-82 (1958) ("When plaintiffs' leases were executed it was the established custom and practice in the field to measure, determine the price, and pay royalty at the wellhead for gas produced. Pipeline

was straightforward — the agreed-upon percentage of the sales price or value of the gas at the wellhead — and post-production costs were not apportioned because there simply were no post-production costs incurred by the producer. Some commentators have also argued that older leases using "at the well" language typically did not identify which post-production costs were deductible because through the life of a typical lease — which can span several decades — new techniques of production and processing may be developed, new gas formations may be discovered, or new government regulations may be enacted.[30]

Prior to 1960, in cases where post-production costs were incurred by a producer for gas that was not actually sold "at the well," courts uniformly permitted the use of the "net back" method approach as one method of calculating the value of the lessor's royalty at the wellhead,[31] and, in the

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facilities did not exist and there was no general market for gas in the area. Although the leases are silent as to where a market must be found, it is evident that the parties anticipated, from the very nature and character of natural gas, that pipe-line transportation would be required in the event of production and they could not reasonably have contemplated that the lessee alone would bear the expense of providing such transportation to a point off the leases for sale and delivery to a purchaser for ultimate compensation.").

30 Brian S. Wheeler, "Deducting Post-Production Costs When Calculating Royalty: What Does the Lease Provide?," 8 *Appalachian J. L.* 1, at 4 (2008) ("*What Does The Lease Provide?*").

31 *See e.g.,* David E. Pierce, "The First Marketable Product Doctrine: Just What Is the "Product"?," 37 *St. Mary's L. J.* 1, 30 (2005) ("*The First Marketable Product Doctrine*") ("The general rule establishing that a lessee could properly calculate its royalty payments at the wellhead was 'a well recognized, basic concept of oil and gas law for many decades.'") (*quoting* La Fitte Co. v. United Fuel Gas Co., 284 F.2d 845, 849 (6th Cir. 1960)). *See also* Williams & Meyers, § 645 (noting that that a contrary view did not arise until the 1960s). Even in states that have adopted the marketable product rule, such as Kansas and Oklahoma, early cases had previously permitted a lessee to use the workback method as calculating the value of the lessor's royalty. *See e.g.* Matzen v. Hugoton Prod. Co., 321 P.2d 576, 581 (Kan. 1958); Molter v. Lewis, 134 P.2d 404, 407 (Kan. 1943); Scott v. Steinberger, 213 P. 646, 647 (Kan. 1923); Harding v. Cameron, 220 F. Supp. 466, 471 (W.D. Okla. 1963); Johnson v. Jernigan, 475 P.2d 396, 398 (Okla. 1970); Cimarron Utils. Co. v. Safranko, 101 P.2d 258, 260 (Okla. 1940). *See e.g.,* La Fitte Co. v. United Fuel Gas Co., 284 F.2d 845, 849 (6th Cir. 1960) (holding that the market value of gas was to be determined at the wellhead); Warfield Natural Gas Co. v. Allen, 88 S.W.2d 989, 992 (Ky. 1935) (royalty was to be determined by gross proceeds, as determined at the well, when the lease was silent as to the place of valuation). *See also* Brief of *Amicus Curiae* of Bruce M. Kramer, Kilmer v. Elexco Land

absence an express agreement otherwise, the value of the lessor's royalty was to be determined "at the well."[32]

[b] — The Rationale for the "At the Well" Rule.

The rationale used by courts for adopting the "at the well" rule vary from state to state, but generally involve giving literal interpretation to "at the well" language in oil and gas leases, common usage of the phrase and

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Servs, Doc #114-10, filed August 6, 2014, at 16 ("Amicus Brief") ("In 1979, there was an almost universal understanding in the oil-and-gas industry that royalties were to be measured at the wellhead in the absence of express language to the contrary."). Under a "market value at the well" clause, courts would typically permit one of two methods of calculating royalties. The first, known as the "comparable sales method," determined the market value of oil or gas production at the wellhead by looking to the average prices for the same oil and gas of comparable quality, quantity, and availability that were being received by the lessee or other producers. The second, the workback or "netback" method, determined the market value of the oil or gas production at the wellhead by taking the sales price and then subtracting reasonable post-production costs (including, but not limited to, transportation, gathering, compression, processing, treating, and marketing). Of the two methods, the "comparable sales" method was usually preferred. *The First Marketable Product Doctrine*, at 31.

[32] *See*, *e.g*., Scott v. Steinberger, 213 P. 646, 647-48 (Kan. 1923) (holding that the value of lessor's royalty should be determined at the point of measurement and delivery where the pipeline and the well connected); Rains v. Kentucky Oil Co., 255 S.W. 121, 122-23 (Ky. 1923) (holding that lessor was entitled to one-eighth of the fair market price of the gas at the well); Wall v. United Gas Public Serv. Co., 152 So. 561 (La. 1934) (holding that the lessor's royalty should be determined based on the market price or value of the gas as it emerges at the wellhead); Kretni Dev. Co. v. Consolid. Oil Corp., 74 F.2d 497, 500 (10th Cir. 1934) (holding that the lessors are entitled to the royalty gas "at the connection with the pipe line" or the "proceeds from its sale at that point"); Danciger Oil & Refineries, Inc. v. Hamill Drilling Co., 171 S.W.2d 321 (Tex. 1943) (holding that royalty payments were to be based on the value of the gas as produced, before processing). The 10th Circuit's early decision in *Kretni* specifically rejected the lessor's argument that the implied duty to market obligated the lessee to provide for transportation costs to a viable market. *See Kretni*, 74 F.2d at 500 ("It may be conceded for the purpose of this case that a lessee is obligated to put forward a reasonable effort to market gas produced on the leased premises, but certainly that duty does not extend to the point of providing pipe line facilities ninety miles in length at a large outlay of money with an attending financial hazard due to possible exhaustion of the supply and other frequently encountered factors, in order to reach a market at which the product may be sold."). The court's decision in *Rains v. Kentucky* also rejected this argument. *See Rains*, 200 Ky. at 483 ("While the lessee of a gas well may be under the duty of using reasonable effort to market the gas, we are not inclined to view that this duty, in the absence of a contract to that effect, is so exacting as to require him to market the gas by obtaining a franchise from some town or city and distributing the gas to the inhabitants thereof.").

terminology in the oil and gas industry, and practical considerations such as bringing consistency to royalty payments.

Early decisions in Louisiana endorsed the traditional view that production occurs when the oil or gas is severed at the wellhead because that is the point at which the parties come into ownership of the commodity, and thus title "vests" in the lessor and lessee in the proportions set forth in the lease.[33] For example, in *Wall v. United Gas Public Service Co.*, the Supreme Court of Louisiana evaluated a royalty clause calling for a royalty of "one-eighth (1/8) of the value of such gas calculated at the market price per thousand feet[.]"[34] The pivotal question was whether the term "market price" meant the price at the well or the price the gas would bring in a market remote from the well.[35] The court held that the clause provided for the "market price" *at the well*, reasoning that title vests in the commodity at this point, and "while there is to be no division of the gas in kind, it is nevertheless contemplated that there shall be a 'division,' not of the gas in kind but of its *value* as fixed by the market price."[36] The court further rejected the premise that it "was the duty of the lessees to bear all the expense of carrying the gas to a market beyond the gas field."[37] Decisions in other jurisdictions have cited to, and endorsed, this view.[38]

Other jurisdictions, including Texas, California, Kentucky, and Pennsylvania, have reasoned that the words "market value at the well" is well-established lexicon in the oil and gas industry, and is used as a means of distinguishing between gas sold in the form in which it emerges at the wellhead and gas which has had value added by transportation or processing.[39] For example, the Fifth Circuit Court of Appeals' decision in

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33 *Wall*, 152 So. at 910.

34 *Id*. at 563.

35 *Id*.

36 *Id*.

37 *Id*. at 564.

38 *See*, *e.g*., Heritage Res. v. Nationsbank, 939 S.W.2d 118, 129 (Tex. 1995); Montana Power Co. v. Kravik, 586 P.2d 298, 302 (Mont. 1978); Kretni Dev. Co. v. Consol. Oil Corp., 74 F.2d 497, 500 (10th Cir. 1934).

39 Piney Woods Country Life School v. Shell Oil Co., 726 F.2d 225, 240 (5th Cir. 1984). *See also* Ramming v. Natural Gas Pipeline Co., 390 F.3d 366, 372 (5th Cir. 2004) ("'Market

Piney Woods Country Life School v. Shell Oil Co., applying Mississippi law, reasoned that the function of the "at the well" language is to "adjust for imperfect comparisons" in determining market value.[40] Deduction for processing and transportation costs is an indirect means of determining what a buyer would have paid at the wellhead.[41]

Yet another reason articulated by courts for adopting the "at the well" rule is to ensure that lessors do not obtain different royalties depending on when and where in the value-added production process the gas was sold.[42] The Supreme Court of Pennsylvania in *Kilmer v. Elexco Land Servs.* recognized the value of the use of the net-back method as eliminating the potential for inconsistent royalties to lessors on the same quality and quantity of gas

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value at the well' is an established term in oil and gas lexicon."); Heritage Res. v. Nationsbank, 939 S.W.2d 118, 122 (Tex. 1996) ("The terms 'royalty' and 'market value at the well' have well accepted meanings in the oil and gas industry."); Martin v. Glass, 571 F. Supp. 1406, 1411 (N.D. Tex. 1983) ("It is well settled that the phrase 'at the well received,' or similar terminology, establishes the 'point' at *the mouth of the well*. . . . Accordingly, the royalty is free of all costs (e.g. exploration, drilling, operation, etc.) up to this point."); Atl. Richfield Co. v. Cal., 214 Cal. App. 3d 433, 541 (Cal. Ct. App. 1989) ("The term 'at the well' when used with reference to oil and gas royalty valuation, is commonly understood to mean that the oil and gas is to be valued in its unprocessed state as it comes to the surface at the mouth of the well."); Kilmer v. Elexco Land Servs., 990 A.2d 1147, 1157 (Pa. 2009) ("In the industry, as referenced above, the 'expenses of production' relate to the costs of drilling the well and getting the product to the surface, but do not encompass the costs of getting the product from the wellhead to the point of sale, as those costs are termed 'post-production costs.' 'Although the royalty is not subject to costs of production, usually it is subject to costs incurred after production, e.g. production or gathering taxes, costs of treatment of the product to render it marketable, costs of transportation to market.'") (citations omitted); Baker v. Magnum Hunter Prod., No. 2012-CA-001016-MR, 2013 Ky. App. Unpub LEXIS 545, at *4-5 (Ky. Ct. App. June 28, 2013) (holding that the language "market value at the well" was unambiguous, and adopting the definition provided in Black's Law Dictionary as "[t]he value of oil or gas at the place where it is sold, minus the reasonable cost of transporting it and processing it to make it marketable."). *See also* Bice v. Petro-Hunt, L.L.C., 768 N.W.2d 496, 502 (N.D. 2009) ("We conclude the term market value at the well is not ambiguous. We join the majority of states adopting the 'at the well' rule and rejecting the first marketable product doctrine. Thus, we conclude the district court properly determined Petro-Hunt can deduct post-production costs from the plant tailgate proceeds prior to calculating royalty.").

40 *Piney Woods*, 726 F.2d at 240.

41 *Id*.

42 *Kilmer*, 990 A.2d at 1158.

coming out of the well.[43] The practical reality is that there is seldom a market at the place of production, and the deregulation of the gas industry no longer necessitates the sale of gas to pipeline companies at the wellhead.[44] In the modern natural gas market, gas may be sold at several locations downstream and using a net-back approach provides consistency in the royalties received by the lessors.[45]

Finally, several courts, applying traditional rules of contract interpretation and analysis, have reasoned that the words "at the wellhead" must be given some meaning and cannot be mere subterfuge, and the only reasonable interpretation of such language is to establish the point at which the value of the lessor's royalty is to be determined. For example, the Court of Appeals of Michigan's decision in *Schroeder v. Terra Energy*, reasoned that "the use of the language 'gross proceeds at the wellhead' . . . appears meaningless in isolation because the gas is not sold at the wellhead[.] . . . However, if the term is understood to identify the location at which the gas is valued for purposes of calculating a lessor's royalties, then the language 'at the wellhead' becomes clearer and has a logical purpose in the contract."[46] Further, based on "[b]asic principles of economics," the court reasoned, the use of the netback method provides a means of determining what the value of such "proceeds" at the well would be required in the absence of an actual sale of gas at the wellhead.[47] Thus, as a matter of pure contract law, the only reasonable interpretation of "at the well" language is to determine the point of valuation of the lessor's royalty interest.[48]

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43 *Id*.

44 Amicus Brief, at 11.

45 *Kilmer*, 990 A.2d at 1158.

46 Schroeder v. Terra Energy, 188, 565 N.W.2d 887, 894 (Mich. Ct. App. 1997).

47 *Id*. at 893 ("[b]asic principles of economics require that, in determining the 'gross proceeds at the wellhead' in the absence of an actual sale of gas at the wellhead resulting in ascertainable gross proceeds, the gross proceeds from a sale elsewhere must be extrapolated, backwards or forwards, to reflect the appropriate adjustments due to differences in the location, quality, or characteristics of what is being sold.").

48 *Id*. at 894 ("We adopt the interpretation of 'at the well(head)' as used in these cases because we believe that it better conforms with the parties' intent as gleaned from the contractual language. In interpreting contracts capable of two different interpretations, we

[c] — Criticisms of the "At the Well" Rule.

Although the "at the well" approach was widely adopted and uniformly recognized until the 1960s, it was not without its critics. In addition to general criticisms by academics that oil and gas leases were inherently unfair to lessors who lack the necessary expertise to negotiate clauses to protect their interests,[49] the at-the-well approach has also been criticized as giving the lessee (which is in the best position to control post-production costs) a windfall. The lessee has the greater insight into what precise charges are being deducted from the ultimate sale price and whether those charges are fair, reasonable, and adequately supported. The lessor, who generally has no industry knowledge, is left without the ability to determine whether the charges (many of which may be with affiliates of the lessee) are appropriate. Because the lessor (who owns the minerals) is receiving a significantly smaller share of the benefits, these courts reason that it is fair to place the burden of these charges on the producer.[50]

Courts have also criticized the "at the well" default rule as turning royalty interest holders into "working interest ownership without the attendant rights."[51] In *Wood*, the Oklahoma Supreme Court reasoned that working interest owners share costs under an operating agreement *because* they have "input into the cost-bearing decisions." Because a royalty interest owner has no such rights, it would be unfair to burden such owners with the burdens of working interest ownership when they have no input on cost-bearing decisions.[52] The Supreme Court of Colorado echoed this view when it adopted the marketable product rule in *Garman v. Conoco, Inc.*, reasoning that "[a]llocating these costs to the lessee is also traceable to the

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prefer a reasonable and fair construction over a less just and less reasonable construction.") (citations omitted).

49 *The First Marketable Product Doctrine*, at 38 (noting the criticism of Professor Maurice Merrill, who argued in his treatise that "the lessor's opportunity to protect himself by exact stipulation is illusory," in light of the unequal bargaining power, as he saw it, between lessors and lessees).

50 Wood v. TXO Prod. Corp., 854 P.2d 880, 882–83 (Okla. 1992).

51 *Id*.

52 *Id*.

basic difference between cost bearing interests and royalty and overriding royalty interest holders," and that "[n]o such right [to object to the operator's course of conduct] exists for nonworking interest owners."[53]

[2] — The "Marketable Product" Rule: A Diverging Approach to Royalty Calculations.

A minority of jurisdictions, beginning in the 1960s, have adopted what is now referred to as the marketable-product rule, placing upon the lessee the burden of certain post-production costs for both enhancing and transporting the raw gas severed from the wellhead.

Although there are several permutations of this theory — and, in fact, no two states adopting the marketable product rule have endorsed the exact same rule[54] — in a pair of decisions in 1992 and 1998, the Oklahoma Supreme Court adopted what is commonly attributed as the modern "first-marketable product" rule, holding that a royalty interest may bear post-production costs of transporting, blending, compression, and dehydration, when the costs are reasonable, when actual royalty revenues increase in proportion to the costs assessed against the royalty interest, and when the costs are associated with transforming an already marketable product into an enhanced product.[55] Absent express language to the contrary, the default rule is that royalties are not subject to those post-production costs required to make the gas marketable.[56]

Jurisdictions that have adopted the marketable-product rule in some form include Oklahoma,[57] Colorado,[58] Kansas,[59] West Virginia,[60] and Virginia

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53 Garman v. Conoco, Inc., 886 P.2d 652, 660 (Colo. 1994).

54 For a further state-by-state discussion on the various permutations of this rule, see *The First Marketable Product Rule*, at 53-79.

55 Mittelstaedt v. Santa Fe Minerals, Inc., 954 P.2d 1203, 1210 (Okla. 1998).

56 Rogers v. Westerman Farm Co., 29 P.3d 887, 906 (Colo. 2001).

57 Wood v. TXO Prod. Corp., 854 P.2d 880 (Okla. 1992); *Mittelstaedt*, 954 P.2d 1203.

58 Garman v. Conoco, Inc., 886 P.2d 652 (Colo. 1994); *Rogers*, 29 P.3d 887.

59 Gilmore v. Superior Oil Co., 388 P.2d 602 (Kan. 1964); Sternberger v. Marathon Oil Co., 894 P.2d 788 (Kan. 1995).

60 Wellman v. Energy Res., Inc., 557 S.E.2d 254 (W.V. 2001); Estate of Tawney v. Columbia Natural Res., LLC, 633 S.E.2d 22 (W. Va. 2006).

(through a federal decision).[61] However, Oklahoma's characterization of the first-marketable product rule has not been adopted wholesale by other jurisdictions.

[a] — Origin and Evolution of the "Marketable Product" Theory.

Until the 1960s, all of the states that had addressed the issue of whether the netback methodology was permissible, either by default or by interpreting language providing for the royalty to be calculated "at the well," came out in favor of permitting the lessee to calculate royalties by using the netback methodology.[62] Beginning with the work of two professors at the University of Oklahoma in the mid-20th century, a contrary view emerged that was adopted, at least in part, by the Supreme Court of Kansas in 1964. It was not until decades later, however, that other states followed suit. Beginning with the Supreme Court of Oklahoma's decision in *Wood v. TXO Prod. Corp.* in 1992, other states soon followed and adopted variations of the rule — Colorado in 1994, West Virginia in 2001, and Virginia (through a federal court "Erie guess") in 2011.[63]

Commentators have often credited the origins of the "marketable product" theory to the works of two academics, Maurice H. Merrill and Eugene O. Kuntz — both former professors at the University of Oklahoma School of Law — who have been cited by courts that have rejected the "at the

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61 Legard v. EQT Prod. Co., No. 1:10cv00041, 2011 U.S. Dist. LEXIS 2943 (W.D. Va. Jan. 11, 2011). For purposes of this chapter, we do not address other states that may have altered, by statute, the method of royalty calculations in their respective jurisdictions. The substance and focus of this chapter is on how courts in the United States have addressed the issue of post-production costs and the judicial creation of the marketable product rule. The enactment of statutes that supersede one or both rules does not inform this analysis.

62 Amicus Brief, at 16 ("In 1979, with the singular exception of Kansas, all of the states that had discussed the issue of whether the netback methodology could be used had come out in favor of allowing the lessee to calculate royalties by taking a downstream price or value and then netting it back to the wellhead through the use of the netback methodology.").

63 Although Arkansas issued a decision in 1988 that did not permit the deduction of post-production costs in determining the lessor's royalty, the Supreme Court of Arkansas did not adopt, reject, or address at all the marketable product rule in its decision in *Hanna Oil*.

well" doctrine in favor of the "marketable product" view.[64] Both professors were highly critical of the current state of the law as it developed in the early to mid-20th century.

Professor Merrill published two editions of a treatise entitled The Law Relating to Covenants Implied in Oil and Gas Leases in 1926 and 1940,[65] in which he argued for the imposition of additional implied covenants in oil and gas leases to protect lessors and other royalty owners.[66] Professor Merrill expressed doubt that lessors could protect themselves in lease negotiations — lacking expertise or knowledge regarding the provisions necessary for protecting their interests — and thus the lessor's ability to protect themselves by stipulation was "illusory." In his second edition, Professor Merrill specifically argued that the implied covenant to market should include the obligation to "prepare [the product] for market, if it is unmerchantable in its natural form."[67] It was this second treatise that was cited to, and relied on, in the first known court case to expand the "duty to market" to include the duty to make a marketable product — *Gilmore v. Superior Oil Co.*, explained in further detail below.[68]

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64 *See*, *e.g*., *The First Marketable Product Doctrine*, at 38.

65 Maurice H. Merrill, *The Law Relating to Covenants Implied in Oil and Gas Leases* (1926); Maurice H. Merrill, *The Law Relating to Covenants Implied in Oil and Gas Leases* (2d ed. Supp. 1964).

66 *The First Marketable Product Doctrine*, at 38. *See also What Does The Lease Provide?*, at 12 (noting that "[t]he reasoning behind using the implied covenant to market to prohibit or limit deductions for certain post-production costs was first enunciated by Professor Maurice Merrill in 1940").

67 *The First Marketable Product Doctrine*, at 39 (*quoting Merrill*, 2d ed., at 214-15).

68 Gilmore v. Superior Oil Co., 388 P.2d 602, 607 (Kan. 1964). *See also* West v. Alpar Res., 298 N.W.2d 484, 490 (N.D. 1980) (citing to Merrill's treatise on the implied covenant to market). The court in *Gilmore* cited Merrill's treatise for the proposition that "[i]f it is the lessee's obligation to market the product, it seems necessary to follow that his is the task also to prepare it for market, if it is unmerchantable in its natural form. No part of the costs of marketing or of preparation for sale is chargeable to the lessor. This is supported by the general current of authority." *Gilmore*, 388 P.2d at 607. Although the court noted that Professor Merrill's statement was "unqualified," it nonetheless adopted this general proposition of law. *Id*. Other commentators have noted that Professor Merrill's blanket statement that "[t]his is supported by the general current of authority," was patently wrong. *The First Marketable Product Doctrine*, at 40 ("He was wrong. The general current of

Professor Eugene Kuntz, on the other hand, is largely credited as originating the second rationale adopted by courts for endorsing the "marketable product" rule — that lessees should not be permitted to deduct all of its downstream expenses in determining the value of the lessor's royalty because the duty of "production" of the lessee does not cease until a "marketable" product has been created.[69]

While not all courts that have adopted the marketable product rule have focused on the point at which "production" has been achieved, and instead relied on the implied duty to market alone, the "production" rationale was adopted by Colorado in its pair of decisions *Garman v. Conoco, Inc*. (1994) and *Rogers v. Westerman Farm Co*. (2001).[70]

Thus, the origins of the "marketable product" rule have been credited by some commentators as beginning with the works of these two professors.[71]

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authority did not support his interpretation of the implied covenant to market; rather, the case law at the time of Merrill's treatise uniformly recognized that a lessee could properly deduct marketing costs and other expenses in applying a workback calculation to determine the value of price of its production at the wellhead.").

69 Eugene Kuntz, *A Treatise on the Law of Oil and Gas* (W. H. Anderson Co. 1962). *See also The First Marketable Product Doctrine*, at 41.

70 *See, e.g.,* Garman v. Conoco, Inc., 886 P.2d 652, 657-61 (rejecting the rationale of "at the well" states that gas is "produced" when it is severed from the land at the wellhead); Rogers v. Westerman Farm Co., 29 P.3d 887, 900 (Colo. 2001) ("In Colorado, we decline to follow the rule that gas is 'produced' once physically severed, and thus, decline to adopt the reasoning regarding the deductibility of costs adopted by these jurisdictions."). The Supreme Court of Colorado in *Rogers* also cited Professor Kuntz's treatise directly for the proposition that "[The] broader rule holds that costs incurred after a marketable product has been obtained, that either enhance the value of the product or cause the product to be transported to another location, are shared by the lessee and the lessor." *Rogers*, 29 P.3d at 900 (citing 3 Eugene Kuntz, *A Treatise on the Law of Oil and Gas*, § 40.5, at 351 (1989 & 2001 Supp.).

71 For a discussion on the works of these professors and their influence on the creation of the marketable product rule, see *The First Marketable Product Rule*, at 38. Notably, an additional academic that is not discussed here, but had an influence on the marketable product rule as it developed in these jurisdictions, is Professor Owen Anderson, who published a series of law review articles in the late 1990s. *Id*. at 42. At the time of the writing of his first articles, however, Oklahoma, Kansas, and Colorado had already adopted the marketable product rule. Notwithstanding this, the Supreme Court of Colorado in *Rogers v. Westerman Farm Co*. looked heavily to Anderson's analysis in determining that "at the well" language is silent as to post-production costs and should be construed against the lessee. *See Rogers* 29 P.3d at 898-99.

The first state to expressly adopt some version of the marketable product rule was the Supreme Court of Kansas in 1964. In *Gilmore v. Superior Oil Co*., the Supreme Court of Kansas, citing to Merrill on Covenants Implied in Oil and Gas Leases, was the first court to hold that the lessee's implied obligation to market the product included the obligation to make the gas marketable. *Gilmore* involved the interpretation of an oil and gas lease providing for a royalty of "1/8 of the market value of such gas at the mouth of the well[.]"[72] The court, noting that "[c]onstruction of oil and gas leases containing ambiguities shall be in favor of the lessor and against the lessee," ultimately concluded that the implied obligation controlled and that, absent an express provision in the lease, it was the lessee's duty to prepare the gas into a marketable condition.[73] Shortly thereafter, the same court in *Schupbach v. Continental Oil Co*. determined that a lease providing for a royalty of "1/8th of the proceeds of the sale thereof at the mouth of the well," did not permit the lessee to deduct post-production costs in determining the value of the lessor's royalty.[74]

Ironically, both of these decisions appeared to be a departure from the court's decision in *Matzen v. Hugoton Prod. Co*., only eight years earlier, that seemingly upheld the lessee's ability to use the netback method in determining the value of the lessor's royalty.[75] In *Matzen*, the Supreme Court of Kansas interpreted a royalty clause providing for a royalty of "one-eighth of the proceeds from the sale of gas," as providing a royalty to be determined by "proceeds from the sale of gas, wherever and however ultimately sold . . . less reasonable expenses incurred in its gathering, transporting, processing and marketing."[76] In fact, the court in *Matzen* explicitly rejected the view that the "duty to market" obligated the lessee to incur all costs to transport and process gas, concluding that the "duty did not extend to providing a gathering system to transport and process the gas off the leases at a large

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72 Gilmore v. Superior Oil Co., 388 P.2d 602, 605 (Kan. 1964).

73 *Id*.

74 Schupbach v. Continental Oil Co., 394 P.2d 1 (Kan. 1964).

75 Matzen v. Hugoton Prod. Co., 321 P.2d 576, 578-79, 582 (1958).

76 *Id*. at 463.

capital outlay with attending financial hazards in order to obtain a market at which the gas might be sold."[77]

Despite these two decisions that appeared to depart from both Kansas law and well-established precedent throughout all the states, these decisions did not gain traction in any other jurisdiction for over three decades. In fact, only three years after *Gilmore* and *Schupbach*, a federal court interpreting these decisions held that the holdings of these cases were limited, and did not require a lessee to bear all the costs of transporting gas to a distant commercial market, including compression and gathering costs.[78]

In 1988, the Supreme Court of Arkansas in *Hanna Oil & Gas Co. v. Taylor* was the second court to deny the use of the netback method in calculating royalties in a lease that contained "at the well" language, but for different reasons. In *Hanna Oil*, the Arkansas Supreme Court, in evaluating a royalty clause providing for "one-eighth of the proceeds received by Lessee

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77 *Id*. at 462.

78 Ashland Oil & Ref. Co. v. Staats, Inc., 271 F. Supp. 571, 575 (D. Kan. 1967) ("We will not enlarge the lessee's duty to market production so as to require it to devote a long and costly gathering system to transport gas to the nearest commercial market. The two states cases do not support such a holding and nowhere have we found the lessee's duty to market thus extended."). Three decades letter, the Supreme Court of Kansas attempted to reconcile its holding in *Matzen* with its prior decisions *Gilmore* and *Schubach*. In the 1995 case *Sternberger v. Marathon Oil Co*., the Supreme Court of Kansas confirmed that Kansas endorses the "marketable product" rule — holding that "[t]he lessee . . . under an oil and gas lease has the duty to produce a marketable product, and the lessee alone bears the expense in making the product marketable" — but also holding that non-operating interest holders nonetheless must bear their proportion of post-production expenses, at least for transportation, when the lease provides that royalties are to be paid based on the "market price at the well," and there is no market at the well. Sternberger v. Marathon Oil Co., 894 P.2d 788, paragraphs 1 and 2 of syllabus (1995). In its decision, the court determined that the royalty language calling for a royalty of "one-eighth (1/8) of the market price at the well for gas sold or used," was not ambiguous, although it was "silent as to deduction [of post-production costs]." *Id*. at 794. The court then determined that the language "at the well" clearly specified the location at which the value of the lessor's royalty would be calculated, and that "transportation costs are borne proportionately by the lessor and the lessee where the royalty is to be determined at the well but no market exists at the well." *Id*. at 794-96. As explained further below, this variation has come to be known as the "first marketable product rule," as Kansas is one of two jurisdictions that does not require gas to be transported to a market before it can be deemed "marketable."

at the well for all gas," determined that the word "proceeds" means total proceeds, rather than "net" proceeds, and did not permit the deduction of post-production costs in calculating the royalty.[79]

Notably, the court did not rely on any implied covenant in *Hanna Oil*, but rather, decided the case based on contract interpretation and the "clear language of the agreement[.]"[80] Further, the court did not cite to or rely on either the *Gilmore* or *Schupbach* decisions — rather, it was a case of pure contract interpretation under Arkansas law. As such, although *Hanna Oil* is often cited in cases adopting the marketable product rule,[81] its analysis neither explicitly adopts nor rejects a variation of the theory. At least two federal decisions interpreting *Hanna Oil* have concluded that, despite marketable-product decisions citing *Hanna Oil* in support of the marketable product rule, the Arkansas court's ruling neither adopts nor rejects the marketable product rule, and the law in Arkansas is unclear on the issue.[82]

Relying on the trilogy of cases from Kansas and Arkansas — *Gilmore*, *Schupbach*, and *Hanna Oil & Gas Co. v. Taylor* — Oklahoma became the second state to explicitly expand the implied duty to market as including "the cost of preparing the gas for market" in 1992.[83] In *Wood v. TXO Prod. Corp.*,

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79 Hanna Oil & Gas Co. v. Taylor, 759 S.W.2d 563, 564-65 (Ark. 1988).

80 *Id*. at 565.

81 *See*, *e.g*., Garman v. Conoco, Inc., 886 P.2d 652, 658 (Colo. 1994); Mittelstaedt v. Santa Fe Minerals, 954 P.2d 1203, 1212 (Okla. 1998); Rogers v. Westerman Farm Co., 29 P.3d 887, 897 (Colo. 2001).

82 *See*, *e.g*., Riedel v. XTO Energy, Inc., 257 F.R.D. 494, 505 (E.D. Ark. 2009) ("The Court agrees that Arkansas law is, in fact, unclear, and that, it can not be said that Arkansas has joined the states of Colorado and Oklahoma in adopting what is a minority position with respect to the deduction of post-production costs."); Wallace v. XTO Energy, Inc., Case No. 4:13-cv-00608, 2014 U.S. Dist. LEXIS 117286, at *8 (E.D. Ark. Aug. 22, 2014) ("Defendants are mistaken in asserting that Arkansas law clearly rejects the marketable condition rule. Arkansas law as to the marketable condition rule is unclear, and, thus, its purported rejection cannot be the basis for dismissal of plaintiffs' breach of contract claim.") (citing *Riedel*, 257 F.R.D. at 503-05).

83 Wood v. TXO Prod. Corp., 854 P.2d 880, 882-83 (Okla. 1992). Ironically, although the *Wood* court stated that it was "choos[ing] to follow the holdings of the Kansas and Arkansas courts," the Supreme Court of Arkansas in *Hanna Oil & Gas Co. v. Taylor*, 759 S.W.2d 563, 564-65 (Ark. 1988), did not rely on the duty to market, or mention it at all. Rather, as explained in *Hanna Oil*, the Arkansas Court determined the term "proceeds" to mean

the Supreme Court of Oklahoma was called upon to answer the following certified question:

> "Is an oil and gas lessee/operator who is obligated to pay the lessor '3/16 at the market price at the well for the gas sold,' entitled to deduct the cost of gas compression from the lessor's royalty interest?"[84]

The Supreme Court of Oklahoma answered the certified question in the negative. In its decision, the *Wood* court avoided any contract interpretation analysis at all, and instead held that "[w]e interpret the lessee's duty to market to include the cost of preparing the gas for market."[85] The decision, however, left unanswered the question of *what* costs may be included as necessary to market.

Six years later, the Oklahoma Supreme Court refined its holding in *Wood* and fashioned what is commonly referred to as the modern "first-marketable product" rule. In *Mittelstaedt v. Santa Fe Minerals, Inc*., the court was called on to answer the following certified question:

> "In light of the facts as detailed below, is an oil and gas lessee who is obligated to pay '3/16 of the gross proceeds received for the gas sold' entitled to deduct a proportional share of transportation, compression, dehydration, and blending costs from the royalty interest paid to the lessor?"[86]

The Supreme Court of Oklahoma once again answered the certified question in the negative. However, the court qualified its answer by also concluding that a lessor must bear a proportionate share of such costs if the lessee can prove (1) that the costs enhanced the value of an already marketable product; (2) that such costs are reasonable, and (3) that actual

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total proceeds, rather than "net" proceeds, and determined that the unambiguous language therefore did not entitle the lessee to deduct compression costs in calculating the value of the lessor's royalty. *Id*. at 564-65.

84 *Wood*, 854 P.2d at 880.

85 *Id*. at 882.

86 Mittelstaedt v. Santa Fe Minerals, 954 P.2d 1203, 1204-05 (Okla. 1998).

royalty revenues increased in proportion with the costs assessed against the nonworking interest.[87]

The Supreme Court of Oklahoma's decision in *Wood* — which brought attention to the decisions of the Supreme Court of Kansas and the theories of Professor Merrill that had, by and large, been completely ignored for decades by other states — seemingly prompted litigation in several other states to revisit the issue of royalty calculation and the default "at the well" rule that had been in place for over a century.[88] As a result, various permutations of the "marketable product" rule arose in several other states — some explicitly adopting it (Colorado), some implicitly adopting it in a different form (Kansas), and others purporting not to adopt it but nonetheless providing their own theory that largely resembles it (West Virginia).

[b] — Recent Precedent: Variations of the "Marketable Product" Theory.

Although "marketable product" jurisdictions generally agree that merely extracting gas from the wellhead does not discharge the lessee's duty of production, there is considerable disagreement between these jurisdictions as to when a "marketable" product has been achieved, or when "production" has occurred.

For example, Oklahoma and Kansas have determined that the implied duty to market requires the lessee to pay for post-production costs only until a marketable product is created. Lessors are still required to bear a proportion of costs for transportation to distant markets and to enhance an already marketable product.

Colorado and West Virginia, in contrast, have determined that a marketable product has only been achieved when the product is both physically sufficient and in the location of a commercial marketplace to be sold. Thus, the lessee must bear all costs in not only processing the gas, but also to transport the gas to a point of sale.

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87 *Id*. at 1205.

88 Williams & Meyers, § 645 (noting that "[t]hese cases have prompted litigation in other states seeking to persuade the courts to follow the same approach.").

These differences have garnered much criticism from leading authorities about the marketable product rule, who have argued that the rule has been applied inconsistently amongst the states purporting to adopt it.[89] The variations of these rules are described in detail below.

The first variation of the "marketable product" rule is known as the "*first* marketable product rule," which has been adopted and applied by Oklahoma and Kansas courts.[90] The first marketable product rule generally holds that the lessee's duty of "production" has been fulfilled when a marketable product has been achieved, regardless of whether the product itself is at a location where it can be sold. Generally, "[o]nce a marketable product is obtained, reasonable costs incurred to transport or enhance the value of the marketable gas may be charged against nonworking interest owners."[91]

The Supreme Court of Oklahoma specifically refined its version of the "first marketable product" view in the 1998 case *Mittelstaedt v. Santa Fe Minerals, Inc*. In *Mittelstaedt*, the court held that the lessor must bear a proportionate share of certain post-production costs, after a marketable product has been obtained, if the lessee can show (1) the cost enhances the value of an already marketable product, (2) such costs are reasonable, and (3) actual royalty revenues increased in proportion with the costs assessed against the nonworking interest.[92]

What constitutes a "marketable" product, however, has by and large been left undefined by the courts.[93] The Supreme Court of Kansas has broadly referred to the lessee's duty to make gas "marketable," as "putting the gas

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89 *See*, *e.g.*, *The First Marketable Product Doctrine*, at 29 (describing the evolution of the marketable product doctrine as transforming the jurisprudence regarding royalty calculations "from consistency to chaos").

90 *See* Sternberger v. Marathon Oil Co., 894 P.2d 788 (Kan. 1995); Mittelstaedt v. Santa Fe Minerals, Inc., 954 P.2d 1203 (Okla. 1998).

91 *Sternberger*, 894 P.2d 788, at paragraph 3 of syllabus.

92 *Mittelstaedt*, 954 P.2d at 1205.

93 *The First Marketable Product Doctrine*, at 63. (noting that the Supreme Court of Oklahoma in *Mittelstaedt* "did not attempt to define either the term 'marketable' or the term 'product.'"). *See also Sternberger*, 894 P.2d 788 (failing to provide a definition of either "marketable" or "product," but concluding as a matter of law that the gas was marketable at the well).

in condition to be sold[.]"[94] In its most recent decision, the court recognized that "[w]hat it means to be 'marketable' remains an open question," but is *not* "interstate pipeline quality standards or downstream index prices."[95] Despite this, the court declined to provide a definition of what constitutes a "marketable" product. The Supreme Court of Oklahoma has similarly declined to adopt a definition of "marketable" or "product."[96]

Although the rules set forth in *Sternberger* and *Mittelstaedt* are markedly similar, one important distinction exists between these two jurisdictions. In Oklahoma, the lessee bears the burden of showing that the cost enhances the value of an already marketable product, is reasonable, and actually increases royalty revenues.[97] In essence, the lessee must assert and prove, akin to an affirmative defense, that it did not breach the implied covenant to market by deducting post-production costs in determining the value of a lessors' royalty.[98] In Kansas, however, although the lessee bears the burden of proving that costs incurred to transport or enhance the value of marketable gas were "reasonable,"[99] subsequent decisions have made clear that it is the lessor's burden to prove that the lessee breached the implied covenant to market.[100]

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94 Coulter v. Anadarko Petroleum Corp., 292 P.3d 289, 306 (Kan. 2013) ("The lessee . . . must bear the entire expense of producing the gas at the wellhead pursuant to the terms of the oil and gas lease. Additionally, the lessee must also bear the entire cost of putting the gas in condition to be sold pursuant to the court-made 'marketable condition rule.'").

95 Fawcett v. Oil Producers, Inc., No. 108, 666, 2015 Kan. LEXIS 376, at *25 (Kan. July 2, 2015).

96 *See Mittelstaedt*, 954 P.2d 1203.

97 *Mittelstaedt*, 954 P.2d at 1210 ("In sum, a royalty interest may bear post-production costs of transporting, blending, compression, and dehydration, when the costs are reasonable, when actual royalty revenues increase in proportion to the costs assessed against the royalty interest, when the costs are associated with transforming an already marketable product into an enhanced product, **and when the lessee meets its burden of showing these facts**.") (emphasis added).

98 *Id*. *See also The First Marketable Product Doctrine*, at 65 (noting that "Oklahoma effectively places the burden on the lessee – in the nature of an affirmative defense – to disprove a lessor's claim that the lessee breached the implied covenant to market by deducting post-production costs from its royalty payments").

99 *Sternberger*, 894 P.2d 788, at paragraph 3 of syllabus.

100 Smith v. Amoco Prod. Co., 31 P.3d 255, 274 (Kan. 2001) (noting that "the lessors have the burden of proof").

In contrast to the first-marketable product rule, other courts have taken the implied duty to market a step further and have determined that a "marketable product" has not been obtained until the product is *both* in a "marketable" condition in which it can be sold, *and* has been transported to a viable market for sale.

In its first decision to address royalty issues with respect to post-production costs, the Supreme Court of Colorado adopted generally the marketable product rule in its 1994 decision *Garman v. Conoco, Inc*. In *Garman*, the Supreme Court of Colorado answered a certified question as to whether "under Colorado law, is the owner of an overriding royalty interest . . . required to bear a proportionate share of post-production costs, such as processing, transportation, and compression, when the assignment creating the [interest] is silent as to how post-production costs are borne," in the negative.[101] The court held generally that "the implied covenant to market obligates the lessee to incur those post-production costs necessary to place gas in a condition acceptable for market,"[102] but did not specifically address what post-production costs, in its view, were necessary to bring gas into a "marketable" condition.

This question was addressed when the Supreme Court of Colorado revisited the marketable product rule seven years later in *Rogers v. Westerman Farm Co*. In *Rogers*, the court rejected the lessees' arguments that they could deduct post-production costs necessary for the transportation of gas that was otherwise saleable, aka "marketable," in the form that it emerged from the wellhead, instead holding that "the more accurate definition of marketability 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."[103] Thus, the court essentially added a second "prong" to the first-marketable product rule, holding that "[g]as 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

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101 Garman v. Conoco, Inc., 886 P.2d 652, 653-54 (Colo. 1994).

102 *Id*. at 659.

103 Rogers v. Westerman Farm Co., 29 P.3d 887, 903 (Colo. 2001).

saleable in the oil and gas marketplace."[104] The court further determined that the question as to whether gas is marketable "is a question of fact, to be resolved by a fact finder."[105]

The Supreme Court of Colorado's decision in *Rogers* was a significant deviation from other jurisdictions that had previously adopted the "first" marketable product rule — Oklahoma and Kansas — which both held that gas may be marketable "at the well," in the condition in which it emerges at the wellhead.[106]

Invoking the authority and reasoning of the prior decisions issued in Kansas, Oklahoma and Colorado, West Virginia adopted what some have construed as yet another variation of the "marketable product" rule in 2001. In *Wellman v. Energy Res., Inc.*, the Supreme Court of West Virginia held that the implied duty to market requires the lessee to "bear all costs incurred in exploring for, producing, marketing, and transporting the product *to the point of sale*."[107]

Six years later, in *Estate of Tawney v. Columbia Natural Res., LLC*, the same court held that "at the well" type language was ambiguous and insufficient to alter the default rule that "the lessee must bear all costs of marketing and transporting the product to the point of sale."[108] Notably, the court's decision in *Tawney* echoed the language in *Wellman* that required the lessee to bear costs *to the point of sale*, as opposed to the market.[109]

Although several commentators have noted that the court's holdings in *Wellman* and *Tawney* arguably take the marketable product doctrine further than *Rogers* by requiring the lessee to bear all costs of transporting the gas to

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104 *Id*. at 906.

105 *Id*.

106 *See* Sternberger v. Marathon Oil Co., 894 P.2d 788 (Kan. 1995); Mittelstaedt v. Santa Fe Minerals, Inc., 954 P.2d 1203 (Okla. 1998). *See also The First Marketable Product Doctrine*, at 71 (noting that "by adding a 'marketable-location' component to the first marketable product doctrine, *Rogers* deviated dramatically from other first marketable product cases").

107 Wellman v. Energy Res., Inc., 557 S.E.2d 254, paragraph 4 of syllabus (W. Va. 2001) (emphasis added).

108 Estate of Tawney v. Columbia Natural Res., LLC, 633 S.E.2d 22, 27 (W. Va. 2006).

109 *Id*.

the point at which it is *actually* sold, as opposed to a point where it is capable of being sold in a market,[110] at least one federal decision has interpreted the "point of sale" language of *Wellman* as only obligating the lessee to bring the gas to the market, which aligns with the Colorado version of the marketable product rule.[111] A full discussion of *Wellman* and its progeny, and subsequent cases, is discussed *infra* Section 22.03[3].

[c] — Criticisms of the "Marketable Product" Theory.

Perhaps the strongest criticism of decisions that have adopted the "marketable product" rule is that several of these decisions have either completely ignored, read the meaning out of, or effectively treated as surplusage, "at the well" language in oil and gas leases. With the exception of Kansas, nearly every marketable product jurisdiction to address the issue has held that "at the well"-type language is ambiguous and insufficient to allocate post-production costs between the lessor and lessee, or ignored it all together.

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110 *See* Williams & Meyers, § 645 ("In many senses, *Tawney* goes further than *Rogers* and other cases because it seemingly requires the lessee to bear the full costs of transporting the natural gas to the point of sale even if it is in a marketable condition prior to the point of actual sale. *Rogers* seemingly requires the lessee to pay on the value of a marketable product at some point where there is a regular market for the gas, while the Oklahoma jurisprudence seemingly still allows for transportation deductions once the product is deemed to be marketable. West Virginia, however, requires the lessee to pay royalty based on the sales price regardless of whether the natural gas is marketable at the well or in the pipeline delivering the natural gas to the ultimate end-user."); *The First Marketable Product Doctrine*, at 78 ("Arguably, *Wellman* took the first marketable product doctrine even a step beyond *Rogers*. . . . The court essentially held that even if a lessee acquires a marketable product at the wellhead or at an intermediate location short of the actual point of sale, the lessee may nonetheless have to pay its lessors a proportionate share of the actual price that the lessee receives for its production at the point of sale without taking into account any enhanced value the lessee may have added to the production through its transportation, compression, treating, processing, gathering, dehydration, or marketing efforts."); *What Does The Lease Provide?*, at 9 ("As a general rule, states that have adopted the marketable product approach have held that the term 'at the well' does not adequately identify those post-production costs a lessee may deduct when calculating royalty. The marketable product rule seems to be an attempt on the part of many courts and commentators to apply equitable principles to the rules of contract interpretation.").

111 W. W. McDonald Land Co. v. EQT Prod. Co., 983 F. Supp. 2d 790 (S.D.W. Va. 2013).

Some examples where the courts have ignored "at the well" language entirely is represented in the Supreme Court of Oklahoma's pair of decisions in *Wood v. TXO Production Corp.* and *Mittelstaedt v. Santa Fe Minerals, Inc.* In *Wood*, the court held that royalty language calling for a royalty of "3/16 at the market price at the well for the gas sold," did not permit the lessee to deduct the costs of gas compression in determining the value of the lessor's royalty.[112] In its decision, the *Wood* court did not address the "at the well" language at all, instead holding — in somewhat conclusory fashion — that the lessee's duty to market includes the cost of preparing the gas for market. The court did not engage in a contract interpretation analysis.

In its subsequent decision in *Mittelstaedt*, the same court was called on to answer a certified question regarding whether a royalty clause generally providing for "3/16 of the gross proceeds received for the gas sold" entitled the lessee to deduct a proportion of post-production costs in determining the value of the lessor's royalty. Significantly, although "at the well" language was not included in the certified question itself, the court noted that one of the royalty clauses at issue provided for a royalty of "3/16 of the gross proceeds, **at the mouth of the well**, received by lessee for the gas[.]"[113] Although recognizing this distinct royalty clause, the court once again ignored the express language of the lease and relied on the implied covenant to market, standing alone, in answering the certified question in the negative.[114]

The few cases in marketable product jurisdictions that have addressed the "at the well" language have generally held that such language is ambiguous or silent as to the allocation of post-production costs. One notable decision is the Supreme Court of Colorado's decision in *Rogers v. Westerman Farm Co.* In *Rogers*, the court held that lease language providing for the royalty to be

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112 Wood v. TXO Prod. Corp., 854 P.2d 880 (Okla. 1992).

113 Mittelstaedt v. Santa Fe Minerals, Inc., 954 P.2d 1203, 1206 (Okla. 1998).

114 *See* Williams & Meyers, § 645 ("The question certified to the court did not contain this reference to the 'mouth of the well,' and it is not clear from the Oklahoma court's opinion that this phrase was part of the question it was answering. If it was, the court fails to deal adequately with the significance of the phase in determining the contract's allocation of costs between lessee and lessor. The Court seems to treat the implied covenant to market as trumping the express provision limiting the calculation of the royalty to the gross proceeds measured at the mouth of the well.").

based "at the well" or "at the mouth of the well," was *silent* with respect to the allocation of post-production costs.[115] As a result, the court invoked the "generally accepted rule that oil and gas leases are strictly construed against the lessee in favor of the lessor," and thus looked to the implied covenant to market in determining that the leases did not allocate post-production costs.[116] The *Rogers* decision has generally been criticized as using the implied covenant to supplant and/or rewrite unambiguous lease terms in favor of the lessee.[117] Significantly, the decision did not identify any alternative reasonable interpretation of the "at the well" language before concluding that it was ambiguous.

More recently, the Supreme Court of West Virginia held in its decision *Estate of Tawney v. Columbia Natural Res.*, that "at the well language," is ambiguous and is not effective to permit the lessee to deduct post-production costs from the value of the lessor's royalty. Although the court appeared to give more weight to "at the well" language, it nonetheless followed the same path as *Rogers* and determined that the phrase was ambiguous and, therefore, should be construed against the lessee. The court concluded as a matter of law that "at the well" language does not indicate "*how* or *by what method*

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115 Rogers v. Westerman Farm Co., 29 P.3d 887, 897 (Colo. 2001).

116 *Id*. at 901.

117 *See, e.g.*, David E. Pierce, "Royalty Jurisprudence: A Tale of Two States," 49 *Washburn L.J.* 347, 359 (2010) ("*A Tale of Two States*") ("Although the court concluded the 'at the well' language was silent regarding the 'allocation of costs,' that conclusion did not explain why it ultimately gave no effect to the 'at the well' language. To explain the nullification of the express 'at the well language, the court turned to the implied covenant to market, which it held 'controls the lessee's duty to make the gas marketable.' The final step in this rather disjointed metamorphosis was to create the content of the implied covenant that will supplant the 'at the well' language."); *The First Marketable Product Rule*, at 68 ("[O]n the basis of its 'strict' rule of lease construction, the court rejected the majority approach and held that the terms 'at the well' and 'at the mouth of the well' were 'silent with respect to allocation of costs.' The Supreme Court of West Virginia did not identify any alternative definition for these terms; for all practical purposes, it simply deleted these terms from the leases at issue in the case."); John W. Broomes, "Waste Not, Want Not: The Marketable Product Rule Violates Public Policy Against Waste of Natural Resources," 63 *Kan. L. Rev.* 149, 170 (2014) ("*Waste Not, Want Not*") ("[T]he court ignores express 'at the well' language in the royalty clauses, rendering those words utterly meaningless, thus violating the canon of construction against rendering contract terms as mere surplusage").

the royalty is to be calculated or the gas is to be valued."[118] Notably, like *Rogers*, the court did not set forth or recognize any alternative reasonable interpretation for "at the well" language before invoking the secondary canon of contract interpretation of construing the agreement against the drafter-lessee. As a result, the "at the well" language was effectively declared surplusage with no meaning or effect.[119]

Several decisions adopting the "marketable product" rule have also been highly criticized by authorities in the oil and gas field as misconstruing and incorrectly expanding the common-law implied "duty to market," as including the obligation to create a "marketable product." Kansas, Oklahoma, Colorado, and West Virginia have all cited to, at least in part, the implied "duty to market" as at least one basis for adopting the marketable product theory.[120]

The implied duty to market, prior to the Supreme Court of Kansas' decision in 1964, was traditionally understood as obligating the lessee to market the oil or gas produced under a reasonably prudent operator standard.[121] The implied duty to "market" generally encompassed two aspects: (1) timing, in that "the lessee owe[s] a duty to market its production, if

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118 Estate of Tawney v. Columbia Natural Res., LLC, 633 S.E.2d 22, 28 (W. Va. 2006).

119 *See* Williams & Meyers, §645 ("West Virginia appears to give more weight to the express language used in the instrument than does Colorado, but in the end the court's conclusion that use of 'wellhead' language was ambiguous leaves one scratching one's head as to whether the court was really looking at the bargain struck between the parties or just imposing what it perceived to be a 'fair' and/or 'equitable' result. . . . If anything, the term 'wellhead' is very precise and definite because it is a clearly recognizable place which even laypersons can understand. Nonetheless, the *Tawney* court concluded that the express language really did not deal with the issue of using the netback methodology.").

120 *See*, *e.g*., Gilmore v. Superior Oil Co., 388 P.2d 602 (Kan. 1964); Wood v. TXO Prod. Corp., 854 P.2d 880 (Okla. 1992); Garman v. Conoco, Inc., 886 P.2d 652 (Colo. 1994); Sternberger v. Marathon Oil Co., 894 P.2d 788 (Kan. 1995); Rogers v. Westerman Farm Co., 29 P.3d 887, 906 (Colo. 2001); Wellman v. Energy Res., Inc., 557 S.E.2d 254 (W. Va. 2001); *Tawney*, 633 S.E.2d 22.

121 Williams & Meyers, § 645 ("In the marketing covenant, the question generally asked by the courts heretofore has been whether the lessee has marketed as a prudent operator, looking to the business judgment standards of other similarly situated prudent operators.").

prudently possible, within a reasonable period of time"; and (2) pricing, in that "the lessee owe[s] a duty to market its production for a reasonable price."[122]

In contrast to this traditional view, beginning with the Supreme Court of Kansas' decision in *Gilmore*, and later adopted by the courts in Oklahoma, Colorado, and West Virginia, marketable-product jurisdictions have been criticized as enlarging this implied covenant to create a separate and new covenant in and of itself — the implied covenant to create a marketable product or to prepare the product for market. As explained by a critique of the Supreme Court of Colorado's decision in *Rogers*, Williams & Meyers notes that the *Rogers* decision invented an entirely new implied covenant in and of itself:

> The Colorado Supreme Court has taken the implied covenant *to market as a prudent operator* and made it an independent duty not concerned with whether the operator has acted prudently. What thecourt has actually done is to create an entirely new implied covenant, an *implied covenant to prepare for market*.[123]

This enlargement of the implied duty to market was also noted by the dissent in *Wood v. TXO Prod. Corp.*, where four dissenting justices disagreed with what they perceived to be "Arkansas' and Kansas' judicial enlargement of the lessee's duty to market the gas."[124] Professor Owen Anderson, a leading proponent of the "marketable product" rule and editor of Kuntz's treatise on oil and gas, recognizes this judicial expansion of the covenant to market, but nonetheless has argued that such expansion is justified.[125]

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[122] *The Marketable Product Doctrine*, at 23. *See also What Does The Lease Provide?*, at 11-12 ("In general, early cases dealing with the covenant to market dealt with the complete failure of a lessee to produce and market gas.") (quoting Scott Lansdown, "The Marketable Product Rule," 44 *S. Tex. L. Rev.* 667, 670 (2003)).

[123] Williams & Meyers, § 645.

[124] Wood v. TXO Prod. Corp., 854 P.2d 880, 886 (Okla. 1992).

[125] *What Does The Lease Provide?*, at 25 ("I will be the first to concede that the implied covenant to market has grown like Topsy. Arguably, it should be confined to its original purpose: to require the lessee to diligently seek a market for gas reserves that are shut-in. The expansion of this covenant would be largely unnecessary if the royalty clauses were simply construed in light of their purpose, in light of the lessor's reasonable expectations, and

More recent jurisprudence has explicitly acknowledged that the "duty to market," has now been expanded into a separate duty to "*prepare* gas for market." Notably, the most recent decision issued by the Supreme Court of Kansas, *Fawcett v. Oil Producers, Inc*., recognized the traditional two-prong aspect of the implied duty to market — pricing and timing — in its decision, stating that "[t]o satisfy this duty, an operator must market its production at reasonable terms within a reasonable time following production."[126] However, the court then went further to explain that such covenant also includes "an operator's **duty to prepare gas for market**," if it is "unmerchantable in its natural form[.]"[127] The court's decision in *Fawcett* effectively recognizes and adopts Williams & Meyer's criticisms by explicitly acknowledging that the "duty to market," now includes, in its jurisdiction, a separate duty to "prepare" gas for market.

Yet another criticism of the marketable product rule is the difficulty in determining when the gas has become a "marketable product." Despite the several distinct views and permutations of the marketable product rule, each jurisdiction has universally struggled with — and adopted varying views about — when oil or gas is "marketable."

For example, although both Oklahoma and Kansas generally hold that the lessee's duty of production is achieved once a "marketable" product has been produced, neither court has endeavored to define these terms.

The Supreme Court of Oklahoma's decision in *Mittelstaedt*, although enunciating a three-prong test for determining when post-production costs are properly deducted in determining the value of the lessor's royalty, did not define the terms "marketable" or "product."[128] Instead, it merely noted

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in light of the lessee's general duty to deal with the lessor fairly – especially where royalty matters are concerned.") (quoting Owen L. Anderson, "Royalty Valuation: Should Royalty Obligations Be Determined Intrinsically, Theoretically, or Realistically?" *(Part 2)*, 37 *Nat. Resources J.* 611, 630 n. 89 (1997)).

126 Fawcett v. Oil Producers, Inc., No. 108, 666, 2015 Kan. LEXIS 376, at *21 (Kan. July 2, 2015).

127 *Id*. (emphasis added).

128 *Mittelstaedt*, 954 P.2d at 1205; *see also The First Marketable Product Doctrine*, at 64 ("Significantly, however, the [Mittelstaedt] court did not attempt to define either the term 'marketable' or the term 'product.'").

that "in some cases a royalty interest may be burdened with post-production costs, and in other cases it may not," leaving the decision to the trier of fact.[129] Ironically, however, in at least one decision prior to *Mittelstaedt*, the Supreme Court of Oklahoma effectively concluded as a matter of law that dehydration and gathering are necessary to prepare gas production for a commercial market.[130]

The Supreme Court of Kansas has similarly refused to offer a definition of the term "marketable." In its most recent decision, *Fawcett v. Oil Producers, Inc.*, the Supreme Court of Kansas recognized that "[w]hat it means to be 'marketable' remains an open question," and that "[n]otably absent from these cases is any discussion of the price, quality or condition at which gas becomes 'marketable[.]'"[131] Despite recognizing that the term "marketable" was an open question, the court concluded as a matter of law that it was not simply "interstate pipeline quality standards or downstream index prices[.]"[132] Although not offering an alternative definition of the term, the court went on to conclude as a matter of law that, whatever "marketable" means, gas is deemed marketable as a matter of law when "the operator delivers the gas to the purchaser in a condition acceptable to the purchaser in a good faith transaction."[133]

By contrast, Colorado endeavored to define the term "marketable" by adopting the definition that gas is in a "marketable" condition 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."[134] Nonetheless, the court went on to conclude that "[t]he determination of whether gas is marketable is a question of fact, to be resolved by a fact

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129 *Mittelstaedt*, 954 P.2d at 1205.

130 *The First Marketable Product Doctrine*, at 61-62 (citing TXO Prod. Corp. v. State ex rel. Comm'rs of the Land Office, 903 P.2d 259, 262-63 (Okla. 1994).

131 *Fawcett*, 2015 Kan. LEXIS 376 at *25.

132 *Id*.

133 *Id*. at *28.

134 Rogers v. Westerman Farm Co., 29 P.3d 887, 906 (Colo. 2001).

finder."[135] In essence, similar to *Fawcett*, it would appear that gas is "marketable" if it is in a condition acceptable to a purchaser. However, unlike Kansas, simply identifying a potential purchaser at the wellhead is insufficient under Colorado law. The court decreed, as a matter of law, that a "marketable location," could only be a location that involves a commercial exchange, in a "commercially viable market for the gas."[136]

The inability of marketable-product jurisdictions to provide a precise definition of "marketability," and the uncertainty and real possibility of inconsistent jury verdicts, has led to significant criticism by commentators and other courts evaluating the marketable product rule.

The Supreme Court of North Dakota, for example, cited this inconsistency and ambiguity in marketable product jurisdictions as one of the several reasons it rejected the marketable product rule in its decision in *Bice v. Petro-Hunt, L.L.C.*[137] The court observed that "[t]he problem that has emerged with the first marketable product doctrine is the difficulty in determining when the gas has become a marketable product. This problem is highlighted by the fact that even the states which follow the 'marketable product' rule have failed to articulate a clear standard for determining when a marketable product has been created."[138] As yet another example, in adopting a definition of the term "royalty" that allowed for the "netback" approach, the Supreme Court of Pennsylvania also cited consistency as one of the several reasons for allowing the use of the netback method in determining the lessors' royalty. The court observed that, without using the netback method, lessors could receive "different royalties on the same quality and quantity of gas[.]"[139] Although *Kilmer* did not address the inconsistent definitions

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135 *Id*.

136 *Id*. at 910.

137 Bice v. Petro-Hunt, L.L.C., 768 N.W.2d 496, 502 (N.D. 2009).

138 *Id*. (internal quotation marks and citation omitted).

139 Kilmer v. Elexco Land Servs., 990 A.2d 1147, 1158 (Pa. 2009) ("[T]he natural gas can be sold at different degrees of processing for different prices and at different prices based upon the proximity of the market to high demand cities. If one company sells it at a point halfway to fully processed (or half-way to New York City), the landowner will get dramatically lower royalties than a neighbor whose gas is sold after it is fully processed. The use of the

of "marketable" by other jurisdictions, it nonetheless illuminated the fact that the marketable product rule can result in inconsistency in payments to lessors based on the same quality and quantity of gas even with the standard application of the rule.

Finally, leaving the question to the jury, especially without any meaningful guidance or definition as to what constitutes a "marketable" product, will inevitably lead to both inconsistent jury verdicts and burdensome litigation as lessors and lessees quibble over what constitutes a "marketable" product. As noted by one commentator, "[a]bsent a clear, easily understood point (*i.e.*, the wellhead) where a lessee may begin deducting its costs, a lessee operating in a 'marketable product' jurisdiction 'will [likely] be faced with an endless wave of expensive, burdensome and wasteful litigation.' The point of valuation for royalty purposes becomes a matter of fact, not law."[140] As a result, the marketable product rule arguably encourages inconsistency in at least two ways: (1) by permitting different royalties to lessors for the same quality and quantity of gas depending on at what point it is sold downstream; and (2) inconsistent jury verdicts determining that the same quality gas at the same location is "marketable" or "unmarketable," depending on their interpretation and conception of the facts of each case.

Another, more nuanced, criticism of the marketable product rule is that adherence to the rule encourages the "waste" of natural gas resources because the increased expense borne entirely by the operator/lessee encourages the premature cessation of production.[141] As a general rule, most oil and gas producing states have some form of statute declaring that the public policy of each state is to avoid the waste of oil and gas resources.[142] "Physical waste,"

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net-back method eliminates the chance that lessors would obtain different royalties on the same quality and quantity of gas coming out of the well depending on when and where in the value-added production process the gas was sold.").

140 *What Does The Lease Provide?*, at 25 (quoting Scott Lansdown, "The Marketable Product Rule," 44 *S. Tex. L. Rev.* 667, 701 (2003)).

141 *Waste Not, Want Not*, at 183.

142 *See id*. (noting that Kansas, Oklahoma, West Virginia, and Colorado each have similar statutes declaring that it is in the public interest of each state to protect against the waste of oil and gas natural resources).

as the term is used and commonly understood and defined in the oil and gas industry, is defined as "the loss of oil or gas that could have been recovered and put to use," and includes the "failure to recover the maximum quantity [of oil or gas] which theoretically could be produced."[143]

The typical habendum clause of an oil and gas lease provides for a fixed term of a few years, known as the primary term, and generally includes a clause for a secondary term of indefinite duration providing for perpetuation of the lease "as long thereafter as oil or gas is produced in paying quantities."[144] "Paying quantities" is typically determined by whether the oil and gas produced is "sufficient to yield a return in excess of operating costs," excluding drilling and capital costs.[145]

As a result, the practical effect of the marketable product rule is that a greater share of post-production costs is taken from the lessee's revenue stream, thus lowering the threshold at which the operating costs exceeds the production's value. This phenomenon is explained by John W. Broomes in his article, *Waste Not, Want Not*:

> When gas is sold off the leased premises, the lessee's revenue stream is also reduced by the post-production costs incurred to gather, treat, and transport the gas to the point of sale. In non-Marketable Product Rule jurisdictions, the lessor bears its proportionate share of those post-production costs. However, in Marketable Product Rule states, the lessee's share of production revenue is further burdened with the lessor's share of post-production costs from the wellhead to the point where the gas is placed in marketable condition, or even further to a marketable location (for Colorado) or the ultimate point of sale (for West Virginia). Since this shifting of post-production costs is not accompanied by any increase in the lessee's production revenue, in most cases the unavoidable result is that the underlying lease will terminate due to cessation of production in paying quantities at

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143 *Id*. (citing Patrick H. Martin & Bruce M. Kramer, Williams & Meyers Oil And Gas Law 45, 821 (2009)).

144 *Id*. at 182.

145 *Id*. (citing Martin & Kramer, at 821).

an earlier point in time, and with less overall recovery of natural gas, than if the lessor had been required to bear its share of post-production costs.[146]

Thus, as the argument proceeds, the marketable product rule results in a detrimental effect to nearly everyone — the lessee is burdened by additional post-production costs, the public interest suffers from a premature cessation of oil and gas production, and even the lessor may suffer if the cessation of production occurs in a rising market.[147]

[3] — Other Issues Related to Royalty Valuation: Price Terms and "Market Value" v. "Proceeds" Clauses.

A determination of whether the value of the lessor's royalty is to be determined "at the well," or when a "marketable product" has been obtained does not necessarily end the debate over the value of the lessor's royalty. The typical oil and gas lease will include either a "market value" royalty clause, where the royalty calculation is based on a determination of the fair market value of the gas produced, or a "proceeds" royalty clause, where the royalty calculation is based on the amount of revenue actually received from the sale of gas.[148] The question of what constitutes "market value," however, has also generated a substantial amount of litigation and disagreement.

Until the 1970s, it was generally well settled in the oil and gas industry that "market value" referred to the value of the gas at the time of production and delivery rather than the price agreed to by the operator in a long-term sales contract independent of the lease.[149] This rule is commonly referred to as the "Vela" rule, based on a decision from the Texas Supreme Court in

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146 *Id*. at 183.

147 *Id*.

148 Amoco Prod. Co. v. First Baptist Church, 611 S.W.2d 610 (Tex. 1980). The traditional "netback" method can be used by a lessee under both a market value or proceeds clause for the purpose of estimating the *value* or *price* of the lessee's production at the wellhead. *The First Marketable Product Rule*, at 36.

149 Piney Woods Country Life School v. Shell Oil Co., 726 F.2d 225, 233 (5th Cir. 1984) (citations omitted).

Texas Oil & Gas Corp. v. Vela.[150] The *Vela* court reasoned that the impetus was on sophisticated operators to protect themselves against increases in market price when drafting lease terms, and their failure to do so did not require the court to rewrite the terms of the parties' contract to account for unforeseen market fluctuations.[151]

Beginning in the early 1970s, however, the determination of what constituted "market value" generated substantial litigation due to the unforeseen rise of natural gas prices as a result of actions taken by the Organization of Petroleum Exporting Countries (OPEC).[152] Operators, many of whom entered into long-term sales contracts with buyers, saw increasingly diminished profits as nonoperating owners' royalties increased based on the market price of gas, while the revenue actually generated remained stagnant pursuant to long-term supply contracts entered into by lessees.

As a reprieve to oil and gas producers facing ever-slimming revenues, in 1981 the Oklahoma Supreme Court in *Tara Petroleum Corp. v. Humphrey* abrogated the traditional *Vela* rule in its jurisdiction, and held that terms such as "market value" and "market price" are equivalent to the dedicated contract price under which the producer sells natural gas, provided the contract was negotiated in good faith and at arm's length.[153] The *Tara* court reasoned that the *Vela* rule was "unfair" to producers, who were forced to pay a royalty based on the current, steadily-increasing price, taking an ever larger and larger portion of the producer's revenues.[154]

The *Tara* rule, however, has not been well received by other jurisdictions and remains an outlier decision that has been highly criticized. The few jurisdictions that have adopted the *Tara* rule include Oklahoma, Arkansas, and Louisiana.[155]

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150 Texas Oil & Gas Corp. v. Vela, 429 S.W.2d 866, 871 (Tex. 1968).

151 *Id*.

152 *Piney Woods*, 726 F.2d at 228.

153 Tara Petroleum Corp. v. Hughley, 630 P.2d 1269 (Okla. 1981).

154 *Id*. at 1274.

155 *Piney Woods*, 726 F.2d at 233 (citing Hillard v. Stephens, 637 S.W.2d 581 (Ark. 1982); Henry v. Ballard & Cordell Corp., 418 So. 2d 1334 (La. 1982)).

The Fifth Circuit Court of Appeals' pointed decision in *Piney Woods* highly criticized the *Tara* decision, arguing that the *Tara* rule was inherently unfair to lessors. Specifically, the court in *Piney Woods* rejected the underlying reasoning of the *Tara* rule, arguing that the risk that a lessee voluntarily assumes when entering into a long-term sales contract is "no more than the risk assumed by every business venture who undertakes the role of a middleman."[156] Because operators "[knew] what a 'market value' lease was and what a 'proceeds' lease was," and contracted to voluntarily assume the risk of a volatile market, it was not the prerogative or function of the courts to "intervene on behalf of producers experienced in the petroleum industry[.]"[157] Doing so would "deprive lessors of their legitimate contractual expectations," such as where a landowner decides to accept a market-value royalty clause because of an expectation that the market value will rise.[158] The court also reasoned that the *Vela* rule encouraged renegotiation of the lease. If continued operation became so unprofitable for the lessee that it was more economical to cease production, a lessor would have a strong incentive to renegotiate the lease because a cessation of production would mean the end of *all* royalties until if and when a new lessee could be found.[159] Consequently, as a matter of pure economics, a lessee could find a reprieve from an ever-increasing market price, without court intervention, by simply renegotiating the terms of the lease with the landowner.

§ 22.03. State of the Law Across the Appalachian Basin.

With the exception of West Virginia, states in the Appalachian Basin, by and large, have either explicitly followed, or adopted the reasoning of, the majority of jurisdictions that have adopted and adhered to the "at the well" rule for determining the value of the lessor's royalty. Recent decisions in Pennsylvania and Kentucky are likely to have a continued influence in the region as states that have yet to answer the question — such as Ohio — will

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156 *Id*. at 237.

157 *Id*. at 236-37.

158 *Id*.

159 *Id*.

look to these neighboring states, as well as other jurisdictions that have a more established history of oil and gas jurisprudence for guidance. A state-by-state analysis of recent decisions in the Appalachian Basin is presented below.

[1] — Kentucky.

[a] — The United States Court of Appeals for the Sixth Circuit Court Determines xthat Kentucky Follows the "At The Well" Rule in *Poplar Creek*.

In 2011, the Sixth Circuit Court of Appeals, relying on several Kentucky cases and a previous decision by the Sixth Circuit interpreting a Kentucky lease, determined that Kentucky follows the at-the-well rule and permits the deduction of post-production costs in the absence of express language to the contrary.[160] The royalty clause at issue in *Poplar* stated in relevant part:

> To pay to the Lessor a royalty for the gas produced and marketed from any gas well on the leased premises at the rate of one-eighth (1/8) part of the wholesale ***market value of such gas at the well*** based on the usual price paid therefor in the general locality of said leased premises.[161]

The *Poplar* court relied heavily on the Sixth Circuit's previous decision in *Lafitte Co. v. United Fuel Gas Co*.[162] The court in *Poplar* interpreted *Lafitte* to hold that "a presumption exists that the wellhead is the point of sale and delivery at which point the royalty is to be computed, absent an express stipulation to the contrary."[163] In *Lafitte*, the court held that a royalty clause providing for a royalty of "one-eighth (1/8) of the gross income received by the Lessee" was an "open-end gas royalty clause, with the value of royalty . . . to be determined at the wellhead."[164]

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[160] Poplar Creek Dev. Co. v. Chesapeake Appalachia, L.L.C., 636 F.3d 235 (6th Cir. 2011).

[161] *Id*. at 238.

[162] Lafitte Co. v. United Fuel Gas Co., 284 F.2d 845 (6th Cir. 1960) (applying Kentucky law).

[163] *Poplar Creek*, 636 F.3d at 242.

[164] *Lafitte Co*., 284 F.2d at 846 (emphasis added).

Lafitte itself relied on two lines of older Kentucky cases. First, *Warfield Natural Gas Co. v. Allen*,[165] which *Lafitte* held was controlling on how and where the value of the gas is to be determined.[166] And second, *Rains v. Kentucky*,[167] and *Reed v. Hackworth*,[168] which *Lafitte* held were dispositive of the issue of the basis of computation of royalties when the lease is silent on the subject. The court in *Lafitte* read *Rains v. Kentucky*, and *Reed v. Hackworth*, to hold that, where a lease is silent as to marketplace and price, royalties should be based upon the market value of the gas at the well.[169]

Poplar also relied on *Cumberland Pipe Line Co. v. Commonwealth*.[170] In *Cumberland*, the highest court of Kentucky (at the time) addressed whether a state tax levied on the "market value" of all crude petroleum produced in Kentucky violated the Interstate Commerce Clause. The court held that it did not because the tax was levied at the point of production, and held that "the market value upon severance (at the well) could be calculated by using the market price at the point of sale, then deducting the costs incurred to get the gas to the market[.]"[171]

After reviewing these cases, the Sixth Circuit in *Poplar* determined that "Kentucky follows the 'at-the-well' rule which allows for the deduction of post-production costs prior to paying appropriate royalties," and that "'at-the-well' refers to gas in its natural state, before the gas has been processed or transported from the well."[172] Because the lessee in *Poplar* did not sell the gas "at the well" it was "within its rights, under Kentucky law and the

165 Warfield Natural Gas Co. v. Allen, 88 S.W.2d 989 (Ky. 1935).

166 *Id*. (holding that where an oil and gas lease providing for a royalty of one-eighth of the proceeds received, but did not contain a provision as to where the lessee was to find a market, should be construed to fix the market value of the gas at the place of production, even though the gas was sold elsewhere).

167 Rains v. Kentucky, 255 S.W. 121 (Ky. 1923).

168 Reed v. Hackworth, 287 S.W.2d 912 (Ky. 1956).

169 *Lafitte Co*., 284 F.2d at 849.

170 Cumberland Pipe Line Co. v. Commonwealth, 15 S.W.2d 280 (Ky. 1929).

171 *See Poplar*, at 243 (interpreting the holding in *Cumberland*).

172 *Id*. at 244.

parties' contract, to subtract gathering, compression, and treatment costs before paying royalties on the market value of the gas."[173]

Several federal opinions post-*Poplar* have followed suit and held that other post-production costs, including severance taxes, are properly deductible under Kentucky law.[174]

[b] — The Court of Appeals of Kentucky Follows *Poplar* and Determines "At-The-Well" Language Is Unambiguous and Permits the Deduction of Post-Production Costs.

Kentucky's state courts have also followed *Poplar*. In 2013, the Court of Appeals of Kentucky affirmed the result in *Poplar*, and held that the language "market price at the well for gas" was unambiguous and permitted the lessee to "deduct reasonable costs of transportation and processing prior to calculating market value from which to pay out the royalties."[175] The court first noted with favor the several federal decisions, *Poplar* and its progeny, holding that Kentucky follows the "at the well" rule, and "permits a lessee to deduct the costs of gathering, compression and treatment prior to determining the market value of the gas before apportioning the appropriate royalties."[176] The court also relied on the definition in *Black's Law Dictionary* for "market value at the well," and *Cumberland Pipe Line Co*.[177], to hold that the

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173 *Id*.

174 *See* K&D Energy v. KY USA Energy Inc., 448 B.R. 191, 195 (Bankr. 2011) (refusing to certify question to the Kentucky Supreme Court on post-production costs, holding that "the Poplar Creek case is definitive on the issue," and "clearly sets forth that the at-the-well rule is the appropriate rule to be applied by Kentucky courts."); Appalachian Land Co. v. EQT Prod. Co., E.D.KY. No. 7:08-139-KKC, 2012 U.S. Dist. LEXIS 19671, at *7-8 (Feb. 16, 2012) (following *Poplar* and holding that post-production costs, including Kentucky severance taxes (not addressed in *Poplar*), are "deductible" in determining the lessors' royalty).

175 Baker v. Magnum Hunter Prod., 2013 Ky. App. Unpub. LEXIS 545, at *5 (June 28, 2013).

176 *Id*. at *4, citing *Poplar, Appalachian Land, KY USA Energy*, and Thacker v. Chesapeake Appalachia, 695 F. Supp. 2d 521 (E.D. Ky. 2010).

177 *Black's Law Dictionary* defines "market value at the well" as meaning "[t]he value of oil or gas at the place where it is sold, minus the reasonable cost of transporting it and processing it to make it marketable." *Id*. at *4. The *Baker* court held that this definition was

language "market price at the well for gas" was unambiguous and permitted the deduction of post-production costs in calculating market value to pay royalties. Plaintiff appealed the decision to the Kentucky Supreme Court. As of the date of this submission, the case is still pending.

[2] — Pennsylvania.

[a] — The Guaranteed Minimum Royalty Act.

Pennsylvania is unique among the states located in or around the Appalachian Basin in that it has enacted a Guaranteed Minimum Royalty Act (GMRA).[178] The GMRA requires that leases guarantee the landowner-lessor "at least one-eighth royalty of all oil, natural gas or gas of other designations removed or recovered from the subject real property."[179] Any lease that does not comply with this requirement "shall not be valid."[180] As a result, one important difference in Pennsylvania is that "while in other jurisdictions the calculation of royalties depends primarily upon the construction of royalty clauses in a lease, the analysis in Pennsylvania begins with the threshold requirement in the statute and its influence on the ability of the parties to negotiate royalty clauses in a lease."[181]

The GMRA, however, does not define the term "royalty" and is silent on the allocation of post-production costs.[182] Further, "[t]o the dismay of both Landowners and Gas Companies, the GMRA does not use any of the terms suggested by the parties, such as 'at the wellhead,' 'post-production costs,' or 'point of sale.'"[183] This ambiguity led to a flurry of litigation seeking to

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adopted in *Cumberland*, which held that "the value at the wells should be ascertained from the evidence of the market value after the oil has completed its journey through the channels of commerce and has been sold in the market. . . . The value at the place of production is the selling price less the cost of transportation to the place of sale." Cumberland Pipe Line Co. v. Commonwealth, 15 S.W.2d 280, 284 (Ky. 1929).

178 58 P.S. § 33. (Now called "Oil and Gas Lease Act.").

179 *Id*.

180 *Id*.

181 Bibikos and King, "A Primer on Oil and Gas Law in the Marcellus Shale States," 4 *Tex. J. Oil Gas & Energy* L. 155, 181 (2009).

182 Kilmer v. Elexco Land Servs., 990 A.2d 1147, 1157 (Pa. 2010).

183 *Id*.

void leases in 2009 on the basis that the deduction of post-production costs from the lessors' royalty violated the GMRA because it resulted in the lessors receiving less than the statutorily-required 1/8th minimum.

[b] — The Supreme Court of Pennsylvania Adopts a Definition of "Royalty" Consistent with the "At the Well" Rule in *Kilmer v. Elexco Land Servs*.

In response to this flood of litigation, and at least three federal decisions declining to adopt a definition of "royalty" in the GMRA as permitting the deduction of post-production costs, the Supreme Court of Pennsylvania answered the question of whether the calculation of royalties using the "net-back" method violated the statute in *Kilmer v. Elexco Land Servs*.[184] The royalty clause at issue in *Kilmer* provided for a royalty of "one eighth (1/8th) of the sales proceeds actually received by Lessee from the sale of such production, less this same percentage share of all Post Production Costs, as defined below . . . ."[185] "Post-Production" costs were defined in the lease as including:

> (i) all losses of produced volumes (whether by use as fuel, line loss, flaring, venting or otherwise); and (ii) all costs actually incurred by Lessee from and after the wellhead to the point of sale, including, without limitation, all gathering, dehydration, compression, treatment, processing, marketing and transportation costs incurred in connection with the sale of such production.[186]

Relying on the historical and accepted definitions of "royalty" and "production," the *Kilmer* court upheld the validity of the royalty clause under the GMRA. The court noted that Williams & Meyers defined "royalty" as "[t]he landowner's share of production, free of expenses of production,"[187] and that "[i]n the industry, as referenced above, the 'expenses of production'

184 *Id*. at 1157-1158.

185 *Id*. at 1150.

186 *Id*.

187 *Id*. at 1157 (citing Williams & Meyers, *Manual of Oil and Gas Terms* (2009)).

relate to the costs of drilling the well and getting the product to the surface, but do not encompass the costs of getting the product from the wellhead to the point of sale, as those costs are termed 'post-production costs.'"[188] The court further observed that, "although the royalty is not subject to costs of production, usually it is subject to costs incurred after production, *e.g.*, production or gathering taxes, costs of treatment of the product to render it marketable, costs of transportation to market."[189] The court also found persuasive the reasoning that "the net-back method eliminates the chance that lessors would obtain different royalties on the same quality and quantity of gas coming out of the well depending on when and where in the value-added production process the gas is sold."[190] Accordingly, the court held that "the GMRA should be read to permit the calculation of royalties at the wellhead, as provided by the net-back method in the Lease[.]"[191]

In deciding *Kilmer*, the Pennsylvania Supreme Court effectively overruled three prior federal court decisions that refused to accept an industry, technical meaning in the context of a motion to dismiss.[192]

Although *Kilmer* clearly adopted the definition of "royalty" consistent with the at-the-well rule, it did not explicitly reject the marketable-product rule or explicitly hold that such deductions were permissible when leases were *silent* as to post-production costs. Further, *Kilmer* involved a question of statutory interpretation of the term "royalty," leaving open the question of future challenges based on specific lease language. Certain commentators have expressed skepticism that *Kilmer* puts the post-production issue to rest in Pennsylvania as a matter of public policy:

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188 *Id*.

189 *Id*.

190 *Id*. at 1158.

191 *Id*.

192 *See*, *e.g*., Stone v. Elexco Land Servs., M.D. Pa. No. 3:09cv264, 2009 U.S. Dist. LEXIS 45897 (June 1, 2009) (declining to adopt the definition of "royalty" that permitted the deduction of post-production costs, noting that some jurisdictions have adopted the marketable-product rule to determine a "royalty" when the lease is silent as to post-production costs); Price v. Elexco Land Servs., M.D. Pa. No. 3:09cv433, 2009 U.S. Dist. LEXIS 58268 (July 9, 2009) (holding the same); Kropa v. Cabot Oil & Gas Corp., 609 F. Supp. 2d 372 (M.D. Pa. 2009) (holding the same).

> *Kilmer* is a limited victory for [the] industry's struggle against the marketable-product rule for calculating royalty. The court did not directly reject the marketable-product rule and pointedly noted that the Pennsylvania legislature might determine as a matter of public policy that the royalty-valuation point should be downstream in a deregulated gas industry.[193]

As set forth below, subsequent decisions post-*Kilmer* have not put this issue to rest.

Lessees may, however, take some comfort from the case law post-*Kilmer*; several cases have generally upheld the validity of leases providing for the deduction of post-production costs, holding that such clauses did not violate the GMRA.

At least one large class-action lawsuit, *Pollock v. Energy Corp. of Am.*, has resulted in several opinions, some of which address the outer scopes of *Kilmer* and what post-production costs are properly deducted. In *Pollock*, the U.S. District Court for the Western District of Pennsylvania held that, under *Kilmer*, royalty clauses providing for a royalty of "one-eighth of the net proceeds received from the sale of gas" permitted the deduction of post-production costs for marketing costs and transportation charges that occurred **prior to the sale** of gas.[194] However, the court noted that the lessee could **not** deduct any transportation charges that occurred post-sale.[195]

In addition to *Pollock*, several other decisions have upheld the validity of oil and gas royalty clauses with similar language.[196] Further, at least one

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193 3-40 Kuntz, *Law of Oil and Gas*, § 40.5.

194 Pollock v. Energy Corp. of Am., W.D. Pa. No. 10-1553, 2015 U.S. Dist. LEXIS 11908, at *5 (Feb. 2, 2015) ("under *Kilmer*, post-production costs properly deducted from royalties include marketing costs and transportation charges").

195 *Id*. (interstate transportation charge deductions that incurred after title to the gas was transferred were not permissible).

196 *See*, *e.g*., Rodriguez v. Anadarko E&P Co., L.P., M.D. Pa. No. 3:08-CV-2068, 2010 U.S. Dist. LEXIS 127188 (Dec. 1, 2010) (upholding validity of royalty clause providing for a royalty of "1/8 of the revenue realized by lessee for all gas . . . less the cost to transport, treat and process the gas . . ."); Ulmer v. Chesapeake Appalachia, LLC, M.D. Pa. No. 4:08-cv-2062, 2011 U.S. Dist. LEXIS 38499, at *8 (Apr. 8, 2011) (holding that "*Kilmer* was not meant to be read narrowly" and "the type of post-production costs permitted are not confined to the

decision has upheld the validity of a royalty clause provision that was silent as to the deduction of post-production costs under the GMRA. In *Katzin v. Cent. Appalachia Petroleum*, the court held that a royalty clause provision providing for a royalty of "one-eighth of the revenue realized by Lessee for all gas and the constituents thereof produced and marketed," permitted the deduction of post-production costs under *Kilmer*, although the lease was silent as to what post-production costs, if any, were deductible.[197] The court determined that the royalty provision was not invalid under the GMRA, despite not specifying what costs may be deducted, if any, because Pennsylvania law implied a promise by the lessee to comply with the mandates of the GMRA.[198] Thus, although the royalty payments may not have actually satisfied the requirements of the GMRA, lessors would have to bring "a breach of contract action based upon a breach of this implied promise," to recover damages, rather than seeking to void the lease.[199] The court did not address what post-production costs were properly deductible.

[3] — West Virginia.

[a] — West Virginia Adopts a Variation of the Marketable-Product Rule – *Wellman v. Energy Res., Inc.*

The Supreme Court of Appeals of West Virginia adopted a variation of the "marketable product" rule in 2001 in *Wellman v. Energy Res., Inc*. Relying on the decisions of Colorado, Oklahoma and Kansas (*Garman*, *Wood*, and *Gilmore*, respectively), the court concluded that, "if an oil and

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exact type set forth in the *Kilmer* lease" "upholding the deduction of post-production costs 'to transport, treat and process the gas and any losses in volume to point of measurement that determines the revenue realized by Lessee'"); Puza v. Elexco Land Servs., M.D. Pa. No. 3:09-CV-589, 2010 U.S. Dist. LEXIS 43346 (May 3, 2010) (upholding lease providing for payment of one-eighth royalty after deducting post-production costs); Carey v. New Penn Exploration, Inc., M.D. Pa. No. 3:09-CV-188, 2010 U.S. Dist. LEXIS 52199, at *4 (Apr. 28, 2010) (upholding lease provision providing that "Plaintiffs will receive a one-eighth royalty after deduction of post-production expenses incurred downstream of the wellhead").

[197] Katzin v. Cent. Appalachian Petroleum, 39 A.3d 307, 309 (Pa. Sup. Ct. 2012).

[198] *Id*. at 309.

[199] *Id*.

gas lease provides for a royalty based on proceeds received by the lessee, unless the lease provides otherwise, the lessee must bear all costs incurred in exploring for, producing, marketing, and transporting the product ***to the point of sale***."[200]

The royalty clause at issue provided, in relevant part:

> Lessee agrees to deliver to Lessor, in tanks, tank cars, or pipe line, a royalty of one-eighth (1/8) of all oil produced and saved from the premises, and to pay to Lessor for gas produced from any oil well and used by Lessee for the manufacture of gasoline or any other product as royalty one-eighth (1/8) of the market value of such gas at the mouth of the well; is [if] such gas is sold by the Lessee, then as royalty ***one-eighth (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.[201]

Despite language calling for the royalty to be determined by proceeds from the sale of gas at the mouth of the well, the court nonetheless ruled that post-production costs were not deductible in determining the value of the lessors' royalty.

The court based its decision on two findings: First, like Colorado, Kansas and Oklahoma, West Virginia "holds that a lessee impliedly covenants that he will market oil or gas produced."[202] Second, the court believed that "historically the lessee has had to bear the cost of complying with his covenants under the lease," and therefore, "it reasonably should follow that the lessee should bear the costs associated with marketing products produced under a lease."[203] The court avoided the issue of whether the royalty clause language itself was sufficient to evidence an intent for the lessors to share in post-production costs, noting that "whether that was actually the intent and the effect of the language of the lease is moot" because the lessee introduced

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200 Wellman v. Energy Res., Inc., 557 S.E.2d 254, 265 (W. Va. 2001) (emphasis added).

201 *Id*. at 257-58.

202 *Id*. at 265 (citation omitted).

203 *Id*.

no evidence to show that the costs were actually incurred or reasonable.[204] This question is later answered in *Tawney*, discussed below.

[b] — West Virginia Sets Standards for What Language Is Sufficient to Allocate Post-Production Costs in *In re Tawney v. Columbia Natural Res., LLC*.

In *Estate of Tawney v. Columbia Natural Res.*, the Supreme Court of Appeals of West Virginia once again took up the issue of post-production costs in addressing two questions certified from the lower court regarding what lease language is sufficient to indicate an intention to allocate post-production costs to the lessor.[205] The Supreme Court consolidated the questions into a single question for its review:

> In light of the fact that West Virginia recognizes that a lessee to an oil and gas lease must bear all costs incurred in marketing and transporting the product to the point of sale unless the oil and gas lease provides otherwise, is lease language that provides that the lessor's 1/8 royalty is to be calculated "at the well," "at the wellhead" or similar language, or that the royalty is "an amount equal to 1/8 of the price, net of all costs beyond the wellhead," or "less all taxes, assessments, and adjustments" sufficient to indicate that the lessee must deduct post-production expenses from the lessor's 1/8 royalty, presuming that such expenses are reasonable and actually incurred.

The court answered the question in the negative, holding that the "at the well" language was "ambiguous, and, accordingly, is not effective to permit the lessee to deduct from the lessor's 1/8 royalty any portion of the costs incurred between the wellhead and the point of sale."[206] The court determined that in order to properly allocate post-production costs between the lessor and lessee under an oil and gas lease, the lease must "[1] expressly

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204 *Id*.

205 Estate of Tawney v. Columbia Natural Res., LLC, 633 S.E.2d 22 (2006).

206 *Id*., paragraph 11 of syllabus.

provide that the lessor shall bear some part of the costs incurred between the wellhead and the point of sale, [2] identify with particularity the specific deductions the lessee intends to take from the lessor's royalty (usually 1/8), and [3] indicate the method of calculating the amount to be deducted from the royalty from such post production costs."[207] The court reasoned that "wellhead"-type language is ambiguous and "lacks definiteness," because it does not indicate "how or by what method the royalty is to be calculated or the gas is to be valued."[208] The court noted the absence of any specific provisions pertaining to marketing, transportation, or processing of gas and noted that the "traditional rule" was for lessors "to receive a royalty of the sale price of gas[.]" In the face of this purported ambiguity, the court applied the traditional rule of construing contract ambiguous language "against the lessee" and ruled against the operator.[209]

[c] — Authorities and Analysis Post-*Tawney* – Difference Between Other "Marketable Product" Jurisdictions and Uncertainty of Whether Lessee Must Bear Costs "To the 'Market'" or to "The Point of Sale."

As noted by Williams & Meyers, the court's decision in *Tawney* goes farther than other marketable-product jurisdictions "because it seemingly requires the lessee to bear the full costs of transporting the natural gas to the point of sale even if it is in a marketable condition prior to the point of actual sale."[210] "West Virginia . . . requires the lessee to pay royalty based on sales price regardless of whether the natural gas is marketable at the well or in the pipeline delivering the natural gas to the ultimate end-user."[211] Further, there is some lingering uncertainty under *Wellman* or *Tawney* as to whether a lessee must bear costs "to the market," or to "the point of sale." Though both decisions refer to the "point of sale," at least one federal court has interpreted

207 *Id*., paragraph 10 of syllabus.

208 *Id*. at 28.

209 *Id*. at 28-30.

210 Williams & Meyers, § 645.

211 *Id*.

the decisions as obligating the lessee to bear the costs of bringing the gas *to the market*, and not just a point of sale.[212] In *McDonald*, the court held that, "when *Tawney* and *Wellman* are read in their entirety, it becomes clear that lessees must bear the costs of bringing gas *to the market*, not just a point of sale."[213] The *McDonald* court relied on the fact that *Tawney*'s factual analysis suggested a duty to bring the gas to the market, although it uses the language "point of sale," and that both *Wellman* and *Tawney* "indicated that it was adopting a version of the 'marketable product' rule" in which "lessees impliedly covenant to bear the costs of getting gas into marketable condition and transporting it to market."[214] This distinction has not been decided by the Supreme Court of West Virginia.

[4] — Ohio: The State of the Law is Unsettled But May Be Resolved Soon.

Ohio has not directly addressed whether it follows the "at the well" approach or some version of the "marketable product rule." However, the issue may be decided soon. In *Lutz v. Chesapeake Appalachia, L.L.C.*, the United States District Court for the Northern District of Ohio recently certified the question to the Supreme Court of Ohio. The District Court asked of the Supreme Court of Ohio:

> Does Ohio follow the "at the well" rule (which permits deduction of post-production costs) or does it follow some version of the "marketable product rule" (which limits the deduction of post-production costs under certain circumstances)?[215]

The Supreme Court of Ohio accepted the certified question for review on June 3, 2015.[216]

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212 *See* W. W. McDonald Land Co. v. EQT Prod. Co., 983 F. Supp. 2d 790 (S.D.W. Va. 2013). As noted in *McDonald*, this is a crucial distinction because a point of sale may be "at the wellhead (upstream from the market) or at a burner tip (downstream from the market)." *McDonald*, 983 F. Supp. 2d at 800.

213 *Id*. at 800.

214 *Id*. at 801.

215 Lutz v. Chesapeake Appalachia, L.L.C., 31 N.E.3d 653, 654 (Ohio 2015).

216 *Id*.

Regardless of which court ultimately answers the question (the Supreme Court of Ohio, the Northern District of Ohio, or an Ohio trial or appellate court), there is no controlling law on this specific subject. The answer may lie, however, in Ohio contract law – specifically, in Ohio law governing contract interpretation.

[a] — There Is Limited Ohio Oil and Gas Law on the Specific Subject of Post-Production Costs.

A few older cases have been cited by lessors as authority that Ohio lessees are not entitled to deduct post-production costs when including royalties.[217] However, these cases add little to the ultimate debate and may have little impact on the ultimate issue. Likewise, one Ohio appellate court decision, *Schmidt v. Texas Meridian Resources*,[218] appeared to favor the "at the well" approach, but arguably did so *in dicta*.

In *Busbey v. Russell*, the Harrison County Court of Common Pleas interpreted a royalty provision obligating the lessee to pay "one-eighth of income dollars," to require the lessee to pay the royalty based upon gross income generated with no deduction for operating costs.[219] The court stated that "net income can only be ascertained by taking the costs of improvements as well as the mere expenses of running the business into account."[220] The decision is silent as to whether costs such as transportation, gathering, compression and processing are properly chargeable when calculating the royalty owner's interest. Further, it appears that the issue of post-production costs was not before the court. Rather, the case focused on whether "income" in the royalty clause meant "gross income" or "net income." Production costs are the responsibility of working interest owners and not charged to the royalty interest, in any event. Hence, *Busbey* will likely have little precedential value.

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217 *See* Busbey v. Russell, 10 Ohio C.D. 23 (1898); Blackwood v. SKZ, Inc., Case No. 88-N-130 (Guernsey Co. C.P. 1988); Legleitner v. Dover Oil Co., Case No. 82 M 178 (Washington Co. C.P. 1982).

218 Schmidt v. Tex. Meridian Res., No. 94CA12, 1994 Ohio App. LEXIS 6105 (Ohio Ct. App. Dec. 30, 1994).

219 *See* Busbey v. Russell, 10 Ohio C.D. 23 (1898).

220 *Id*. at 15.

In *Blackwood v. SKZ, Inc.*, the Guernsey County Court of Common Pleas had the post-production cost issue before it, but declined to issue an opinion.[221] There, lessors filed suit seeking damages for the lessee's deduction of post-production costs from royalties under seventeen separate leases. Four leases contained a "gross proceeds" royalty clause; eight contained "market value at the well" clauses; and five contained a "field market price" royalty clause. Both the lessee and the lessors submitted motions for summary judgment. The trial court granted the lessors' motion for summary judgment without opinion. Thereafter, the parties settled and vacated the judgment. Inasmuch as no opinion was ever issued and the judgment was vacated, this trial court decision offers no persuasive or controlling authority.

A third case, *Legleitner v. Dover Oil Co.*, was a declaratory judgment action brought in the Guernsey Court of Common Pleas.[222] At issue was whether the lessee could pass through to the royalty owners a 20-cent per MCF fee charged by a third party to transport natural gas from the wellhead to a pipeline one mile away. The lease provided "should a well be found producing gas only, then the lessor shall be paid for each gas well at the rate of 1/8, so long as gas is sold therefrom, payable monthly when so marketed." The court noted that the lease was completely silent as to such matters and, accordingly, resorted to parol testimony and the custom and practice in the industry to determine the parties' intentions. There is no suggestion in the opinion that the ***lessee*** offered any parol testimony on the question of transportation costs. The court considered the lessor's testimony that transportation costs were never mentioned in the lease negotiations and the testimony of an expert who stated that it was not customary for oil and gas producers in Washington County, Ohio, to assess such costs against the royalty interest. This one-sided parol testimony, coupled with the court's application of the standard rule of construction that contract terms are construed strictly against the drafter (the lessee), led the court to conclude that the transportation costs were not properly chargeable to the landowner's

221 *See* Blackwood v. SKZ, Inc., Case No. 88-N-130 (Guernsey Co. C.P. 1988).

222 *See* Legleitner v. Dover Oil Co., Case No. 82 M 178 (Washington Co. C.P. 1982).

royalty interest under the parties' specific lease. The court properly limited its holding to the record in that case, however. Accordingly, this trial court opinion also is of little precedential value.

More recently, in *Schmidt*, the lessor complained the lessees had wrongfully deducted transportation costs from royalty payments. The lower court denied the lessees' motion for summary judgment and awarded damages to the lessors. On appeal, the lessees urged the court to hold that such costs may be deducted, but the appellate court declined to do so on other grounds relating to the parties' course of conduct. However, the court cited with apparent approval the extrinsic evidence of custom and practice presented by the lessees in support of their position that these terms permitted the deduction of transportation costs from royalty payments:

There was no evidence whatsoever introduced to rebut this expert testimony. Moreover, [the lessees] are correct in their assertion that [the expert's] explanation of this practice in the Ohio oil and gas industry is consistent with the position of most other jurisdictions. Although the reasoning in those jurisdictions vary somewhat from case to case…a consistent theme among all of them is that no market exists for the natural gas at the point where it is removed from the well; that the lessee provides a valuable service in transporting that gas to a market and thereby increasing its value and price to the benefit of the lessor; and that the lessee should be entitled to charge a fee for rendering that service (citations omitted).[223]

Despite these statements, the Court of Appeals upheld the trial court's judgment permitting the lessors to recover the transportation costs that had been charged against their royalty interest. The court based its decision on the fact that over a period of several years the original lessee of the subject premises did <u>not</u> deduct transportation costs from the royalty interests. As a result, the court found that the parties' course of performance had modified the lease:

> Even assuming *arguendo* that the royalty provisions, as written herein, allowed for the deduction of transportation costs, it is evident

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223 Schmidt v. Tex. Meridian Res., No. 94CA12, 1994 Ohio App. LEXIS 6105, at 14 (Ohio Ct. App. Dec. 30, 1994).

> that subsequent events altered that arrangement. Oil and gas leases, as discussed previously, are contracts and are subject to certain fundamental contract principles. It is well-settled law that a party may waive the terms of a written contract by words or conduct . . . . A continued, different, "course of performance" between parties manifests a modification of the original agreement . . . . It makes no difference what name is applied to that theory, whether it be waiver, estoppel, novation or what have you; the theory is simply that the parties showed that they did not intend a particular provision of the contract to be strictly observed.[224]

Busbey and *Schmidt* figure prominently in plaintiffs' papers in the *Lutz* case. In *Lutz*, plaintiffs argue in their initial filings with the Supreme Court of Ohio that post-production costs are necessarily among the "costs of doing business" that *Busbey* held are the full responsibility of the lessee. Plaintiffs also argued that *Schmidt* controls on the issue of the parties' course of dealing, claiming that the lessees' alleged failure in *Lutz* to deduct post-production costs for certain periods of time resulted in a modification of the parties' lease. *Busbey* is too far afield to resolve this important issue, however, and *Schmidt* really only applies to the specific course of dealing among the parties to that case.

[b] — Ohio Contract Law and the Competing Rules.

Though no oil and gas cases provide controlling guidance on the specific issue of whether Ohio follows the at-the-well or marketable product rule, the larger body of Ohio law, particularly Ohio contract law, is arguably more consistent with the at-the-well rule than the marketable product doctrine.

Ohio contract law is consistent with the rationale employed by courts adopting the "at the well" rule. The starting point for any analysis in Ohio is the royalty language in the lease itself. Ohio courts honor the right to contract and follow traditional principles of contract interpretation when reviewing the

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224 *Id*. at *15-16.

terms and conditions of an oil and gas lease.[225] In this regard, leases, like all contracts, are construed as a whole to ascertain and give effect to the parties' intentions, as evidenced in the first instance by the contract language.[226] And, that language will be given its plain and ordinary meaning unless some other meaning is clearly intended from the document.[227] Technical terms will be given their technical meaning, unless a different intention is clearly expressed.[228] Where the contract language is clear and unambiguous, it must be applied as written and cannot be interpreted to, in effect, create a new contract for the parties.[229] A contract does not become ambiguous simply because it will work a hardship on one of the parties.[230]

Where the language is ambiguous, however, its proper interpretation is a question of fact and subject to construction by the trier-of-fact under the totality of the facts and circumstances. This includes parol evidence. However, parol evidence is also to be analyzed so as to give effect to the intent of the parties, **as expressed in the language of the lease**. That is, parol evidence is only relevant to help explain the words in the contract.[231] Such extrinsic evidence may include: (1) the circumstances surrounding the parties at the time the contract was made; (2) the objectives the parties intended to accomplish by entering into the contract; and (3) any acts by the parties that demonstrate the construction they gave to their agreement.[232] When parol evidence cannot clarify the parties' intent, a court will then and only then

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225 *See*, *e.g*., Harris v. The Ohio Oil Co., 48 N.E. 502, 506 (Ohio 1897) (observing that oil and gas leases "are contracts, and the terms of the contract with the law applicable to such terms, must govern the rights and remedies of the parties.").

226 *See*, *e.g*., Alexander v. Buckeye Pipe Line Co., 374 N.E.2d 146, 150 (Ohio 1978); Foster Wheeler Enviresponse, Inc. v. Franklin County Convention Facilities Auth., 678 N.E.2d 519, 526 (Ohio 1997).

227 Alexander, 374 N.E.2d at 150.

228 *Foster Wheeler*, 678 N.E.2d at 526.

229 *Alexander*, 374 N.E.2d at 150.

230 *Foster Wheeler*, 678 N.E.2d at 526.

231 Cline v. Rose, 645 N.E.2d 806, 809 (Ohio Ct. App. 1994).

232 *In re* Estate of Taris, 2005-Ohio-1516, ¶ 33 (10th Dist. 2005).

apply the secondary rule of contract construction that ambiguous language is to be construed against the drafter.[233]

Several "at the well" jurisdictions with similar rules of contract interpretation as Ohio have determined that the plain, ordinary and generally-accepted meaning of the phrase "at the well" is unambiguous and refers to gas in its unprocessed state as it emerges from the wellhead. For example, in *Poplar Creek Dev. Co v. Chesapeake Appalachia, L.L.C.*, the Sixth Circuit held that the plain meaning of the phrase "at the well" is "gas in its natural state, before the gas has been processed or transported from the well," and therefore permitted the lessee to deduct post-production costs before paying royalties.[234]

Ohio courts may also be guided by prevailing case law that recognizes the generally-accepted view that "at the well" language has a long standing and unambiguous meaning in the oil and gas industry. Decisions from Texas, Pennsylvania, Kentucky, North Dakota, Michigan, California, and the Fifth and Sixth Circuits have all determined that the phrase "at the well," "at the wellhead" or "market value at the well" are unambiguous, established terms in the oil and gas lexicon that permit the deduction of post-production expenses.[235] Ohio courts, which are required to interpret technical terms in

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233 Reida v. Thermal Seal, Inc., 2002-Ohio-6968, ¶ 29 (10th Dist. 2002).

234 Poplar Creek Dev. Co. v. Chesapeake Appalachia, L.L.C., 636 F.3d 235, 244 (6th Cir. 2011) (citing with approval Piney Woods County Life School v. Shell Oil Co., 726 F.2d 225, 240 (5th Cir. 1984) ("at the well" means landowner royalty must be based on value of untreated gas where produced, not at a distant market). *See also*, Baker v. Magnum Hunter Prod., 2013 Ky. App. Unpub. LEXIS 545, at *4-5 (June 28, 2013) (relying on the definition of "market value at the well" defined in *Black's Law Dictionary* as "[t]he value of oil or gas at the place where it is sold, minus the reasonable cost of transporting it and processing it to make it marketable.").

235 *See*, *e.g*., Heritage Res. v. Nations Bank, 939 S.W.2d 118, 122 (Tex. 1995); Martin v. Glass, 571 F. Supp. 1406, 1411 (N.D. Tex. 1983); Kilmer v. Elexco Land Servs., 990 A.2d 1147, 1157-58 (Pa. 2009); *Baker*, 2013 Ky. App. Unpub. LEXIS 545 at *5; Bice v. Petro-Hunt, L.L.C., 768 N.W.2d 496, 502 (N.D. 2009); Schroeder v. Terra Energy, 565 N.W.2d 887, 894 (Mich. Ct. App. 1997); Atl. Richfield Co. v. Cal., 214 Cal. App. 3d 533, 541 (Ct. App. 1989); Piney Woods Country Life School v. Shell Oil Co., 726 F.2d 225, 240 (5th Cir. 1984); Ramming v. Natural Gas Pipeline Co., 390 F.3d 366, 372 (5th Cir. 2004); Poplar Creek Dev. Co. v. Chesapeake Appalachia, L.L.C., 636 F.3d 235, 244 (6th Cir. 2011).

accordance with their particular trade or industry meaning, may find these decisions persuasive.

By contrast, the various legal rationale offered in support for the "marketable product" rule are generally inconsistent with Ohio principles regarding the right to contract and contract interpretation. For example, the Supreme Court of Colorado's decision in *Rogers v. Westerman Farm Co.*, and the Supreme Court of Appeals of West Virginia's decision in *Estate of Tawney v. Columbia Natural Res., LLC*, both held that "at the wellhead"-type language was ambiguous in isolation and therefore legally meaningless.[236] The courts in those cases made little attempt to look to the technical meaning of the terms, or to parol evidence, as would be required under Ohio law, before construing the language against the drafter-lessee. These decisions also run afoul of Ohio's well-established principle of contract interpretation that the court must give effect to ***all*** of the words in the agreement. If one construction of the contract would make words or provisions superfluous, but another gives them effect, an Ohio court is bound to uphold the latter interpretation.

Along similar lines, Ohio courts do not permit implied covenants to overrule the parties' expressed intentions in the language of a contract. As discussed *supra*, Section 22.02[3][a], decisions from marketable-product jurisdictions have also attracted criticism for "treat[ing] the implied covenant to market as trumping the express provision limiting the calculation of the royalty to the gross proceeds measured at the mouth of the well."[237] Although Ohio recognizes several implied covenants in an oil and gas lease, including an implied covenant to market, Ohio courts have not shown a great proclivity to override the express terms of a written agreement with implied obligations. As a result, the reasoning and analysis employed by marketable-product jurisdictions for adopting the marketable product rule may not have much influence in Ohio courts, which have historically rejected attempts by lessors to impose implied obligations over express contractual language.

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236 Rogers v. Westerman Farm Co., 29 P.3d 887, 906 (Colo. 2001); *In re* Tawney v. Columbia Natural Res., LLC, 633 S.E.2d 22, 28 (W.V. 2006).

237 *See*, *e.g.*, Williams & Meyers, § 645.

The law is generally settled in Ohio that, with respect to oil and gas leases, there can be no implied covenant with respect to any subject matter that is expressly covered by the language of the parties' contract.[238] This general proposition of law has been affirmed by the Supreme Court of Ohio and Ohio district courts on innumerable occasions, and is summarized in *Downtown Assocs., Ltd. v. Burrows Bros. Co.*:

> In construing and interpreting the provisions of percentage leases, the courts have applied traditional contract principles. The object of contract construction and interpretation is to ascertain and effectuate the intent of the parties to the agreement when drafted. This intent is determined by the language of the lease, in relation to its objectives, and the surrounding circumstances. Implied covenants in leases are disfavored at law, and are justified only when necessary to effectuate the intentions of the parties, and certainly not where the subject matter is clearly delineated in the contract.[239]

For example, the recent development of the Utica Shale in Ohio has given rise to a number of lawsuits seeking to terminate lessors' long-term leases on the basis that various operators have failed to meet their implied obligation to fully develop the leasehold. Although Ohio has generally recognized an implied covenant to reasonably develop, Ohio courts have enforced with near-unanimity the express language of oil and gas leases that have either modified or disclaimed such implied covenants entirely.[240] Central to all

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[238] *See*, *e.g.*, Harris v. The Ohio Oil Co., 48 N.E. 502, 506 (Ohio 1897) (holding that an implied covenant can only be inferred where the lease is silent); Hupp v. Beck Energy Corp., 20 N.E.3d 732, 755 (Ohio Ct. App. 2014) ("[A]n implied covenant can only be construed in a lease if there are no express provisions to the contrary").

[239] Downtown Assocs., Ltd. v. Burrows Bros. Co., 518 N.E.2d 564, 566 (Ohio Ct. App. 1986).

[240] Bushman v. MFC Drilling, Inc., No. 2403-M, 1995 Ohio App. LEXIS 3061 (Ohio Ct. App. July 19, 1995); Bilbaran Farm, Inc. v. Bakerwell, Inc., 993 N.E.2d 795 (Ohio Ct. App. 2013); Bohlen v. Anadarko E&P Onshore, LLC, 2014-Ohio-5819, ¶ 32 (Ct. App. 2014); Hupp v. Beck Energy Corp., 20 N.E.3d 732 (Ohio Ct. App. 2014) (in each case, the court upheld a disclaimer of implied covenants in the lease, holding that an implied covenant to reasonably develop could not arise when the subject matter was directly addressed in the parties' contract).

these decisions is the prevailing view in Ohio that implied obligations cannot prevail over the express terms of the parties' contract.

Other decisions in "at the well" jurisdictions have treated implied covenants similarly. As just one example, the Supreme Court of Texas in *Yzaguirre v. Kes Res*. rejected the lessors' attempts to "use an implied marketing covenant to negate the express royalty provisions in the leases and transform the 'market value' royalty clause into a 'higher of market value or proceeds' royalty."[241] In deciding that the lessors were not entitled to a higher royalty merely because the lessee had negotiated "a sales contract that [turned] out to be especially lucrative," the court noted that, (similar to Ohio), "Texas law has long recognized that an oil and gas lease imposes duties on the lessee that extend beyond the terms of the lease itself ***if the lease is silent*** on certain subjects."[242] Because "there is no implied covenant when the oil and gas lease expressly covers the subject matter of an implied covenant," the court refused to impose the implied covenant to market over the express terms of the parties' contract.[243]

Further, giving effect to "at the well" language would also be consistent with Ohio's long-standing principle of contract interpretation that the court must give effect, if possible, to all the words and provisions contained therein.[244] If one construction of the contract would make words or provisions meaningless, while another construction would give them meaning or purpose, a court is bound to uphold the later interpretation as a matter of law.[245] Other states that share this general proposition of law have endorsed the "at the well" view, reasoning that the only reasonable interpretation of "at the well" language is to identify the location at which gas is valued for purposes of calculating a lessor's royalty.[246]

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241 Yzaguirre v. Kes Res., 53 S.W.3d 368, 374 (Tex. 2001).

242 *Id*. at 373-74 (emphasis added).

243 *Id*.

244 Foster Wheeler Enviresponse v. Franklin Cnty. Convention Facilities Auth., 678 N.E.2d 519, 526 (Ohio 1997).

245 *Id*.

246 *See*, *e.g*., Schroeder v. Terra Energy, 565 N.W.2d 887, 894 (Mich. Ct. App. 1997).

Thus, if the parties have agreed by contract to value the lessor's royalty "at the well," Ohio courts are unlikely to derive an alternative location or impose an implied obligation over the express terms of the parties' contract. To adopt the reasoning of the Oklahoma, Colorado or West Virginia Courts (construing such language to be "silent," although providing no alternative interpretation for the words "at the well") is seemingly inconsistent with Ohio law.

§ 22.04. Conclusion.

The law governing royalty calculations within the Appalachian Basin is still developing as courts continue to address the varying positions and reasoning of "at the well" and "marketable" product jurisprudence, and how the differing lines of cases conform or conflict with local settled law. At least two jurisdictions have adopted or taken positions consistent with the "at the well" rule — Kentucky (at the appellate court level) and Pennsylvania — at least one state has implicitly adopted a variation of the "marketable product" rule — West Virginia — and the highest court of one state — Ohio — is poised to issue a decision on the issue within the next year. Operators are advised to pay particular attention to the pending cases in these states, and to future decisions in these jurisdictions that will develop the outer boundaries and applications of the "at the well" and "marketable product" rules.

Chapter 23

Conventional and Unconventional Warfare: The Increasing Criminalization of Both Clearly Wrong and Seemingly Ordinary Activities in the Mineral Industries

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§ 23.01. Introduction.

High profile incidents such as multiple fatalities in coal mines or widely publicized environmental releases can impose enormous pressure not only on those directly involved, but also on regulators and prosecutors. The pressures on regulators may include demands to: 1) control an on-going environmental event; 2) determine the "cause" of an event; and/or 3) punish those responsible. The pressure on prosecutors may include one or more of the same demands. Several highly publicized events in central Appalachia have resulted in pressure by union and safety advocates and by consumers on regulators and prosecutors to hold someone accountable. Failure or inability to influence or deflect public perception can result in your client becoming the primary target of a prosecutor. When that happens, practitioners need to understand that the tools available to federal prosecutors to advance charges — whether for crimes directly connected to the high-profile event or not — may only be limited by a prosecutor's imagination. There are many federal statutes that were adopted to address a particular problem that do not necessarily include principles limiting their use to the type of problem that gave them

birth. As a result, counsel representing targets of federal investigations need to understand that the investigator and a prosecutor may target activity *other* than that which garnered public attention in the first place.

For example, in April 2010, 29 coal miners died in the non-union Upper Big Branch (UBB) Mine in West Virginia. Under pressure from the United Mine Workers of America and others, federal prosecutors slowly built a case against Massey Energy's former Chairman, Don Blankenship, after indicting a number of employees on charges unrelated to the UBB fatalities. In November 2014, federal charges were brought against Blankenship. As with the other indicted Massey employees, the charges against Blankenship were not directly related to the UBB explosion. Rather, Blankenship was charged with more general violations of federal mine safety regulations. Blankenship was also charged with making false statements in certain Securities Exchange Commission (SEC) filings. The securities charges, which implicated otherwise normal business activities, notably carried much more severe penalties than the misdemeanor MSHA (Mine Safety and Health Administration) charges.

In another high-profile incident, a material used in the coal preparation process leaked from a storage tank into a river used for supplying public water in Charleston, West Virginia in January 2014 — during the legislative session annually convened in the city. Suddenly, every resident and outsider alike armed with a Facebook or Twitter account and access to the Internet became an expert on leak prevention, water treatment and blame assessment.[1] Federal prosecutors ultimately secured guilty pleas under conventional environmental laws that have low burdens of proof, but only after advancing novel theories under the Clean Water Act and accusing a defendant of bankruptcy fraud based on a brief filed by his lawyer. Whether the defendants could have prevailed at trial is unknown. But each of them was subjected to dauntingly

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1 *See, e.g.*, Emily Corio and Maryanne Reed, *How Social Media Changed the Equation on the West Virginia Chemical Leak Story*, mediashift.org (Mar. 31, 2014), http://mediashift.org/2014/03/how-social-media-changed-the-equation-on-the-west-virginia-chemical-leak-story/.

expensive defenses and a list of charges that presented the risk of substantial jail time — strong incentives to plead guilty.

§ 23.02. Power to Prosecutors: Proliferation of Federal Criminal Statutes and Effect of Sentencing Guidelines.

[1] — Expansion of Federal Laws.

Others have written of the simultaneous growth of federal criminal statutes and the decline in the threshold of guilt.[2] As a consequence, they claim, many acts undertaken with no "criminal intent" are criminally chargeable[3] — a fact which vests prosecutors with formidable coercive power.

[2] — *Yates v. United States.*

In 2001, the massive accounting fraud scheme perpetrated by the Enron Corporation and its outside auditor, Arthur Andersen LLP, was exposed. The subsequent investigation revealed that Arthur Andersen had shredded many possibly incriminating documents in order to cover up the scheme.[4] Congress responded by promulgating the Sarbanes-Oxley Act, which was specifically designed "to protect investors and restore trust in financial markets" in the

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2 Gary Fields and John R. Emshwiller, "As Criminal Laws Proliferate, More Are Ensnared," *Wall Street Journal* (July 23, 2011), http://www.wsj.com/articles/SB10001424052748703749504576172714184601654. The Heritage Foundation has reviewed the growth of federal crimes. John S. Baker, Revisiting the Explosive Growth of Federal Crimes, The Heritage Foundation (June 16, 2008), http://www.heritage.org/research/reports/2008/06/revisiting-the-explosive-growth-of-federal-crimes. A report it issued in 2008 cited a 1998 ABA report as stating that more than 40 percent of federal criminal provisions enacted since the Civil War were enacted between 1970 and 1998. *Id*. (citing Task Force on Federalization of Criminal Law, American Bar Association, *The Federalization of Criminal Law*, at 7 (1998)).

3 Gary Fields and John R. Emshwiller, "As Criminal Laws Proliferate, More Are Ensnared," *Wall Street Journal* (July 23, 2011), http://www.wsj.com/articles/SB10001424052748703749504576172714184601654.

4 Yates v. United States, 134 S. Ct. 1074, 2015 WL 773330, No. 13-7451 at *6 (Feb. 25, 2015).

wake of the Enron scandal.[5] Prior to Enron, the law merely criminalized intimidating, threatening, or persuaded someone else to shred documents — not the actual shredding itself.[6] The Sarbanes-Oxley Act included an "anti-shredding" provision that criminalized the actual destruction of records.[7]

In 2007, a state fish and wildlife officer deputized as a federal agent boarded a commercial fisherman's boat off the Gulf coast of Florida during a routine offshore patrol.[8] While the officer was on board inspecting the boat's safety equipment, he allegedly observed some red grouper that were slightly smaller than the minimum harvesting limit.[9] He issued a civil citation to the fisherman and instructed the fisherman to keep the fish until he returned to shore.[10] Four days later, after the boat had returned to port, the officer re-examined the fish and, after questioning, determined that the undersized fish had been tossed overboard.[11]

Nearly three years after the inspection, criminal charges were brought against the fisherman.[12] Under the relevant federal law regarding grouper, the fisherman would have been subject to a civil penalty for violating regulations requiring immediate release of undersized grouper.[13] Such violations contemplated a fine starting at $500 or fishing license restrictions.[14]

Instead, the Department of Justice (DOJ) charged the fisherman with destroying property to prevent a federal seizure[15] as well as with violating the "anti-shredding" provisions of the Sarbanes-Oxley Act.[16] Under the

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5 *Id*. at *2.
6 *Id*. at *6 (citing 18 U.S.C. § 1512(b)).
7 *Id*. (citing 18 U.S.C. § 1519).
8 *Id*. at *2-3.
9 *Id*. at *3.
10 *Id*.
11 *Id*. at *4.
12 *Id*.
13 *Id*. at *3 (citing 50 C.F.R. § 622.37(d)(2)(ii)).
14 *Id*. (citing 16 U.S.C. §§ 1857(1)(A), (G), 1858(a), (g)).
15 *Id*. at *4 (citing 18 U.S.C. § 2232(a)).
16 *Id*.

Act, the fisherman was subject to 20 years in federal prison.[17] It is unclear whether the fisherman received any civil penalties related to the undersized grouper violations.[18]

The fisherman was convicted and sentenced to 30 days in prison in addition to a period of supervised release.[19] The appeal made its way to the United States Supreme Court, which eventually overturned the conviction. The Court ultimately concluded that the anti-shredding provision of the Sarbanes-Oxley Act must be limited to the sort of behavior that the Act was actually designed to prohibit — destruction of objects that are actually used to store information.[20] Although the conviction was ultimately overturned, the *Yates* case serves as an example of the lengths federal prosecutors may be willing to go to when motivated to find a crime with a substantial penalty attached.

[3] — Sentencing Guidelines: Transfer of Power from Judiciary to Prosecutors.

Until 1984, federal judges enjoyed wide latitude in applying criminal sentences.[21] However, the Sentencing Reform Act of 1984 abolished indeterminate discretionary sentencing.[22] The Act created the United States Sentencing Commission ("Commission"), an independent agency of the judicial branch charged with developing a set of Guidelines and policy statements for use by federal courts when sentencing convicted offenders.[23]

The outgrowth of the Act — the Sentencing Guidelines — has transferred inordinate power from the judiciary to the executive branch. Prosecutors can, by selecting the charges they bring, effectively guarantee jail time for those who are convicted at trial — a powerful incentive for the defendant

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17 18 U.S.C. 1519.

18 *Yates*, 134 S. Ct. 1074, 2015 WL 773330, No. 13-7451 at *4.

19 *Id*. at *5.

20 *Id*. at *2.

21 United States Sentencing Commission, *Guidelines Manual*, § 1A1.2 (Nov. 2014).

22 *Id*. § 1A1.3, p.s.

23 *Id*. § 1A1.1.

to plead guilty to a lesser charge and for the prosecutor to advance charges that have a coercive effect.

[a] — Development of Sentencing Guidelines.

The Commission's initial Guidelines went into effect in 1987.[24] Pursuant to the Sentencing Reform Act's requirements, the Guidelines were categorized by both offensive behaviors and "offender characteristics."[25] The Act also required that the Guidelines include ranges of appropriate sentences based on coordination of offense behavior categories with offender characteristics.[26]

The Act requires judges to select sentences within the Guideline's ranges.[27] It also allows a sentencing court to depart from the Guideline range in an atypical case, but must specify its reasons for doing so.[28] If the court sentences within the Guidelines, appellate review is limited to the proper application of the Guidelines.[29] If the court departs from the Guidelines, a reviewing court may determine whether the departure was reasonable.[30]

[b] — Objectives of the Sentencing Reform Act and Sentencing Guidelines.

Congress highlighted three primary objectives in developing the Sentencing Reform Act in order to "enhance the ability of the criminal justice system to combat crime through an effective and fair sentencing system."[31]

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24 *Id*. § 1A3.1 Historical n. Over the years, the Sentencing Guidelines have been the subject of substantial criticism. As will be discussed *infra*, the Guidelines are now merely advisory, but still are routinely applied by courts.

25 *Id*. § 1A1.2. An example of an "offender characteristic" is "offender with one prior conviction not resulting in imprisonment." *Id*.

26 *Id*. The Guidelines require narrow imprisonment ranges. The maximum prison sentence cannot exceed the minimum by more than 25 percent or six months, whichever is greater. *See* 28 U.S.C. § 994(b)(2).

27 United States Sentencing Commission, *Guidelines Manual* § 1A1.2 (Nov. 2014).

28 *Id*. *See also* 18 U.S.C. § 3553(b).

29 United States Sentencing Commission, *Guidelines Manual* § 1A1.2 (Nov. 2014).

30 *Id*. *See also* 18 U.S.C. § 3742.

31 United States Sentencing Commission, *Guidelines Manual* § 1A1.2 (Nov. 2014).

These three objectives are honesty, uniformity and proportionality.[32] While the Guidelines promote the notion of "honest" sentencing by abolishing the parole system, the objectives of uniformity and proportionality involved the balancing of competing interests.

[i] — Promoting Honesty in Sentencing.

Before the Sentencing Guidelines were established, judges were free to impose indeterminate sentences that were often eventually reduced by the parole commission.[33] Thus, the sentences levied by courts rarely reflected the actual amount of prison time served. Instead of parole, the Guidelines provide that an offender will serve the actual "honest" sentence imposed by a judge, with an allowance for a 15 percent reduction for good behavior.[34]

[ii] — Balancing Uniformity and Proportionality.

Unlike honesty, the goals of uniformity and proportionality are inherently at odds with one another. The Guidelines Manual notes that a sole focus on establishing uniform sentencing would create a broad, disproportionate system, while a focus on proportional sentencing would create a system that is too unwieldy to efficiently operate. For example, a highly uniform sentencing system that included only a few simple offense categories would be very efficient but would also be unfairly broad, applying the same sentence to activities of varying severity that happen to fall under the same broad offense category.[35] Conversely, a highly proportional sentencing system would bring fairer sentencing practices, but the challenges of implementing a "system tailored to fit every conceivable wrinkle of each case would quickly become unworkable and seriously compromise the certainty of punishment and its deterrent effect."[36]

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32 *Id*.

33 *Id*.

34 *Id*.

35 *Id*.

36 *Id*.

Given the disparate arguments concerning uniformity and proportionality, the Commission considered implementing a "broad category approach" to promote uniformity while leaving judges with discretion to select particular sentences across a wide range.[37] However, the Commission rejected such an approach, fearing that granting judges such discretion would result in a reversion to the sort of disparate sentencing practices that the Commission was created to eliminate.[38] Ultimately, the Commission settled on a "balanced" approach that significantly curtailed the judge's role in determining an appropriate sentence for a given case.

[c] — Judicial Departures from Sentencing Guidelines.

The Commission has allowed courts to depart from the Guideline ranges, but only under limited circumstances. As a result, courts are generally discouraged from imposing sentences outside of the Guideline range.

[i] — Statutory Departure Policy.

Section 3553 of the Sentencing Reform Act governs the imposition of sentences.[39] Subsection (a) requires that the sentencing Guidelines are considered, but allows a court to consider a number of other factors in imposing a sentence.[40] However, subsection (b) provides that a court "shall" impose a sentence within the Guidelines and may only depart from them upon a finding that "an aggravating or mitigating circumstance of a kind, or to a degree, not adequately taken into consideration by the Sentencing Commission in formulating the Guidelines that should result in a sentence different from that described."[41]

The Commission has given two reasons to support this departure policy. First, it would be impossible for the sentencing Guidelines to encompass the

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37 *Id*.

38 *Id*.

39 18 U.S.C. § 3553.

40 *Id*. at § 3553(a).

41 *Id*. at § 3553(b).

entire range of possible offenses and corresponding sentences.[42] Second, the Commission did not believe that courts would depart from the Guidelines very often.[43]

[ii] — Case Law Regarding Departures.

In 2005, the United States Supreme Court held that an "enhanced" sentence mandated by the Sentencing Guidelines but based on a judge's findings that were not made by the jury (or admitted by the defendant) violated the Sixth Amendment and was thus unconstitutional.[44] In particular, the Court in *United States v. Booker* found that even though the federal sentencing statute allows for departures, the sentencing Guidelines were nonetheless binding upon all federal judges.[45] The Court reasoned that, despite the availability of departures from the Guidelines, such departures would not be available in every case, "and in fact are unavailable in most."[46] Indeed, in *Booker* the factual scenarios did not allow for departures from the Guidelines.[47] As a result, the district court applied a sentence that was mandated by the Guidelines, but was discordant with Supreme Court precedent articulated in *Blakely v. Washington*[48] and *Apprendi v. New Jersey*.[49] In those cases, the Court held that sentences must be imposed within the range supported by a jury's findings in order to comply with the Sixth Amendment.[50] Because the sentence in *Booker* was not supported by jury findings, the Court held that it violated the Sixth Amendment.[51]

To remedy the constitutional violation exposed in *Booker*, the Court "severed and excised" the provision of the Sentencing Reform Act that made

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42 United States Sentencing Commission, *Guidelines Manual*, § 1A1.4(b), p.s. (Nov. 2014).
43 *Id*.
44 United States v. Booker, 543 U.S. 220, 245 (2005).
45 *Id*. at 233-35.
46 *Id*. at 234.
47 *Id*. at 235.
48 Blakely v. Washington, 542 U.S. 296 (2004).
49 Apprendi v. New Jersey, 530 U.S. 466 (2000).
50 *See Blakely*, 542 U.S. at 303 (citing *Apprendi*).
51 *Booker*, 543 U.S. at 244.

the Guidelines mandatory.[52] The Court thus rendered the Guidelines advisory in nature.[53] The Court found that this modified advisory sentencing system "remains consistent with Congress' initial and basic sentencing intent."[54] The Court maintained that, even though the Guidelines were not mandatory, judges must still consider and take them into account when sentencing.[55]

The *Booker* Court additionally ruled that appellate review of district court sentences would be conducted under a "reasonableness" standard.[56] The Supreme Court revisited the question regarding the appellate standard of review in *Rita v. United States*.[57] In *Rita*, the Court clarified that an appellate court may provide a presumption of reasonableness when reviewing sentences imposed by a district court that fall within a range set by the Guidelines.[58]

Booker and its progeny therefore set forth a sentencing court's obligations in applying the Sentencing Guidelines. All district courts must calculate and consider the Guidelines, even though they are now merely advisory.[59] In addition to the Guidelines, a district court must also consider the other factors provided under 18 U.S.C. § 3553(a), as well as any grounds for departure from the Guidelines.[60] On appeal, a reviewing court will determine whether the sentencing court properly calculated the Guidelines, then determine whether the imposed sentence was reasonable, "tak[ing] into account the totality of

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52 *Id*. at 245 (severing and excising provision of 18 U.S.C. § 3553(b)(1) as "incompatible" with the Court's constitutional holding).

53 *Id*.

54 *Id*. at 264.

55 *Id*.

56 *Id*. at 261.

57 Rita v. United States, 551 U.S. 338 (2007).

58 *Id*. at 347.

59 *See* United States Sentencing Commission, *Guidelines Manual*, § 1A2 (Nov. 2014) (citing 18 U.S.C. § 3553(a)(4), (a)(5); *Booker*, 543 U.S. at 264 ("The district courts, while not bound to apply the Guidelines, must . . . take them into account when sentencing."); *Rita*, 551 U.S. at 351 (directing district courts to begin sentencing analysis by calculating the appropriate Guidelines range); Gall v. United States, 552 U.S. 38, 49 (2007) ("As a matter of administration and to secure nationwide consistency, the Guidelines should be the starting point and the initial benchmark.")).

60 United States Sentencing Commission, *Guidelines Manual*, § 1A2 (Nov. 2014) (citing *Rita*, 551 U.S. at 351).

the circumstances, including the extent of any variance from the Guidelines range."[61] As a result, even though the Guidelines are now only "advisory," they are still widely used as the primary basis for sentencing.

[d] — Sentencing Guidelines and the Role of the Prosecutor.

Prosecutors generally enjoy "wide latitude in determining when, whom, how, and even whether to prosecute for violations of Federal criminal law."[62]

The advent of the Sentencing Guidelines, in addition to the ability to shape what charges are brought, has taken much influence in the sentencing context away from the court and given it to the prosecutor. Under this system, a prosecutor can seek severe charges against a defendant and, upon a conviction, the judge will be encouraged to impose a sentence within the Guideline range, even if the judge may believe a lesser sentence should be imposed. Thus, by possessing the knowledge of the Sentencing Guidelines and having almost complete prosecutorial discretion in the charges to be brought against a defendant, prosecutors now play a pivotal role, and correspondingly have increased influence, in the ultimate sentence which a convicted defendant may receive.

§ 23.03. Tools Available to Prosecutors: Investigative Resources and Techniques.

Federal prosecutors have substantial investigative resources at their disposal. The Federal Bureau of Investigation (FBI) remains one of the most sophisticated law enforcement agencies in the world and employs about 35,000 people.[63] Individual agencies such as the Environmental Protection Agency (EPA) also have their own criminal investigation divisions.[64] Beyond

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61 *Id*. (citing *Gall*, 552 U.S. at 51).

62 Deputy Attorney General, U.S. Department of Justice, *Memorandum, Federal Prosecution of* Corporations, § II.B (June 16, 1999).

63 *FBI Quick Facts*, https://www.fbi.gov/about-us/quick-facts (last visited Sep. 10, 2015).

64 *Criminal Enforcement: Special Agents*, http://www2.epa.gov/enforcement/criminal-enforcement-special-agents (last visited Sep. 10, 2015).

these vast resources, federal investigations engage in certain tactics that shift the playing field in favor of the prosecutor.

[1] — Non-Consensual Federal Interviews of Corporate Employees.

[a] — Investigative Tactics.

Frequently, the first time an attorney may hear that either an individual or a corporate client is under investigation is when a search warrant has been executed or an individual employee has been interviewed without prior notice or counsel. It is a common practice of federal investigators to show up unannounced at the home of an employee and seek to interview him or her. Unless a work force has already been counseled, more often than not the employee will talk to the investigators. In-house counsel will frequently not learn about the interview until the following days.

In such an interview, there will usually be two investigators who take detailed notes and then reduce them to written reports. These reports, which may reflect mistakes or pre-formed conclusion about facts that investigators "want" to hear, will not be made available to an individual or corporate client until the latter stages of an investigation or enforcement proceeding. By then, your client may be facing a "swearing" contest with two federal agents, both of whom will be armed with statements based on contemporaneous notes purported to reflect the entirety of an interview. So effective has been the use of this system in securing convictions that until recently the FBI routinely *declined* to record interviews.[65]

Counsel for a corporate defendant whose employees have been interviewed will quickly want to gain some control over and understanding of the investigation. There are several things that in-house and outside counsel should consider. First, counsel can notify employees that investigators may seek to interview them and advise them that they are free to decline the interview requests. In order to avoid possible obstruction charges against

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65 *See* discussion about DOJ policies regarding audio recordings of interviews, *infra*, § 23.03 [2].

the employees or counsel, this advice should be in writing and advise the employee that the choice to be interviewed is his or hers to make, and if they choose to talk they should be careful to tell the truth because there have been many cases where confused employees panicked or equivocated and were later charged with obstruction of justice. Second, counsel will likely want to contact the local United States Attorney's Office to learn more. Third, an employee may want to immediately consider its own internal investigation to determine if it has a previously unknown problem because employers can have a strong incentive to cooperate with investigations in order to protect their officers.[66]

[b] — The "No-Contact" Rule.

Almost every practicing attorney is bound by, and adheres to, the Model Rules of Professional Conduct. Rule 4.2 of the Model Rules provides that "[i]n representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law."[67] This is known as the "no-contact" rule. The "no-contact" rule was designed to protect overreach by opposing counsel, protect the attorney-client privilege, and prevent disclosure of privileged or sensitive information.[68] It applies equally to individuals and corporations.[69] It also applies to investigators hired by federal attorneys.

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66 Deputy Attorney General, U.S. Department of Justice, *Memorandum, Federal Prosecution of* Corporations, § VI. (June 16, 1999); *see also* discussion of "Responsible Corporate Officer" doctrine, *infra*, § 23.04 [3] [a].

67 ABA Model Rules of Professional Conduct, Rule 4.2 (2015).

68 ABA Formal Ethics Opinion 95-396 (1995).

69 *See, e.g.*, Hill v. St. Louis Univ., 123 F.3d 1114, 1121 (8th Cir. 1997) (acknowledging that the "no-contact" rule applies equally to organizational employees); Dent v. Kaufman, 406 S.E.2d 68 (W. Va.1991) (recognizing application of "no-contact" rule to corporate employees); ABA Model Rules of Professional Conduct, Rule 4.2, cmt. 4 (prohibiting communication "with persons having a managerial responsibility . . . or whose statements may constitute an admission on the part of the organization.").

[c] — Department of Justice Interpretations of the "No-Contact" Rule.

Historically, the principles embodied by Rule 4.2 have been in conflict with the DOJ and its stated needs for achieving the goals of federal law enforcement. Several cases in the 1980s and early 1990s held that the "no-contact" rule does not apply to pre-indictment investigations.[70] Another case, however, held that such pre-indictment investigations could violate the rule.[71] In *United States v. Hammad*, the Second Circuit found that a federal prosecutor had violated the "no-contact" rule when he directed an informant to elicit incriminating statements from a defendant in an arson investigation and to present the defendant with a fake grand jury subpoena.[72]

In light of the *Hammad* ruling, Attorney General Richard Thornburgh articulated the DOJ's position that the "no-contact" rule did not apply to federal prosecutors so long as they were conducting "authorized law enforcement activity."[73] While some courts validated this position,[74] others rejected the idea that all pre-indictment investigative activities were exempt from the "no-contact" rule.[75]

Next, likely in response to inconsistent court decisions involving the Thornburgh Memorandum, the DOJ promulgated new regulations regarding

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70 *See, e.g.*, United States v. Ryans, 903 F.2d 731, 739 (10th Cir. 1990), *cert. denied*, 498 U.S. 855 (1990); United States v. Kenny, 645 F.2d 1323, 1339 (9th Cir. 1981), *cert. denied*, 452 U.S. 920 (1981).

71 United States v. Hammad, 858 F.2d 834 (2d Cir. 1988), *cert. denied*, 498 U.S. 871 (1990).

72 *Id*. at 839-840.

73 Richard Thornburgh, U.S. Department of Justice, *Memorandum, Communications with Persons Represented by Counsel* (June 6, 1989).

74 *See* United States v. Balter, 91 F.3d 427 (3d Cir. 1996), *cert. denied*, 519 U.S. 1011 (1996); United States v. Heinz, 983 F.2d 609, 613 (5th Cir. 1993); *Ryans*, 903 F.2d 731, 739, *cert. denied*, 498 U.S. 855 (1990); *In re* Doe, 876 F. Supp. 265, 269 (M.D. Fla. 1993).

75 *See* United States v. Hammad, 858 F.2d 834, 838-40 (2d Cir. 1988), *cert. denied*, 498 U.S. 871 (1990); *In re* Doe, 801 F. Supp. 478, 486-87 (D.N.M. 1992) (holding that federal prosecutors may not ignore "no contact" rule); United States v. Scozzafava, 833 F. Supp. 203, 208-09 (W.D.N.Y. 1993) (applying "no-contact" rule to federal prosecutors); United States v. Lopez, 4 F.3d 1455, 1463-64 (9th Cir. 1993) (dismissing charges because of violation of "no contact" rule).

when and how federal attorneys could communicate with represented individuals in the course of federal investigations.[76] These regulations authorized contact with individuals and organizations so long as they had not been indicted in a civil or criminal enforcement action — which is directly contrary to the "no contact" rule embodied in Model Rule 4.2.[77] The DOJ regulations did not stop there. They additionally authorized contact with represented persons "pursuant to discovery procedures . . . or administrative process," or in the course of investigating different or additional criminal activity.[78] The DOJ regulations even purported to supersede state and local federal court ethics rules regarding contacts by DOJ attorneys or agents, "regardless of whether such rules are inconsistent or consistent with this regulation."[79]

The new DOJ regulations also included rules regarding communications with corporate employees. These rules likewise differed from traditional ethics rules. For example, the new rules only prohibited contact with "high-level" employees after an organization had been named as a defendant or with "controlling individuals" of organizations that had not been named but were targets of an investigation.[80]

[d] — McDade Amendment.

Congress invalidated the DOJ regulations by enacting the Citizens Protection Act, also known as the McDade Amendment, in 1998.[81] Former Congressman Joseph McDade had been indicted on several federal charges, including RICO violations, related to an alleged scheme to provide government contracts in exchange for campaign contributions.[82] Numerous times during the course of the investigation and trial, McDade made

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76 59 Fed. Reg. 39, 910 (Aug.4, 1994) (former 28 C.F.R. Part 77 (1998)).

77 Former 28 C.F.R. §§ 77.3, 77.7 (1998).

78 *Id*. at § 77.6(b), (e).

79 59 Fed. Reg. 39,910, at 39, 916 (Aug. 4, 1994).

80 *Id*. at 39, 912.

81 28 U.S.C. § 530B.

82 United States v. McDade, No. 920249, 1992 WL 151314, at *1 (E.D. Pa. June 19, 1992).

protests against the ethical behavior of the federal prosecutors.[83] McDade was ultimately acquitted,[84] and upon his return to Congress he introduced several bills aimed at curbing excessive prosecutorial practices at the federal level.[85] These attempts eventually culminated in the passage of the McDade Amendment.[86]

The McDade Amendment provides that "[a]n attorney for the Government shall be subject to State laws and rules, and local Federal court rules, governing attorneys in each State where such attorney engages in that attorney's duties, to the same extent and in the same manner as other attorneys in that State."[87] The Amendment also required the DOJ to amend its regulations to conform to the statute.[88]

[2] — Department of Justice Policies Regarding Audio Recordings of Interviews.

For decades, the FBI and other federal law enforcement agencies did *not* electronically record even custodial interviews. In 2006, the FBI's Office of General Counsel distributed a memorandum "[t]o clarify existing FBI policy on electronic recording of confessions . . . ."[89] That memorandum clarifies that agents "may *not* electronically record confessions or interviews, openly or surreptitiously, unless authorized by the [Special Agent in Charge]."[90] The memo also blatantly stated that the non-recording policy had long worked to the FBI's advantage, and that a change might expose distasteful investigative practices and erode conviction rates.[91] In 2014, however, Deputy Attorney

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83 Fred C. Zacharias and Bruce A. Green, "The Uniqueness of Federal Prosecutors," 88 *Geo. L.J.* 207, 211 (2000).

84 "Veteran Congressman Acquitted in Bribe Case," *Wash. Times*, Aug. 2, 1996, at A5.

85 *See, e.g.*, H.R. 3396, 105th Cong. (1998); H.R. 232, 105th Cong. (1997); H.R. 3386, 104th Cong. (1996).

86 Pub. L. No. 105-277, 112 Stat. 2681, 2681-118 to -119 (1998).

87 28 U.S.C. § 530B(a) (2006).

88 *Id*. at § 530B(b).

89 *See* Choi Jung-Won, Federal Bureau of Investigation, *Memorandum, Electronic Recording of Confessions and Witness Interviews* (March 23, 2006).

90 *Id*., p. 1.

91 *Id*., p. 3. The memorandum concluded the following regarding the "sound reasons behind the FBI policy on electronic recording . . . .":

General James Cole issued a memorandum establishing a presumption that the FBI and other Justice Department agencies would electronically record statements made by individuals detained for custodial interviews.[92] The policy does not, however, apply to field interviews of non-detained witnesses. Thus, for a non-detained witness a later swearing match will put the witness' unrecorded memory with the agents' nearly contemporaneous written reports — a match not often won by the witness.

§ 23.04. Use of Federal Tools and Authority to Punish Seemingly Ordinary Activity.

[1] — Context Matters.

High profile incidents create pressure to bring criminal charges. In this arena, public perception can matter, and efforts by public relations specialists to respond to the media on behalf of a potential prosecutorial target antithetical to the "bunker" mentality are frequently assumed by defense counsel.

Media specialists play an increasingly important role for maintaining corporate image and in some businesses this role in a time of crisis may be primary. For lawyers accustomed to being "in charge" of a case, there can be unpleasant clashes with media consultants who insist that corporate management make public statements. In media-centric locations, though, where pressure to advance criminal charges are more intense, the work of

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> First, the presence of recording equipment may interfere with and undermine the successful rapport-building interviewing technique which the FBI practices. Second, FBI agents have successfully testified to custodial defendants' statements for generations with only occasional, and rarely successful, challenges. Third, as all experienced investigators and prosecutors know, perfectly lawful and acceptable interviewing techniques do not always come across in recorded fashion to lay persons as proper means of obtaining information from defendants. Initial resistence [sic] may be interpreted as involuntariness and misleading a defendant as to the quality of the evidence against him may appear to be unfair deceit.

Id. (footnote omitted).

92 James M. Cole, U.S. Department of Justice, *Memorandum, Policy Concerning Electronic Recording of Statements* (May 12, 2014); Douglas Starr, "The F.B.I.'s Interrogations, Finally on Film," *New Yorker* (June 3, 2014), http://www.newyorker.com/news/news-desk/the-f-b-i-s-interrogations-finally-on-film.

good crisis management consultants can be invaluable in minimizing the "demonization" process of social media and the press.

More challenging to the lawyer, will be ensuring that post-incident emails and text-messages speculating on "what-if" scenarios are not freely distributed — frequently by employees who possess little expertise or first-hand knowledge but plenty of desire to communicate their thoughts.[93]

[2] — Don Blankenship.

On April 5, 2010, the Upper Big Branch mine (UBB), owned by Massey Energy, exploded, killing 29 coal miners. It was the deadliest accident in the United States coal industry since 1970.[94] The explosion was widely reported in the national media, and President Obama eulogized the miners in Beckley, West Virginia, three weeks after the incident.[95] A federal investigation led by the United States Attorney's Office in Charleston, West Virginia was commenced on May 14, 2010.[96] Several lower-level Massey employees and managers were indicted during the investigation.[97] On November 13, 2014, more than four years after the investigation began, federal charges were brought against former Massey CEO Don Blankenship.[98]

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93 Years ago, one of the authors participated on a crisis management team in response to an explosion and fatality. After working to protect interviews of employees as both work product and privileged, he learned that a separate group of in-house engineers had been working independently to determine the "cause" of the incident and writing their work in notes and flip charts. It will be important for counsel in those type of cases to quickly learn of and control those types of communications.

94 Associated Press, "Massey Shares Rise on Blankenship News," *Charleston Gazette*, Dec. 7, 2010, *available at* http://www.wvgazettemail.com/News/montcoal/201012070454.

95 Associated Press, "A Timeline of Events in Upper Big Branch Disaster," *Fox News* (Nov. 13, 2014), http://www.foxnews.com/us/2014/11/13/timeline-events-in-upper-big-branch-disaster/.

96 *Id*.

97 Ken Ward, Jr., "More UBB Prosecutions Sought," *Charleston Gazette*, Dec. 16, 2011, *available at* http://www.wvgazettemail.com/News/201112160120.

98 Indictment, United States v. Blankenship, No. 5:14-cr-00244 (Nov. 13, 2014), *available at* http://www.wvgazettemail.com/assets/PDF/CH62291113.pdf.

[a] — No Charges Relating to Upper Big Branch.

Blankenship was not charged with causing the UBB explosion, but rather for violating federal mine safety regulations not claimed to have caused the explosion. Specifically, Blankenship was charged with conspiracy to willfully violate mandatory Mine Safety and Health Standards ("Mine Act Conspiracy")[99] and conspiracy to defraud an agency of the United States — both misdemeanors.[100] The indictment alleged that Blankenship instructed subordinates to violate MSHA standards and to take actions that were likely to cause violations of MSHA standards.[101] The indictment also alleged that Blankenship refused to provide UBB with enough workers and resources to reasonably comply with MSHA standards, and that Blankenship gave and instructed subordinates to give advance warning of MSHA inspections in order to cover up any potential violations.[102]

[b] — SEC Charge for Approving a Seemingly Ordinary Press Release.

The Blankenship indictment additionally included two felony charges stemming from a Massey press release filed with the Securities and Exchange Commission that contained statements that Massey did not condone MSHA violations and that Massey strives to always be compliant with all safety regulations.[103] The United States claimed that Blankenship had approved the release but knew it was false because he had been engaged in MSHA violations.

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99 30 U.S.C. § 820(d).

100 18 U.S.C. § 371.

101 Indictment at 34-36, *Blankenship*, No. 5:14-cr-00244 (Nov. 13, 2014), *available at* http://www.wvgazettemail.com/assets/PDF/CH62291113.pdf. This is an example of a press release that most lawyers would have allowed their investor relations of SEC compliance personnel to file without a serious thought, and yet it became the source of a felony indictment against the former chairman. It is unclear whether anyone would have foreseen this charge, but this is a shining example of why in-house and outside counsel need to consult with criminal defense lawyers early in high profile crises.

102 *Id*. at 36.

103 Indictment at 41-42, *Blankenship*, No. 5:14-cr-00244 (Nov. 13, 2014), *available at* http://www.wvgazettemail.com/assets/PDF/CH62291113.pdf.

[3] — Freedom Industries Chemical Spill.

On January 9, 2014, Freedom Industries leaked a chemical, 4-methylcyclohexane methanol or "MCHM,"[104] into the Elk River in Charleston, West Virginia. The spill affected the availability of water to approximately 300,000 residents across nine counties.

More than 24 hours after the spill was reported, Freedom gave its first public statements regarding the spill.[105] Gary Southern, the President of Freedom, spoke for about 10 minutes at a now-infamous press conference. He was sharply criticized for providing little information, attempting to rush through the conference, and repeatedly drinking bottled water — a symbol of the crisis.[106] He could have been any of us, and probably would have benefitted from early consultations with counsel and public relations specialists.

A federal investigation, spearheaded by the local United States Attorney, was initiated less than a month after the spill.[107] On December 17, 2014, more than 10 months later, federal charges were brought against former officials of Freedom Industries. Three former owners of Freedom were charged with negligent discharge of a pollutant and unpermitted discharge of refuse matter. The company's president at the time of the spill was additionally charged with wire and bankruptcy fraud. The December 17 indictment alleged that Freedom failed to inspect and maintain the storage tank that leaked and that the officers would not approve business expenditures unless

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104 MCHM is a chemical used in the coal-washing process. It separates coal from impurities such as dirt and other rock. It is one of the many chemicals used to wash coal, and does not have many other uses. *See* David Biello, "How Dangerous Is the Coal-Washing Chemical Spilled in West Virginia?," *Scientific American*, Jan. 10, 2014, http://www.scientificamerican.com/article/how-dangerous-is-the-chemical-spilled-in-west-virginia/.

105 Dave Boucher, "Freedom Industries Provides Scant Details About WV Chemical Leak," *Charleston Daily Mail*, Jan. 10, 2014, *available at* http://www.wvgazettemail.com/News/201401100128.

106 Jared Hunt, "Freedom Industries Could Use PR Advice," *Charleston Daily Mail*, Jan. 16, 2014, *available at* http://www.wvgazettemail.com/Business/JaredHunt/201401150221.

107 Andrea Lannom, *Federal Investigators Examine Freedom Tanks*, Jan. 28, 2014, *available at* http://www.wvgazettemail.com/News/201401280047.

they would result in increased revenue or were immediately necessary to maintain equipment.[108]

[a] — Former Officers Charged for Spill Occurring After Sale of Facility.

In December 2013, the month prior to the release, the three owners of Freedom Industries sold their shares to a Pennsylvania-based chemical company.[109] The buyer hired a third party to conduct an inspection of the facility as part of its due diligence.[110]

Despite not owning the facility at the time of the release, the three former owners were charged under the "responsible corporate officer," or "RCO" doctrine with causing the post-sale discharge from the facility.[111] The RCO doctrine allows prosecutors to impose criminal liability upon individuals based on their position within an entity — regardless of whether that individual was personally responsible or even had awareness of any wrongdoing.[112]

The United States Supreme Court has rationalized the application of the RCO doctrine:

> "The requirements of foresight and vigilance imposed on responsible corporate agents are . . . demanding, and perhaps onerous, but . . . no more stringent than the public has a right to expect of those who voluntarily assume positions of authority in . . . enterprises whose

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108 Associated Press, "4 Indicted in West Virginia Chemical Spill Case," *Fox News* (Dec. 17, 2014), http://www.foxnews.com/us/2014/12/17/4-former-chemical-company-executives-indicted-on-pollution-charges-in-west/.

109 Steven Mufson, "New Owner of Freedom Industries Must Face Fallout of West Virginia Chemical Spill," *The Washington Post*, Jan. 17, 2014, http://www.washingtonpost.com/business/economy/new-owner-of-freedom-industries-must-face-fallout-of-west-virginia-chemical-spill/2014/01/17/77b1a572-7df2-11e3-93c1-0e888170b723_story.html.

110 *Id*.

111 Indictment at 7, United States v. Farrell, No. 2:14-cr-00264 (Dec. 17, 2014), *available at* http://media.wvgazette.com/static/coal%20tattoo/Freedom%20Indictment.pdf.

112 The RCO doctrine stems from the decision in U.S. v. Dotterweich, 320 U.S. 277 (1943). Congress expressly inserted the doctrine into the Clean Water Act. 33 U.S.C. § 1319(c)(2) & (6).

services and products affect the health and well-being of the public . . . ."[113]

In other words, the RCO doctrine assigns corporate officers the duty to prevent violations of public welfare laws. The doctrine is effectively a form of strict liability because it allows prosecutors to obtain convictions without evidence of culpable intent or state of mind. Indeed, the word "responsible" in the RCO doctrine connotes responsibility for the entity, not the conduct.

Because the general principle of the RCO doctrine is at odds with the traditional concepts of criminal responsibility, the doctrine has been considered controversial. Nevertheless, in extraordinary circumstances federal investigators and prosecutors are under more pressure, and are thus more likely to, look for creative mechanisms such as the RCO doctrine to pursue convictions. In the case of Freedom Industries, not only did the prosecutors rely on the RCO doctrine but applied it to persons who were no longer in charge of the business or the site when the release occurred. Thus, the United States charged them for the pre-sale behavior of their business.

[b] — Clean Water Act Misdemeanors.

The former officers were charged with negligently discharging pollutants without a permit[114] as well as with violating their Clean Water Act-based "storm water" permit by failing to implement mandated management controls.[115] Both actions are misdemeanors.[116]

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113 United States v. Park, 421 U.S. 658, 672 (1975).

114 33 U.S.C. § 1319(c)(1). According to the United States, Freedom's permit authorizing storm water discharges into the Elk River did not allow for MCHM discharges. Indictment at 6, *Farrell,* No. 2:14-cr-00264, *available at* http://media.wvgazette.com/static/coal%20tattoo/Freedom%20Indictment.pdf.

115 33 U.S.C. § 1319(c)(1)(A). The Clean Water Act provides that an individual or entity may be held criminally liable for knowingly or negligently discharging a pollutant in violation of a permit. *Id*. The federal indictment charged the former officers with knowingly violating a permit condition by failing to implement a "Stormwater Pollution Prevention Plan" as required by Freedom's permit and consequently failing to implement "stormwater management controls" that should have been included in such a plan. Indictment at 13, *Farrell,* No. 2:14-cr-00264, *available at* http://media.wvgazette.com/static/coal%20tattoo/Freedom%20Indictment.pdf.

116 33 U.S.C. §§ 1319(c)(1) & 1319(c)(1)(A).

The former officers were also charged with the unlawful deposit of "refuse" in navigable waters. Prosecutors added this charge pursuant to a criminal statute originally promulgated in 1899. Under that statute, it is illegal to dispose "any refuse matter of any kind or description" into navigable waters.[117] These activities are also considered misdemeanors.[118]

On March 16, 2015, two of the former officers entered guilty pleas for unlawfully discharging MCHM into the Elk River without a permit.[119] Even though neither was an officer with Freedom at the time of the spill, the United States effectively claimed that the company's pre-sale actions caused the post-sale discharges and used the RCO doctrine to impute the wrongdoing to the former officers.

[c] — Charges for False Statements: Taken to Extreme and Later Dropped.

Gary Southern, President of Freedom Industries at the time of the spill, was charged with many of the same Clean Water Act misdemeanors as well as several more serious bankruptcy-related charges.[120]

Federal prosecutors charged Southern with bankruptcy fraud,[121] alleging that he misrepresented the duration and extent of his role at Freedom during bankruptcy hearings and depositions.[122] Prosecutors also alleged that Southern "[k]nowingly . . . caused to be filed" a false notice in bankruptcy court when he withdrew a prior "application" and claimed that the "[Freedom]

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117 33 U.S.C. § 407.

118 33 U.S.C. § 411.

119 "Former Freedom Industries Executives Plead Guilty to Environmental Crimes," Pittsburgh Press, http://www.fbi.gov/pittsburgh/press-releases/2015/former-freedom-industries-executives-plead-guilty-to-environmental-crimes (last viewed Sep. 10, 2015).

120 Indictment at 15, *Farrell,* No. 2:14-cr-00264, *available at* http://media.wvgazette.com/static/coal%20tattoo/Freedom%20Indictment.pdf.

121 18 U.S.C. § 157(2) & (3). Bankruptcy fraud is a felony punishable by a prison term of up to five years. *Id*. at § 157(2).

122 Indictment at 19-22, *Farrell,* No. 2:14-cr-00264, *available at* http://media.wvgazette.com/static/coal%20tattoo/Freedom%20Indictment.pdf.

incident occurred a mere 6 working days after he became the President of the Debtor, for which he bears no fault . . . ."[123]

The allegations regarding Southern's "knowingly causing to be filed" a false bankruptcy notice was the fruit of particularly creative thinking by the prosecutors. Southern's attorneys had undoubtedly drafted the document in question and Southern had undoubtedly relied on his attorneys' expertise in drafting the particular language of that document. Nonetheless, the prosecutors decided to hold him criminally liable for language that appeared in a bankruptcy filing.

Southern was additionally charged with wire fraud[124] for allegedly distributing email from a financial advisor detailing asset protections under Florida law.[125] Accordingly, pursuant to the bankruptcy and wire fraud charges, Southern's indictment additionally sought the forfeiture of his assets derived from proceeds traceable to the alleged violations.[126] The forfeiture request implicated millions of dollars in assets, including a Bentley coupe.[127]

In August 2015, Southern pled guilty to the misdemeanor charges.[128] In exchange for the plea, prosecutors dropped the bankruptcy-related charges.[129] The deal also allows Southern to recover his seized assets.[130] He is, however, still subject to at least 30 days in prison and a fine of up to $300,000.[131]

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123 *Id*. at 22-23.

124 18 U.S.C. § 1343. Wire fraud is a felony that carries a prison sentence of up to 20 years. *Id*.

125 Indictment at 25, United States v. Farrell, No. 2:14-cr-00264 (Dec. 17, 2014), *available at* http://media.wvgazette.com/static/coal%20tattoo/Freedom%20Indictment.pdf.

126 *Id*. at 36-37.

127 *Id*. at 37.

128 Jonathan Mattise, *Last of 6 Company officials Charged in West Virginia Chemical Spill Pleads Guilty to Pollution*, Associated Press (Aug. 19, 2015), *available at* http://www.usnews.com/news/business/articles/2015/08/19/last-official-charged-in-chemical-spill-pleads-guilty.

129 *Id*.

130 *Id*.

131 *Id*.

§ 23.05. Representing Targets.

There are different challenges presented in representing business organizations and individuals which or who face potential charges for environmental crimes. For example, low thresholds for imposing criminal liability for simple negligence, coupled with the RCO doctrine, can make supervisory personnel criminally responsible for the wrongdoing of subordinates — even if the supervisors played no direct role in the wrongdoing. But EPA and DOJ, however, retain policies designed to provide corporations and their supervisors with some measure of comfort that they will not be prosecuted if they maintain systems designed to discover and report environmental violations and wrongdoing.[132] Thus, corporations may be interested in discovering and reporting the wrongdoing of front-line employees to regulators, and the job of corporate counsel may be to aid such an investigation and to report findings to agencies or prosecutors.

Those representing individuals may have a different set of concerns. Their clients not only face potential criminal liabilities if they do talk to either prosecutors or their employers, but also face possible disciplinary action or termination if they do *not* cooperate with an internal investigation by their employer. Nonetheless, both employers and employees alike are subject to some of the same investigation techniques of federal agencies, prosecutors and investigators. In some cases, the first time you or a business organization will know about a federal investigation is after an employee has been visited at his or her home by federal agents.

§ 23.06. Conclusion.

Federal agencies and prosecutors have the ability to wield enormous power. Companies and individuals alike must be keenly aware of their rights and obligations when an investigation is initiated by federal authorities. The retention of experienced counsel, both criminal and otherwise, is critical for companies and individuals to navigate the overwhelming laws, regulations, and legal tactics they may encounter. Such incidents or investigations impose

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132 *EPA's Audit Policy*, http://www2.epa.gov/compliance/epas-audit-policy (last viewed Sep. 10, 2015).

considerable stress and pressure on companies and individuals and require immediate and constant attention. Assistance from experienced attorneys and experts is crucial in order to endure the ordeal, protect and defend a defendant's rights, and hopefully bring about an ultimately beneficial and successful resolution.

Chapter 24

Natural Gas Infrastructure Siting — The Environmental Angle

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§ 24.01. Introduction.

The extraction of shale gas in the Appalachian Basin from the Marcellus and Utica formations caused an explosion in the need for new or improved natural gas infrastructure. Building or upgrading this infrastructure is a heavily regulated, expensive and time-consuming process. Pipelines and compressor stations are not popular with the local residents and environmental groups. With the growth in infrastructure construction,[1] there has been a growth in environmental challenges at both the state and federal level.

Thanks to the Natural Gas Act, most of the disputes ultimately end up in one of two places: in front of the Federal Energy Regulatory Commission or in federal appellate courts. But the infrastructure road is fraught with environmental challenges. As the current Federal Energy Regulatory Commission (FERC) chairwoman, Cheryl LaFleur, stated earlier this year:

> Pipelines are facing unprecedented opposition from local and national groups including environmental activists. These groups are very active in every FERC docket, as they should be, as well as in my email inbox seven days a week, in my Twitter feed, at our open meetings demanding to be heard, and literally at our doors closing down First Street so FERC won't be able to work.[2]

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1 According to the FERC website, as of time of publication, major pipeline projects totaling more than 1,723 miles were submitted for consideration between 2010 and 2014. This figure would not include some of the more recent projects that have generated comment and controversy to get gas out of the Appalachian Basin. The miles of pipeline approved by the FERC peaked in 2006 at about 3000 miles and bottomed out in 2012 with three miles approved. In 2014, FERC approved less than 500 miles of pipeline. *See* http://www.ferc.gov/industries/gas/indus-act/pipelines/pending-projects.asp; http://www.ferc.gov/industries/gas/indus-act/pipelines/approved-projects.asp.

2 Tr. Nat'l Press Club Luncheon with Cheryl LaFleur, January 27, 2015, p. 5. https://www.press.org/sites/default/files/20150127_lafleur.pdf.

§ 24.02. Overview of Governing Federal Statutory and Agency Oversight.

Congress enacted the Natural Gas Act (NGA) with the "principal purpose" of "encourag[ing] the orderly development of plentiful supplies of . . . natural gas at reasonable prices."[3] Subsidiary purposes include respecting "conservation, environmental, and antitrust" limitations.[4] The NGA vests the FERC with authority to regulate the transportation and sale of natural gas in interstate commerce, including authority to issue certificates permitting the construction or extension of natural gas transportation facilities.[5]

The FERC has plenary jurisdiction over the transportation of natural gas in interstate commerce; the sale of natural gas in interstate commerce for resale to the consumer; and natural gas companies that are engaged in such transportation for sale.[6] The exception to FERC's jurisdiction, known as the Hinshaw Amendment exception, excludes a natural gas company that receives all gas from within the boundaries of a state; all such gas is ultimately consumed within the state; and the state regulates the intra-state gas company's accompanying facilities and rates.[7]

[1] — Brief Outline of the Pipeline Approval Process.

A pipeline project begins with an "open season" in which the midstream company offers contracts for future supplies of gas to potential customers. This can be transportation or storage or a combination. Once contracts are established, the midstream company will file a voluntary pre-filing, which defines the project, the siting of pipelines, storage and compressor stations,

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3 Myersville Citizens for a Rural Cmty., Inc. v. FERC, 783 F.3d 1301, 1307 (D.C. Cir. 2015), *citing* NAACP v. Fed. Power Comm'n, 425 U.S. 662, 669-70, 96 S. Ct. 1806, 48 L. Ed. 2d 284 (1976). The NGA citation is ch. 556, 52 Stat. 821 (1938), codified as amended at 15 U.S.C. § 717 *et seq*.

4 *NAACP*, 425 U.S. at 670 and n. 6.

5 15 U.S.C. § 717f(c).

6 15 U.S.C. § 717(b), *see e.g*. Fuel Safe Washington v. FERC, 389 F.3d 1313, 1317 (10th Cir. 2004) (citation omitted).

7 15 U.S.C. §717(c), *see also, Fuel Safe Washington*, 389 F.3d at 1317.

and provides other details. The purpose of pre-filing, according to the FERC, is to "proactively pursue issues" with the people who are likely to be most "affected by the lateral infrastructure," thus minimizing issues "before the application is ever brought to the Commission."[8] The gas company must also notify state, local, and federal agencies that would be required to evaluate, permit, or are affected by the project, as well as potentially affected landowners. The pre-filing triggers company-sponsored open houses that are opportunities for transmitting information to the public, but not an opportunity for the public to comment on or participate in the process. At the conclusion of the open houses, the FERC may hold public scoping meetings along the project route. At this time, the public may appear and make comments for the record or may submit written comments to the FERC under the applicable pre-filing docket number assigned to the project.

The pre-filing does initiate the environmental review process, and at this point, the FERC will issue a Notice of Intent to prepare an environmental assessment (EA) or an environmental impact statement (EIS) as required by the National Environmental Policy Act (NEPA).[9] NEPA serves as the country's "basic national charter" for environmental protection by requiring the federal government to consider the environmental consequences of its actions, including permits.[10] Failure to comply with NEPA is a common challenge brought against pipeline construction in these processes.

The conclusion of the pre-filing activities initiates the application for a Certificate of Convenience and Public Necessity, which must contain a description of the project, route maps, construction plans, project schedules, information on permits required from other agencies, environmental reports and mitigation strategies, and route alternatives.

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8 *Industry Activities*, Fed. Energy Regulatory Comm'n, http://ferc.gov/industries/gas/indus-act.asp.

9 42 U.S.C. §§ 4321-4347.

10 *See* 42 U.S.C. § 4331(b)(1) and 40 C.F.R. § 1500.1 (2013), *see also Fuel Safe Washington*, 389 F.3d at 1317-1318, Sierra Club v. U.S. Army Corps of Eng'rs, 990 F. Supp.2d 9, 18 (D.D.C. 2013).

[2] — Review of Environmental Impact and Concerns.

With respect to environmental concerns, however, the public input is limited to written comments or participation in the public meetings. That level of interaction in the FERC proceedings is escalated at two points: (1) during the comment period for a draft environmental impact statement and (2) once the application for a certificate is filed.[11] At these points, there is a right to intervene.

Almost any individual or group may intervene in the FERC proceeding after an application is submitted by filing a motion, typically within twenty-one days of the FERC's notice of the gas company's application in the FederalRegister, though there is a late-filing procedure and intervenor status may be granted for good cause shown.[12]

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11 *See, e.g.* http://www.ferc.gov/help/how-to/intervene.asp.

12 All motions to intervene should be submitted to the Commission pursuant to 18 C.F.R. § 385.214:

> (a) *Filing*. (1) The Secretary of Energy is a party to any proceeding upon filing a notice of intervention in that proceeding. If the Secretary's notice is not filed within the period prescribed under Rule 210(b), the notice must state the position of the Secretary on the issues in the proceeding.
>
> (2) Any State Commission, the Advisory Council on Historic Preservation, the U.S. Departments of Agriculture, Commerce, and the Interior, any state fish and wildlife, water quality certification, or water rights agency; or Indian tribe with authority to issue a water quality certification is a party to any proceeding upon filing a notice of intervention in that proceeding, if the notice is filed within the period established under Rule 210(b). If the period for filing notice has expired, each entity identified in this paragraph must comply with the rules for motions to intervene applicable to any person under paragraph (a)(3) of this section including the content requirements of paragraph (b) of this section.
>
> (3) Any person seeking to intervene to become a party, other than the entities specified in paragraphs (a)(1) and (a)(2) of this section, must file a motion to intervene.
>
> (4) No person, including entities listed in paragraphs (a)(1) and (a)(2) of this section, may intervene as a matter of right in a proceeding arising from an investigation pursuant to Part 1b of this chapter.
>
> (b) *Contents of motion*. (1) Any motion to intervene must state, to the extent known, the position taken by the movant and the basis in fact and law for that position.
>
> (2) A motion to intervene must also state the movant's interest in sufficient factual detail to demonstrate that:
>
> (i) The movant has a right to participate which is expressly conferred by statute or by Commission rule, order, or other action;

[3] — Environmental Review — National Environmental Policy Act (NEPA) Requirements.

At least one court has likened the FERC's docket in the environmental review process as a "central conduit and repository for information requests and responses" that "is the foundation for the consolidated record" for

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(ii) The movant has or represents an interest which may be directly affected by the outcome of the proceeding, including any interest as a:
(A) Consumer,
(B) Customer,
(C) Competitor, or
(D) Security holder of a party; or
(iii) The movant's participation is in the public interest.
(3) If a motion to intervene is filed after the end of any time period established under Rule 210, such a motion must, in addition to complying with paragraph (b)(1) of this section, show good cause why the time limitation should be waived.
(c) *Grant of party status*. (1) If no answer in opposition to a timely motion to intervene is filed within 15 days after the motion to intervene is filed, the movant becomes a party at the end of the 15-day period.
(2) If an answer in opposition to a timely motion to intervene is filed not later than 15 days after the motion to intervene is filed or, if the motion is not timely, the movant becomes a party only when the motion is expressly granted.
(d) *Grant of late intervention*. (1) In acting on any motion to intervene filed after the period prescribed under Rule 210, the decisional authority may consider whether:
(i) The movant had good cause for failing to file the motion within the time prescribed;
(ii) Any disruption of the proceeding might result from permitting intervention;
(iii) The movant's interest is not adequately represented by other parties in the proceeding;
(iv) Any prejudice to, or additional burdens upon, the existing parties might result from permitting the intervention; and
(v) The motion conforms to the requirements of paragraph (b) of this section.
(2) Except as otherwise ordered, a grant of an untimely motion to intervene must not be a basis for delaying or deferring any procedural schedule established prior to the grant of that motion.
(3)(i) The decisional authority may impose limitations on the participation of a late intervener to avoid delay and prejudice to the other participants.
(ii) Except as otherwise ordered, a late intervener must accept the record of the proceeding as the record was developed prior to the late intervention.
(4) If the presiding officer orally grants a motion for late intervention, the officer will promptly issue a written order confirming the oral order.

review.[13] For example, in the *AES Sparrows Point LNG* case, the Army Corps of Engineers was responsible for evaluating authorization under CWA § 404, as well as other permits relating to dredging; the EPA, U.S. FWS, and NOAA commented, and the Maryland Department of Environmental Protection was charged with reviewing the project under CWA § 401(a)(1).[14] If a project succeeds in securing all of the required state, local and federal permits to construct the pipeline, the last resort for those in opposition to the pipeline is often to challenge the FERC certification, alleging inadequacy of the environmental review. The best strategy is to have a comprehensive Environmental Assessment and Environmental Impact Statement, if required, that takes into account all environmental impacts, mitigation strategies, and possible alternatives. The FERC is given great deference, but only when it has had the opportunity to consider all aspects of the environmental impacts.

§ 24.03. The Environmental Assessment, the Draft Environmental Impact Statement and the Final Environmental Impact Statement.

[1] — The Environmental Assessment.

Frequently the subject of challenges in pipeline processes — natural gas and otherwise — are the final environmental impact statements (FEIS) issued by the FERC. Environmental Impact Statements (EIS) are required by NEPA before major federal actions that "significantly affect the quality of the human environment."[15] Agencies are required by NEPA to take a "hard look" at potential environmental impacts.[16] An agency may "preliminarily prepare an Environmental Assessment (EA) to determine whether the more

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13 AES Sparrows Point LNG v. Wilson, 589 F.3d 721, 724 (4th Cir. 2009) (considering Maryland Department of Environmental Protection's denial of a § 401(a)(1) permit in an application for an LNG marine import terminal and related pipeline).

14 *Id*.

15 *See Myersville*, 783 F.3d at 1322, citing 42 U.S.C. § 4332(C).

16 *See* 42 U.S.C. § 4332(2)(C), *see also Sierra Club*, 990 F. Supp.2d at 25.

rigorous EIS is required."[17] The EA is required to include a discussion of reasonable alternatives to the proposed action, meaning that the alternative must be technically and economically feasible and must meet the purpose and of the agency's directives, including the proposed action.[18] If the EA concludes that there is a "finding of no significant impact" (FONSI) on the human environment, then an EIS is not required, and the agency's NEPA documentation obligations are discharged.[19] NEPA obligations are "essentially procedural" and do not mandate a "particular substantive result."[20]

[2] — Consideration of Reasonable Alternatives.

Another aspect to the NEPA requirement that the FERC contemplate reasonable alternatives to the proposed action is the requests for alternate siting of projects.[21] As part of a project to expand service capacity in New York's southern border, Millennium Pipeline Company (Millennium) applied to the FERC for a certificate for its project to build a natural gas compressor station in the Town of Minisink, New York.[22] The Town of Minisink responded with hundreds of verbal and written comments to the FERC and the formation of the Minisink Residents for Environmental Preservation and Safety (MREPS).[23] During the FERC process, several residents urged an alternative site for the compressor station, with proponents advocating this less residentially dense area and the proximity to the existing Meter

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17 *Myersville*, 783 F.3d at 1323, *citing* 40 C.F.R. §§ 1501.4, 1508.9.

18 *Id*., *citing* Theodore Roosevelt Conservation P'ship v. Salazar, 661 F.3d 66, 72 (D.C. Cir. 2011); 43 C.F.R. § 46.420(b) (additional case citation omitted).

19 *Id*. at 1322, *citing* 40 C.F.R. §§ 1508.9(a)(1), 1508.13; 18 C.F.R. § 380.2(g).

20 *Id*., *quoting* Vermont Yankee Power Corp. v. NRDC, 435 U.S. 519, 558, 98 S. Ct. 1197, 55 L. Ed.2d 460 (1978) and *citing Theodore Roosevelt Conservation P'ship*, 661 F.3d at 66, 68.

21 Minisink Residents for Envtl. Pres. and Safety v. FERC, 762 F.3d 97, 102 (D.C. Cir. 2014).

22 *Id*.

23 *Id*. at 103.

Station.[24] The alternate site required replacement of a seven-mile segment of pipe, including crossing the Neversink River, which was not required at the Minisink location.[25] In response to the alternate site proponents, the FERC sent notice to landowners in the alternate site vicinity as well as to landowners along the Neversink River and solicited comments.[26]

The EA found the Minisink location environmentally preferable, "due principally to the negative environmental consequences that would flow from an upgrade of the Neversink segment," even though there were some positive aspects to the alternate site.[27] The EA found that the project would have no significant environmental impact as long as certain mitigation measures were implemented.[28] Predictably, this generated "a slew of comments," and the FERC voted to issue a certificate of public convenience and necessity to Millennium, undertaking "an extensive environmental analysis in its order, leaning heavily on the results of the EA."[29] In the end, the FERC adopted the EA, its mitigation measures, and its conclusion.[30] MREPS sought review of the FERC's Order.[31]

The court reviewed the record, much of it summarized *supra* and determined that the FERC had satisfied its obligation to consider logical alternatives to the Minisink location, noting the Order's recitation of the exploration, as well as the fact that the FERC went as far as to notify landowners who would be affected by the alternate site and solicit comment

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24 *Id*.
25 *Id*.
26 *Id*.
27 *Id*.
28 *Id*.
29 *Id*. at 103-104.
30 *Id*. at 104. The FERC's decision was not unanimous. Commissioners Wellinghoff and LaFleur voted against certification and would have selected the alternate site. *Id*. Commissioner Clark concurred, asserting that the FERC was not required to select the site with the fewest environmental impacts, as long as there were other acceptable sites. *Id*.
31 *Id*. at 105. In the meantime, the compressor station was completed and put into service. *Id*. This did not moot MREPS' challenge since the petitioners asserted ongoing harm to their aesthetic, health, and property interests. *Id*. at 106.

from them.[32] Interestingly, had Millennium intended, as petitioners asserted, to upgrade the pipeline along the Neversink River in the future regardless of the location of the compressor station, the FERC would have been required to consider this.[33] The saving grace seemed to be that the FERC had heard this argument and considered its merits during the process.[34]

[3] — Finding of No Significant Impact.

In order for a FONSI to withstand judicial scrutiny, the agency must have concluded that either there would be no significant impacts or that there are planned measures to mitigate environmental impacts.[35] The appellate review

is to ensure that "no arguably significant consequences have been ignored."[36] There are four areas of judicial inquiry: (1) has the agency "accurately identified the relevant environmental concern;" (2) has the agency "taken a hard look at the problem in preparing its EA;" (3) is the agency "able to make a convincing case for its finding of no significant impact;" and (4) has the agency "shown that even if there is an impact of true significance, and EIS is unnecessary because changes or safeguards in the project sufficiently reduce the impact to a minimum."[37] In both an EA and an EIS courts are to apply a "rule of reason" an agency's NEPA analysis and refuse to "flyspeck" the agencies findings in search of "any deficiency

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32 *Id*. at 107. The court observed that filing a supplemental notice in response to the proposal of an alternate site was a "relatively unusual" additional step by the FERC. *Id*.

33 *Id*. The court discussed this at some length even though the FERC had found that this potential upgrade was not sufficiently certain to be taken into account. This is a cautionary practice note, to be sure. *See also* City of Pittsburgh v. Federal Power Comm'n, 237 F.2d 741, 750-752 (D.C. Cir. 1956).

34 *Id*. at 109-110.

35 *Myersville,* 783 F.3d at 1322, *quoting* Michigan Gambling Opposition v. Kempthorne, 525 F.3d 23, 29 (D.C. Cir. 2008).

36 *Id*., *quoting* TOMAC v. Norton, 433 F.3d 852, 860 (D.C. Cir. 2006) (additional citation omitted).

37 *Id*., *quoting Michigan Gambling*, 525 F.3d at 29 (additional citation omitted).

no matter how minor."[38] The two environmental analyses are not created equal: an agency's consideration of alternatives for an EIS is more rigorous than an EA.[39]

[4] — The Draft Environmental Impact Statement and the Final Environmental Impact Statement.

If there is no FONSI, there are six steps in the FERC's environmental impact review process: (1) a notice of intent to prepare an impact statement, (2) a draft environmental impact statement (DEIS), (3) public hearings, (4) staff review and evaluation of the comments, (5) a final environmental impact statement (FEIS), and (6) FERC consideration of the final statement.[40]

The DEIS's adequacy can be a subject for appeal.[41] The standard of review for the DEIS is whether the description in the DEIS is sufficient to provide "a springboard for public comment."[42] The *National Committee for the New River* court considered the content of the comments to the DEIS, which were "sufficiently detailed and critical of particular deficiencies in the

38 *Id., quoting* Nevada v. Dep't of Energy, 457 F.3d 78, 93 (D.C. Cir. 2006); *Minisink Residents*, 762 F.3d at 112.

39 *Id.* at 1323, *citing cf* 40 C.F.R. § 1508.9(b) (requiring "brief discussion[ ]" of alternatives in an EA) with *id.* § 1502.14(a) (requiring agency to "[r]igorously explore and objectively evaluate all reasonable alternatives" when EIS required); *see also* Envtl. Prot. Info. Ctr. v. U.S. Forest Serv., 451 F.3d 1005, 1016 (9th Cir.2006) ("[A]n agency's obligation to consider alternatives under an EA is a lesser one than under an EIS") (internal quotation marks omitted); La. Crawfish Producers Ass'n–W. v. Rowan, 463 F.3d 352, 357 (5th Cir.2006) ("[T]he range of alternatives that the [agency] must consider decreases as the environmental impact of the proposed action becomes less and less substantial.") (second alteration in original) (internal quotation marks omitted*);* Mt. Lookout–Mt. Nebo Prop. Prot. Ass'n v. FERC, 143 F.3d 165, 172 (4th Cir.1998); Friends of Ompompanoosuc v. FERC, 968 F.2d 1549, 1558 (2d Cir.1992); Olmsted Citizens for a Better Community. v. U. S., 793 F.2d 201, 208 (8th Cir.1986); River Rd. Alliance, Inc. v. Corps of Engineers of U.S. Army, 764 F.2d 445, 452 (7th Cir.1985) (all citations and parentheticals in original).

40 National Committee for the New River v. FERC, 373 F.3d 1232, 1326 (D.C. Cir. 2004).

41 *See e.g., National Comm.*, 373 F.3d at 1328.

42 *Id.* (finding that any deficiencies in the DEIS were ultimately cured by the FEIS) quoting Robertson v. Methow Valley Citizens Council, 490 U.S. 332, 349-350, 109 S.Ct. 1835, 104 L.Ed.2d 351 (1989) (quotes in original).

DEIS," the source of the comments, which included both local organizations and federal agencies, and the ability of the FERC to respond to the deficiencies in the DEIS in the FEIS.[43] Notably, the addressed deficiencies did not make the DEIS deficient because the submissions criticizing the DEIS fulfilled its purpose of eliciting comment and suggestion.[44] The court quoted *Robertson's* explanation of NEPA's "action forcing" purpose and the EIS's role: an EIS serves "in two important respects. . . . [i]t ensures that the agency, in reaching its decision, will have available, and will carefully consider, detailed information concerning significant environmental impacts; it also guarantees that the relevant information will be made available to the larger audience that may also play a role in both the decision making process and the implementation of that decision."[45] Importantly, this leaves open the possibility that DEIS deficiencies could create circumstances of actual prejudice if the omission left the affected public without information about a proposed project and subsequently left the FERC without public or agency comment on a material environmental aspect of the project.[46] This type of deficiency may not be curable by the FEIS.[47]

Also relevant when considering challenges to a FEIS, NEPA does not require that a complete plan be formulated at the beginning of the process, "but only that proper procedures be followed for ensuring that environmental consequences have been fairly evaluated."[48] Both the FERC and courts have recognized that in large, complicated projects involving considerable preparation, segments of such projects may proceed at different speeds.[49] The

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43 *Id*.

44 *Id*. at 1329.

45 *Id*. at 1328, quoting *Robertson*, 490 U.S. at 349 (omitting internal citations).

46 *Id*. at 1329.

47 *Id*.

48 *Id*. citing *Robertson*, 490 U.S. at 352.

49 *Id*. The *New River* court specifically noted that landowners denying survey and environmental assessment access could slow down segments, and that this was not a tactic that could arrest progress on other aspects or segments of the project. Since in the author's experience, such denials for land entry are often encouraged by environmental groups opposed to the pipeline, this is a key recognition by the FERC and the courts.

solution in the *New River* case was that gaps in the DEIS, such as proposals for major river crossings considered to be environmentally sensitive, were remedied first, by recognition of the gaps in the DEIS, and second, by including "conditions to address those gaps before construction and operation could proceed" in the FEIS.[50]

Another potential trap is DEIS supplementation. Generally speaking, an agency is not required to supplement an EIS every time new information is received after the EIS is finalized.[51] The analysis is one of the "rule of reason" that requires a supplemental EIS "if the new information shows that the remaining action will affect the quality of the environment 'in a significant manner or to a significant extent not already considered.[52] If new information would likely generate comments from previously uninterested parties, however, it is likely to become relevant in a challenge.[53]

[a] — Segmentation.

In fairness, the Tennessee Gas Pipeline did not battle to be in the D.C. Circuit on this issue, as it did in a case discussed *infra*. While it was at war with the PADEP after the Delaware Riverkeepers challenged its permits in Pennsylvania, the Delaware Riverkeepers simultaneously petitioned the FERC for a rehearing of its Order granting certification for the pipeline project discussed *infra*, and when this was denied, filed a petition for review,

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50 *Id*. Later in the opinion, the *New River* court specified that the FEIS responded to new information provided in the process subsequent to the DEIS and included proposed conditions responsive to that information that were ultimately adopted by the FERC. *Id*. at 1331.

51 *Id*. at 1330, citing Marsh v. Oregon Nat'l Resources Council, 490 U.S. 360 (1989) at 373.

52 *Id*., quoting *Marsh,* 490 U.S. at 274. The *New River* court phrases the test slightly differently, requiring a new EIS where new information 'provides a seriously different picture of the environmental landscape.' Quoting Olmsted Falls v. FAA, 292 F.3d 261, 274 (D.C. Cir. 2002). Even more helpful is the application of the arbitrary or capricious standard of review and the accompanying deference to the agency to decisions by the FERC that the DEIS supplementation is not required. *Id*., citing *Marsh*, 490 U.S. at 375-76.

53 *See e.g., infra, Minisink Residents*, 762 F.3d at 97, 102.

but on entirely separate grounds from the ones asserted in Pennsylvania: the Delaware Riverkeepers Network asserted that the FERC impermissibly segmented review of the pipeline project and failed to consider cumulative impacts.[54]

The NEPA-mandated environmental impact analysis includes direct, indirect, and cumulative effects.[55] The standard of review under NEPA is the deferential review of agency actions "to ensure that the agency has adequately considered and disclosed the environmental impact of its actions and that its decision is not arbitrary or capricious."[56] Reasoned decisionmaking is required — not conclusory statements of "no impact."[57]

Impermissible segmentation of a NEPA review occurs when an agency "divides connected, cumulative, or similar federal actions into separate projects and thereby fails to address the true scope and impact of the activities that should be under consideration."[58] Actions or projects that will have "cumulative or synergistic environmental impact upon a region" that are "pending concurrently before an agency" must be comprehensively considered.[59] Briefly summarized, there are three types of actions in considering the scope of EIS: (1) actions that may be connected, meaning closely related and including actions that are interdependent parts of a larger

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54 Delaware Riverkeepers Network v. FERC, 753 F.3d 1304, 1312 (D.C. Cir. 2014).

55 *Fuel Safe Washington*, 389 F.3d at 1327, citing 42 U.S.C. § 4332(2)(C)(i) (NEPA) and 40 C.F.R. § 1508.8.

56 *Delaware Riverkeepers,* 753 F.3d at 1312-1313, *quoting* Baltimore Gas & Elec. Co. v. NRDC, 462 U.S. 87, 97-98, 103 S.Ct. 2246, 76 L.Ed.2d 437 (1983) (internal quotes omitted); and *citing* Nat'l Comm. for the New River, Inc. v. FERC, 373 F.3d 1323, 1327 (D.C. Cir. 2004); *see also Myersville*, 783 F.3d at 1326-1327 (finding that the Cove Point LNG facility was not a connected action to Dominion's Allegheny Storage Project since they are unrelated and neither depended on the other for justification).

57 *Id*. at 1313, *citing* Found. On Econ. Trends v. Heckler, 756 F.2d 143, 154 (D.C. Cir. 1985); and *quoting* Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto Ins., 463 U.S. 29, 43and 52, 103 S.Ct. 2856, 77 L.Ed.2d 443 (1983).

58 *Id*.

59 *Id*., *quoting* Kleppe v. Sierra Club, 427 U.S. 390, 410, 96 S. Ct. 2718, 49 L.Ed.2d 576 (1976) (internal quotes omitted).

action and depend on the larger action for their justification; (2) cumulative actions that when viewed with other proposed actions have cumulatively significant impacts; and (3) similar actions that, when viewed with other reasonably foreseeable or proposed agency actions, "have similarities that provide a basis for evaluating their environmental consequences together, such as common timing or geography."[60] The justification against segmentation is to prevent agencies from finding insignificant environmental impact by chopping up a project into "multiple individual actions."[61]

The 40-mile pipeline project that was the subject of *Tennessee Gas Pipeline Co. LLC v. Delaware Riverkeepers Network* was actually an upgrade of a much longer natural gas pipeline, the 300 Line, for which Tennessee Gas Pipeline had submitted four separate project proposals — each reviewed separately by the FERC — totaling 200 miles of continuous pipeline, each approved and constructed in rapid succession from 2010 to 2013.[62] The legal kerfluffle began when the FERC recommended a FONSI for the Northeast Project after the agency completed the EA, "even though the applications for the second and fourth upgrade projects were pending before the FERC" at the time.[63] As an initial matter, the four projects had "a clear physical, functional, and temporal nexus" between them, described as "self-evident interrelatedness."[64] Since the FERC did not consider the other segments of

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60 *Id*. at 1313-1314, *quoting* 40 C.F.R. § 1508.25.

61 *Id*. at 1314, *quoting* NRDC v. Hodel, 865 F.2d 288, 287 (D.C. Cir. 1988) (internal quotes omitted).

62 *Id*. at 1307-1308. The Western Leg of the project resulted in parallel lines; the Eastern project consisted of parallel lines and renovations to compression and monitoring infrastructure; the Northeast project was five new segments of pipe, as well as modification to existing compression and metering infrastructure.

63 *Id*. at 1308. The Northeast Project belongs to our friends from the *Tennessee Gas Pipeline Co. LLC* case, *see infra*.

64 *Id*. Other observations made by the court include: there are no linear offshoots to the Eastern Leg; the gas enters the system at one end and exits at a terminus after passing through new pipe sections and improved compressor stations; the upgrade projects were completed in the same general timeframe; FERC was aware of the interconnectedness of the project during the environmental review of the Northeast Project. *Id*. at 1308-1309.

the overall projects, the court found the EA deficient in "its failure to include any meaningful analysis of the cumulative impacts of the upgrade projects."[65] Because the FERC violated NEPA, the entire pipeline project was remanded back to the FERC for further consideration.[66]

[b] — Standing.

Just when proposed pipelines appear destined to spend years in court being challenged by environmental opponents, the courts remind parties that Article III still applies. As an initial matter, a petitioner must have standing, even if the petitioner has been involved in the FERC proceeding.[67]

Constitutional standing has three elements: (1) petitioner must have suffered an "injury in fact;" (2) the injury must be "fairly traceable to the challenged action of the defendant;" and (3) the injury must be redressable by a favorable judicial decision.[68] The "conjectural or hypothetical" injury does not satisfy Article III.[69] In the *No Gas Pipeline* case, there was no

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65 *Id*. at 1320. The Council on Environmental Quality defines "cumulative impacts" as "the impact on the environment which results from the incremental impact of the action when added to other past, present, and reasonably foreseeable future actions regardless of what agency (Federal or non-Federal) or person undertakes such other actions. Cumulative impacts can result from individually minor but collectively significant actions taking place over a period of time." *Id*. at 1319, *quoting* 40 C.F.R. § 1508.7. Meaningful cumulative impact analysis must identify "(1) the area in which the effects of the proposed project will be felt; (2) the impacts that are expected in that area from the proposed project; (3) other actions—past, present, and proposed, and reasonably foreseeable—that have had or are expected to have impacts in the same area; (4) the impacts or expected impacts from these other actions; and (5) the overall impact that can be expected if the individual impacts are allowed to accumulate." *Id*., *quoting* Grand Canyon Trust v. FAA, 290 F.3d 339, 345 (D.C.Cir.2002) (internal quotes omitted). The court determined that the "three. . . upgrade projects preceding and following the Northeast Project were clearly 'other actions — past, present, and proposed, and reasonably foreseeable.'" *Id*., *quoting Grand Canyon Trust* at 345.

66 *Id*.

67 No Gas Pipeline v. FERC, 756 F.3d 764, 767 (D.C. Cir. 2014).

68 *Id*., citing Lujan v. Defenders of Wildlife, 504 U.S. 555, 560-561, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992) (quotations in original).

69 Occidental Permian Ltd. v. FERC, 673 F.3d 1024, 1026 (D.C. Cir. 2012), *quoting Lujan*, 504 U.S. at 560. The takeaway from *Occidental Permian Ltd*. is that the hypothesized injury does not confer standing if that injury relates to events or actions performed by a third party

standing for petitioners claiming injury in the form of "certainty that radon levels in the residences will increase once gas from [Marcellus shale] sources that have higher radon levels. . . then currently supplied gas begins to flow through [the proposed] pipelines into their homes."[70] The court characterized these injuries as those that "have neither occurred nor become imminent."[71]

In the *Myersville Citizens for a Rural Community, Inc*. the FERC conditioned its certificate to Dominion for its proposed expansion of natural gas facilities in the northeastern U.S., including the compressor station at issue, on receipt of appropriate permits under the Clean Air Act, and this was attacked as a violation of the either the NGA or the portions of the Clean Air Act within the NGA's savings clause.[72] Dominion, who intervened in the proceeding against the FERC challenging its certificate, asserted that the Myersville Citizens group lacked standing to argue that the FERC had violated the NGA's savings clause, arguing that the Myersville Citizens group lack "prudential standing" to challenge the FERC certificate as they are outside of the zone of interest of the NGA.[73] The FERC's interpretation of its authority to grant a certificate of public convenience and necessity is judicially reviewed by application of the two-step, agency deferential, *Chevron* analysis: (1) has Congress spoken directly to the issue, and if not, (2) is the agency's interpretation based on permissible construction of the statute.[74] The court upheld the FERC, but determined that Dominion had it wrong — the Myersville Citizens group did have standing.[75]

The "zone of interest" test is a simple determination, "using traditional tools of statutory interpretation, whether a legislatively conferred cause of

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in reaction to the project permitted by the FERC or if that injury is based on speculation regarding what the FERC might do with rates in the future. *Id*. at 1026-1027.

70 *No Gas Pipeline*, 756 F.3d at 767 (emphasis omitted).

71 *Id*. at 768.

72 *Myersville Citizens*, 783 F.3d at 1315.

73 *Id*. at 1315-1316.

74 *Id*. at 1315, *citing* Chevron U.S.A. Inc. v. NRDC, 467 U.S. 837, 842-843, 104 S. Ct. 2778, 81 L. Ed.2d 694 (1984); Okla. Natural Gas Co. v. FERC, 28 F.3d 1281, 1283–84 (D.C. Cir. 1994); N. Natural Gas Co. v. FERC, 827 F.2d 779, 784 (D.C. Cir. 1987).

75 *Id*.

action encompasses a particular plaintiff's claim."[76] In other words, does the plaintiff's claim come within the "zone of interests protected by the law invoked."[77] As the terminology used implies, this is a lenient test utilizing a general presumption "that a statutory cause of action is limited to plaintiff's whose injuries are proximately caused by violations of the statute."[78] The Myersville Citizens group's claims that the FERC certificate and CAA permit caused environmental injuries to them as residents near the compression station, including noise and air pollution, was sufficient to confer standing under the NGA and the CAA.[79] Dominion's was a valiant effort, but keeping environmental intervenors from taking a shot at a certification and issued permits is an uphill climb. Fortunately, Dominion's case has a happy ending.[80]

[5] — Deference to the FERC and Its Process.

There is some judicial comfort in defending FERC certificates. In describing the attempts of environmental groups, aligned with fuel oil dealers, protesting a natural gas pipeline, the D.C. Court of Appeals paid closer attention to the facts in the record than to the accusations made by this coalition, noting that "[t]he Coalition cannot, by sheer multiplication of innuendo, overcome the strong presumption of agency regularity. . . . [d]

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76 *Id*., quoting Lexmark Int'l, Inc. v. Static Control Components, Inc., __ U.S. __, 134 S. Ct. 1377, 1387, 188 L.Ed.2d 392 (2014) (internal quotes omitted).

77 *Id*., *quoting Lexmark*, 134 S. Ct. at 1388 (internal quotes omitted).

78 *Id*., *quoting Lexmark*, 134 S. Ct. at 1390 (internal quotes omitted). Indeed, a "would-be plaintiff is outside the statute's 'zone of interests' only if the plaintiff's interests are so marginally related to or inconsistent with the purposes implicit in the statute that it cannot reasonably be assumed that Congress intended to permit the suit." *Id*. at 1316, *quoting* Match–E–Be–Nash–She–Wish Band of Pottawatomi Indians v. Patchak,132 S. Ct. 2199, 2210, 183 L. Ed.2d 211 (2012) *(quoting* Clarke v. Securities Indus. Ass'n, 479 U.S. 388, 399, 107 S. Ct. 750, 93 L. Ed.2d 757 (1987)) (internal quotes omitted).

79 *Id*. at 1317. The court also dismissed Dominion's argument that the Myersville Citizens group lacked Article III standing because the injuries were only procedural and not concrete. *Id*. In fact, the court found that the alleged injuries — depressed property values around the compressor, increased noise and air pollution, visual blight, and heightened safety risks — were concrete, stemmed from the allegedly unlawful certificate, and was redressable through judicial review. *Id*.

80 The Myersville Citizens group's petition for review of the FERC's order was denied. *Id*. at 1327 and discussed in more detail, *supra*.

espite all their sound and fury, the attacks of the Coalition ultimately prove impotent."[81] The coalition's challenge to the certification included a laundry list of allegations from improper *ex parte* communications to due process violations, which were picked apart easily by the court.[82] Of perhaps more interest to gas companies and legal practitioners is the discussion of what constitutes the "substantial evidence" test under the NGA.[83] The statement of the test is that the evidence relied upon by the FERC "must be substantial in light of the whole record."[84] There is a corollary that fits the description of the FERC's role as previously discussed: "interested parties must have an opportunity 'to introduce adverse evidence and criticize evidence introduced by others.'"[85] Again, the court reviewed the record, the criticisms leveled by the coalition at the project and its data, and the totality of the proceedings in determining that the evidence was substantial and that there was ample opportunity to present evidence and criticism.[86]

[6] — Scope of Appeal — Or Why You Have to Raise Everything Every Time.

One reason why proceedings in front of the FERC are so vigorous and why obtaining a Certificate of Public Convenience and Necessity is not the end of the saga, is because of § 19(b) of the NGA.[87] No objection to the FERC's issuance of a certificate shall be considered by the appellate court

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81 Louisiana Ass'n of Indep. Producers and Royalty Owners v. FERC, 958 F.2d 1101, 1111 (D.C. Cir. 1992) (*per curiam*), *citing e.g.,* Withrow v. Larkin, 421 U.S. 35, 55, 95 S.Ct. 1456, 43 L.Ed.2d 712 (1975); United States v. Morgan, 313 U.S. 409, 421, 61 S.Ct. 999, 85 L.Ed.2d 1429 (1941).

82 *See id*. at 1113 and 1115.

83 *Id*. at 1115.

84 *Id*., *citing* Universal Camera Corp. v. NLRB, 340 U.S. 474, 488, 71 S.Ct. 456, 464, 95 L.Ed. 456 (1951); Association of Data Processing Serv. Orgs. v. Board of Governors of the Fed. Reserve Sys., 745 F.2d 677, 681-86 (D.C. Cir. 1984).

85 *Id., quoting* Mobil Oil Corp. v. FPC, 483 F.2d 1238, 1258 (D.C.Cir.1973) (emphasis omitted)*; see also* Wisconsin Gas Co. v. FERC, 770 F.2d 1144, 1167-68 & n. 38 (D.C.Cir.1985) (limiting Mobil Oil on other grounds)*, cert. denied,* 476 U.S. 1114, 106 S.Ct. 1968, 90 L.Ed.2d 653 (1986).

86 *Id*. at 1117.

87 15 U.S.C. §717r(b).

"unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do.[88] In other words, a party — like an intervenor — must "exhaust its administrative remedies before seeking judicial review."[89] The courts have fleshed out the legal concept of "exhaustion": a prerequisite to judicial review is the presentation of a ground for objection in an application for rehearing in front of the Commission.[90] This exhaustion policy applies to procedural matters as well as substantive matters.[91] More particularly in *Fuel Safe Washington*, this applied to challenges to the scope of the FERC's regulatory authority.[92] The issue in *Fuel Safe Washington* seemed at first blush to be

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88 *Id.*

89 *Fuel Safe Washington*, 389 F.3d 1313, 1320 (10th Cir. 2004), *quoting* Fed. Power Comm'n v. Colo. Interstate Gas Co., 348 U.S. 492, 499, 75 S. Ct. 467, 99 L. Ed. 583 (1955).

90 *Id.*

91 *Id.* at 1320-1321, citing, *e.g.*, R.R. Comm'n v. FERC, 874 F.2d 1338, 1342 (10th Cir.1989) (refusing to consider an objection to expert witnesses because not raised in petition for rehearing before FERC); Phillips Petroleum Co. v. Fed. Power Comm'n, 556 F.2d 466, 471 (10th Cir.1977) (refusing to consider whether a contract was renewed for purposes of obtaining a new rate because the issue was not raised in the petition for rehearing before FERC); Skelly Oil Co. v. Fed. Power Comm'n, 401 F.2d 726, 729 (10th Cir. 1968) (refusing to consider arguments by amicus because "not raised by any party on an application for rehearing as required by § 19(b) of the Act"); Pan Am. Petroleum Corp., 268 F.2d at 829–30 (refusing to consider challenge to an order which was not challenged in a petition for rehearing). Other courts have similarly applied § 19(b). *See, e.g.*, Nat'l Comm. for the New River, Inc. v. FERC, 373 F.3d 1323, 1332 (D.C. Cir. 2004) (refusing to consider whether Commission adequately considered alternatives because not raised in petition for rehearing); Consol. Gas Supply Corp. v. FERC, 611 F.2d 951, 959 (4th Cir. 1979) (noting that "this rule [of exhaustion of administrative remedies] is particularly applicable when, as here, the objections are procedural and, if sound, subject to correction").

92 *Id.* at 1321-1322, citing Sunray Mid–Continent Oil Co. v. Fed. Power Comm'n, 364 U.S. 137, 156–57, 80 S. Ct. 1392, 4 L. Ed.2d 1623 (1960) (applying § 19(b)'s requirement that all issues submitted for judicial review must be raised before the Commission to refuse to address an argument that the Commission's order might violate the Natural Gas Act and thereby impermissibly extend its regulatory jurisdiction); Intermountain Municipal Gas Agency v. FERC, 326 F.3d 1281, 1285 (D.C. Cir. 2003) (refusing to address, because not raised in the petition for rehearing, petitioner's challenge to "FERC's interpretation of the Hinshaw Amendment to preclude exempting [from FERC regulation] a system which delivers gas that is subsequently transported temporarily out of state but returned for ultimate consumption within the state of delivery");4 Aquenergy Sys., Inc. v. FERC, 857 F.2d 227, 230 (4th Cir.1988) (expressly responding to petitioner's argument that "the Commission lacks

straightforward. The pipeline at issue did not transport gas in interstate commerce and the FERC has plenary jurisdiction over the transportation of natural gas in interstate commerce.[93] Further, Whatcom County — but not the petitioners — had raised the exact issue in a motion to dismiss the application.[94] There is no bootstrapping an argument before an appellate court, even if another party argued the precise issue in front of the FERC.[95]

[7] — Obtaining Permits Within the FERC Regulatory Framework.

The NGA does have pre-emption assistance for pipeline projects seeking to thwart environmental legal and process protests — or at the least, gain certainty in the regulatory system — for environmental and related permits.[96] There are three exceptions to the FERC certificate pre-emption under the NGA: the Clean Water Act (CWA); the Clean Air Act (CAA); and the Coastal Zone Management Act (CZMA). All three of these regulatory programs are at the intersection of state and federal environmental protection, and therefore all three have been the subject of challenges to natural gas projects. What is at

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jurisdiction because operation of the project does not affect interstate commerce" and stating "[w]e decline to consider this contention because it was not presented to the Commission" and "[w]e will not consider a contention not presented to, or considered by, the Commission"). *Cf*. City of Farmington v. FERC, 820 F.2d 1308, 1311 n. 1 (D.C. Cir. 1987) (in rejecting FERC's argument that the court lacked jurisdiction to hear petitioner's challenge to FERC's decision that petitioner's gas purchases were subject to FERC's regulatory jurisdiction, the court did not rely upon the rule that subject matter jurisdiction may be raised at any time).

93 *Id*. at 1319.

94 *Id*. at 1322.

95 *Id*., *citing inter alia*, Process Consumers Group v. FERC, 912 F.2d 511, 514 (D.C. Cir. 1990) ("[T]he party seeking review must raise its objections in its own application for rehearing to the Commission."); Columbia Gas Transmission Corp. v. FERC, 848 F.2d 250, 255 (D.C. Cir. 1988). (stating that a court cannot "consider an objection not raised by petitioner but argued to FERC by another party to the same proceeding").

96 *See* Tennessee Gas Pipeline Co. LLC v. Delaware Riverkeeper Network, 921 F. Supp. 2d 381 (M.D. Pa. 2013). Although this case is discussed for its analysis of the interplay between the FERC certification and CWA § 401 permits, this case is only the beginning of the story. The Delaware Riverkeepers, once in the proper court, successfully challenged the environmental assessment for improper segmentation of the project, Delaware Riverkeeper Network v. FERC, 753 F.3d 1304 (D.C. Cir. 2014), a case discussed *supra*.

stake is the right to appeal directly to federal appellate court pursuant to the Energy Policy Act of 2005 (EPACT).[97] The EPACT amended section 19 of the NGA, providing natural gas companies with a "cause of action in federal court to challenge an agency's order, action or failure to act with respect to permits necessary for the construction or operation of natural gas projects.[98] While there is limited legislative history, the congressional indication — and judicial interpretation — regarding the purpose of the EPACT is that it was designed to address situations in which applicants "were encountering difficulty proceeding with natural gas projects that depended on obtaining state agency permits."[99] Under the guidance of 15 U.S.C. § 717r(d), if the court finds that an agency's order or action (1) " is inconsistent with the federal law governing the permit, and (2) would prevent the construction, expansion, or operation of the proposed natural gas facility," then the court remands the proceeding to the agency "to take appropriate action consistent

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97 *See* Islander East Pipeline Co., LLC v. Connecticut Dept. of Environ'l Protection, 482 F.3d 79, 85 (2d Cir. 2006) ("*Islander I*").

98 *Id*.; Islander East Pipeline Co., LLC v. McCarthy, 525 F.3d 141, 149 (2d Cir. 2008) ("*Islander II*") (EPACT affords "original and exclusive jurisdiction over any civil action for the review of an order or action of a Federal agency. . . or State administrative agency acting pursuant to Federal law to issue, condition, or deny any permit, license, concurrence, or approval. . . required under Federal law for the construction of a natural gas facility") (*quoting* 15 U.S.C. § 717r(d)(1)) (internal quotes omitted); *Tennessee Gas Pipeline*, 921 F. Supp. 2d at 391 ("the extremely limited legislative history of Section 717r also supports finding that Congress intended to cut out all review after the original agency made its permitting decision").

99 *Islander I*, 482 F.3d at 85, *referencing* Reg'l Energy Reliability & Sec.: DOE Auth. to Energize the Cross Sound Cable: Hearing Before the H. Subcomm. on Energy & Air Quality, 108th Cong. 8 (2004) (statement of Rep. Barton) (discussing an earlier version of the EPACT, and explaining that "the comprehensive energy bill requires States to make a decision one way or another, and removes the appeal of that decision to Federal court," which "will help get projects, like the Islander East natural gas pipeline, constructed"); Natural Gas Symposium: Symposium Before the S. Comm. on Energy & Natural Res., 109th Cong. 41 (2005) (statement of Mark Robinson, Director, Office of Energy Projects, FERC) (observing that, prior to the enactment of the EPACT, NGA applicants were subject to "a series of sequential administrative and State court and Federal court appeals that [could] kill a project with a death by a thousand cuts just in terms of the time frames associated with going through all those appeal processes") (alterations and quotes in original parentheticals).

with the order of the [c]ourt."[100] Further, the EPACT provides for expedited review of the agency's order, action, or failure to act.[101]

[a] — Clean Water Act.

A sister case to our segmentation example delves into the NGA preemption, applying it to the CWA.[102] The *Tennessee Gas Pipeline* court had for consideration a motion seeking emergency preliminary injunction seeking to preempt the Pennsylvania Environmental Hearing Board (EHB) from reviewing permits issued by the Pennsylvania Department of Environmental Protection (PADEP) as required by a FERC order.[103] FERC granted the Tennessee Gas Pipeline Co. a Certificate of Public Convenience and Necessity to install and operate pipeline and compression facilities in Pennsylvania and New Jersey.[104] The certificate required compliance with the environmental mitigation measures contained in the EA, which, in turn, required compliance with applicable state federal, state, and local laws and

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100 *Id.*, *quoting* 15 U.S.C. § 717r(d)(3) (quotes in original).

101 15 U.S.C. § 717r(d)(5); *see also Islander I*, 482 F.3d at 85. Interestingly, *Islander I* applied the brand new EPACT (indeed *Islander's* petition for review was filed on the day that this NGA amendment was signed into law) review standards and remanded the Connecticut Department of Environmental Protection's (CTDEP) denial of the pipeline's water quality certification back to the agency, finding the denial "arbitrary and capricious. The ruling also required the CTDEP "to conduct the type of review contemplated by federal law, within seventy-five days of issuance of this opinion, or if the CTDEP is unwilling or unable to do so, to abdicate its authority to issue a WQC in this case." *Islander 1*, 482 F.3d at 105. The Islander East Pipeline Co.'s celebration would have been short lived: when the matter reappeared on the Second Circuit's docket after CTDEP again denied Islander's attempt to secure a water quality certification, the Court found that the subsequent denial, based on the record, was not "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" and denied Islander's petition for review. *Islander II*, 525 F.3d at 164. For the legal geeks out there, Judge Restani wrote *Islander I* and dissented in *Islander II*. She was not persuaded, it seems, that inclusion of "voluminous information" in a record cures other inadequacies, such as erroneous information and an agency's failure to fully explain its decision. *Islander II* at 170 (Restani, J. dissenting).

102 *Tennessee Gas Pipeline*, 921 F. Supp. 2d at 385 (noting in n. 7 that the EHB opined that this situation was a carve out within an occupied field where "federal regulation may tolerate or authorize exercises of state authority").

103 *Id*. at 383.

104 *Id*. at 384.

the receipt of certain state law permits.[105] The court noted that the FERC addressed criticisms of the EA in the final order, including the Sierra Club's assertion that violation of Pennsylvania's Clean Streams Act "was a near certainty."[106] The environmental groups then filed a Request for Rehearing and requested a stay of the order, which the FERC denied.[107] In the meantime, Tennessee Gas Pipeline obtained three permits from the PADEP, which ultimately were characterized as CWA § 401 permits.[108] As the FERC issued a Notice to Proceed, the Delaware Riverkeeper Network challenged the PADEP permits, and the EHB promptly scheduled a hearing.[109]

Generally speaking, the NGA carves out an exception for the CWA: "[e]xcept as specifically provided in this chapter, nothing in this chapter affects the rights of States under the Federal Water Pollution Control Act [the Clean Water Act] (33 U.S.C. § 1251, *et seq*.)."[110] The interplay with § 401 is the requirement that any applicant for a federal permit for an activity that "may result in any discharge into navigable waters, shall provide the licensing or permitting agency a certification from the State in which the discharge originates or will originate."[111] The judicial verdict? Congress wholly preempted natural gas regulation, but did not supersede any other federal statutory requirements, such as § 401.[112] In other words, the NGA preempts state and local permits, but not state authorizations mandated by federal law.[113] Interestingly, the CWA inhabits a unique space, being "notable in effecting a federal-state partnership to ensure water quality. . . around

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105 *Id*. at 383-384.

106 *Id*. at 384.

107 *Id*.

108 *Id*. at 384 and 387. The permits were one, Erosion and Sediment Control General Permit (ESCGP–1) under 25 Pa. Code Ch. 102, and two, Water Obstruction & Encroachment Permits under 25 Pa. Code Ch. 105.

109 *Id*. at 385.

110 *Id*. at 386 (alterations in original).

111 *Id*., *citing* 33 U.S.C. § 1341(a)(1) (internal quotes omitted).

112 *Id*., *quoting Islander I*, 482 F.3d at 90 *(citing Schneidewind,* 485 U.S. at 300–01, 108 S. Ct. 1145) (other internal citations omitted in original).

113 *Id*.

the country, so that state standards approved by the federal government become federal standard for that state.[114] Resolution of the *Tennessee Gas Pipeline* issue required an analysis of the intersection between the NGA and the CWA.[115]

In a nutshell, the PADEP and the Delaware Riverkeepers Network argued that the permits at issue were pursuant to state law and not recognized under § 401 as a delegated federal program or a program solely derived from federal law, but rather, fell under § 401(d) that allows states to ensure that federal permits meet state water quality standards after a site specific environmental review.[116] Thus, these permits were not issued under § 402 (NPDES) or under § 404 (dredge and fill), which are federally delegated permitting functions.[117] The court took a deeper dive into the nature of the permits, observing that both water permits stated that the issuance of the permit also constituted "approval of a Water Quality Certification under Section 401 of the Federal Water Pollution Control Act" and concluding that, while the permits may

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114 *Id., quoting Islander II*, 525 F.3d at 143 (internal quotes omitted).

115 *Id*.

116 *Id*. at 387 (internal quotes omitted).

117 *Id*. This argument is quite fascinating, as it appears to be an attempt to distinguish PADEP permitting from the CTDEP permitting, discussed in the *Islander I* and *II* cases. The first case to argue that EPACT did not apply was *Islander I,* in which the petition for expedited review of CTDEP's refusal to issue a WQC was filed the same day that the new law was signed. *Islander I*, 482 F.3d at 88. The CTDEP asserted that the court had no jurisdiction over the matter, citing the 11th Amendment, the 10th Amendment and retroactivity. *Id*. Now, for the interesting part: CTDEP did "not dispute that by accepting a role as deputized regulator under the CWA, a state agrees to waive its immunity from suit under section 19(d) of the NGA." *Id*. at 90. Instead, CTDEP argued that it "did not knowingly agree that its participation in the NGA and CWA regulatory scheme would be conditioned upon accepting federal jurisdiction over its decisions made pursuant to that scheme" — an argument too clever by half and easily disposed of with the conclusion that "by going forward with its federally deputized role even after the EPACT's enactment, Connecticut has now knowingly waived its immunity from section 19(d) suit in order to receive the benefits of participating in the NGA and CWA regulatory scheme." *Id*. (citations omitted). The court was also conscious of Connecticut's decision to continue to actively litigate the permit denials in the state arena after it became aware of the federal exercise of jurisdiction and of its election "not to abdicate its deputized authority back to the federal government." *Id*. Presumably, there was no real danger of Connecticut opting out of the NGA and CWA regulatory scheme, and since *Islander II* upheld CTDEP's denial, the argument seems a bit petulant in retrospect.

have been issued using state substantive standards, they were labeled as CWA certifications.[118] The third permit, referenced in both of the water permits, was an erosion and sediment control plan, which PADEP claimed was not a WQC and therefore, not reviewable in federal court under the NGA.[119] At oral argument, however, PADEP was hoisted on its own petard when counsel argued that it was "beyond dispute" that the erosion and sediment control plan was related to the water permits and that the PADEP "issued these permits together for a reason and they all represent our protection of water quality standards."[120] The court readily agreed that the permits were so interrelated that the NGA preempted all of them, concluding that review was only appropriate in federal appellate court and noting for good measure that this would avoid "conflicting outcomes" and "cumbersome" separate judicial reviews.[121]

Not unlike the *Islander I* and *Islander II* cases, all is not necessarily well for the petitioner once the petitioner has battled its way into federal appellate court. The next chapter in the Tennessee Gas Pipeline Co. saga was the Delaware Riverkeepers Network's challenge to the sufficiency of the FERC's NEPA review — also known as our previous segue into the realm of segmentation.[122]

[b] — The Clean Air Act.

The NGA savings clause also preserves the Clean Air Act (CAA), an exercise in cooperative federalism.[123] Securing an air quality permit is often required in large projects, at a minimum, for compressor stations. Maryland,

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118 *Id*. (quoting the permits at issue, which were contained in the record) (internal quotes omitted).

119 *Id*.

120 *Id*. (internal quotes and additional reference to the permits being tied together in a "very steadfast way" omitted).

121 *Id*. at 387-388.

122 *Delaware Riverkeeper Network*, 753 F.3d 1304, 1308 (D.C. Cir. 2014) as discussed *supra*.

123 42 U.S.C. § 7401 *et seq*.; *see also Myersville*, 783 F.3d at 1317-1318, *quoting* Dominion Transmission, Inc. v. Summers, 723 F.3d 238, 240 (D.C. Cir. 2013).

the state to which Dominion Transmission, Inc. (Dominion) had to apply for the Clean Air Permit had submitted its state implementation plan (SIP) for the EPA's air quality standards.[124] Maryland's SIP was approved by the EPA and incorporated by reference in the Code of Federal Regulations, including the provision that "governs permits to construct emissions sources such as the Myersville compressor station."[125] Dominion provides interested practitioners and legal scholars an opportunity to examine how the CAA works in the procedural — and appellate — scheme of the NGA.[126]

Dominion sought to construct a natural gas compressor in Myersville, Maryland as part of a larger project of constructing infrastructure and facilities in Ohio, West Virginia, Pennsylvania, and Maryland to increase capacity.[127] After application to the FERC for its certificate of public convenience and necessity, Dominion applied to the Maryland Department of the Environment (MDE) for an air quality permit to address the pollutants emitted by its proposed compressor.[128] In order to receive this permit, the MDE requires that an applicant submit documentation demonstrating: (1) "that the [proposed source] has been approved by the local jurisdiction for all zoning and land use requirements;" or (2) "that the source meets all applicable zoning and land use requirements."[129] The MDE notified Dominion that it had failed to meet these requirements.[130] Dominion responded and then

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124 *Myersville*, 783 F.3d at 1318.

125 *Id.*; *see also Dominion Transmission*, 723 F.3d at 241 (citing 40 C.F.R. § 52.1070).

126 Because intervenors often challenge certification after other challenges have been fought in federal appellate court, it is not always apparent from the case name that one is reading about the same gas project. Such is the case with Dominion and its air permits. Dominion brought a legal challenge against Maryland for failure to issue the permits in *Dominion Transmission, Inc. v. Summers* and a citizens' group challenged the FERC's certificate, including the FERC's treatment of the CAA, in *Myersville Citizens for a Rural Community, Inc. v. FERC*.

127 *Dominion Transmission*, 723 F.3d at 241.

128 *Id*.

129 *Id*., *quoting* Md. Code § 2-404(b)(1) (alteration in original).

130 *Id*.

filed a zoning application with the Town of Myersville.[131] In short, the MDE kept returning Dominion's application for an air quality permit, and the zoning application was denied as "contrary to the local development plan," an endangerment to public health, and a nuisance.[132]

Regardless of (in spite of?) the air permit/zoning permit imbroglio, the FERC issued the certificate of public convenience and necessity for the Dominion project, including the Myersville compressor station.[133] The detailed order addressed the comments received that were critical of the Myersville location, but ultimately, the FERC concluded "that the Myersville site is the more appropriate site for the Maryland compressor station."[134] Dominion optimistically re-applied to the MDE for its air quality permit, brandishing its FERC certificate and asserting that it now satisfied Maryland's requirements because "all local zoning and land use requirements had been preempted by FERC's certificate and were therefore not 'applicable.'"[135] Well, perhaps Dominion was being pragmatic in realizing that it needed a final rejection in order to obtain appellate review because the effect of its reapplication was immediate communication from the MDE — including a letter that the MDE sent to the Myersville Citizens for a Rural Community assuring them that the MDE would not proceed with the application — that Dominion was not going to receive the coveted air quality permits.[136] Dominion wasted no time in petitioning for appellate review of the MDE's refusal to process the air quality permit application.[137]

Maryland argued that (1) jurisdictional requirements had not been met for appellate review, and (2) it was immune from jurisdiction under the

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131 *Id*. The name of the subsequent case should be a give-away as to how that zoning application went for Dominion since the group protesting the zoning application calls itself Myersville Citizens for a Rural Community.

132 *Id*. at 241-242.

133 *Id*. at 242.

134 *Id*., *quoting Dominion Transmission,* 141 F.E.R.C. ¶ 61,297 (2012) (the FERC order) (internal quotes omitted).

135 *Id*.

136 *Id*.

137 *Id*.

11th Amendment.[138] The first argument invokes EPACT, and attempted yet another subtle distinction to escape federal appellate review.[139] The NGA standard for reviewable conduct is an alleged "failure to act by a . . . State administrative agency acting pursuant to Federal law to issue, condition, or deny any permit required by Federal law . . . for a facility subject to . . . section 717f of this title."[140] Maryland argued that it had not failed to act "because the refusal to process the application was the result of numerous *actions*, including a review of the application, a determination that it was inadequate under § 2-404(b)(1), and notifications to interested parties."[141] The court steered MDE back on course, holding that since the MDE failed to "issue, condition, or deny" the permit, as described by § 717f, it had jurisdiction to consider whether its decision to refuse to process the application was lawful.[142] The Eleventh Amendment immunity assertion met a similar fate: the court did not need to reach a waiver argument raised by Dominion[143] because the *Ex Parte Young* exception applied, allowing suits against state officers for prospective relief for an ongoing violation of federal law.[144]

Maryland's (continued) reluctance to submit to the jurisdiction of the appellate courts dispatched, the court turned to the merits of Dominion's claim that the MDE's failure to act on its air quality permit application was "arbitrary, capricious, an abuse of discretion, or otherwise contrary to law."[145] Dominion first argued that the NGA preempted the state law requirement that the proposed compressor station demonstrate, under a CAA

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138 *Id*.

139 *Id*.

140 *Id*., *quoting* 15 U.S.C. § 717r(d)(2) (alterations in original).

141 *Id*. In other words, if MDE did *anything* from its self-prescribed laundry list regarding the permit, it had not failed to act.

142 *Id*.

143 Dominion utilized an *Islander I*-type argument here. *Id*., *citing* 482 F.3d at 89-90. *See supra* for a discussion of the *Islander I* and *Islander II* cases.

144 *Id*. at 243, *citing* Verizon Md. v. Md. Pub. Serv. Comm'n, 535 U.S. 635, 645, 122 S. Ct. 1753, 152 L. Ed.2d 871 (2002). The Eleventh Amendment is discussed more thoroughly *infra* and perhaps, fittingly, also involves Maryland.

145 *Id*., citations omitted. Each of these individual arguments constitutes a practice point.

permit, compliance with state local law since the NGA would preempt that local law to the extent that it required more than the FERC did for a natural gas facility.[146] This is the wrong question. Since the CAA is expressly not preempted, the question is whether or not 2-404(b)(1) is part of Maryland's SIP, since laws that are part of the SIP are not preempted unless the NGA specifies.[147] Dominion pivoted easily, arguing that this nightmare zoning requirement was not part of the Code of Federal Regulations that lists the

EPA-approved Maryland laws.[148] Alas, no. The now-infamous 2-404(b)(1) is incorporated by reference through two regulations that from the Maryland code provisions that are listed.[149] Undaunted, Dominion asserted that, regardless, it has complied with the terms of 2-404(b)(1) because, although it was unable to show local approval, "Dominion attempted to show compliance with zoning and land use requirements."[150] Further, because these zoning and land use requirements are local laws, and thus preempted by the NGA, these laws cannot be a requirement for satisfaction of § 2-404(b)(1).[151] The court agreed, finding that the MDE could not rely solely on local laws preempted by the NGA to refuse to process an application and explaining that the NGA preempts state and local law to the extent these "conflict with federal regulation or would delay the construction and operation of facilities approved by FERC."[152]

What does this victory mean? The case is remanded to the MDE since the MDE is still in charge of determining whether or not Dominion has complied with 2-404(b)(1).[153] The MDE, once it receives a FERC certificate, must then determine which of the local laws are now preempted by the NGA and which

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146 *Id*.

147 *Id*.

148 *Id*.

149 *Id*. at 244.

150 *Id*.

151 *Id*. Maryland's only response to this is that it has always required actual written approval from a local zoning authority, a requirement that, as the court correctly finds, ignores both the conjunction "or" and the entire second subsection of § 2-404(b)(1). *Id*. at 244-245.

152 *Id*. at 245, *quoting Dominion Transmission*, 141 F.E.R.C. at ¶ 62,298.

153 *Id*.

still remain applicable to the natural gas facility at issue.[154] Then, if there are any local laws remaining — *i.e*., not pre-empted — the MDE must make a determination that either "Dominion has not demonstrated compliance, or it must process Dominion's application for an air quality permit."[155]

Thanks to the Intervenors, legal NGA/CAA geeks get the rest of the story.[156] After the remand, the MDE found that the only remaining local law that was not preempted by the NGA was a requirement that Dominion submit a construction site plan to the Town, which Dominion had done.[157] The MDE processed Dominion's air quality permit application and issued an air quality permit.[158] This quickly became a basis to challenge the FERC's certificate.[159]

The Myersville Citizens group's arguments challenged the ability of the FERC to issue a certificate that was conditioned on the "applicant's subsequent receipt of the requisite air quality permit."[160] Frankly, what the arguments boiled down to is this: the Myersville Citizens group was angry that the MDE issued the air quality permit.[161] The court, however, refused to take up the MDE's decision, noting that this was not properly before it, and directing the petitioners to the appropriate forum if they wanted to challenge the MDE's interpretation of which local laws related to the CAA survive preemption.[162] At any rate, there was no provision of either the CAA or the NGA that prevents the FERC from issuing a conditional certification.[163]

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154 *Id*., *citing Dominion Transmission*, 141 F.E.R.C. at ¶ 62,298.

155 *Id*.

156 *Myersville*, 783 F.3d at 1318-1319.

157 *Id*. at 1318.

158 *Id*.

159 *Id*.

160 *Id*.

161 *Id*. at 1319. The Myersville Citizens group was angry under several theories, including the unfairness of the court requiring the MDE to reconsider its refusal to process the air quality permit application and the unlawful influence of the FERC's certificate on the MDE by forcing the MDE to ignore their local regulations. *Id*. at 1319-1320.

162 *Id*. at 1320-1321.

163 *Id*. at 1321.

[c] — Coastal Zone Management Act — The Final Preempted Regulatory Scheme.

The Coastal Zone Management Act (CZMA)[164] is the final piece in the trio of environmental regulatory schemes that is not preempted by the NGA.[165] Briefly, the CZMA's purpose is "to encourage states to develop land-use planning programs that will preserve, protect, and restore the environment of their coastal zones."[166] States are authorized to create Coastal Zone Management Plans ("CMP") that set forth the state's "objectives, policies, and standards to guide public and private uses of lands and waters in the coastal zone."[167] NOAA has the authority to approve a state's CMP, and once this occurs, federal grant funds become available for administering the coastal zone management programs.[168] The CZMA also mandates that any federal agency activity affecting the state's coastal zone 'be carried out in a manner which is consistent to the maximum extent practicable with the enforceable policies of approved CMPs."[169] Importantly, this grants the states with approved CMPs "the right to engage in 'consistency review,'" which affords a conditional veto for federally permitted projects found to be inconsistent with the 'enforceable policies of the state's approved [CMP]' subject only to an override by the Secretary of Commerce.[170]

The *AES Sparrows Point LNG* case centers around a proposed LNG import terminal with necessary transmission in a "heavily industrialized coastal area on the Chesapeake Bay."[171] Public opposition to the proposed LNG import terminal prompted approval of Bill 71-06 by the County

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164 16 U.S.C. §§ 1451 *et seq*.

165 *See* AES Sparrows Point LNG, LLC v. Smith, 527 F.3d 120, 124 (D.C. Cir. 2008); 15 U.S.C. § 717b(d).

166 *Id*. at 123, *quoting* Shanty Town Assocs., Ltd. P'ship v. EPA, 843 F.2d 782, 793 (4th Cir. 1988) (internal quotes omitted).

167 *Id*., *quoting* 16 U.S.C. § 1453(12).

168 *Id*., *quoting* 16 U.S.C. § 1455.

169 *Id*., *quoting* 16 U.S.C. § 1456(c)(1).

170 *Id*., *quoting* 16 U.S.C. § 1456(c)(3)(a); *see generally* California Coastal Comm'n v. Granite Rock Co., 480 U.S. 572, 590-591, 107 S. Ct. 1419, 94 L. Ed.2d 577 (1987).

171 *Id*.

Council.[172] Bill 71-06 amended county zoning regulations to dictate that an LNG terminal can only be constructed with a "special exception" and must also be located five miles from residential zones and 500 feet from businesses.[173] Perhaps not surprisingly, Bill 71-06 would have prevented AES from constructing the LNG facility at Sparrows Point.[174]

AES brought suit in federal court claiming that the NGA preempted Bill 71-06 because the FERC has exclusive jurisdiction to site LNG terminals, and the district court agreed.[175] Undeterred by triple preemption, the County Council passed Bill 9-07, which makes the siting of LNG facilities "a matter of coastal concern by amending the County's Zoning Regulations to include LNG terminals among the prohibited uses in the Chesapeake Bay Critical Area."[176] Naturally, the AES proposed Sparrows Point site is within the Chesapeake Bay Critical Area.[177] Bill 9-07 prompted AES to seek essentially the same relief with the courts.[178] The County, however, having apparently read *AES I*, was not finished. It requested amendment of the County's Chesapeake and Atlantic Coastal Bay's Critical Area Protection Program (CAPP) to include Bill 9-07's LNG siting restrictions.[179] The CAPP is one of the 50 state laws in Maryland identified in its CMP as "effectuating Maryland's coastal management policies."[180] Maryland never presented Bill 9-07 to NOAA for approval, and this — it's only misstep in defying *AES I* preemption — was its undoing.[181]

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172 *Id*. at 124.
173 *Id*.
174 *Id*.
175 *Id*., *citing* AES Sparrows Point LNG, LLC v. Smith, 470 F. Supp.2d 586, 601 (D. Md. 2007) (*AES I*) (the *AES I* court *thoroughly* agreed, finding express preemption, field preemption, and conflict preemption).
176 *Id*.
177 *Id*. Similarly, it is probably not a coincidence that the definition of "Liquefied Natural Gas Facility" in Bill 9-07 and the NGA are the same. *See id*. at n. 4.
178 *Id*. Thus, the author will refer to this case as *AES II*.
179 *Id*.
180 *Id*.
181 *Id* at 125, 127.

The truth is, the NGA does carve out the CZMA and the approved state CMPs fall within it.[182] Because of the county's failure to present this "substantial change in the uses subject to management" by the CMP to NOAA, as required by 16 U.S.C. § 1455(e)(1), it is not part of the CMP, and the court never reaches the question of that interplay between the CZMA and the NGA.[183] In fact, the court specifically has no opinion as to whether or not Bill 9-07 would fall within the NGA Savings Clause if it were properly incorporated into Maryland's CMP, but then notes "some indication that NOAA would not approve an LNG terminal ban as an amendment to a state's CMP."[184]

§ 24.04. Conclusion.

The increased environmental challenges to pipeline and compressor construction will continue to generate more legal theories to stop or delay infrastructure development. There are steps that can be taken during the FERC process to both the FERC and the applicant support of Certificate of Convenience and Public Necessity, including notifying all interested parties and agencies who *may* be affected by the proposed infrastructure, soliciting comment, and considering reasonable alternatives and mitigation. With respect to the intersection between the state and federal regulation under the CAA, the CWA, and the CZMA, care must be taken to focus on

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182 *Id*. at 126 ("[U]nless a state law prohibiting the siting of LNG terminals is exempted from § 717b(e)(1)'s preemptive effect by some other provision of federal law, it is unenforceable under the Supremacy Clause").

183 *Id* at 126-127, *quoting*16 U.S.C. § 1455(d)(8).

184 *Id*. at n.9; *see* Coastal Zone Management Act Federal Consistency Regulations, 71 Fed. Reg. 788, 823–24 (Jan. 5, 2006) (discussing the intersection of the NGA and CZMA and stating that "NOAA will not approve State policies that on their face contain requirements that are preempted by Federal law.") (parenthetical in original). The *AES II* court continues: "However, NOAA could change its position or simply decline to decide at all which state policies are or are not preempted. Indeed, NOAA has approved LNG terminal bans in CMPs in the past, at least before the NGA was amended in 2005 to give FERC exclusive authority to site LNG terminals." *See* New Jersey v. Delaware, 552U.S. 597, 128 S.Ct. 1410, 1426, 170 L.Ed.2d 315 (2008) (noting that Delaware's CMP contains an LNG terminal ban approved in 1979) (parenthetical in original).

the requirements of the federal statutes (not pre-empted) and the state and local requirements (pre-empted by the NGA) so that careful arguments can be crafted distinguishing the two, should permits be delayed or challenged.

Chapter 25

Held By Production Leases: When Are They Actually Held?

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§ 25.01. Introduction.

The 21st century, in its relatively short span of 15 years, has seen remarkable change in the energy sector, and every resource from renewables to coal to oil and gas has been affected. Incredible discoveries and new technologies for the development and production of both oil and gas have resulted in the large scale displacement of coal for energy power generation, and, for the first time in our lifetimes, we have gained independence from reliance on foreign oil. Enhanced air quality regulations have influenced closure of coal-fired power plants so that in 2015, use of gas has exceeded coal in electric power generation for the first time. No one would have forecast any of this in the year 2000.

If we look back to the turn of the century, the Nymex price of gas was $2.36.[1] Indeed, this price was not much different than the average wellhead price of gas from 1985 to 2000, $2.01. This relatively long period of stable but low prices resulted in demand for natural gas catching up with supply and a stagnation in new drilling. Suggestion was made in some quarters that gas resources were being depleted. In the cyclical gas business, demand appeared to outpace supply, and gas prices spiked to $8.90 in December 2000. Prices settled back and reached a low of $2.19 in September 2001, but then averaged about $3 in 2002. Starting in 2003, however, average prices jumped to $7 and climbed to an all-time high of $13.42 in October 2005. The sustained high price levels from 2003 to 2010 were unprecedented in the history of

1 All natural gas prices are taken from Energy Information Administration, Henry Hub Natural Gas Spot Prices (2015), available at http://www.eia.gov/dnav/ng/hist/rngwhhdm.htm.

the gas industry, and, at these prices, the gas business was good and a surge in drilling of new conventional wells occurred.

During this period, a small Texas company, Mitchell Energy, employed a "slickwater" hydraulic fracture technique in the Barnett Shale formation in Texas.[2] The "slickwater," likened to water and dish soap, was highly successful and provided the first glimpse of the forthcoming revolution in shale gas plays. Shortly after, in 2004, Range Resources used a similar hydraulic fracturing technique in its Renz Well in Washington County, Pennsylvania, and found similar success. Back in Texas, Devon Energy, with expertise in horizontal drilling, acquired Mitchell Energy and drilled horizontal wells into the Barnett shale with multi-stage hydraulic fracturing completions, again with high success. Following suit again, Range Resources began drilling horizontal wells in 2007 in Washington County. Range's successes were not made public until 2008; however, as rumors spread and ultimately the news of this success became known, a fervor for property to develop quickly emerged, and the competition for acreage caused lease prices to escalate from historical prices of $1 per acre to $500 per acre, then to $1,000 per acre, and then to as much as $10,000 and more per acre. These prices were staggering, and the magnitude of the investment, both in lease acquisition and development costs, set dramatically new levels. In some cases, the significant investment in lease acquisition has driven the new development necessary to hold leases.

In many cases, producers have acquired acreage by purchasing existing leases, which were developed with shallow wells many years ago. Again, the acquisition costs have set unprecedented new levels, and, thus, the value of these leases is high. Buyers assume in each instance that the leases are "held by production." But are they? Stated more specifically, has there been "production" sufficient to extend the term of these old leases or might there have been a cessation or a lack of profitable production which might have caused termination? Looking forward, the boom in new drilling has resulted

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[2] Marcellus Shale Advisory Commission, Rep. 2011-01, p. 17, Governor's Report on the Marcellus Shale (2011), *available at* http://www.marcellus.psu.edu/resources/PDFs/MSACFinalReport.pdf.

in a glut of gas on the market and a corresponding drop in prices to the $2 range. Assuming a lease was valid when wells were drilled, what analysis might apply with depressed gas prices and an inability to operate profitably? This chapter explores the requirements for extending the term of an oil and gas lease and the hidden dangers which may cause termination, sometimes unexpectedly.

[1] — The Oil and Gas Lease Term Clause.

From the early days of the oil and gas industry, a standard oil and gas lease has adhered to certain common terms, and one of the core provisions has always been the term clause, which will provide for a "primary term," a finite period stated in days, months or years, and an "extended" or "secondary" term, which will be an indefinite period lasting as long as oil or gas are produced from the leased premises. In its simplest form, an oil and gas lease will provide: "This lease shall have a term of ten years from the date hereof and as long thereafter as oil and gas, or either, are produced from the leased premises." The fixed term of years — in this example, 10 years — is the "primary term," and, if production is obtained, the period "thereafter" is the "extended" or "secondary" term. This term clause will be coupled with a rent clause, which provides for rent, historically in periodic payments, to be made during and to cover the primary term and a royalty clause to provide for payments after production is obtained and during the extended term.

Thus, a primary term allows the lessee a finite period to evaluate the property, arrange for financing as necessary, obtain drilling permits and authorizations, and possibly acquire surrounding acreage that can be supported with the pipeline infrastructure. To extend the lease during the primary term, the lessee must either pay rent or drill a well and obtain production of oil or gas. In order to propel the lease from the primary term to the extended term, a well must be drilled and, generally, production obtained. Thereafter, the lease will be extended so long as oil or gas isproduced.[3] Hence, a lease extended by production is "held by production," or, in common parlance, "HBP." The secondary or extended term, or sometimes

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3 3 Williams & Meyers, *Oil and Gas L*aw 601.4 at 9-10 (1985).

the "thereafter"[4] term, can continue for an indefinite period of time beyond the primary term's expiration, and, during this time, the lessee can continue producing from one or possibly more wells for as long as operations are economic or profitable.

While these lease provisions may seem simple and straightforward — either pay rent or produce oil or gas — there are few areas of the law more replete with litigation than the term and royalty clauses of oil and gas leases. Indeed, the case law over many years has resulted in the drafting of lease terms with increasing sophistication, almost universally, to expand the acts, which, if taken by an oil and gas lessee, will extend the term.

Accordingly, a modern lease might provide as an example:

> "This Lease shall remain in force for a primary term of **Five (5) years** from **________ _______, 2015** the effective date, and shall continue beyond the primary term as to the entirety of the Leasehold if any of the following is satisfied: (i) operations are conducted on the Leasehold or lands pooled/unitized therewith in search of oil, gas, or their constituents, or (ii) a well deemed by Lessee to be capable of production is located on the Leasehold or lands pooled/unitized therewith, or (iii) oil or gas, or their constituents, are produced from the Leasehold or lands pooled/unitized therewith, or (iv) if the Leasehold or lands pooled/unitized therewith is used for the underground storage of gas, or for the protection of stored gas, or (v) if prescribed payments are made, or (vi) if Lessee's operations are delayed, postponed or interrupted as a result of any coal, stone or other mining or mining related operation under any existing and effective lease, permit or authorization covering such operations on the leased premises or on other lands affecting the leased premises, such delay will automatically extend the primary or secondary term of this oil and gas lease without additional compensation or performance by Lessee for a period of time equal to any such delay, postponement or interruption.

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4 *Id*.

> If there is any dispute concerning the extension of this Lease beyond the primary term by reason of any of the alternative mechanisms specified herein, the payment to the Lessor of the prescribed payments provided below shall be conclusive evidence that the Lease has been extended beyond the primary term."

In turn, this clause will be coupled with a "shut in" clause, which expressly allows the cessation of production, but extension of the lease term by payment of "shut in" rent. In short, a modern lease will provide for an expansive list of acts which might extend the term of a lease. In oil and gas law, like any area of contract interpretation, the cardinal rule of interpretation universally applied is that a contract will be enforced as written. So, while many of the terms of a modern lease have not been tested, this cardinal rule will be the starting point for any challenge. This chapter will focus on the terms of older, less sophisticated leases.

[2] — Nature of an Oil and Gas Leasehold Estate.

The oil and gas lease, like any other lease, creates an estate in land of limited duration. Ownership of the land, which in almost all states includes oil and gas, remains in the landowner/lessor so long as the minerals remain in place. Unlike commercial and residential leases, however, oil and gas leases, like other mineral leases, contemplate that the lessee will take part of the estate, the oil and gas, and thereby diminish the reversion, which the owner has when the lease terminates.

The motivation for the owner in entering an oil and gas lease, generally, is to earn income from valuable resources, which the owner lacks the expertise and resources to develop on his own. This major premise often rises to the forefront in disputes over the term of oil and gas leases, and a recognition is generally given to the fact that the basic purpose of an oil and gas lease is to earn income, both to the lessee and to the lessor, and this can occur only if there is development.[5] From this basic premise, and absent express provisions,

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5 Johnson v. Armstrong, 81 W. Va. 399, 94 S.E. 753 (W. Va. 1918). Goodwin v. Wright, 163 W. Va. 264, 268, 255 S.E.2d 924, 926 (W. Va. 1979); Hite v. Falcon Partners, 13 A.3d 942, 945 (Pa. Super. 2011).

courts have generally inferred implied covenants that property be developed[6] and that the minerals be marketed in a fashion that benefits both parties.[7]

To the extent that an oil and gas lease "grants" the oil and gas, or the right to develop the oil and gas, for a term of years, and this grant is coupled with detailed operating rights and obligations, most jurisdictions treat the lease as both a conveyance of rights in real property from the lessor to the lessee and as a contract between the lessor and the lessee.[8]

[a] — Inchoate Estate During Primary Term.

During the primary term, or at least until development occurs, the nature of the estate is viewed in many jurisdictions as creating a license or an option and is often characterized as an inchoate right,[9] which may blossom into a fee simple determinable,[10] while others classify it as a *profit a prendre*.[11]

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6 *Johnson,* 81 W. Va. 399; *Goodwin,* 163 W. Va. 264, *Hite,* 13 A.3d 942; .*see also*, Todd v. Mfrs' Light & Heat Co., 90 W. Va. 40, 110 S.E. 446 (922); Estate of Tawney v. Columbia Natural Res., L.L.C., 219 W. Va. 266, 633 S.E.2d 22 (2006).

7 Gazin v. Pan Am. Petroleum Corp., 367 P.2d 1010 (Okla. 1962).

8 *Hite,* 13 A.3d 942; *Goodwin,* 163 W. Va. 264.

9 *See, e.g.,* Eastern Oil Co. v. Coulehan, 65 W. Va. 531, 64 S.E. 836 (1909) ("In this state and in Pennsylvania such leases are generally treated as mere licenses vesting no estate; the title thereto, both as to the period of years and the term thereafter remaining inchoate and contingent on the finding of oil and gas."); Smith v. Root, 66 W. Va. 633, 66 S.E. 1005 (1910) ("It simply gave them the exclusive right to make exploration upon the land for oil and gas. Their right was simply an inchoate right, not a vested estate in the land.); Parish Fork Oil Co. v. Bridgewater Gas Co., 51 W. Va. 583, 591 (1902) ("Until oil is discovered in paying quantities, the lessee acquires no title under such lease."); *Hite,* 13 A.3d 942 ("[T] he title conveyed is inchoate and initially for the purpose of exploration and development. If development during the primary term is unsuccessful, no estate vests in the lessee."); Lowther Oil Co. v. Miller-Sibley Oil Co.; Urpman v. Lowther Oil Co., 53 W. Va. 501 (1903); *see also* footnotes 1 through 4 above.

10 *See, e.g.,* Snyder Bros. v. Peoples Natural Gas Co., 450 Pa. Super. 371, 378 (1996) ("[T] he interest granted to lessee is a fee simple determinable; the lessor retains a reversionary interest."); Luckel v. White, 819 S.W.2d 459, 464 (Tex. 1991) ("In Texas, a typical oil and gas lease actually conveys the mineral estate (less those portions expressly reserved, such as royalty) as a determinable fee.").

11 *See, e. g.,* Rich v. Doneghey, 71 Okla. 204, 206 (1918) ("The right . . . is an incorporeal hereditament; or more specifically, as designated in the ancient French, a *profit a prendre*, analogous to a profit to hunt and fish on the land of another.").

[b] — Vested or Determinate Estate

When development occurs, and especially when oil or gas is discovered, courts generally hold that the oil and gas lease becomes a vested estate.[12] In doing so, there is a recognition of the investment made by the lessee, and inherent in the concept of "vesting" is the fact that courts will not allow the estate to be easily lost, unless the condition, "production," is not met. The West Virginia Supreme Court described the nature of the traditional oil and gas leasehold term as follows:

> A habendum clause in an oil and gas lease (or other mineral lease) providing for a short primary term and a secondary term for 'so long as' production in paying quantities or operations therefor continue, or similar language, conveys a "determinable" interest, that is, an interest subject to a special limitation. Such an interest automatically terminates by its own terms upon the cessation of production or operations during the secondary term.[13]

Thus, the "habendum" or "term" clause in an oil and gas lease serves to define and limit the duration of the term of the estate conveyed.[14] So long as the condition, "production," is met, though, the term will continue for an indefinite time.[15]

Traditional wells in the eastern United States can produce for very long periods — 70 and 80 years and more and counting — and during this time the lease is not only the central, but typically the only, operating document between the parties. What may be unique to the oil and gas industry is the fact that, until recent years, compelling reasons for modification of original leases have rarely occurred. Thus, when development of the Marcellus and Utica formations is proposed, and horizontal wells are to be drilled under leases held by old production, dual questions will exist: first, has the lease

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12 Eastern Oil Co. v. Coulehan, 65 W. Va. 531, 533 (1909); Brown v. Haight, 435 Pa. 12, 17, 255 A.2d 508, 511 (1969); Duke v. Sun Oil Co., 320 F.2d 853 (5th Cir. 1963).

13 Bryan v. Big Two Mile Gas Co., 213 W. Va. 110, 113, 577 S.E.2d 258, 261 (2001) (citing Syl. Pt. 2, McCullough Oil, Inc. v. Rezek, 176 W. Va. 638, 346 S.E.2d 788 (1986)).

14 R. Donley, *The Law of Coal, Oil And Gas in West Virginia and Virginia* § 69 (1951).

15 3 Williams & Meyers, *Oil and Gas L*aw § 601.4 at 9-10.

actually been held by production, and, second, are the terms of the lease adequate for the development which is anticipated? This chapter addresses the first question only.

[3] — The Meaning of "Production."

The term "production" would seem to be straightforward and mean, literally, that oil or gas are being produced from the lease premises; however, early case law, particularly in West Virginia, allowed a more relaxed standard, at least in order to propel the term from the primary term to the extended term. These early cases addressed the question whether an oil and gas lease could be extended beyond the primary term in instances where the operator commenced drilling operations but failed to establish production before the end of the primary term. Thus, in the first early case,[16] a well was commenced within the primary terms, and gas in "paying quantities" was discovered, but the lessee was unable to put the well into production. The court nevertheless held that the term was extended. In later cases,[17] the same facts were addressed; however, the lessee was unable to show that the discovery was in paying quantities. Again, the court held the term continued. In a different vein, the lessee in *Eastern Oil Co. v. Coulehan*[18] drilled a well and was nearing completion on a Saturday. The primary term expired on Sunday, and the lessor prevented working on the Sabbath. The court held the lessor's interference served to extend the term. These cases each recognize the substantial investment made by the operator and the "gross injustice" that might occur if the lease was not extended.[19] Collectively, these cases establish the principle that if there has been "substantial compliance" with the lease by discovering oil or gas, the lease term will be extended so long as the operator has a "reasonable basis for the expectation of profitable returns"[20] and is diligently seeking to produce, even though the literal condition that

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16 Barbour-Stedman & Co. v. Tompkins, 81 W. Va. 116, 93 S.E. 1038 (1917).

17 South Penn Oil Co. v. Snodgrass, 71 W. Va. 438, 76 S.E. 961 (W. Va. 1912), Ohio Fuel Oil Co. v. Greenleaf, 84 W. Va. 67, 99 S.E. 274 (W. Va. 1919).

18 *Eastern Oil*, 65 W. Va. 531, 64 S.E. 836, 841 (W. Va. 1909).

19 *Id*.

20 *Barbour, Stedman & Co*., 81 W. Va. 116.

"production" exists is not met.[21] Diligence, in turn, is tested by the facts and circumstances of each case.[22]

§ 25.02. Held By Production.

In the majority of producing states, actual production of oil and gas is required for the lease to extend into the secondary term.[23] As discussed above, a few states, like West Virginia, allow the discovery of oil and gas without production at the end of the primary term to extend the lease. So long as the lessee is diligently seeking to obtain production, these states similarly adhere to the requirement that there be production to continue to the term of the lease.[24] The question then becomes what kind of production will be necessary. At most, a typical oil and gas lease might provide that the production be "in paying quantities," but seldom will a lease say more.

[1] — The "Paying Quantities" Standard — General Considerations.

The courts have, with limited exceptions,[25] addressed the question of the type of "production" necessary to extend the term of a lease by holding that to continue the term of the lease, production must be in paying quantities; that is, the production must be "commercial" or "profitable."[26] According

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21 *Also see*, *Gazin*, 367 P.2d at 1013, "where the court held that when a well, capable of producing in paying quantity, was drilled within the primary term, the term was extended so long as the lessee exercised "reasonable diligence in seeking and obtaining a satisfactory market within a reasonable time under the facts and circumstances."

22 *Bryan*, 577 S.E.2d at 269-270.

23 *See also* Baldwin v. Blue Stem Oil Co., 189 P. 920 (Kan. 1920); Standard Oil & Gas Co. v. Barnhill, 107 S.W.2d 746 (Tex. Civ. App. 1937); Hanna v. Shots, 163 Ohio St. 144, 125 N.E. 338 (Ohio 1955), at Syl. Pt. 2.

24 *Parish Fork Co.*, 51 W. Va. 583.

25 Gillespie v. Ohio Oil Co., 260 Ill. 169, 102 N.E. 1043; McGraw Oil & Gas Co. v. Kennedy, 65 W. Va. 595, 64 S.E. 1027 (1909); *South Penn Oil Co*., 71 W. Va. 438 (1912).

26 Swiss Oil Corp. v. Riggsby 252 Ky. 374, 67 S.W.2d 30 (1933); Kerr v. Hillenberg, 373 P.2d 66 (Okla. 1962); Young v. Forest Oil Co., 194 Pa. 243, 45 A. 121 (1899) (small profit); Benedum-Trees Oil Co. v. Davi, CA 6 Tenn. 107 F.2d 981 (1939), cert. den. 310 U.S. 634, 84 L. Ed. 1404, 60 S. Ct. 1076 (apparently applying Tennessee law, reasonable return); Garcia v King, 139 Tex. 578, 164 S.W.2d 509 (1942) (small profit); Patton v. Rogers, Tex. Civ. App. 417 S.W.2d 470 (1967), error ref n r e (small profit); Lowther Oil Co., 53 W. Va. 501 (1903) (small profit); Barbour, Stedman & Co., 81 W. Va. 116 (1917).

to one court: "'Produced,' 'produced in paying quantity,' and 'found in paying quantities' must mean about the same thing, else substance will be subordinated to shadow or mere technicality."[27] Profitability, in turn, is measured by net profits from operations, that is, the income from sales must exceed the cost of operations without regard to the capital cost of drilling a well.[28] Thus, a well that may never recover the cost of drilling is nevertheless considered profitable if it has net profits from ongoing operations.

Varying factors can lead courts to apply the requirement of "paying quantities" in different ways. In a very general context, many decisions hold that "paying quantities" is determined from the subjective viewpoint and judgment of the lessee or operator when exercised in good faith.[29] Thus, the "prevailing rule seems to be that [the] phrase 'paying quantities' is to be construed from the standpoint of the lessee, and by his judgment if exercised in good faith."[30] The Texas Supreme Court announced a "paying quantities" definition that recognizes a prudent operator standard in this way:

> [T]he standard by which paying quantities is determined is whether or not under all the relevant circumstances a reasonably prudent operator would, for the purpose of making a profit and not merely for speculation, continue to operate a well . . . .[31]

These cases would suggest that while much may be left to the lessee's viewpoint, a close examination indicates that operations must either achieve, or have a reasonable expectation of achieving, a net profit. Therefore, if a well, or operations under a lease, pays a profit, however small, over operating expenses, it is considered to be producing in paying quantities, even if operations do not recover capital costs of lease acquisition, development and drilling. In cases of marginal operations, courts will generally show deference

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27 *South Penn Oil Co.,* 71 W. Va. 438; *see also,* Clifton v. Koontz, 160 Tex. 82, 325 S.W.2d 684 (1959).

28 "Meaning of Paying Quantities in Oil and Gas Lease," 43 *A.L.R.*3d 8 (Originally published 1972).

29 *Young,* 194 Pa. 243; *Lowther Oil Co.,* 53 W. Va. 501, Syl. Pt. 1.

30 Blausey v. Stein, 1978 Ohio App. LEXIS 9031 at *6 (1978).

31 *Clifton*, 160 Tex. 82, 325 S.W.2d 684.

to a lessee's judgment and take into consideration any other matter that a reasonably prudent operator would consider in continuing with operations.

[2] — Free Gas.

It is common for an oil and gas lease to provide that the lessor may take gas from a well for domestic purposes at no charge. If that is all that occurs, and there is no commercial sale of oil or gas, the question is whether producing free gas for a landowner will constitute "production."

In the West Virginia case of *Goodwin v. Wright*, the lessor prevailed in a suit to set aside an oil and gas lease where, although a well on the property provided free gas to the lessor, no production had been marketed and sold from the property and no royalties paid to the lessor by the lessee in over four years.[32] The court based its decision on the rationale that the purpose of an oil and gas lease is for the production of the minerals "in the ordinary sense of the term," which results in royalty to the lessor.[33] In holding that production must be in paying quantities, the court stated the following with regard to the free gas:

> From a reading of the entire instrument it is evident that the royalty provision is a primary matter, while the free gas, like the provision for burying lines below plow depth, is a secondary matter.[34]

While it might seem axiomatic that a lessor who utilizes free gas by connecting to the lessee's well would waive, or otherwise be precluded from raising, the issue that the lease has terminated for lack of production, the *Goodwin* court held there was no estoppel preventing the lessor from challenging the lease. The court reasoned that the lessor had both the right to free gas and the right to have the lease terminate at the end of its term. As to the primary obligation to produce in paying quantities, the court clarified

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32 *Goodwin*, 163 W. Va. at 265.

33 *Id*.

34 *Id*. at 69, 927 (citing Metz v. Doss, 114 Ill. App. 2d 195, 252 N.E.2d 410 (1969), where the Illinois court held that a lessor, by taking free gas, is not estopped from challenging the lease, and that furnishing free gas to a lessor does not constitute "production," which will keep the lease in effect).

that paying quantities meant "commercial" production, which generates net profits to the lessee and royalty income to the lessor.

This rule has been followed generally where the issue has been raised.[35]

[3] — Profitability — an Economic Analysis.

Where challenges have been specific to the issue of profitability, courts are more stringent in applying a direct economic analysis of operating costs to determine whether operations have been profitable, although questions may exist over the period of time to consider and the appropriate items of cost to include.

Stated most simply, the Texas court in *Sullivan and Garnett v. James*[36] concluded that with the use of the operator's own numbers, "by simply adding up the receipts on the one hand and the expenditures on the other, the difference would readily determine the profit or loss."[37]

In an Ohio case,[38] proof was offered that gross receipts from operations were $2,887, and the court calculated operating costs as $3,741, including the sum of $2,887 as the value attributed to the lessee's labor. The lessee in that case performed all labor himself, and, on appeal, the court held it was improper to attribute a cost not actually incurred, stating: "[t]he fact that a lessee can keep operating costs at a minimum should inure to his benefit in a determination of whether a well produces in paying quantities."[39] Thus, when the attributed, or estimated, cost of the lessor's labor was eliminated from the equation, the operations were profitable.

In *Imperial Colliery Co. v. Oxy USA Inc.,*[40] a robust examination was made of the issue of paying quantities in the context of a large lease entered in 1944 with 14 producing wells. The lessee in that case had internal memoranda

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35 Babb v. Clemens, 687 A.2d 1120, 1122 (Pa. Super. 1996); Tisdale v. Walla, 94-A-008, 1994 WL 738744 (Ohio Ct. App. Dec. 23, 1994); *Goodwin,* 163 W. Va. 264; Curry v. TNG, Inc., 410 S.E.2d 415 (W. Va. 1991).

36 Sullivan and Garnett v. James, 308 S.W.2d 891 (Tex. Civ. App. 1958).

37 *Id*. at 893.

38 *Blausey*, 61 Ohio St.2d 264.

39 *Id*.; 400 N.E.2d at 410.

40 Imperial Colliery Co. v. Oxy USA Inc., 912 F.2d 696 (4th Cir. 1990).

indicating losses from operations began in 1978. OXY was unable to provide complete accounting for operations for any year after 1978 and, absent complete records of costs, the lessor offered expert testimony to establish the missing cost items and provided an operating model demonstrating that operations, in each year from 1978 to the time suit was filed in 1985, were conducted at a loss. The court followed the general rule that "paying quantities" is measured by "operating costs" and not the cost of drilling or other capital expense, and found that under any analysis the lease as a whole operated at a loss from 1978 to 1985 when suit was filed. Accordingly, the condition that production occur profitably was not met, and the lease was held to terminate. As part of its decision, the court held that the lease as a whole must operate profitably and refuted a contention that the term would have been extended if any single well out of the 14 wells could have been shown to be profitable.

These cases demonstrate that, while great deference will be given to the judgment of the operator, the question of paying quantities, or profitability, can be a hard economic analysis that compares current income with current expenses. In these cases, the questions will likely devolve into an analysis of those costs that should be considered, and these are "largely a matter of expert and technical knowledge."[41] Specific costs, such as the lessee's own labor or the efficiencies employed by an operator, will be important, as seen in the Ohio cases above. Looking beyond these items, costs such as "taxes, overhead charges, labor, repairs, depreciation on salvageable equipment" have been approved,[42] although depreciation, generally, has been disapproved as an operating expense.[43] "Marketing" costs are generally stated to be operating expenses,[44] while "re-working" costs have been specifically held to be "analogous, and closely related, to the initial drilling expenses."[45] Further,

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41 Weisant v. Follet, 17 Ohio App. 371 (1922).

42 Skelly Oil Co. v. Archer, 356 S.W.2d 774, 781 (Tex. 1961).

43 *Clifton*, 160 Tex. 82, 325 S.W.2d 684.

44 Cowden v. Central Crude Oil Co., 217 S.W.2d 109 (Tex. App. 1948).

45 Pshigoda v. Texaco, 703 S.W.2d 416, 418, 419 (Tex. App. 1986). For an exhaustive examination of particular costs, *see*, "Meaning of 'Paying Quantities' in Oil and Gas Lease," 43 *A.L.R.*3d 8.

such expenses are "a one time, single expense item" that should be treated as a capital expense rather than an operating cost.[46]

An interesting twist on the profitability analysis is seen in the Ohio case of *Weisant v. Follett*,[47] where the lessee "shackled" wells on the leased premises in question with a large number of other wells and used a single power plant for pumping. The lessor, in attempting to prove that operations were not "paying," urged that the test should be whether the cost of operating the three wells on the leased premises should be made as if they were operated alone. The court was persuaded by the fact that the method of operation was customary in the area, and that the lessor who lived on the property was familiar with it. Accordingly, the court found that "it may be assumed" that in entering the lease, the lessor understood that the lessee "would have the right to pump oil in this manner."[48] Moreover, the court recognized the "large expenditure in the drilling of wells and in the developing of the lease," finding that it would be "unjust" to require a test for profitability "not in general use, and which, if generally applied, would put an end to the operation of thousands of wells in this territory by lessees who have developed them."[49]

> A series of Texas cases[50] developed the following two-pronged test for profitability:
>
> (1) does the production yield a profit after deducting operating and marketing costs . . . and (2) would a prudent operator continue, for profit and not for speculation, to operate the well as it has been operated.

Following this test of profitability, the court in *Pshigoda v. Texaco*[51] added:

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46 *Id*.

47 Weisant v. Follett, 17 Ohio App. 371 (1922).

48 *Id*. at 383.

49 *Id*.

50 *Garcia,* 139 Tex. 578; *Clifton,* 160 Tex. 82, 325 S.W.2d 684; *Skelly Oil Co.,* 163 Tex. 336; *Pshigoda*, 703 S.W.2d 416.

51 *Pshigoda,* 703 S.W.2d 416.

> Central to the [analysis] is the philosophy that fixed or periodic cash expenditures incurred in the daily operation of a well (sometimes called out-of-pocket lifting expenses) are to be classified as operating expenses, while one time investment expenses, such as drilling and equipping costs are to be treated as capital expenditures.

In considering the question of "paying" production, a question may exist with respect to the time period for testing profitability. General guidance on this issue is provided in *Clifton v. Koontz*, where the court rejected the lessor's contention that a cessation-in-production clause providing a 60-day grace period defined the period for examination of profitable operations, and held that where production never ceased, "the 60-day clause is not definitive of the period over which the trier of the facts must determine whether a lease is producing in paying quantities."[52] The court stated:

> There can be no arbitrary period for determining the question of whether or not a lease has terminated for the additional reason the [sic] there are various causes for slowing up of production, or a temporary cessation of production, which the courts have held to be justifiable. . . . We again emphasize that there can be no limit as to time, whether it be days, weeks, or months, to be taken into consideration in determining the question of whether paying production from the lease has ceased. . . .[53]

In the end, the *Koontz* court concluded that the factor for consideration is "a reasonable period of time under the circumstances."[54] In the *Pshigoda* case, the lessor urged that a single period of 23-1/2 months prior to the litigation should have been considered and, although perhaps moot, based on other decisions in the case, the court affirmed the consideration by the court of an additional 17-month period, reasoning that "the time frames adopted by the trial court are reasonable."[55]

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52 *Clifton*, 160 Tex. at 88, 325 S.W.2d at 690.

53 *Id*.

54 *Id*. at 88; 325 S.W.2d at 691.

55 *Pshigoda*, 703 S.W.2d at 419; *see also* Ballanfonte v. Kimbell, 373 S.W.2d 119 (Tex. Civ. App. 1963), where a 13-month period was approved.

[4] — Profitability in Depressed Markets.

The introduction to this chapter describes the fluctuation in gas prices in the 21st century starting at a little above $2.00, rising to all-time highs in 2005 and falling back to the $2.00 and below range. Development during this time reached unparalleled highs and, with inflation operating costs, have certainly increased. Of all expenses an operator might encounter today, however, transportation and pipeline access costs have seen the most dramatic increase. Thus, with a glut of gas, low prices and high operating costs, some operators may find it difficult to operate profitably.

Our research shows that gas prices in the Dominion system at South Point were $1.41 in May 2015, and that the following might represent operations in central Appalachia, at least for those operators on the Dominion transportation system:

Inside FERC Dominion South Point Index May 2015 (as published)	Per Dth	$1.41
Royalty Interest (depends on lease before or after transport)	-12.5%	($0.18)
Overriding royalty (if payable)	.03125	($0.04)
WV County Tax (% varies by county)	2.0%	($0.03)
Gathering (assumed percentage - fee structure varies)	10.5%	($0.15)
Processing (assumed percentage cost - fee structure varies)	0.5%	($0.01)
Firm transportation (fixed fee per Dth)		($0.57)
Marketing fee (varies, assumed 3.5%)	-$0.05	($0.04)
WV Severance Tax (calculated lss 15% safe harbor transport credit)	-5.00%	($0.06)
WV Workers Comp. Severance Tax (fixed - $0.047/MCF)	-$0.047	($0.05)
Operating cost (varies assumed $1.35 per Dth)	-$1.35	($1.35)
	Operator loss per Dth	($1.07)

The chart graphically illustrates conditions in a depressed market and the potential that an operator with substantial investment in drilling and development might find it impossible to operate at a profit, particularly under the hard economic analysis of cases such as *Imperial Colliery*. If we harken back to certain core principles applied by the courts, indicating that the requirement of production is satisfied if the operator has a "reasonable basis

for the expectation of profitable return,"[56] and if we take into account the universal proposition that operations must be assessed from the perspective of the operator using good faith judgment, it would seem the market forces, particularly temporary ones, which are beyond the operator's control and any diligence he or she might exercise, should result in a tempered requirement of "paying quantities."

In one of the few cases to address this question, the Tenth Circuit Court of Appeals considered an oil and gas lease that was operated profitably until a depression in the oil market caused prices to drop and operations under the lease to occur at a loss. The lease in that case provided that the term would continue as long as oil or gas were "produced." Absent the qualification "in paying quantities," the court, first, "assumed without deciding, that 'in paying quantities'" was an implied qualification of 'production.' It then refuted the lessor's claim that the lease expired for failure to produce in paying quantities, holding:

> We are of the opinion that the parties, when they used such phrase [produced in paying quantities], contemplated normal conditions and not the unusual conditions to which we have referred, and intended that the question of whether the requirements thereof were being met should be determined in the light of such normal conditions; and that if the wells would produce a profit over operating expenses under normal conditions and the [lessee] is willing to continue to operate them at a loss believing in good faith that normal conditions will return and the wells will ultimately produce a profit over operating expenses, it cannot be said that the wells are not producing oil in paying quantities within the meaning of the lease.

The reasoning of the federal court in this case, which was decided under Oklahoma law, is unique, but sound. Considering the scenario in the east, the general principles articulated by the Ohio, Pennsylvania and West Virginia courts, which allow deference to the good faith judgment of a lessee, which recognize the significant investments made, which recognize the 'reasonable

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56 *Barbour, Stedman & Co,* 93 S.E. at 1040; *see also, supra,* Section 25.02[c].

expectations' of producers, and which are often tailored to unique facts, would seem to compel the same result if a similar challenge were made in one of these states.

[5] — Production from Shallow Formations Only.

Acquisitions in recent years of older leases that are 'held by production' typically involve leases where production has occurred from shallow wells only, so that over the life of the leases, there has been no development of deeper horizons. The question as to the potential partial termination of deep formations, or correspondingly, the question whether shallow production will hold deep formations, has been answered in Ohio and Pennsylvania.[57]

In the Ohio instance, the landowners challenged whether the production of 15 wells from the Germantown Sand Formation under two leases — the Burton Lease and Miller Lease — also held the "deep rights." The basis for the challenge was that a previous assignment of shallow rights excepted and reserved the deep rights, and, in that case, the deep rights or formation had never been developed. Accordingly, the question raised was whether continued production from the shallow formations with no development as to the deep formations continued to hold the deep formations.[58] The Fourth District Court of Appeals of Ohio began by examining the granting and habendum clauses under Ohio oil and gas contract law as set forth in *Harris v. Ohio Oil Co*., 57 Ohio St. 118, 48 N.E. 602 (1897).[59] The granting clauses in each of the leases at issue covered "all the oil and gas in and under" the tracts.[60] The Miller Lease provided "for the term of two years from the date hereof and as much longer as oil or gas is founded in paying quantities," and

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57 Marshall v. Beekay, 2015 Ohio 238, 27 N.E.3d 1 (4th Dist. 2015); Popa v. CNX Gas Company, LLC, 2014 WL 3749415 (N.D. Ohio 2014); Gardner v. The Oxford Oil Co., 2013 Ohio 5885, 7 N.E.3d 510 (7th Dist. Ohio 2013); Caldwell v. Kriebel Resources Co., LLC, 72 A.3d 611, 2013 Pa. Super. 188 (Pa. 2013); Delmas Ray Burkett, II Revocable Trust ex rel. Burkett v. Exco Resources, LLC, 2014 WL 585884 (W.D. Pa. 2014); s*ee also* Ferrera v. Questar Exploration and Production Co., 70 So. 3d 974 (La. App. 2 Cir. 2011).

58 *Marshall,* at ¶¶ 1-4.

59 *Id*. at ¶¶ 10-13.

60 *Id*. ¶ 12.

the Burton Lease provided "for the term of one years [*sic*] from the date hereof and as much longer as oil or gas is found in paying quantities."[61] The court determined that the crux of the case was whether the production in paying quantities from the shallow wells held the "deep rights" or whether the 1960 assignment severed the original oil and gas leases and created two separate and distinct leases in which the implied covenant to reasonably develop applied separately to both the shallow and deep formations.[62] Ultimately, the court affirmed the decision of the trial court that the 1960 assignment of the shallow rights did not create separate and distinct leaseholds, but, rather, that the production in "paying quantities" from the shallow formations held all depths and all formations covered by the original oil and gas leases.[63]

A similar decision was reached in Pennsylvania[64] and, given the similarity in laws in the eastern states, it is submitted that each would reach the same result.

§ 25.03. Cessation of Production.

The literal habendum clause language that the term will continue "so long as oil or gas are produced" creates a "determinable estate," that is, one based on a condition, which, if not met, causes the lease to automatically terminate.[65] No action for termination to occur is required by either the lessee or lessor.[66] The termination results in an automatic reversion of all oil and gas rights to the lessor.[67] Once terminated, a lease may not be revived by production or other physical act,[68] and an effort to resume production by a

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61 *Id*.

62 *Id*. at ¶ 13.

63 *Id*. at ¶¶ 16-21.

64 Caldwell v. Kriebel Res. Co., LLC, 2013 Pa. Super. 188.

65 Brown v. Haight, 255 A.2d 508 (Pa. 1969); Peckham v. Dunning, 125 N.Y.S.2d 895 (1953); Am. Energy Serv. v. Lekan, 75 Ohio App. 3d 205, 598 N.E.2d 1315 (1992); *Bryan*, 213 W. Va. 110, 577 S.E.2d 258; Wheeler & Lemaster Oil & Gas Co. v. Henley, 398 S.W.2d 475 (1965).

66 McCullough Oil, Inc, 176 W. Va. 638, 346 S.E.2d 788 (1986).

67 *See, e.g., Bryan*, 213 W. Va. at 113, 577 S.E.2d at 261.

68 Jolynne v. Michaels, 191 W. Va. 406, 413, 446 S.E.2d 494, 501 (1994).

lessee, or, more accurately, a former lessee, will at least in one jurisdiction constitute a trespass.[69] According to the West Virginia court:

> As with the lack of production (or under some mineral leases, the lack of operations) at the end of the primary term, an oil and gas lease (or other mineral lease) automatically terminates immediately upon the cessation of production during the secondary term, unless there is a cessation of production clause . . ., or in the absence of such a clause, unless the cessation of production is only 'temporary.'

Some leases may contain express provisions that contemplate temporary cessation, and these may contain grace periods for the resumption of production. Where a lease does not contain such a provision, courts, in recognition of the substantial investment normally made in oil and gas development and the nature of both the operations and the markets, nearly always recognize that events in the normal course, many beyond the operator's control, may cause production to cease. The harsh result of losing a lease and the investment made has led courts to carve out a relaxation of the requirement of production by recognizing a 'temporary cessation in production' doctrine.

[1] — Temporary Cessation of Production.

The temporary cessation doctrine recognizes that cessations in production can result from a variety of causes, and, under this doctrine, the term of a lease will continue during the cessation so long as the cause is justified, the length of time is reasonable and, perhaps most importantly, the operator is diligent in seeking to restore production. According to one court:

> Courts universally recognize the proposition that a mere **temporary cessation** in the production of gas or oil **will not terminate the lease** under a habendum clause of an oil and gas lease **where the owner of the lease exercises reasonable diligence and good faith in attempting to resume production of the well**. A critical factor in determining the reasonableness of the operator's conduct is the length of time the well is out of production. Additionally, **in determining**

69 *Bryan*, 213 W. Va. at 121, 577 S.E.2d at 269.

> **the reasonableness of the lease owner's conduct, all attendant circumstances must be taken into account.**[70]

Perhaps the most extensive discussion of this doctrine and the nature of an oil and gas lease are seen in the West Virginia case of *McCullough Oil, Inc. v. Rezek,*[71] where the court offered the following:

> In the absence of a cessation of production clause, the courts in virtually all jurisdictions addressing the issue have developed a "temporary" cessation of production doctrine, whereby a mere "temporary" cessation of production during the secondary term for equipment repairs or technical problems, reworking operations, lack of a market, etc., does not result in an automatic termination of the lease, as these types of delays are normally not protracted and are incidental to the normal operation of the lease; they must, therefore, have been contemplated by the parties to be excusable. *See* Anderson v. Schaffner, 90 W. Va. 225, 229, 110 S.E. 566, 567 (1922). *See also annot.*, 100 A.L.R.2d 885 (1965 and Later Case Service). Factors to be considered in deciding whether a cessation of production is "temporary" include the length of time without production, the cause of the delay and whether the lessee exercised reasonable diligence to resume production. [further citations omitted].[72]

Hence, whether the cessation was temporary or permanent in nature is dependent on multiple factors, including the length of time, the cause of the cessation and the diligence of a lessee, all of which are usually questions of fact.[73]

[a] — Length of Time for Cessation.

Clearly, the longer the cessation of production, the more likely it will be considered a permanent abandonment of the leasehold.

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70 Wagner v. Smith, 8 Ohio App. 3d 90, 92-93, 456 N.E.2d 523, 525-26 (1982) (emphasis added).

71 *McCullough Oil, Inc.*, 176 W. Va. 643, 346 S.E.2d at 794.

72 *Id.*, 346 S.E.2d 788 (footnote 5).

73 *Bryan*, 213 W. Va. at 118, 577 S.E.2d at 266.

> "A review of the reported cases reflects that while courts tend to hold the cessation of production temporary when the time periods are short, lessees have, for the most part, been held not to have proceeded diligently when the cessation from production exists for two years or more."[74]

In West Virginia, a statutory presumption of abandonment occurs if no production occurs for two years. This statute provides:

> There is a rebuttable legal presumption that the failure of a [lessee] to produce and sell or produce and use for its own purpose for a period of greater than twenty-four months . . . oil and/or gas produced from such leased premises constitutes an intention to abandon any oil and/or gas well . . . on said leased premises.[75]

The length of time, though, can be much less than two years, as demonstrated in the West Virginia case of *Bryan v. Big Two Mile Gas Co.*, where a cessation due to a faulty meter was found to exist for about four months. Evidence that the operator could have replaced the malfunctioning meter in a "matter of days" was held to be a sufficient basis for the jury to conclude that the cessation was unexcused and that the lease terminated. In at least one Arkansas case, a cessation of more than four years was considered temporary.[76] The length of time without production, then, is almost always considered, along with other factors in determining whether the cessation is excused.[77]

[b] — The Reason for the Cessation.

The second consideration on the issue of a "temporary" cessation is the reason for the cessation. The "reasons" for cessation can vary and may

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74 *Wagner*, 8 Ohio App.3d at 94, 456 N.E.2d at 526 (emphasis added).

75 W. Va. Code § 36-4-9a (2015).

76 Saulsberry v. Siegel, 252 S.W.2d 835 (Ark. 1952) (Wells were destroyed by fire and took four years to repair. Additionally, Lessors did not claim the lease terminated during the four years the wells were not producing but, rather, made the claim approximately 20 years later.).

77 *McCullough Oil, Inc.*, 176 W. Va. 638, 346 S.E.2d at 788 (1986); *Wagner*, 8 Ohio App.3d at 93, 456 N.E.2d at 526.

include, among other things, the need for equipment or technical repairs, reworking operations, pipeline constraints or simply a lack of market for production. One West Virginia court indicated that a temporary cessation is excusable when "the reason for the period of cessation is incidental to the normal operation of the lease . . . ."[78] When cessation results from circumstances beyond the lessee's control, though, a longer cessation is more likely to be considered temporary than if the circumstances were within the lessee's control as a prudent operator.[79] Thus, it is expected and reasonable that a well may need to be taken out of production temporarily, but there is a direct correlation between the length of the cessation, the reason for it and the diligence of the operator in remedying the problem.

The reasonableness of the time of the cessation can be measured by the length of time it might take to fix a problem. Thus, in *Bryan v. Big Two Mile Gas Co.*, a four-month cessation was not excused when the evidence demonstrated that the malfunctioning equipment could have been replaced in a "matter of days."[80]

[c] — The Diligence of the Lessee.

The third, and perhaps most important, consideration in testing whether a cessation is temporary is the diligence of the operator in restoring production. If a lessee is slow to act, acts in bad faith or otherwise does not meet the standard of a diligent, prudent operator, the cessation is more likely to be treated as permanent.[81] In *Wagner v. Smith*, the Ohio court considered all three factors where a lessee failed to produce for three years due to water in the borehole, resulting in a failure of the well to produce. However, the court's holding was largely based on the lessee's lack of diligence, in that the evidence indicated that the lessee did not discover the well defect until six months after production had ceased, and repairs were not undertaken

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78 *Bryan*, 213 W. Va. at 118, 577 S.E.2d at 266.

79 Hill v. Trenkle, 251 A.D. 782, 297 N.Y.S. 1020 (4th Dep't 1937). *See* N.Y. Jur. Mines § 50.

80 *Bryan*, 213 W. Va. at 118, 577 S.E.2d at 266.

81 *Wagner*, 8 Ohio App.3d at 94, 456 N.E.2d at 526.

for another year after that.[82] The *Wagner* court, accordingly, overturned the trial court and held:

> [I]n light of the totality of circumstances, that appellee did not proceed with the diligence required in respect to the rights of the lessors and that the cessation of production was for an unreasonable length of time and, thus, was more than a 'temporary' cessation of production.

Pennsylvania, unlike West Virginia, Ohio, New York and Kentucky, has no case recognizing the temporary cessation of production doctrine.[83] However, a period of cessation, followed by a renewal of production, has been held to result in a tenancy at will.[84] Thus, in Pennsylvania, when a leasehold ceases production but the lessee revives operations thereon, a tenancy at will occurs rather than an automatic termination, so that the lessee is not liable for trespass, and the lessor must then notify the lessee of its desire to terminate the lease. A similar result can occur in other states, such as Kentucky, where a lessee drilled a well, but abandoned its lease for lack of production, only then to re-enter the property with the acquiescence of the lessor and begin operations again.[85] In such an instance, although subject to the will, and

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82 *Id*. at 93, 456 N.E.2d at 526.

83 The issue of "temporary cessation" was referenced once by the Pennsylvania Supreme Court in *Cole v. Philadelphia Co*., 26 A.2d 920 (Pa. 1942), when the court rejected a producer's argument that "temporary cessation" constituted "abandonment" of the lease. *Cole*, 26 A.2d at 923. The landowner in *Cole* sued to recover unpaid royalties. *Id*. at 921. The producer defended the suit on the grounds that he had "abandoned" the lease prior to that time by temporarily disconnecting the well. *Id*. The *Cole* panel opined that "[a] cessation of operations for a short time does not signify the same intention of abandonment." *Id*. Remarkably, outside of the *Cole* opinion, there does not appear to be another Pennsylvania appellate court that has even addressed the issue of "temporary cessation."

84 *Heasley,* 2012 Pa. Super. 151, 52 A.3d 341; *see also, Cassell*, 193 Pa. 359 (holding that the moment an oil and gas lessee stops producing from the property, the lessor has the right to terminate the lessee's tenancy, and if the lessee holds over, it is as a tenant at will).

85 Bay State Petroleum Co. v. Penn Lubricating Co., 121 Ky. 637, 87 S.W. 1102 (1905); *see also*, *Bryan*, 577 S.E.2d 258, 266 (containing dicta that a holdover tenancy may arise if the lessor were to accept payments or acquiesce in the continued use of the land by the operator).

possibly the knowledge, of the lessor, the lessee was allowed to continue to operate the property without being liable for trespass.

[2] — Cessation Due to Price or Depressed Markets.

As this chapter is written, many areas of the country, particularly the eastern mineral-producing states, are seeing all-time high prices of natural gas fall to all-time lows and an oversupply condition which will likely not end any time soon. In this cyclical gas marketplace,[86] producing gas profitably in certain areas might be difficult. Our discussion above at Section 25.02, particularly in the example given with prices at $1.41 per dth, indicates that production at a profit in some areas might be difficult to impossible, given the depressed market, and this might occur despite the diligent efforts of the operator. The question this presents is whether an operator, who, despite best efforts cannot operate profitably, can cease production in hopes that market conditions will improve.[87]

Unfortunately, no case could be found that squarely addresses this question and provides guidance on the ability of an operator to invoke the temporary cessation in production doctrine and keep a lease in effect without "production," when confronted with the alternative of either operating at a loss or shutting-in. This dilemma pivots on the question of whether courts will show deference to an operator's diligence, good faith judgment and "reasonable expectations" or whether a court might take a more hard line approach and find that, so long as a market exists, a lease will remain in effect only so long as profitable production occurs, or, stated another way, might a court hold that the temporary cessation of production doctrine does not apply if there is a market, albeit at a loss.

An analytically related situation presents itself where a market for natural gas exists, but the lessee's best economic judgment is that total economic return from the well may be maximized by voluntarily shutting-in the well for a period of time until the market for natural gas improves and it may

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86 Introduction and Section 25.02[4].

87 *See generally,* J. Thomas Lane, Thomas A. Heywood, "Maintaining Oil and Gas Leases in Depressed Gas Markets" 8 *E. Min. L. Inst.* 14 (1987).

reasonably be expected that prices for natural gas will increase. Does the lessee have discretion under an oil and gas lease to make the decision to shut-in a well and not market gas where a market, albeit a poor one that could earn a slight profit, is available? Under the typical habendum clause, there is no easy answer to this question.

Again, we are not aware of a reported case that squarely addresses the situation in which a lessee has voluntarily capped production during the secondary term of an oil and gas lease because of dissatisfaction with the price the gas is bringing, although the well is still capable of producing and could, in fact, yield a slim profit under existing conditions. However, the few reported cases, which involve similar conditions or touch upon related issues, have inconsistent results, but most suggest that a lessee has a certain amount of discretion in rejecting unfavorable sales contracts and in shutting-in wells under certain circumstances.

The least favorable result from the operator perspective is *Hutchinson v. McCue*,[88] where the Fourth Circuit Court of Appeals held that a lease terminated where a lessee, after drilling and producing from two wells, ceased making deliveries of gas from the wells under an existing sales contract, shut-in the producing wells, and attempted to negotiate a long-term contract at a better price. Although such a contract was ultimately negotiated and a third well was drilled, a variety of problems prevented the sale of any gas under the second contract until approximately eight months after the expiration of the 10-year primary term of the lease and five years after production ceased. Without production, no rentals or royalties whatsoever were paid after the original sale contract was terminated and, more importantly, after expiration of the primary term of the lease.

The majority in *Hutchinson*, over the vigorous dissent of Judge Parker, concluded that the lessee had failed to operate the premises with the diligence and efficiency required of the lessee. Given that much of the majority's analysis focused on the fact that the lessor received no benefit from the lease after the wells were shut-in, it is unclear whether the majority would have reached the same conclusion had the lessee been paying shut-in

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88 Hutchinson v. McCue, 101 F.2d 111 (4th Cir.) cert. denied 308 U.S. 564 (1939).

royalties in accordance with the terms of a shut-in royalty provision or had the lessee demonstrated that operations under the available market would have been at a loss. In any event, the court in this case did not consider the "reasonable expectations" of the operator, and the court noted that although market conditions were bad, the court concluded that the "evidence offers no sufficient explanation" why sales were curtailed by the operator.[89]

Additionally, at least one Illinois court has expressly held that the fact of a depressed market cannot be used to justify nonproduction as a depressed market does not prevent the operation of a well.[90] That court found that the market conditions could not justify the nonproduction because "the depressed price of oil was not contracted against" in the lease.[91] Other courts have similarly held that "fluctuations" in market prices may not excuse a lessee's failure to produce in paying quantities,[92] though such a market state may justify cessation for a reasonable time.[93]

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89 The majority's ruling in Hutchinson has been criticized as wrongly decided, both explicitly, *see* Weaver, "Implied Covenants in Oil and Gas Law Under Federal Energy Price Regulation," 34 *Vand. L. Rev.* 1473, 1517 n.164 (1981), and implicitly, *see* Pierce, "Lessee/ Lessor Relations in a Turbulent Gas Market," 38th *Inst. on Oil & Gas L. & Tax'n*, Ch. 8 (Matthew Bender & Co. 1987).

90 Dart v. Leavell, 795 N.E.2d 310, 315 (Ill. App. Ct. 2003).

91 *Id.*

92 *See, e.g.*, Smith v. Marshall Oil Corp., 85 P.3d 830, 834 (Okla. 2004). In *Smith*, the lessee "offered no compelling equitable considerations" that would justify his decision not to produce; rather, the court noted, the lessee testified that he "deliberately ceased production, hoping oil and gas prices would rise." *Id.* at 835. The court reiterated that this was the lessee's "mere 'hope.'" That court explicitly stated that "[f]luctuating market prices do not rise to the level of an equitable consideration [which may save a lease from termination even with unprofitable well operations], or an excuse for [a lessee's] failure to produce in paying quantities." *Id.* at 836.

93 Collins v. Mt. Pleasant Oil & Gas Co., 118 P. 54, 56 (Kan. 1911). In *Collins*, the lessee claimed that the wells would have been profitable if the price of oil had remained where it was when the lease was made, but that the price fell from $1.16 to 28 cents per barrel, and that the wells could not operate at a profit at those prevailing rates. *Id.* at 55. The lessee's failure to operate for five years due to impossibility of operating "on a paying basis," despite diligent efforts to find a market for oil, was found to constitute abandonment of the well, thus cancelling the lease. *Id.* at 56.

In *Gazin v. Pan American Petroleum Corporation*,[94] the Supreme Court of Oklahoma considered an action by a lessor seeking to cancel a lease on the alternative grounds that either the lease expired by its own terms or that the lessee had unreasonably delayed the marketing of gas from the well in question. The lease was for a primary term of five years, required the commencement of a well within one year or the payment of delay rentals, and contained the ordinary habendum clause language that the lease would continue in effect for as long as either oil or gas was produced. The lease was executed in May 1954; a gas well capable of producing more than 20 Mcf of gas was completed in October 1956; and shut-in and appropriate delay rentals were paid and accepted during the primary term of the lease. However, no contract for the sale of gas was made until April 1960, some 11 months after the expiration of the primary term of the lease, facts very similar to *Hutchinson v. McCue*.

The Supreme Court of Oklahoma first rejected the lessor's contention that the lease had expired by its own terms, since there was a well capable of production and the lessee had timely paid the delay rentals due under the lease. Turning to the lessor's contention that the lessee had breached the implied covenant to market, the court observed that the lease contained no express marketing requirement; therefore, a requirement to market within a reasonable time would be imposed as part of the implied covenant.

The court next noted that, while earlier Oklahoma cases had held that the implied covenant to market did not require the expenditure of considerable sums of money for equipment or pipeline to market the gas, in this case only a nominal sum would have been required since the gas could have been marketed under a contract with a pipeline company whose pipeline was less than one mile from the well. Accordingly, the simple question before the court was whether the lessee could permissibly refuse to enter into a sales contract with a potential, willing buyer while gas was being shut-in and not marketed.

The pipeline company's initial proposed contract provided that the pipeline company could purchase the gas "as and when needed and required" at the price of $0.10 per Mcf (and later $0.11 per Mcf, pursuant to an escalator

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94 Gazin v. Pan Am. Petroleum Corp., 367 P.2d 1010 (Okla. 1962).

provision). The court's opinion further indicates that the lessee knew from its own experience, and from that of other producers in the area, that the pipeline was purchasing a minimal amount of gas under similar contracts.

After completion of the well, the lessee had also contacted another potential purchaser whose line was located some 18 miles away. This potential purchaser was offering an initial price of $0.15 per Mcf, provided that the lessee could establish reserves in excess of 40 billion cubic feet. Armed with this offer, the lessee continued its negotiations with the first pipeline company and was eventually able to negotiate a contract with the first pipeline company at a price of $0.15 per Mcf, which obligated the pipeline to take or pay for five percent of the proven reserves of every well under the dedicated tract upon the establishment of proven reserves of 20 billion cubic feet of gas. The requisite reserves were established in January 1960, and the contract was executed in April 1960.

The Oklahoma Supreme Court upheld the trial court's finding that the lessee had proceeded with due diligence in seeking and obtaining a satisfactory market within a reasonable time under the facts and circumstances of the case. Indeed, there can be little question but that the lessee conferred a substantial benefit upon the lessor, as well as upon itself, by virtue of its action in rejecting the available contract offer and keeping the wells shut-in, pending the negotiation of a more favorable contract. At the very least, this case stands for the proposition that a lessee may reject the first purchase offer with which it is presented where there exists a reasonable prospect of obtaining a more favorable sales arrangement.

Another case in which a court has explicitly held that a lessee has complied with its implied covenant to market, even though the lessee refused to market gas, is *Poafpybitty v. Skelly Oil Co.*[95] Here, the lessors brought an action for waste and breach of the implied covenant to market against a lessee that was flaring casinghead gas instead of marketing the gas. Despite continuing negotiations for the sale of the gas, the lessee refused to enter into a contract for its sale on the grounds that (1) a better price could be obtained if the same purchaser had the opportunity to buy gas—well gas, as well as

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95 Poafpybitty v. Skelly Oil Co., 517 P.2d 432 (Okla. 1973).

casinghead gas—and (2) there were rumors that another pipeline company might be entering the area and offering a higher price for casinghead gas in the near future.

The Supreme Court of Oklahoma sustained the trial court's ruling that, as a matter of law, the evidence indicated that the lessee had complied with its implied duty to find a market for casinghead gas, insofar as the lessee had complied with the normal procedures and practices within the industry in seeking a market. Although, in *Poafpybitty*, the lessors apparently did not seek cancellation of the lease but merely damages, the case holds that a lessee has not violated the implied covenant to market where it has complied with the normal practices and procedures of the industry in seeking to market its gas and has rejected sales offers in the hope and expectation that a better market could be obtained.

While there are other cases that hold that a lessee need not accept the first gas purchase offer with which it is presented,[96] there are no reported cases that squarely uphold the right of a lessee to shut-in wells already put on line in the absence of express contractual authority to do so. However, in the case of *Nordan-Lawton Oil and Gas Corp. of Texas v. Mille*r,[97] the court upheld the decision of a lessee to shut-in two wells under a gas lease rather than produce the gas where there was a contract in effect pursuant to which gas from the wells could have been marketed. Sales from the wells would have resulted in a downward revision in estimated field reserves and a corresponding decrease in the purchaser's take obligation. Deliveries were being made from two other wells under the lease, so there was no question of production sufficient to sustain the lease. However, the court did reject the lessor's contention that failure to market the gas from the two shut-in wells was, under the circumstances, a breach of the implied covenants to develop and market. In refusing to attach any significance to the lessor's evidence

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96 *E.g.*, Sword v. Rains, 575 F.2d 810 (10th Cir. 1978) (held lease did not terminate although no gas was delivered until some ten months after the expiration of the primary term; test is whether the lessee has acted with due diligence in marketing the gas under the circumstances).

97 *Nordan-Lawton*, 272 F. Supp. 125 (W.D. La. 1967), *aff'd*, 403 F.2d 946 (5th Cir. 1968).

that it would have been better to have negotiated a shorter term contract at a lesser price so as to produce more gas on a current basis, the court observed:

> Thus, the general rule in this regard applicable here is that whatever shortcomings in the lessee's conduct may be revealed by hindsight, a covenant is not breached if, under the circumstances, an ordinary prudent operator might have followed the same course. Such a course has been followed here.[98]

The lessor apparently did not appeal the district court's findings and conclusions on this point.[99]

Although the foregoing cases suggest that a lessee has discretion to reject initial sales offers where there is at least a reasonable expectation that a better contract can be secured and to shut-in wells where to produce gas from such wells would be economically unwise, not every case has looked as favorably upon a lessee who foregoes existing marketing opportunities in the reasonable expectation of securing a better market as seen in *Hutchinson v. McCue*.

From a theoretical perspective, though, it would seem that a lessee should be accorded substantial discretion to shut-in wells for a period of time where the lessee has a reasonable expectation that total economic return from the wells can be maximized after shut-in. Essentially, the duty owed by the lessee to the lessor is the duty of good faith and fair dealing, which inheres in every contract.[100] From this duty of good faith, fair dealing and cooperation springs the obligation imposed on every lessee to conduct operations as an ordinary, reasonable, and prudent operator would, so as to effectuate the purposes of the lease agreement.[101] Thus, commentators are virtually unanimous in the view that a lessee should be afforded discretion to shut-in a well where an

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98 *Id*. at 137-38.

99 *Nordan-Lawton*, 403 F.2d at 946-47, n.1.

100 *See, e.g*., Triangle Mining Co. v. Stauffer Chem. Co., 753 F.2d 734 (9th Cir. 1985).

101 *See, e.g*., Piney Woods Country Life School v. Shell Oil Co., 539, 957 (S.D. Miss. 1982), aff'd, 726 F.2d 225 (5th Cir. 1984), *reh. denied* 750 F.2d 69 (5th Cir. 1984), *cert. denied*, 471 U.S. 1005 (1985) (failure to procure price renegotiation clause in contract for sale of gas does not represent breach of duty to secure highest price for gas; lessee acted with care and diligence required by ordinary, prudent lessee).

operator of ordinary prudence might do so, giving due consideration to the interests of both lessor and lessee, even in the absence of express contractual authority to do so.[102] In these cases, it is submitted that the temporary cessation in production doctrine should apply, and that the "diligence" of the operator should be tested by his efforts to seek a market that ultimately benefits both parties.

[3] — Other "Savings" Events and Special Provisions.

[a] — Cessation Clause with Grace Period.

In lieu of the risks of automatic termination or conversion to a tenancy at will, many leases have express provisions that contemplate cessations and provide a grace period to restore production. In those cases, the grace period has been held to define the period in which a cessation might occur without termination of the lease. According to the West Virginia Supreme Court:

> where an oil and gas lease (or other mineral lease) contains a cessation of production clause applicable to the secondary term, the lease terminates automatically at the end of the 'grace period' provided by such clause, unless production or operations are resumed within the grace period.[103]

[b] — Operations Clause.

An operations clause is commonly used to allow for the lease to continue, absent production, provided that drilling operations are in progress. A typical operations clause provides:

> If, at the expiration of the primary term, Lessee is conducting operations for drilling a new well or reworking an old well, or if, after the expiration of the primary term, production on this lease should

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102 4 Williams & Meyers, Oil and Gas Law § 856.3; Pierce, "Lessee/Lessor Relations in a Turbulent Gas Market," 38th *Inst. on Oil & Gas L. & Tax'n*, Ch. 8 (Matthew Bender & Co. 1987); Weaver, "Implied Covenants in Oil and Gas Law Under Federal Energy Price Regulation," 34 *Vand. L. Rev.* 1473, 1510 (1981). *But see* Sandlin, "Intrastate Marketing of Gas, The Implied Covenant to Market and the Shut-In Gas Royalty," 17 *Ark L. Rev.* 104, 117 (1963).

103 *McCullough Oil, Inc.*, 176 W. Va. at 645, 346 S.E.2d at 795.

> cease, this lease nevertheless shall continue as long as said operations continue or additional operations are had, which additional operations shall be deemed to be had where not more than sixty (60) days elapse between abandonment of operations on one well and commencement of operations on another well, and if production is discovered, this lease shall continue as long thereafter as oil, gas or other mineral is produced and as long as additional operations are had.[104]

Thus, an operations clause serves to make drilling operations a condition, in addition to production, which will extend the term. A key factor in determining whether the lessee's operations have been sufficient to maintain a lease past its primary term is often the demonstrated good or bad faith of the lessee in proceeding to bring a well to completion.[105] One Pennsylvania

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104 Fields v. Stanolind Oil & Gas Co., 233 F.2d 625 (5th Cir. 1956).

105 *See, e.g.*, Pemco Gas, Inc. v. Bernardi, 5 Pa. D. & C.3d 85, 92 (1977) ("... actual drilling is not necessary and ... physical acts normally required to be done prior to the commencement of actual drilling, if done in good faith, are sufficient"); Butler v. Nepple, 354 P.2d 239, 242-243 (Ca. 1960) (cited in *Pemco Gas*, 5 Pa. D. & C.3d at 96) ("[T]he commencement of drilling operations . . . must be something more than a pretense, *i.e.*, must be done with the bona fide intention to follow it with actual drilling operations prosecuted with reasonable diligence."); True Oil Co. v. W. R. Gibson, Jr., 392 P.2d 795, 799-801 (Wyo. 1964) (cited in *Pemco Gas*, 5 Pa. D. & C.3d at 96) (holding that the lessee "did not have a bona fide and unconditional good-faith intention to complete the well" because its intentions were "qualified and contingent upon the success of its negotiations" over a farm-out agreement); Geier-Jackson, Inc. v. W. B. James, 160 F. Supp. 524, 530 (E.D. Texas 1958) (cited in *Pemco Gas*, 5 Pa. D. & C.3d at 96) ("[Lessee]'s intent to drill must have been unqualified. An intent to drill on the happening of certain contingencies such as favorable information gained from the drilling of [another] well or the making of favorable financial arrangements for drilling by the [lessee] . . . would not be sufficient."); Duffield v. Russell, 10 Ohio C.D. 472, 19 Ohio C.C. 266 (Ohio Cir. Ct. 1899) (*affirmed* without comment by Supreme Court of Ohio, 65 Ohio St. 605, 63 N. E. 1127 (1902) (held that staking out the well and purchasing timber on the last day of the primary term with a bone fide intention to drill the well was commencement of operations); Kaszar v. Meridian Oil & Gas Enterprises, Inc., 27 Ohio App. 3d 6, 499 N.E.2d 3 (11th Dist. 1985) (*cert. denied* by Supreme Court of Ohio in Case No. 85-1371) (held the surveying and staking out of the well site, as well as filing documents with the SEC constituted commencement of operations); *but see* Gisinger v. Hart, 115 Ohio App. 115, 184 N.E.2d 240 (4th Dist. 1961) (holding that where the secondary term called for "as much longer as oil and gas is produced in paying quantities" that lease terminated at the end of the primary term since nothing occurred on the tract until 10 days before the expiration of the primary term and the attempt to drill only four days before the expiration of

court has defined good faith in this context as the lessee's "bona fide intention to proceed thereafter [preliminary operations] with diligence toward the completion of the well."[106]

[c] — Pooling and Unitization Provisions.

In today's world, where multi-well pads are used to produce large geographic areas of land by way of horizontal wells that generally transect multiple tracts, the ability of a lessee to pool leaseholds is, in most cases, a necessity. Without the lessor's approval, or a compulsory pooling statute, a lessee generally cannot affect the lessor's rights under the lease by pooled or unitized operations.

An express pooling and unitization[107] provision in a lease will generally provide (i) that production (or operations) from anywhere on the unit shall be treated as if it were on the leasehold property, and (ii) that the lessor will be paid royalty in relation to the amount of leased acreage to the total acreage in the unit. It is the first purpose that we focus on here; namely, a pooling clause's express modification of the traditional habendum of a lease to allow for production from non-leasehold acreage to hold the lease.

Once a leasehold is combined with other properties pursuant to a pooling and unitization clause, then production from a well drilled anywhere within the unit will generally serve to continue the entire leasehold (or only the acreage so unitized ((discussed below in the context of a "Pugh clause")) under the secondary term). Importantly, though, a lessee has a duty of fair dealing or good faith in its exercise of the pooling power.[108]

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the primary term, because it would have been highly unlikely to have "production in paying quantities" at the end of the term so as to extend it, even though the lessors had interfered with lessees in the days right before expiration of the primary term.).

106 *Pemco Gas*, 5 Pa. D. & C.3d at 92.

107 A unitization provision may vary from a pooling provision, in that it is generally applicable in the context of secondary recovery activities, which may encompass an entire oil and gas field; however, for our purposes, such distinction is not important, as a unitization clause will generally also modify the habendum to allow for continuation of the lease without actual operations on the leasehold itself.

108 Imes v. Globe Oil & Refining Co., 184 Okla. 79, 84 P.2d 1106 (1938).

[i] — Pugh Clause.

From the lessor's perspective, a lessee may have too much power under a general pooling and unitization provision. To the extent that the lessor may wish to limit the discretion the lessee has to extend the lease or to affect the lessor's royalty, a pooling variation commonly known as the "Pugh Clause" appears as a compromise of the lessee's pooling and unitization powers. There are infinite iterations of a Pugh clause, including a traditional Pugh clause, which contemplates a vertical separation only, and a horizontal clause, which contemplates a horizontal separation of the leasehold. Following is an example of a standard version that is applicable both vertically and horizontally:

> In the event the leased premises shall be separated or divided into two or more horizons, levels or formations by assignments, or shall be pooled or unitized with other premises, in whole or in part, by agreement or governmental order, such event or events shall constitute a severance of the leased premises, and thereafter the acreage, or horizons, or the acreage and horizons so separated, or the acreage, or horizons, or the acreage and horizons included in each separate pool or unit and the acreage, or horizons, or the acreage and horizons not included within any pool or unit each shall be treated as though covered by a separate lease containing the provisions and stipulations of this instrument.[109]

Thus, the above-quoted clause would have the effect of limiting the acreage/formation that could be held by production from the unit to only those included in the unit. A Pugh clause then still allows a lessee to hold leasehold property by production from other lands, but limits the effect of activities under the pooling clause to only that part of the leasehold included in the pooled unit.

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[109] Houston and Merrill, "A Suggested Oil and Gas Lease Form," 43 *Neb. L. Rev.* 471, 483 (1964).

[ii] — Retained Acreage Clause.

A retained acreage clause is a cousin to a Pugh clause, in that it, too, will limit the extent of the property that can be affected by drilling operations/ production under the lease. Generally, a retained acreage provision is coupled with express drilling obligations, sometimes referred to as a continuous drilling program. Following is an example of a retained acreage clause:

> Upon cessation of continuous drilling operations, except as provided above, this lease and all rights hereunder shall automatically terminate as to all lands covered hereby, SAVE and EXCEPT, as to each well then capable of producing oil and gas in paying quantities together with ___ acres allocated thereto as of the date of such termination, and shall further terminate as to all depths below 100 feet below the total depth in a well located on each such unit, or as to all depths below which the base of the deepest producing formation in each such well, whichever is greater.[110]

A retained acreage provision, like a pooling provision, affects the operation of the habendum clause. However, the retained acreage provision could cause a limitation on the leasehold acreage (or depths/formations) that will be held by production according to the quantity and /or depths of the wells drilled.

Thus, pooling and unitization provisions can operate to hold a lease without actual production from the leasehold. Limitations on the pooling power in the form of a Pugh clause and/or an express drilling requirement, coupled with a retained acreage clause, can change the make-up of the leasehold by causing acreage (or depths/formations) to be released from the held-by production lease.

[d] — Reworking Clause.

As discussed above, most of the producing states recognize the temporary cessation of production doctrine; however, there is a lack of certainty for a

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110 Example taken from Allen D. Cummings, "Rights, Obligations, and Problems of Depth-Severed Mineral and Leasehold Ownership," 49 *Rocky Mtn. Min. L. Inst.* 26 (2003).

lessee as to whether and how it will be applied. In order to make express the terms under which the parties to a lease agree that a temporary cessation is excusable, many lease forms contain a provision along the lines of the following:

> If after discovery of oil, gas or other mineral, the production thereof should cease from any cause, this lease shall not terminate if lessee commences additional drilling or reworking operations within sixty days thereafter, or if it be within the primary term, commences or resumes the payment or tender of rentals, or commences operations for drilling or reworking on or before the rental paying date next ensuing after the expiration of sixty days from date of . . . cessation of production.[111]

Under the above clause, it is highly unlikely that a lease would be held to have terminated for lack of production, provided that drilling or reworking operations commenced within 60 days. Such a provision will substitute for the reasonableness of an operator's diligence under the cessation of production doctrine. However, a potential pitfall for fixing a definite time where cessation is excused is that it may entirely replace the doctrine, which, depending on the facts and the leanings of the court, could have the opposite result of its intent to preserve the lease.[112]

[e] — Shut-In Provisions.

It is common for a lessee to complete a well capable of producing in paying quantities but be unable to produce the well for lack of pipeline infrastructure or a market.[113] Although a few states, like West Virginia, recognize discovery of natural gas as enough to continue a lease beyond the

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111 Roberts v. Corum, 236 Miss. 809, 112 So. 2d 550 (1959).

112 *See* Samano v. Sun Oil Co., 621 S.W.2d 580 (Tex. 1981) (holding that a lease terminated under a 60-day cessation of production clause when there were no operations for 73 days after production stopped); *see also McCullough Oil, Inc.*, 176 W. Va. 638, 346 S.E.2d 788.

113 *See* Derosa v. Hess Ohio Resources LLC, 2014 WL 4249861 (S. D. Ohio 2014) (Slip Copy) (holding that shut-in royalty payments held the acreage within the pooled unit until the gas could be marketed; however, the acreage outside of the pooled unit was not held by the shut-in royalty provision and amounted to a failure of reasonable development, resulting in a termination of those acres outside the pooled unit.).

primary term, most require production. Additionally, even where a lease may be extended by discovery or otherwise, under an implied duty to market, a lessor may assert a termination if a well remains shut-in.[114] Further, when a lease is extended by way of an operations clause (discussed above) in lieu of actual production, there will inevitably be a passage of time, once the well is drilled, before completion of the well and the marketing of the natural gas. To avoid this issue, most oil and gas leases contain a shut-in royalty provision along the lines of the following:

> In the event that production of oil, gas, or their constituents is interrupted and not marketed for a period of twelve months, and there is no producing well on the Leasehold, Lessee shall thereafter, as Royalty for constructive production, pay a Shut-in Royalty equal in amount and frequency to the annual Delay Rental payment until such time as production is re-established (or lessee surrenders the Lease) and this Lease shall remain in full force and effect.[115]

The effect of a shut-in provision is to provide a substitute for production in satisfaction of the habendum clause and in avoidance of an automatic termination for lack of actual production. Thus, as a precursor to a well qualifying for shut-in status, generally such a well must first be completed and capable of producing in paying quantities.[116]

An underlying issue, even where the period of shut-in is limited and expressly stated in the lease, is the length of time that shut-in payments can operate to relieve a lessee from its implied obligation to market production from the property.[117] Another common issue is whether shut-in royalty

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114 3 Williams & Meyers, *Oil and Gas L*aw § 631.

115 Taken from an Appalachian Lease form.

116 3 Williams & Meyers, *Oil and Gas L*aw § 632 at footnote 3.

117 A complete answer to the argument that a shut-in clause is unfair to a lessor because it would allow a lessee to hold a lease forever without producing, is that the lessee owes a duty to be diligent in searching for a market; for a breach of which he is liable possibly for damages, cancellation or an alternative decree. Similarly the shut-in well does not excuse the lessee from the usual implied covenants to further develop, to offset and to otherwise conduct himself as would a reasonable and prudent lessee under the same or similar circumstances

payments can maintain a lease where there is no production for reasons other than a lack of the ability to market. Generally speaking, if the shut-in royalty clause does not limit its application to a lack of a market, the clause should be applied to whatever is the cause of the shut-in, so long as the operator acts in good faith and complies with its other express and implied duties.[118]

[f] — *Force Majeure*.

Most modern oil and gas leases contain a *force majeure* clause, which allows the lessee to preserve the lease when forces beyond its control keep it from developing the oil and gas property. If other clauses do not cover a contingency under which production ceases, then a *force majeure* provision can step in to remedy a failure to produce and sell gas due to unforeseen circumstances. Although many variations of a *force majeure* clause can be found, the following is a straightforward provision that provides for a majority of *force majeure* situations:

> If, after production has been obtained, operations under this lease are delayed, interrupted or prevented by acts of God, fire, riots, wars, strikes, inability to obtain equipment due to governmental order or action, or by failure of carriers to transport equipment, or by regulation of State or Federal action, this lease shall not terminate or be forfeited and no right of damages shall exist against lessee by reason thereof, provided operations are commenced or resumed within a reasonable time after removal of such cause or causes. If at any time within three months prior to the expiration of the primary term of this lease, production has not been obtained and the commencement or continuance of operations for the drilling of a well on said lands is delayed or prevented by any of the causes

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Masterson, "The Shut-In Royalty Clause in an Oil and Gas Lease," Rocky Mtn. Min. L. Inst. 315, 330 (1958). *See also,* Lelong v. Richardson, 126 So. 2d 819, 14 O.& G.R. 951 (La. App. 1961) (suggesting that payment of shut-in royalty does not relieve lessee of his covenant obligations).

118 *But see,* Tucker v. Hugoton Energy Corp., 855 P.2d 929 (Kan. 1993) (holding that shut-in royalty clause could not be used to hold a lease where a market for the gas did exist, but for a very low price).

> mentioned in this paragraph, the said primary term and all other terms of this lease may be extended for successive periods of time while such cause or causes exist, by continuing the payment or tender of delay rentals in the manner and amount and for the periods of time as provided in Paragraphs ____ of this lease for deferment of the commencement of drilling operations during the said primary term.[119]

Although there is not a lot of case law concerning the construction and effect of a *force majeure* clause in the context of an oil and gas lease, generally it appears that courts will give them a narrow construction and application.[120]

[g] — Non-Forfeiture Provision.

In spite of the limitations that may be found in the habendum clauses of the type discussed herein, it is not uncommon to see savings provisions in "thereafter" oil and gas leases such as notice-and-demand clauses or judicial-ascertainment and non-abandonment clauses.[121] The aim of these non-forfeiture provisions is essentially to avoid an automatic termination of the leasehold. An example of one such clause reads:

> After discovery of oil, gas or other minerals upon said premises, the title to all minerals in and upon and underlying the surface of the land described in this lease shall remain and be vested in lessee and shall not revert to lessor nor end until there is a complete, absolute and intentional abandonment by lessee of each and all of the purposes, either express or implied, of this lease and every part and parcel of

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119 Lamczyk v. Allen, 8 Ill.2d 547, 134 N.E.2d 753 (1956).

120 Perlman v. Pioneer Ltd. P'ship, 918 F.2d 1244 (5th Cir. Tex. 1990). For a strict construction of a ***force majeure*** **clause** of a gas sales contract, *see* Gulf Oil Corp. v. Federal Energy Regulatory Comm'n, 706 F.2d 444 (3d Cir. 1983), *cert. denied*, 464 U.S. 1038, 104 S. Ct. 698, 79 L. Ed. 2d 164 (1984).

121 Conny Farms Ltd. v. Ball Resources, Inc., 2011 Ohio 5472 (7th Dist.) ("Conny Farms I") (held that judicial ascertainment clauses within oil and gas leases are unenforceable as against public policy.). But in New Hope Community Church v. Patriot Energy Partners LLC, 2013 Ohio 5882, 6 N.E.3d 70 (7th Dist. 2013) (Same court did not extend *Conny Farms* and held that arbitration clause was valid and not against public policy.).

> the lands described herein. Such abandonment is the only manner by which lessee's title to such minerals can be ended and title to said minerals be reinvested in lessor.[122]

Closely related to the above non-forfeiture provision is a judicial-ascertainment provision, except that judicial ascertainment provides that a lease will not be terminated until final determination of such by a court, and then, after judgment, may even provide that the lessee will have a reasonable opportunity to cure the breach and avoid the termination. Another related clause, a notice-and-demand provision, on the other hand, is drafted so as to require a lessor to provide notice and an opportunity to cure its breach prior to an action for forfeiture or otherwise.

There is an inconsistency, however, between non-forfeiture–type provisions and the limitation found in a habendum clause. This inconsistency may be a difficult hurdle to overcome for a lessee wishing to revive an oil and gas lease that terminated for lack of production.[123] Although courts are reticent to forfeit a real property interest, such as a vested oil and gas leasehold, they also are generally not inclined to allow a contractual expression to trump a habendum clause that clearly indicates the lease ends when production stops. In some cases, the court held that "judicial-ascertainment" clauses are void as against public policy.[124]

§ 25.04. Alternative Lease Forms.

To this point, the focus of this chapter has been on the traditional oil and gas lease habendum clause, which limits the duration of the secondary

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[122] Freeman v. Magnolia Petroleum Co., 141 Tex. 274, 171 S.W.2d 339 (1943).

[123] In *Freeman*, the Texas court held that the leasehold estate automatically terminated where no production had occurred, even though a well, capable of production, had been drilled. The provision quoted was "held to contemplate a discovery and production of gas in *paying* quantities in order thereby to vest title to the minerals" in lessees. *Freeman*, 141 Tex. at 274, 171 S.W.2d at 339. *See also*, Preston v. Lambert, 489 S.W.2d 955, 44 (Tex. Civ. App.–Eastland 1973); Lynch v. Southern Coast Drilling Co., 442 S.W.2d 804 (Tex. Civ. App.–San Antonio 1969). *But see,* Whelan v. Shell Oil Co., 212 S.W.2d 991 (Tex. Civ. App.–Texarkana 1948) (placing some weight on this clause in holding a lease had not been terminated by abandonment).

[124] Wellman v. Energy Resources, 210 W. Va. 200, 557 S.E.2d 254 (2001).

term to a period for which there is production of oil and/or gas. There are many variations on this traditional form that may alter the production requirement.[125] A few key variations will now be examined.

[1] — Flat-rate Royalty Leases.

A flat-rate royalty lease requires royalty of a flat sum; generally per month, quarter or year and per each well drilled on the property or per acre leased. Under a flat-rate royalty lease, the royalty is not related to the amount of oil or gas produced. Flat-rate royalty leases are now somewhat archaic, since many states, such as West Virginia and Pennsylvania, have enacted statutes that require a volumetric royalty.[126] Nonetheless, a flat-rate royalty lease, if still in effect, will most likely be one that is held by production. Following is an example of a typical flat-rate royalty provision:

> [Lessee] to pay seventy-five dollars each three months in advance for the gas from each and every gas well drilled on said premises, the product from which is marketed and used off the premises . . . while the gas from said well is so marketed and used.[127]

Since, under a flat-rate royalty lease, the lessor's royalty is merely based on a well's existence on the property and not on its level of production, it makes no difference to the lessor how much natural gas is produced from the leasehold. In a well-established line of cases in West Virginia, flat-rate royalty leases are distinguished from the "usual" oil and gas lease (production lease), in that, even with a "thereafter" habendum clause, production of oil

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125 The many variations of the traditional "thereafter" habendum clause that have additional or different requirements from production are too numerous to examine in detail here, but may include, *e.g.:* (i) production "by the lessee"; (ii) enumeration of substances that will continue the lease; (iii) a quantity requirement; (iv) production coupled with payments; (v) operations on the premises (discussed above); (vi) continuous drilling program, etc.

126 Guarantee of Minimum Royalties, 58 Pa. Cons. Stat. § 33 (1979); Permits not to be on flat well royalty leases, W. Va. Code § 22-6-8 (1994). These minimum royalty statutes are generally only applicable as to wells drilled or reworked after the effective dates of the laws.

127 From a lease form like the lease at issue in Wellman v. Bobcat Oil and Gas Inc., 2013 WL 1878927 (W. 4th C. W. Va. 2013).

and gas in paying quantities is not expressly required to extend a flat-rate royalty lease beyond the primary term.[128]

In *Bruen v. Columbia Gas Transmission Corporation*, the court stated in its only syllabus point:

> If an oil and gas lease contains a clause to continue the lease for a term 'so long thereafter as oil or gas is produced,' but also provides for 'flat-rate' rental payments, then quantity of production is not relevant to the expiration of the term of the lease if such 'flat-rate' rental payments have been made by the lessee.[129]

In a recent case, *Wellman v. Bobcat Oil and Gas Inc.*,[130] the U. S. Court of Appeals for the Fourth Circuit issued an opinion affirming the U. S. District Court's decision that, as a matter of West Virginia law, a flat-rate royalty lease with a "thereafter" habendum was not forfeited when, by undisputed evidence, there were long periods of time where no oil or gas was produced from the wells on the property. Further, the court held that, even though the lessor asserted that some quarterly flat-rate royalty payments were late or missed altogether, such payments were a contractual obligation, and the lessor's subsequent acceptance of payments thereafter acted to ratify the contractual agreement.[131] The *Bobcat* court based its decision on *Bruen* and also noted that West Virginia has long expressed a "general disfavor of forfeitures in contractual matters within the context of oil and gas lease rental clauses . . . ."[132]

In Pennsylvania, though, a flat-rate royalty lease with a "thereafter" habendum clause may not necessarily be treated differently than a production

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128 *See* Bruen v. Columbia Gas Transmission Corp., 188 W. Va. 730, 426 S.E.2d 522 (1992); Ketchum v. Chartiers Oil Co., 121 W. Va. 503, 5 S.E.2d 414 (1939); McCutcheon v. Enon Oil and Gas Co., 102 W. Va. 345, 135 S.E. 238 (1926); Basell v. West Virginia Central Gas Co., 86 W. Va. 198, 103 S.E. 116 (1920); *McGraw Oil & Gas Co.,* 65 W. Va. 595, 64 S.E. 1027.

129 Bruen v. Columbia Gas Transmission Corp., 188 W. Va. at 730, 426 S.E.2d at 522; *see also* McGraw Oil & Gas Co., 65 W. Va. 595, 64 S.E. 1027.

130 2013 WL 1878927 (W. Va. 2013).

131 *Id*. at 6.

132 *Id*. (quoting from Warner v. Haught, Inc., 329 S.E.2d 88, 95 (W. Va. 1985)).

royalty lease. Pennsylvania, like West Virginia, has an established line of cases that distinguish production royalty from flat-rate royalty leases for habendum purposes. In *T. W. Phillips Gas and Oil Co. v. Komar,*[133] the Pennsylvania Supreme Court affirmed that the lease at issue remained in effect, despite the fact that there was no production from the property, and stated:

> Where a lessor's compensation is subject to the volume of production, the period of active production of oil or gas is the measure of the duration of the lease. Where lessor's compensation is a definite and fixed amount unrelated to the volume of production, the duration of the lease is not measured by the length of time the mineral is actually extracted and marketed, but by the time during which the lease provides that the lessor shall receive the fixed rental. . . .
>
> 227 A.2d. at 165.[134]

More recently, in *Heasley v. KSM Energy, Inc.*,[135] a Pennsylvania superior court applied the rule announced in the *Phillips* case to a "thereafter" lease with a flat-rate royalty, but with the opposite result. The *Heasley* court reasoned that the royalty in *Heasley* differed from *Phillips*, in that "[t] he provisions of the *Phillips* lease agreement required the lessor be paid quarterly, *regardless* of production."[136] However, the *Heasley* court found that the royalty clause under its review required payments for the period during which ". . . the gas from said well is used."[137] The *Heasley* court reasoned that, by this language, and under the habendum clause, the lease "remained in effect only so long as production continued. When production

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133 T. W. Phillips Gas and Oil Co. v. Komar, 424 Pa. 322, 227 A.2d 163 (1967).

134 The *Phillips* court discussing Pennsylvania case law, namely *Cassell v. Crothers*, 193 Pa. 359, 44 A. 446 (1899) (standing for the rule that under a "percentage" royalty, a lease term ends when production ceases), and *Summerville v. Apollo Gas Co.*, 207 Pa. 334, 56 A. 876 (1904) (standing for the rule that where royalty is not tied to production a lease term is dependent only on the duration that lessor is to receive payments).

135 52 A.3d 341 (2012).

136 *Id*. at 346 (emphasis added).

137 *Id*.

ceased, the lease became an at-will tenancy, subject to termination by the lessor at any time."[138]

[2] — Perpetual Leases.

A delay rental, which is payable during the primary term of an oil and gas lease as consideration for foregoing operations, is similar to a flat-rate royalty in that it is a fixed sum payable in lieu of operations and/or production. In a fairly uncommon lease form, an attempt is made to allow for the lease to be extended under a modified habendum that allows for not only production and or operations, but rental payments as well, to continue the lease into the secondary term. Although, generally speaking, parties to a contract are free to negotiate agreements as they see fit, under at least one Pennsylvania case (and conceptually in line with oil and gas jurisprudence from many other jurisdictions),[139] payments alone under such a modified habendum clause were held invalid to continue a lease into the secondary term.

In *Hite v. Falcon Partners*, the habendum clause read as follows:

> "Lessee has the right to enter upon the Property to drill for oil and gas at any time withinone [sic] (1) year from the date hereof and as long thereafter as oil or gas or either of them is produced from the Property, or as operations continue for the production of oil or gas,

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138 *Id*. at 347.

139 An early oil and gas lease form, known as the "no-term" lease, allowed a lessee to either commence drilling operations or pay the lessor a rental to continue the lease with no fixed term. The "no-term" lease was heavily attacked, and multiple jurisdictions refused to enforce them. *See* 3 Williams & Meyers, *Oil and Gas L*aw § 601. The amount of litigation involving the perpetual nature of the "no-term" lease undoubtedly led to its disuse. Nonetheless, even some modern oil and gas leases are subject to attack for provisions that could lead to a perpetual primary term. Recently, in a class action lawsuit styled *Clyde Hupp, v. Beck Energy Corp*., the Common Pleas Court of Monroe County, Ohio, sustained plaintiff's motion for summary judgment with regard to a form of oil and gas lease that the plaintiff class lessor's claim violates public policy due to language that grants the lessee a "unilateral" right to perpetually postpone drilling by payment of rentals. *See* SMJ Monroe County Case No. 2011-345. However, the 7th District Court of Appeals of Ohio reversed this decision, finding the lease was not perpetual in nature. Hupp v. Beck Energy Corp. 2014-Ohio-4255, 20 N.E.3d 732 (7th Dist. 2014) (The Supreme Court of Ohio has accepted this appeal. 141 Ohio St. 3d 1454)).

> or as Lessee shall continue to pay Lessors two ($2.00) dollars per acre as delayed rentals, or until all oil and gas has been removed from the Property, whichever shall last occur."[140]

In *Hite*, the Pennsylvania superior court affirmed the trial court's holding that the lease had expired at the end of the primary term in spite of the fact that payments continued to be made. The court's opinion discusses the history of oil and gas lease agreements and the creation of the "thereafter" habendum clause in concluding:

> [T]he terms of the leases limited the privilege of foregoing production through the payment of delay rental to the one year primary term . . . . [Lessee] was permitted to delay production during the year long primary term of the leases by the tendering of a delay rental payment, but when that primary term ended and [Lessee] failed to commence production, the agreements expired.[141]

The court's holding in *Hite* was largely based on the rationale that the primary term of an oil and gas lease creates in a lessor an inchoate right that vests upon the occurrence of production of the oil and gas.[142] Thus, without production, the lease could not be extended beyond the fixed one-year period, even though the parties contracted for payments to do so. The court further noted that "a lease will not be construed to create a perpetual term unless the intention is expressed in clear and unequivocal terms."[143] It stands to reason that holdings such as the one in *Hite* are also predicated on a public policy, which is applicable in most producing regions and stresses the importance of the efficient and prolific development of natural resources.

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140 *Hite*, 13 A.3d at 943.

141 *Id*. at 950.

142 *Id*. at 949.

143 *Id*. at 947-48 (citing the order of the lower court, which quoted Sterle v. Galiardi Coal & Coke Co., 168 Pa. Super. 254, 257–58, 77 A.2d 669, 672 (1951)). *But see*, Ball v. Ball, 137 Misc. 69, 244 N.Y.S. 300, 302 (Sup. Ct. 1930) (holding that payments could extend the lease beyond a one-year term under language indicating that the lease extends for "as much longer as the rent for failure to commence operation is paid").

A different approach to a "no terms" lease was adopted in West Virginia when the court held that the payment of delay rent will cover the term for which the payment was made—quarterly in those cases—but the lessor could give notice and demand drilling, in which case the lease would terminate unless a well was thereafter drilled within a reasonable time.[144]

[3] — Dual Purpose Leases.

In the Appalachian Basin, it is not uncommon for a habendum clause to contain an additional provision for storage of non-native gas to extend the lease. The "dual purpose" lease is one that grants the lessee the right to store gas within the leased premises and contains an habendum clause that expressly allows for storage activity to continue the lease. There are several variations of the dual-purpose habendum clause. The following is an example from a case out of Pennsylvania involving the continued validity of production rights:

> It is agreed that this lease shall remain in force for the term of ten (10) years . . . and as long thereafter as the above described land, or any portion thereof, or any other land pooled or unitized therewith . . . is operated by the Lessee in the search for or production of oil or gas or as long as gas is being stored, held in storage, or withdrawn from the premises by Lessee. It is agreed that the cessation of production from wells on the leased premises or upon other land unitized therewith, after the expiration of the original term, shall not terminate this lease whether the pooling units have been dissolved or not, if the land is used for the storage of gas prior to the plugging and abandonment of wells from which oil or gas has been produced. It is understood that a well need not be drilled on the premises to permit the storage of gas, and it is agreed that the Lessee shall be the sole judge as to whether gas is being stored within the leased premises and that its determination shall be final and conclusive.[145]

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144 Johnson v. Armstrong, 81 W. Va. 399, 94 S.E. 753 (1918), and Todd v. Manufacturers' Light & Heat Co., 90 W. Va. 40, 110 S.E. 446 (1922).

145 Jacobs v. CNG Transmission Corp., 565 Pa. 228, 772 A. 2d 445, 448 (2001).

In *Jacobs v. CNG Transmission Corp*., the courts, after an interplay between federal and state courts, held that either production or storage of gas under the dual-purpose lease could hold the entire lease, that the delay rental payment "was not necessary to preserve the lessee's future right to drill," but that the lessee had an implied obligation to develop the property for the benefit of both itself and the lessors.[146] A companion case, also from the same federal District Court for the Western District of Pennsylvania, *Penneco Pipeline Corp. v. Dominion Transmission, Inc*., involved the same issue regarding the secondary term of multiple dual-purpose oil and gas leases.[147] Although the habendum clause in the leases at issue in *Jacobs* and *Penneco* were nearly identical, the judge of this federal district court, applying Pennsylvania law in both cases, issued competing opinions.

The primary issue in *Jacobs* and *Penneco* was whether oil and gas leases that provided for production or storage to extend leaseholds for habendum purposes continued in their secondary terms when there had been no production of gas for decades. Importantly, in *Jacobs*, the Third Circuit Court of Appeals certified two questions to the Pennsylvania Supreme Court: 1) whether a court must first find a lease to be ambiguous before deciding whether the production and storage rights are severable, and 2) whether Pennsylvania recognizes an implied covenant to produce under a mineral lease.[148] The Pennsylvania Supreme Court did not address the questions specifically in light of the *Jacobs* facts but, based on the Pennsylvania Supreme Court's opinion, the federal district court in both *Jacobs* and *Penneco* found that the habendum language in the dual-purpose leases at

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146 For a thorough discussion of the *Jacobs* opinions (Jacobs v. CNG Transmission Corp., 332 F. Supp. 2d 759 (W.D. Pa. 2004) and Jacobs v. CNG Transmission Corp., 772 A. 2d 445, 448 (2001)), as well as their counterpart, Penneco Pipeline Corp. v. Dominion Transmission, Inc., WL 1847391 (W.D. Pa. June 25, 2007), s*ee* Bagness, "Two Important Cases Which Impacted The State of Pennsylvania Oil and Gas Law," 29 *Energy & Min. L. Inst*. 12 (2008); Conny Farms LLC v. Ball Resources, Inc., 2013 Ohio 2874, 2013 WL 3380167 (7th Dist. 2013) ("Conny Farms II") (holding the storage of gas under a dual-purpose lease held the entire lease, and that the delay rental payment "was not necessary to preserve the lessee's future right to drill.").

147 *Penneco*, WL 1847391 (W.D. Pa. June 25, 2007).

148 Jacobs v. CNG Transmission Corp., 772 A.2d 445 (Pa. 2001).

issue granted both production and storage rights to be held in entirety, and they were not intended to be severable.

Whether the production and storage rights are severable is an important step in the analysis of the issue of what leasehold rights are "held." In an instructive case out of the state of Kansas, *Rook v. James E. Russell Petroleum, Inc.*, the Kansas Supreme Court held that the production and storage rights under the dual-purpose lease before that court had been severed, and that the production rights were abandoned and terminated in spite of the fact that storage operations were ongoing and subsisting.[149]

The basis for terminating production rights under a dual-purpose lease is generally going to be premised on the implied covenant to develop. Indeed, on remand of *Jacobs*, the district court, even though finding that the production and storage rights were not intended to be severed, nevertheless held that the lease had terminated because of the lessee's failure to produce and sell gas.[150] At the crux of the *Jacobs* court's holding was the court's application of Pennsylvania law to require a lessee to produce oil and gas (thereby generating royalty payments) to maintain a leasehold, as opposed to making mere rental payments for storage, which the court likened to delay rental payments that are unable to extend a lease beyond the primary term.[151]

In contrast, in the *Penneco* decision (issued by a different judge), the federal district court held that storage payments without production of oil and gas were sufficient to maintain oil and gas leaseholds.[152] Importantly, in *Penneco*, unlike *Jacobs*, the court did not find an implied covenant to develop, applicable since the lessor under the dual-purpose lease could be compensated by production royalties *or* storage rental payments.[153] Further, the magisterial judge in *Penneco* found that the rationale of *Jacobs*, namely

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149 Rook v. James E. Russell Petrol., Inc., 679 P.2d 158 (Kan. 1984).

150 Jacobs v. CNG Transmission Corp., 332 F. Supp. 2d 759 (W.D. Pa. 2004).

151 *Jacobs*, 332 F. Supp. 2d. at 786.

152 *Penneco*, WL 1847391 (W.D. Pa. June 25, 2007).

153 *Id*. at *19 (". . . payment of compensation under the alternative gas storage provisions of the leases precludes the application of an implied covenant to develop and produce oil and gas . . . .").

that there was an implied covenant which required production, was not applicable since the case law cited by *Jacobs* involved production-only leases rather than dual purpose leases.[154]

Thus, in Pennsylvania, even after recent and extensive litigation and several lengthy opinions on the issue of whether storage operations alone can hold an oil and gas leasehold under a modified "thereafter" habendum clause, the law on the issue is less than clear. Additionally, there are virtually no cases on the issue from the other states in the Appalachian Basin and very little guidance from outside the region. However, considering the value of large contiguous acreage in today's world of long lateral horizontal well development, production rights under storage fields that may be operated pursuant to dual-purpose leases almost certainly will be an issue of further litigation. To that end, and in light of the little judicial guidance available, it would seem that whether the dual-purpose lease is held by production could be raised under a myriad of different fact patterns. For example, some potential variables include: (i) whether the language in a dual-purpose lease contemplates production *or* storage versus production *and* storage; (ii) whether storage operations have been ongoing; (iii) whether there has never been production from the leasehold or there was production that ceased; (iv) whether the production rights were ever assigned or are even assignable; and, perhaps most importantly, (v) whether the production and storage rights are severable.

§ 25.05. Conclusion.

In conclusion, we have attempted in this chapter to describe the nature of the oil and gas leases and the unique term clause universally found in them. Given the magnitude of investment in oil and gas development today, mostly under leases, issues surrounding the term clause will certainly continue to be developed. We hope this chapter provides a good reference source on issues extant today, as the principles and decisions summarized should guide the outcome of future cases.

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154 *Id*. at *25.

Chapter 26

Water Availability and Use Issues — Is Water the New Oil?

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§ 26.01. Introduction to Water Availability and Use Issues.

Rising demand for water due to population growth and urbanization, coupled with unpredictable weather patterns and widespread droughts, presents formidable challenges for governments and companies alike. A report prepared by the Organisation for Economic Co-operation and Development (OECD) projects that by 2050 more than 40 percent of the world's population will reside in river basins under severe water stress.[1] In that same period, the report anticipates that world-wide water use will increase 55 percent.[2] Climate issues could amplify the already intense competition over water and energy resources. Thus, the current and future availability of water will remain of vital concern for businesses, especially those operating in areas undergoing severe drought conditions.

Litigation and administrative challenges over surface water and groundwater rights have increased in recent years. Industrial users, farmers and ranchers, power generators, cities, and environmental advocates all lay claim to limited water resources. As a result, businesses — particularly large industrial water users — should carefully evaluate their access to water and vigilantly monitor efforts by others to interpret, expand, and amend their water rights.

Companies seeking to understand the risks of increased water scarcity and secure reliable supplies need to understand regulatory trends and litigation involving water rights, much of which occurs at the state level. At the same time, many river systems are subject to interstate compacts and the oversight of interstate river basin commissions. International agreements and treaties further confine the ability of states and nations, as well as companies doing business within their borders, to access and appropriate major water bodies.

The legal framework for water rights — whether at the local, state, federal, or international level — is in constant flux. Water scarcity is a

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1 Leflaive, X., *et al*., "Water," OECD *Environmental Outlook to 2050* (2012).

2 Organisation for Economic Co-operation and Development, *Water Security for Better Lives* (2013). The report defines river basins under severe "water stress" as those where withdrawals exceed forty percent of available resources.

key driver of recent policy initiatives, regulatory changes, and litigation. The combination of drought, increased population and urbanization, and economic development, is forcing lawmakers to consider whether changes to long-standing water rights systems are necessary to address risks of inadequate and unreliable water supplies.

This chapter focuses primarily on recent developments in Texas water law and regulations, although regulations in California and the Mid-Atlantic States are also discussed. There are several reasons for this emphasis. First and foremost, Texas (and California) is experiencing population growth and drought, paired with the rapid development of shale and tight oil formations, and the associated demand for the water necessary to support this development. As a result, the Texas Legislature, Texas agencies, and state and federal courts in Texas are wrestling with water rights issues. Regulators and the public are also subjecting water use by oil and gas operations to greater scrutiny than ever before. Due to Texas' economic clout and status as a bellwether for oil and gas development, legal and industry trends in Texas may influence other states that are confronting similar issues. Companies that are concerned about the security of their water rights and assets should monitor these developments closely.

This chapter also explores significant issues in the law concerning surface water and groundwater to establish a basic framework for understanding recent regulatory developments and judicial decisions. With that framework established, this chapter then surveys a selection of recent rulings and regulations to elucidate how both law and policy can shape and, in turn, be shaped by water shortages. Finally, the chapter considers recent regulatory changes and industry innovations that promote sustainable water management and mitigate the risks of water scarcity.

§ 26.02. Surface Water: Rights and Risks.

This section focuses on laws and institutions related to surface water rights, specifically the right to divert, produce, or use surface water. The purpose of this section is to provide the reader with a basic understanding of the concepts and principles governing surface water rights. This section also addresses several significant legal developments regarding surface water

ownership, management, and regulation. Because a comprehensive treatment of this broad subject is beyond the scope of this chapter, the present discussion must necessarily be in general terms. This chapter does not attempt to cover all aspects of surface water rights, regulations, or litigation.

[1] — Riparian Rights.

State regulation of water acquisition and use depends on the doctrine that governs water rights generally, whether riparian, prior appropriation, or otherwise. Many states east of the Mississippi observe some form of the riparian rights system. A riparian water right entitles the owner of property adjacent to a water course to use any amount of water that is necessary for a reasonable purpose, and prohibits the owner from unreasonably interfering with the uses of other riparian water users. Because the rights of one riparian owner's water needs are weighed equally with the rights of adjacent or downstream riparian owners, state authorities may suspend withdrawals from particular rivers and streams when supplies are limited so that adjacent and downstream users are assured of their reasonable share. For example, the Susquehanna River Basin Commission suspended water usage for hydraulic fracturing operations in portions of eastern Pennsylvania in 2012 due to low river and stream flows.[3] Yet curtailments do not necessarily require a formal drought declaration by a state agency, meaning that companies may receive little or no notice of an impending curtailment. In addition, there may not be an administrative mechanism to define a "drought" and indicate when one begins and ends.

[2] — Appropriative Rights.

In contrast to the riparian rights framework, the appropriative rights system prevails in many of the western United States. An appropriative water right is usufructuary — meaning that it is a right to use the water, rather than to enjoy full possession of the water itself. The appropriative system defines

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3 Press Release, Susquehanna River Basin Comm'n, 37 *Water Withdrawals for Natural Gas Drilling and Other Uses Suspended to Protect Streams* (June 28, 2012), *available at* http://www.srbc.net/newsroom/NewsRelease.aspx?NewsReleaseID=89.

water rights more precisely than the riparian system and its "reasonableness" standard. States that adopt this approach authorize the use of water in a specific quantity, by diversion from a watercourse at a specific location, for a particular beneficial use, and for use on a particular tract of land.

Another important concept in the appropriative rights system is the doctrine of seniority, also known as "first in time, first in right." This doctrine assigns a specific priority date to each water right. During times of shortage, the seniority system determines the allocation of water between appropriators based on their relative priority dates. A senior right holder is entitled to fully exercise his or her right before junior right holders receive any water. The senior right holder can also ask a court or regulator to enjoin an upstream junior right holder from drawing from a common source. These curtailments can also come suddenly, leaving companies expecting to use a junior right unable to obtain the water.

Some jurisdictions use a combination of riparian and appropriative systems and some are currently in the process of changing from a riparian to an appropriative system — which raises concerns with regard to priorities and amounts. New York, for instance, is currently moving to an appropriative system. This constant flux, as well as the difference between jurisdictions with differing legal systems, but connectivity of water, has great potential for conflict — especially in the world of drought.

[3] — Restrictions on Withdrawals.

States using appropriative right systems generally require notification and issuance of permits prior to authorizing the withdrawal and use of surface water. These permitting requirements typically arise under the states' general regulation of the "beneficial use" of water and are not specific to particular industries or purposes.[4] For example, Texas requires public notice as part of an application to appropriate surface water.[5] In turn, those receiving notice can request contested case hearings, resembling a civil trial, to challenge the

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4 *See, e.g.*, 30 Tex. Admin. Code § 295 (West 2013).

5 *Id.* at § 295.151.

application.[6] As a result, the process can be time consuming, contentious, and costly. Other states limit registration or reporting requirements for surface water withdrawals to entities that withdraw particularly large quantities of water. The specific quantity of water and the timeframe of the withdrawal vary widely from state to state.[7]

§ 26.03. Interstate Waters and Institutions.

In addition to permitting or registration requirements imposed by individual states, rights to withdraw interstate surface waters may be subject to one of twenty-seven interstate compacts. An interstate compact is essentially a contract between states that has been approved by Congress under the Compact Clause,[8] and provides a framework for managing and allocating interstate waters. Interstate compacts are a common mechanism for resolving interstate disputes over water rights, which, once ratified by Congress, are fully enforceable in federal court.

Some interstate compacts allocate water between two or more states, while others only provide a framework for cooperation between states. For example, the Rio Grande Compact was formed in 1938 by Colorado, New Mexico, and Texas with the intent to "remove all causes of present and future controversy among these States . . . with respect to the use of the waters of the Rio Grande above Fort Quitman, Texas" and "for the purpose of effecting an equitable apportionment of such waters."[9] The Compact establishes a schedule of deliveries from Colorado to the Colorado-New Mexico state line.[10] New Mexico, in turn, is required to deliver a specific quantity of water in the Rio Grande at Elephant Butte Reservoir, a federal Bureau of Reclamation project that distributes water pursuant to contracts with irrigation

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6 *Id*. at § 295.151(b)(10).

7 *See, e.g*., 25 Pa. Code §110.201 (West 2013) (requiring registration for withdrawals greater than 10,000 gallons over 30 days); W. Va. Code R. § 22-26-3(c) (West 2013) (requiring registration for withdrawals exceeding 750,000 gallons per month).

8 U.S. Const. art. I, § 10, cl. 3.

9 Rio Grande Compact, Tex. Water Code Ann. § 41.009 (West 2013).

10 *Id*.

districts in southern New Mexico and western Texas.[11] The Compact permits New Mexico to accrue credits and debits for deliveries that are above or below the annual quantity specified in the Compact, within certain limits. The Compact grants to Texas various rights regarding the release of accrued debits from upstream storage in Colorado and New Mexico. Thus, the Compact governs certain Colorado and New Mexico releases, deliveries, and storage of Rio Grande water, all with a view to maximizing its use.

Many river basins are also subject to rules and regulations promulgated by federal interstate compact commissions. For example, the Susquehanna River Basin Commission (SRBC) — comprised of environmental regulators appointed by the governors of Pennsylvania, Maryland, and New York, as well as a Division Engineer from the U.S. Army Corps of Engineers — regulates withdrawals of surface water from the Susquehanna River and its tributaries.[12] The SRBC's rules require most businesses to seek SRBC approval for water withdrawals if they intend to use more than 100,000 gallons of water per day.[13] Companies that successfully obtain authorization must then comply with metering requirements, conduct daily use monitoring, and submit quarterly reports of their use.[14]

Regulatory decisions of interstate river basin commissions can significantly impact business operations. For example, the Delaware River Basin Commission (DRBC), which includes the governors of New Jersey, Pennsylvania, Delaware, New York, and a Division Engineer from the U.S. Army Corps of Engineers,[15] instituted a *de facto* moratorium on hydraulic fracturing by indefinitely postponing the enactment of proposed regulations that would permit natural gas drilling in the Delaware River Basin. A major concern for the DRBC is that drilling projects in the Marcellus Shale could

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11 *Id*.

12 *Commissioners and Alternates*, Susquehanna River Basin Comm'n, http://www.srbc.net/about/commissioners/commiss.htm (last visited Aug. 2015).

13 Projects requiring review and approval, 18 C.F.R. § 806.4(a)(8).

14 *Id*. at § 806.22(f)(4).

15 *Commissioners*, Delaware River Basin Comm'n, http://www.state.nj.us/drbc/about/commissioners/ (last visited Aug. 2015).

significantly impair the water resources of the basin by reducing flow in streams and aquifers.[16] The DRBC's proposed regulations would only allow new surface or groundwater withdrawals for natural gas development projects after the DRBC has issued a "docket or protected area permit" expressly approving the use.[17] The application to obtain such a permit is extensive, requiring the applicant to consider impacts to other users and, in some cases, include an "invasive species control plan" to ensure that all water taken from the withdrawal site is managed or treated before further distribution to ensure that invasive species will not enter other watersheds.[18]

§ 26.04. International Treaties.

Surface waters may also be governed by international treaties. Thus, the ability to obtain surface water supplies can be affected by the failure of signatories to comply with treaty conditions and obligations. A prominent example of this situation involves the 1944 Utilization of Waters of the Colorado and Tijuana Rivers and of the Rio Grande Treaty between the United States and Mexico. Under the Treaty, the United States is required to provide Mexico with 1.5 million acre-feet of water from the Colorado River, while Mexico is required to deliver an average of 350,000 acre-feet per year over a five-year cycle. If Mexico fails to meet its delivery obligations due to "extraordinary drought," then it is required to repay its debt during the next five-year cycle. In recent years, Mexico has fallen behind on its obligation. As of September 2014, Mexico has owed the United States 380,000 acre-feet of water, more than all the water consumed in a year by the 1.5 million residents of the Lower Rio Grande Valley in Texas.[19] The water surface crisis

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16 *See Natural Gas Drilling Index Page*, Delaware River Basin Comm'n, http://www.nj.gov/drbc/programs/natural/ (last visited Aug. 2015).

17 *Draft Natural Gas Regulations*, Delaware River Basin Comm'n, § 7.4(a)(2) (revised Nov. 8, 2011), http://www.nj.gov/drbc/library/documents/naturalgas-REVISEDdraftregs110811.pdf (last visited Aug. 2015).

18 *Id*. at § 7.4(d)(1)(vii).

19 Joshua Partlow, "Amid Drought, Texas is Fuming Because Mexico Isn't Sending the Water It Owes," *Wash. Post*, Sept. 8, 2014, *available at*: http://www.washingtonpost.com/world/texas-is-fuming-because-mexico-isnt-sending-the-water-it-owes/2014/09/07/fb82914c-463d-409e-853c-be44e386cc45_story.html (last visited Aug. 2015).

in Texas has become so serious that in June 2013, the Working to Address Treaty Enforcement Rapidly (WATER) for Texas Act was introduced to address Mexico's failure to uphold its water obligations to the United States.

§ 26.05. Recent Case Law.

Litigation and administrative challenges over surface water rights have risen in recent years. Drought conditions and increasing populations have resulted in competing claims by industrial users, farmers and ranchers, cities, and environmental advocates. This section discusses several notable lawsuits filed in Texas state courts and federal courts in Texas that illustrate these conflicts. In addition, interstate and international litigation over water supplies is also on the rise; therefore, this section discusses a recently resolved lawsuit between Texas and Oklahoma regarding rights to surface water from the Red River Basin, as well as an ongoing dispute between Texas and New Mexico regarding the 1938 Rio Grande River interstate compact.

[1] — *Aransas Project v. Shaw.*

In June 2014, the U.S. Fifth Circuit Court of Appeals issued a decision that places a limitation on liability for the "take" of a listed species, so that state and federal agencies (and the private parties who receive permits or licenses from these agencies) are not liable for harm that is far removed from the issuance of the permit.[20] The species at issue was the whooping crane, which is listed as an endangered species under the Endangered Species Act (ESA), and resides in the Aransas National Wildlife Refuge (ANWR).[21] The single remaining flock comprises 300 birds.[22] South Texas experienced a severe drought during the winter of 2008-2009, which caused a decrease in the San Antonio Bay's freshwater, and resulted in the death of an estimated 23 cranes in the flock.[23]

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20 Aransas Project v. Shaw, 756 F.3d 801 (5th Cir. 2014), *cert. denied*, 576 U.S. 2 (2015).
21 *Id.* at 806.
22 *Id.*
23 *Id.*

An environmental organization known as The Aransas Project sued the directors of the Texas Commission on Environmental Quality (TCEQ) for committing an unauthorized "take" of the cranes in violation of the ESA.[24] In almost all cases, a party must obtain a permit from the TCEQ to appropriate state waters.[25] In this case, TCEQ had issued surface water permits to private parties authorizing withdrawals from the San Antonio and Guadalupe Rivers. The Aransas Project contended that the TCEQ's permitting actions significantly reduced freshwater inflow into the cranes' habitat, ultimately causing the cranes' deaths.[26]

A U.S. District Court found that the TCEQ's water-permitting practices proximately caused the cranes' deaths and granted an injunction prohibiting the TCEQ from issuing new permits to withdraw water from rivers that feed the estuary.[27] However, the Fifth Circuit reversed, finding that the chain of causation from the issuance of the permits to the death of the birds was too attenuated and remote to support a "taking" claim under the ESA.[28]

This case was closely watched by industry, non-profits, and public officials due to its implications for water supplies in Texas and on natural resource planning nationwide.[29] If the Fifth Circuit had ruled for the plaintiffs, then the ANWR would have received the first 1.1 million acre-feet from the Guadalupe River before any of the municipal, industrial, and agricultural users in San Antonio and Guadalupe River Basins. This decision also affords greater protection for water users and state and federal permitting authorities when defending alleged "takings" of threatened or endangered species based on the issuance of surface water permits. Although the water

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24 *Id*. at 807.

25 Tex. Water Code §§ 11.022 and 11.121. *See also Surface Water Rights in Texas*, Tex. Comm'n on Envtl. Quality, http://www.tceq.state.tx.us/assets/public/comm_exec/pubs/archive/gi228/index.html (last visited Aug. 2015).

26 *Aransas Project*, 756 F.3d at 807.

27 *Id*. at 807.

28 *Id*. at 823.

29 Neena Satija, "Whooping Crane Case Could Affect State Water Supplies," *Tex. Trib.*, Aug. 8, 2013 http://www.texastribune.org/2013/08/08/whooping-crane-case-could-impact-state-water-suppl/.

users and farmers who benefitted from these permits were not defendants in the lawsuit, the court's reasoning arguably applies to actions by private parties, as long as their withdrawals are consistent with state-issued permits.

[2] — *Texas Commission on Environmental Quality v. Texas Farm Bureau*.

A recent ruling by a Texas court of appeals has called into question the TCEQ's authority to implement drought curtailment rules for surface water withdrawals and diversions during droughts or emergency water shortages.[30] TCEQ adopted drought curtailment rules pursuant to a 2011 amendment to Section 11.053 of the Texas Water Code (Section 11.053) that was to go into effect in May 2012. In final form, the drought curtailment rules authorize the TCEQ director to order the temporary suspension, curtailment, or use of a water right during drought conditions.[31] A suspension order must be drafted to maximize the beneficial use of the water, while minimizing waste and the impact on water rights holders.[32] It must also consider the efforts by the owners of the suspended water right to design and implement water conservation and drought contingency measures.[33] However, TCEQ interpreted the rules as authorizing the issuance of curtailment orders that disregard the state's "first in time, first in rights" system of allocating surface water rights.

In November 2012, the senior rights holder on the Brazos River made a "priority call," asserting that it could not obtain the water to which it was entitled because of diversions by upstream users with junior water rights.[34] In response, the TCEQ issued an order that suspended all junior water

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30 *Texas Farm Bureau v. Texas Comm'n on Envtl. Quality,* Number 13-13-00415-CV (Tex. App.—Corpus Christi) (Apr. 2, 2015).

31 Tex. Water Code Ann. § 11.053 (West Supp. 2012); 30 Tex. Admin. Code § 36.8(a) (2011).

32 30 Tex. Admin. Code § 36.5(b)(1)–(3) (2012).

33 *Id*. § 36.5(b)(4).

34 Executive Order Suspending Water Rights on the Brazos River (November 19, 2012); An Order Affirming and Modifying the Executive Director's Order Suspending Water Rights in the Brazos River Basin, TCEQ Docket No. 2012-2421-WR (Dec. 12, 2012).

rights on the Brazos River, but exempted all municipal users and power generators.[35] The Texas Farm Bureau and several agricultural interests brought suit against the TCEQ seeking a declaratory judgment that the Drought Curtailment Rule and the suspension order were invalid.[36] The Texas Farm Bureau alleged that the order was facially invalid because it exceeded the statutory authority granted under Section 11.053 by disregarding seniority and effectively requiring senior water right holders to provide water rights to preferred junior uses.

Although the TCEQ rescinded the curtailment in January 2013, the litigation was not mooted. In a June 6, 2013 bench ruling, a Texas district court granted the Texas Farm Bureau's motion for summary judgment and denied a competing motion filed by the TCEQ.[37] The district court found that the TCEQ exceeded its emergency suspension powers under Section 11.053 by departing from the priority system. The court went on to say that neither the TCEQ's police power, nor any other general authority to protect public health, safety, or welfare, authorizes the TCEQ to selectively exempt junior water rights from a priority call.

On appeal, the TCEQ argued that the district court misinterpreted Section 11.053 and failed to give appropriate deference to its interpretation of the statute. The court of appeals disagreed, finding that none of the statutes or the constitutional provision cited by TCEQ authorized its suspension order. While the court acknowledged TCEQ's authority to manage and regulate the state's scarce water resources, it noted that its authority cannot exceed its express legislative mandate.

The court of appeals' decision calls into question the legal status of TCEQ's drought curtailment rules and raises questions about how the agency will seek to manage water resources during future droughts. While

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35 Executive Order Suspending Water Rights on the Brazos River (November 19, 2012); An Order Affirming and Modifying the Executive Director's Order Suspending Water Rights in the Brazos River Basin, TCEQ Docket No. 2012-2421-WR (Dec. 12, 2012).

36 Plaintiffs' Original Petition and Request for Injunctive Relief, Texas Farm Bureau v. Commission, No. D-1-GN- 12-003937 (Travis County District Court December 14, 2012).

37 Texas Farm Bureau v. Texas Comm'n on Envtl. Quality, Tex. Dist. Ct., No. D-1-GN-12-003937, 6/6/13 *bench ruling.*

the decision does not invalidate all suspension or curtailment orders, it does require the TCEQ to enforce the priority system strictly when issuing such orders. Notably, the court of appeals acknowledged a conflict in the Texas Water Code between Section 11.053, which directs the TCEQ to follow the priority system when issuing curtailment orders, and Texas Water Code Section 11.024, which establishes a priority preference order for uses during droughts. However, the court said that resolving that conflict is the task of the legislature, not the judiciary.

[3] — *Tarrant Regional Water District v. Herrmann.*

In *Tarrant Regional Water District v. Herrmann*, the Supreme Court confronted a 10-year dispute between Texas and Oklahoma over the Red River Compact.[38] Texas, Oklahoma, Arkansas, and Louisiana created the Red River Compact in 1978 to resolve conflicts over the surface waters of the Red River Basin and to fairly apportion the waters of the Red River and its tributaries between the signatory states.

The case turned on the meaning of a clause in the Compact that grants each of the signatory states "equal rights" to certain excess water in a particular subbasin of the river, with the caveat that no state is entitled to take more than 25 percent. However, the Compact did not directly address whether cross-border diversions were permitted. Texas argued that the Compact authorized it to take 25 percent of all of the excess water from the subbasin, and that it could also enter Oklahoma's part of the subbasin to do so. Oklahoma argued that Texas could only take 25 percent of the excess water from the part of the subbasin within its own borders, and could only enter the territory of another state with that state's consent.

In a unanimous ruling, the Supreme Court held that the Texas water district was free to take up to 25 percent of the excess water in the subbasin from inside Texas and it could demand an accounting if it believed Oklahoma

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38 Tarrant Reg'l Water Dist. v. Herrmann, 133 S.Ct. 2120 (2013).

was diverting more than 25 percent.[39] However, the Court held that Texas could not enter Oklahoma without Oklahoma's consent to divert water.[40]

While the decision's impacts beyond the Red River Compact remain to be seen, the decision creates a strong presumption in favor of states' sovereign prerogative to control natural resources within their borders. The decision also contains language to that effect that will likely be quoted in future cases involving apportionment of waters. Furthermore, *Tarrant* could influence future adjudications involving rapidly-growing metropolitan areas in water-scarce states that rely on interstate water allocations. Already containing over 6.9 million residents, the Dallas-Fort Worth metropolitan area is the fastest growing urban area in the United States. The Tarrant Regional Water District estimates that north Texas, including the Dallas-Fort Worth area, will need to double its water supply by 2050 to meet the anticipated water demands of its growing population and expected economic development. Other rapidly expanding metropolitan areas face similar concerns about increasing water demands. The Court's ruling may prompt states in these areas, particularly those in the arid West, to try to renegotiate their interstate compacts in light of the *Tarrant* decision.

[4] — *Texas v. New Mexico and Colorado.*

Water allocation and administration have long been sources of controversy in the Rio Grande River Basin, where expanded agricultural activity and increasing population have diminished tributary flow and aquifers. Individuals and companies that rely on these sources face administrative, economic, and legal challenges in managing and sharing these water resources. *Texas v. New Mexico and Colorado*, an interstate lawsuit involving questions of water rights definitions, allocation, and administration in the Rio Grande River Basin, illustrates many of these issues.

In January 2013, the Texas Commission on Environmental Quality, on behalf of the State of Texas, sued the State of New Mexico in the U.S. Supreme

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39 *Tarrant*, 133 S. Ct. 2120, slip op. at 2122-24.

40 *Id*.

Court[41] over alleged violations of the Rio Grande Compact.[42] The basis of this dispute is Texas' longstanding complaint that New Mexico has depleted Texas' share of water apportioned by the Compact and allocated under the Rio Grande Project operations.[43] Texas has asked the Court to enjoin New Mexico's diversions and depletions of Texas' share of Rio Grande Project water, order New Mexico to pay for the water it has allegedly appropriated through unpermitted surface water diversions and groundwater pumping, and specifically allocate Texas' portion of water under the Compact.

The Supreme Court was requested to take up this case.[44] Typically, when the Court agrees to take up an interstate water dispute, it appoints a Special Master to receive evidence, make findings of fact and conclusions of law, and prepare a preliminary report for the case.[45] Gregory Grimsal has been sworn in as Special Master. The Court retains authority to approve, revise, or reject any findings, conclusions, or recommendations in a Special Master's report. The Court also considers the parties' own filings and sometimes may allow oral argument. Because the Court is not required to make a decision within any specific timeframe, a final ruling, should the Court decide to take the case, is likely several years away. Nevertheless, the lawsuit merits close observation due to its potential to influence future equitable apportionment cases, and its possible effects on water allocation and administration in the Rio Grande River Basin.

§ 26.06. Groundwater: Rights and Risks.

This section focuses on laws and institutions related to groundwater rights, specifically the right to produce and use groundwater. As with the

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41 Motion for Leave to File Complaint, Complaint, and Brief in Support of Motion for Leave to File Complaint, Texas v. New Mexico and Colorado (Tex. v. N.M.), No. 220141 ORG (U.S. Jan. 8, 2013); U.S. Supreme Court Docket, *Tex. v. N.M.*, http://www.supremecourt.gov/Search.aspx?FileName=/docketfiles/22o141.htm.

42 Act of May 31, 1939, Pub. L. No. 76-96, 53 Stat. 785 (1939) (as amended 1948).

43 Complaint at 2-3, *Tex. v. N.M.*

44 U.S. Supreme Court Docket, *Tex. v. N.M.*, http://www.supremecourt.gov/Search.aspx?FileName=/docketfiles/22o141.htm.

45 *See* Anne-Marie C. Carstens, "Lurking in the Shadows of Judicial Process: Special Masters in the Court's Original Jurisdiction Cases," 86 *Minn. L. Rev.* 625, 654 (2002).

previous section, our intention is to provide the reader a framework for understanding the concepts and principles governing groundwater rights. This section does not attempt to provide a comprehensive treatment of the subject.

This section focuses especially on groundwater rights and management issues in Texas and California. In both of these states, the combination of drought, increasing population, and economic development have led to declining surface water supplies. As a result, obtaining authorization to use surface water has become more burdensome, contentious, and expensive. In these states, groundwater has become a preferred option for municipalities and industry. At the same time, groundwater regulations are undergoing rapid and historic changes.

[1] — Groundwater Management Issues in Texas.

Groundwater is an important source for many Texas water users, particularly in its arid west and central regions. Groundwater usage is prominently featured in Texas' 2012 statewide water plan and in the management strategies of many regional water planning areas. According to the Texas Water Development Board, the total reported groundwater usage in the entire State in the year 2012 was approximately 9.97 million acre-feet.[46]

The Texas Water Code defines groundwater as water that percolates (filters through) under the surface of the land.[47] The term "groundwater" can include percolating water or aquifers; underwater streams and the underground flow of surface streams are considered surface waters.[48] Unlike most other western states, Texas does not have a statewide system for regulation of groundwater. Instead, the Texas Legislature has authorized the creation of local groundwater conservation districts to provide some regulation of groundwater by controlling withdrawals and uses of groundwater in their jurisdiction.

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46 *See* Tex. Water Dev. Bd., *Groundwater Conservation District Facts*, *available at* http://www.twdb.texas.gov/groundwater/conservation_districts/facts.asp.

47 *See* Tex. Water Code § 36.001(5).

48 Tex. Water Code § 11.021(a).

[a] — Groundwater Rights Under Texas Common Law.

A significant challenge for groundwater management in Texas relates to the doctrine of the "rule of capture," which specifies that groundwater is the property of the overlying landowner. In contrast to surface water, which is owned publicly by the state, the rule of capture grants a landowner nearly unlimited freedom to use, transport, and sell all the groundwater that can be drawn from a well on the owner's property.[49] Today, Texas is the only western state that continues to follow this rule.[50]

The Texas Supreme Court first adopted the rule of capture in a 1904 decision, *Houston & Texas Central Railway Co. v. East*.[51] In 1999, the court was asked to change the rule of capture to the beneficial use doctrine or a rule of reasonable use.[52] While the court acknowledged that the groundwater management system implemented through the Texas Water Code has been the subject of much debate, the court declined to insert itself into the "regulatory mix," given the Legislature's express preference to manage groundwater through local groundwater districts.[53]

Most recently, the Texas Supreme Court reaffirmed the rule of capture and the right of "ownership in place" in *Edwards Aquifer v. Day*, a 2012 decision that involved a "takings" claim based on the permitting decisions of the Edwards Aquifer Authority.[54] Although the court affirmed the authority of the Edwards Aquifer Authority and other groundwater conservation districts to regulate groundwater production, the court held that such regulation can

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49 *See* Edwards Aquifer Auth. v. Day, 369 S.W.3d 814, 831-32 (Tex. 2012).

50 House Research Organization Report, *Groundwater Management Issues in Texas*, (June 6, 2006).

51 Houston and T.C. Ry. Co. v. East, 81 S.W. 279 (Tex. 1904) (adopting the English common law rule of Acton v. Blundell, 12 M. & W. 324, 152 Eng. Rep. 1223 (Ex. 1843), that the owner of the land might pump unlimited quantities of water from under his land, regardless of the impact that action might have upon his neighbor's ability to obtain water on his own land).

52 Sipriano v. Great Springs Water of America, Inc., 1 S.W.3d 75 (Tex. 1999).

53 *Id*. at 80.

54 *See* Edwards Aquifer Auth. v. Day, 369 S.W.3d 814 (Tex. 2012).

result in compensable takings claims under the Texas Constitution.[55] As a result, groundwater conservation districts that adopt regulations, such as production limits, well spacing rules, historic use limitations, export regulations, and "desired future conditions" developed at the management area level may be subject to regulatory takings challenges.[56]

[b] — Local Regulation of Groundwater in Texas.

The Texas Legislature has never modified or replaced the rule of capture, but it has exercised its authority to balance landowner interests with the need to conserve water and other natural resources.[57] In 1949, the Legislature authorized the creation of local government entities — groundwater conservation districts ("GCDs") and subsidence districts — with statutory authority to regulate the groundwater withdrawals through decentralized, district-level rules and procedures.[58] The Legislature has stated that groundwater districts are the State's preferred method of groundwater management.[59] As of January 2013, there are two subsidence districts and 99 GCDs throughout Texas.[60]

The rulemaking and permitting powers of GCDs are extensive. A GCD has general authority to "make and enforce rules, including rules limiting groundwater production based on tract size or the spacing of wells, to provide for conserving, preserving, protecting, and recharging of the groundwater or

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55 *Id*. at 817 (holding that "land ownership includes an interest in groundwater in place that cannot be taken for public use without adequate compensation.").

56 In a recent decision, the Texas Fourth Court of Appeals held that the permitting system of the Edwards Aquifer Authority resulted in a compensable "regulatory taking." *See* Edwards Aquifer Auth. v. Bragg, No. 04-11-00018-CV, 2013 WL 4535935 at *21 (Tex. App. – San Antonio Aug. 28, 2013).

57 Texas groundwater is subject to regulation under the state's general police power to protect public health and welfare. This general authority is augmented by the Conservation Amendment (Art. 16, sec. 59) of the Texas Constitution, which established that conservation of water and other natural resources are duties of the State and directs the Legislature to enact laws for this purpose.

58 *See* Tex. Water Code § 36.011 *et seq.*

59 Tex. Water Code § 36.0015.

60 http://www.twdb.texas.gov/groundwater/conservation_districts/facts.asp.

of a groundwater reservoir or its subdivisions in order to control subsidence, prevent degradation of water quality, or prevent waste of groundwater."[61]

All state-recognized GCDs are required to promulgate, implement, and enforce a management plan for the effective administration of groundwater resources within their jurisdiction.[62] The Texas Water Development Board, a statewide agency, sits above the GCDs, and has authority to approve their groundwater management plans.[63] Many groundwater management plans require well drillers to submit reports related to the drilling and completion of water wells and of the production and use of groundwater.[64]

Generally speaking, oil and gas operations are exempt from GCD permitting requirements. The Texas Water Code authorizes the use of groundwater for oil and gas exploration and development without a permit from local conservation districts. Specifically, the Code provides:

> [the] drilling [of] a water well used solely to supply water for a rig that is actively engaged in drilling or exploration operations for an oil or gas well permitted by the Railroad Commission of Texas provided that the person holding the permit is responsible for drilling and operating the water well and the well is located on the same lease or field associated with the drilling rig . . . .[65]

However, with the increase in hydraulic fracturing operations and recent droughts, many local conservation districts have reconsidered whether hydraulic fracturing operations are covered by the groundwater use exception. Some GCDs have decided that the statute may permit a city or conservation district to require a permit for hydraulic fracturing operations as opposed to "exploration and development" operations.[66] This attempted expansion

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61 *Id*. § 36.101.

62 *Id*. § 36.1071.

63 *Id*. § 36.1072.

64 *Id*. § 36.111.

65 *Id*. §§ 36.117(b)(2), 36.117(i).

66 Kate Galbraith, "Fracking Groundwater Rules Reflect Legal Ambiguities," *Tex. Trib.* (Mar. 13, 2013), http://www.texastribune.org/2013/03/13/fracking-groundwater-rules-reflect-legal-ambiguiti/.

of permitting authority by GCDs, when combined with the *Day* decision, may result in increased litigation between the GCDs and the oil and gas industry and landowners that sell water to them. Increased regulation of water withdrawals for hydraulic fracturing could also lead companies to drill wells into deeper, non-potable brackish aquifers that do not have a hydrologic connection with the shallower, potable aquifers that are regulated by the GCDs.

[2] — Groundwater Management Issues in California.

Groundwater accounts for approximately one-third of all water used in California in an average year and nearly half of all water used in a drought year.[67] The state's current drought, now in its fourth year, has led many water users in the state to turn to groundwater supplies to compensate for shortfalls in surface water.

[a] — Groundwater Rights Under California Common Law.

Like Texas, California historically did not have a comprehensive, statewide regulatory scheme governing the extraction or use of groundwater. Instead, most legal rights with respect to groundwater were subject to judicial interpretation. Prior to 1903, California courts generally applied the English common law rule of capture, treating percolating groundwater as part of the surface owner's estate, and, therefore, extractions of water on one's land that interfered with extractions on adjacent lands were not actionable.[68]

In 1903, however, the California Supreme Court repudiated the absolute ownership doctrine and found that reasonable use "limits the right of others to such amount of water as may be necessary for some useful purpose in connection with the land from which it is taken."[69] The court also recognized

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67 Cal. Dep't of Water Res., *Groundwater Introduction*, http://www.water.ca.gov/groundwater/ (last modified Jan. 15, 2015).

68 *See generally* State Water Res. Control Bd, *The Water Rights Process*, http://www.waterboards.ca.gov/waterrights/board_info/water_rights_process.shtml (last visited May 26, 2015) (providing an overview of water law in California).

69 Katz v. Walkinshaw, 141 Cal. 116, 134, 74 P. 766, 771 (1903).

the "rule of correlative rights."[70] Furthermore, in 1928, through the initiative process, the state added a reasonable and beneficial use requirement to the California Constitution,[71] which the court later applied to groundwater.[72]

Consequently, in the event that underground supply cannot meet the needs of all overlying landowners, each owner is entitled to a reasonable share of the supply.[73] Courts may determine the reasonableness of extraction in such cases and restrict overlying landowners to their reasonable share.[74] When there is a surplus of groundwater, the surplus may be extracted for use in more distant areas. These extractions are subject to the doctrine of prior appropriation, and are, therefore, inferior to the rights of landowners who use the water on the overlying land.[75]

California groundwater law thus developed in response to courts' recognition that the common law rule of capture could not sustain continued agricultural and commercial expansion in an arid environment without some modifications. The state's growing population placed increasing demands on groundwater basins which led to groundwater management by adjudication or water district in many parts of California. In practice, however, California's groundwater rights regime resulted in few real limits on groundwater extraction. Indeed, outside of groundwater basins that had undergone court adjudications, groundwater extraction was left largely unregulated, and overlying landowners could extract groundwater and put it to beneficial use without approval from the California State Water Resources Control Board or a state court.[76]

One issue with this groundwater management framework is that individuals have an incentive to continue to maintain or expand groundwater

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70 *Id*. at 136.

71 Cal. Const. art. 10, §. 2 (originally art. 14, § . 3).

72 Peabody v. City of Vallejo, 2 Cal. 2d 351, 40 P. 2d 486 (1935).

73 Pasadena v. Alhambra, 33 Cal. 2d 908, 207 P. 2d 17 (1949).

74 San Bernadino v. Riverside, 186 Cal. 7, 198 P. 784 (1921).

75 Katz v. Walkinshaw, 141 Cal. 116, 135, 74 P. 766, 772 (1903); Los Angeles v. San Fernando, 141 Cal. 3d 199, 293, 537 P. 2d 1250, 1318 (1975).

76 See Cal. State Water Res. Ctrl. Bd., The Water Rights Process, http://www.waterboards.ca.gov/waterrights/board_info/water_rights_process.shtml#rights.

extraction, while disregarding the environmental, economic, and social costs of long-term over-drafting. The flaws inherent in the previous regulatory framework led California to join other western states in establishing a comprehensive statewide system governing groundwater planning, management, and regulation. This shift in policy is due in large part to a combination of a severe, multi-year drought, widespread over-drafting, and consequential subsidence, collapse, and contamination of statewide groundwater basins.[77]

[b] — Statewide Regulation of Groundwater in California.

The Sustainable Groundwater Management Act (the Act),[78] passed by the California Legislature and signed into law in 2014, is California's first comprehensive regulatory program for groundwater. In general, the Act requires all groundwater basins that the California Department of Water Resources designates as high- and medium-priority to achieve sustainable groundwater management. The Act relies on local groundwater sustainability agencies to design plans that achieve sustainability goals. These plans must achieve sustainable groundwater management by avoiding certain "undesirable results" over a 50-year time period.

By January 31, 2020, local agencies in groundwater basins that experience critical overdraft conditions must adopt their plans. The remaining high- and medium-priority basins must adopt their plans by January 31, 2022. And by 2040, all high- and medium-priority basins must attain sustainable groundwater management. Moreover, the Act provides the State Water Resources Control Board backstop authority to develop and implement plans if a local agency fails to satisfy its sustainability objectives.[79]

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77 Ellen Hanak *et al.*, *Reforming California's Groundwater Management*, Pub. Policy Inst. of Cal. (Sept. 2014), http://www.ppic.org/main/publication_show.asp?i=1106.

78 Sustainable Groundwater Management Act of 2014, Cal. Water Code §§ 10720-10736.6.

79 Cal. Water Code § 10735.4(c).

The Act sets specific and enforceable requirements for groundwater management. This legislation affords local agencies substantial flexibility in determining how to achieve sustainable groundwater management.[80] Nonetheless, these agencies, or the State Water Resources Control Board itself, must adopt groundwater plans that avoid the six statutorily specified "undesirable results."[81] Local agencies or the State Water Resources Control Board might consider groundwater management options, such as importing water, that allow stressed basins to remain economically productive while also meeting the law's sustainability goals.[82]

While these new regulations may not offer immediate drought relief or give the state the authority to curtail groundwater extraction in the near-term, supporters believe these measures will ultimately aid in sustainable management of California's groundwater resources. However, critics of the Act worry that the regulations do not adequately recognize or protect existing groundwater rights and investments. Large groundwater users such as public utilities and sizable agricultural operations are likely to bring numerous challenges to the bill alleging violations of due process, equal protection, and property rights. With a 50-year planning period built into the Act, it could be decades before the effects of this legislation are fully realized.

§ 26.07. Selected Trends in Sustainable Water Management.

As previously discussed, the combination of recurring drought, significant population expansion, and associated economic expansion, has resulted in a new level of demand on Texas' limited water supplies. In 2011, Texas experienced one of its worst droughts on record, with 99 percent of the state experiencing extreme, severe, or exceptional drought conditions.[83] The

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80 Cal. Water Code § 10725(b).

81 Cal. Water Code § 10721(w).

82 *Water Supply Management*, Municipal Water District of Orange County, http://www.mwdoc.com/services/water-supply-management (last visited May 26, 2015) (explaining Orange County's use of importing water to meet local needs and ensure a reliable water supply).

83 Tex. Water Dev. Bd., "2012 State Water Plan," p. 14.

2012 State Water Plan observed that "[i]n serious drought conditions, Texas does not and will not have enough water to meet the demands of its people, its business, and its agricultural enterprises."[84] In addition, the population is rapidly increasing at a projected rate of 82 percent between 2010 and 2060. Water demand is projected to increase 22 percent by 2060, although existing water supplies (the amount of water that can be produced under current permits, contracts, and with existing infrastructure) are projected to decrease about 10 percent during that same time. Thus, all water users, including companies engaged in oil and gas exploration and production, must be mindful of the current climate surrounding water usage in Texas.

Recent studies indicate an overall increase in the amount of water used by the Texas oil and gas industry over the past decade. In 2008, the oil and gas industry used approximately 57,000 acre-feet, with hydraulic fracturing accounting for 35,800 acre-feet.[85] By 2011, estimated water use for hydraulic fracturing statewide had risen to 81,500 acre-feet.[86] That figure decreased slightly in 2012, to an estimated 76,722 acre-feet,[87] as water recycling and conservation efforts began to take effect, particularly in water-stressed regions. Researchers further estimate that water usage will increase to about 125,000 acre-feet between 2020 and 2030, followed by a steady decrease in 2060 and beyond.[88] However, even as the amount of water used in oil and gas operations in Texas has increased, the amount remains proportionately small compared to other users, such as irrigation and municipal water supply.

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84 Tex. Water Dev. Bd., "2012 State Water Plan," p. 140.

85 *See* 2011 report of the Texas Water Development Board, *Current and Projected Water Use in the Texas Mining and Oil and Gas Industry,* p. 178.

86 Jean-Philippe Nicot, Robert C. Reedy, Ruth A. Costley, and Yun Huang, *Oil & Gas Water Use in Texas: Update to the 2011 Mining Water Use Report,* Bureau of Economic Geology, Jackson School of Geosciences, the University of Texas at Austin, September 2012, p. 54, http://www.beg.utexas.edu/water-energy/docs/Final_Report_O&GWaterUse-2012_8.pdf.

87 Ceres, Hydraulic Fracturing & Water Stress: Water Demand by the Numbers 49, 65 (2014) , http://www.ceres.org/resources/reports/hydraulic-fracturing-water-stress-water-demand-by-the-numbers.

88 Nicot, *supra* note 86, at 65.

Concerns about shortages, however, have resulted in a widespread perception that all uses are placing the states' water resources at risk. Hence, although studies show that on a statewide level, water used for the exploration, development, and extraction of oil and gas make up less than 1% of the state's water use, it is still discussed by many.[89] Also, that percentage can be much higher in certain localized areas. For example, La Salle County, where the Eagle Ford shale play is located, is projected to allocate 40 percent of its water almost exclusively for hydraulic fracturing by 2020.[90] Competition from other users or industries, particularly on a local basis, present additional challenges to water sourcing in arid or water-scarce regions. And the public's perception of industry's water usage is one of several factors encouraging water recycling and conservation in the energy sector, as can be seen in the evolving use of non-freshwater sources, specifically brackish water and produced water.

[1] — Use of Desalinated and Untreated Brackish Water.

Brackish water[91] is one potential non-freshwater source for both public consumption and industrial use. Texas has an estimated 2.7 billion acre-feet of brackish groundwater, with nearly every region containing some amount.[92] Groundwater is ubiquitous and generally available in each of the state's major shale gas formations; it is most prevalent in the southern Gulf Coast Aquifer, underlying the Eagle Ford Shale in south Texas, and is also plentiful in many parts of west Texas near the Permian Basin.[93] While brackish water requires desalination to be acceptable for public consumption, recent advancements

89 Tex. Water Dev. Bd., Water for Texas: 2012 State Water Plan 140, http://www.twdb.texas.gov/publications/state_water_plan/2012/2012_SWP.pdf (last visited May 20, 2015).

90 Deborah Gordon, Katherine Garner, *Texas's Oil and Water Tightrope*, Carnegie Endowment for International Peace (March 11, 2014).

91 Brackish water is defined as water with total dissolved solids between 1,000 and 10,000 parts per million (ppm).

92 Tex. Water Dev. Bd., "Brackish Groundwater in Texas," p. 3, https://.

93 Tex. Water Dev. Bd., "2012 State Water Plan," December 2011, p. 204.

in technology have enabled the oil and gas industry to use untreated brackish water in their hydraulic fracturing operations.[94]

Despite its promise as a viable alternative source to freshwater, several factors may constrain further use of brackish water.[95] Some municipalities have turned to brackish water as an alternative source, which may result in increased competition for brackish waters of low salinity. In addition, costs associated with transporting brackish water are generally higher than for freshwater. There are also concerns that significant use of brackish water could impact or contaminate freshwater formations. Finally, there are concerns over risks and liabilities associated with storage and transfer of the water.

New technologies are being used for desalination that may make the treatment more affordable and environmentally sound. For instance, the City of El Paso, Texas recently signed a contract with a company to reclaim the discharge from the Kay Bailey Hutchison Desalination Plant (the largest inland desalination plant in the United States). Also, the largest coastal plant to be built in the United States in Carlsbad, California will be online soon to offer a model for coastal plants in addition to the plants in Florida.

[2] — Reuse of Produced Water.

Produced water, also known as flowback fluid, is also gaining traction as an alternative to freshwater within the industry. A significant challenge in using produced water is the significant variance in the chemical composition and characteristics between wells and formations. Typically, produced water includes water in the formation that contains hydrocarbons and salts, natural and inorganic compounds, chemical additives, naturally occurring radioactive materials, and oil and grease associated with production.

Historically, produced water has been managed in three ways: recycling/reuse, disposal, or discharge. Specific options include: on-site injection into disposal wells; disposal at centralized off-site underground injection sites;

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94 Jean-Philippe Nicot and Bridget R. Scanlon, "Water Use for Shale Gas Production in Texas, US," 46 *Envtl. Sci. & Tech.* 3580, 3585 (2012).

95 *Id.*

transportation to and then treatment at a treatment plant,[96] on-site treatment by a mobile unit for oil-field reuse; on-site mixing of produced and freshwater for reuse in hydraulic fracturing operations; discharge under a National Pollutant Discharge Elimination System (NPDES) permit (not allowed for onshore facilities in most circumstances); or treatment for beneficial uses.[97] One analyst has observed that decisions about water management are influenced by the ability (or lack thereof) to obtain discharge permits, the availability of and public concern over disposal wells, and the continued increase in water use, particularly in drought-prone and arid regions.

State policies can also incentivize reuse. For example, in Pennsylvania, a very high percentage (almost 90 percent in some fields) of produced water from the Marcellus Shale formation is recycled due to the limited availability of injection wells and state policies that limit other potential disposal options. In 2013, the Texas Railroad Commission amended Statewide Rule 8 to incentivize water recycling and conservation in the oil field. The rule amendments removed several regulatory barriers to water recycling, for example, by eliminating the requirement to obtain a permit from the Commission if operators are recycling fluid on their own leases, or transferring their fluids to another operator's lease for recycling.[98]

[3] — Advances in Water Recycling Technology.

Significant innovations in recycling technologies and treatment methods of produced water have occurred in recent years, assisted in part by federal and private research institutions. The National Energy Technology Laboratory (NETL) has partnered with Los Alamos National Laboratory, the New

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96 The U.S. Environmental Protection Agency recently proposed first-time effluent limitation guidelines for the discharge of produced water from unconventional shale formations. If finalized, EPA's proposal will prohibit discharges of produced water to publicly-owned treatment works. EPA is also considering whether to propose guidelines for discharges to privately owned centralized treatment works. 80 Fed. Reg. 18557 (Apr. 7, 2015).

97 *See* Blythe Lyons, *Produced Water: Asset or Waste*, prepared for The Atlantic Council of the United States, May 2014, p. 7, *available a*t: http://www.atlanticcouncil.org/images/publications/Produced_Water_Asset_or_Waste.pdf.

98 16 Tex. Admin. Code. § 3.8 *et seq*.

Mexico Institute of Mining and Technology, and The University of Texas on a long-term project to develop and test a prototype for a new treatment system that uses an innovative filtration method to remove problem contaminants and that would facilitate on-site treatment of produced water.[99] More recently, NETL sponsored research that led to the development of a new treatment system that, according to the agency, successfully treated flowback water from a hydraulic fracturing site in Pennsylvania,[100] resulting in significant reductions in the producer's disposal costs.[101] Other research efforts have focused on improving existing techniques. NETL partnered with Texas A&M University, Argonne National Laboratory, and industry to develop improved reverse osmosis membrane filtration technology for the removal of salt from produced water. The desalination technology developed through this project led to the construction of a large-scale mobile unit and the development of a commercial oilfield treatment system at a site in Texas.[102]

§ 26.08. Water Markets.

The drought, the increase in water use, the decrease in supply of fresh water, and the ever-changing regulatory structure at the state, interstate and international levels pose the inevitable question — is it time for a water market? Should water be based on a market economy or will it be subsidized by governments? It is clear that the cost of water is currently rising — either in costs to procure or in the regulatory or litigation matters surrounding the same. Is water the new oil? As prices increase will there be stability or will prices continue to rise? Should those living in areas where the "rule of capture" applies run to grab land? One thing is undeniable — unless we

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99 U.S. Gov't Accountability Office, GAO-12-156, Energy-Water Nexus: Information on the Quantity, Quality, and Management of Water Produced during Oil and Gas Production, 33 (2012).

100 Comprehensive Lifecycle Planning and Management System for Addressing Water Issues Associated with Shale Gas Development in New York, Pennsylvania and West Virginia, Final Scientific / Technical Report, funded by the Department of Energy and prepared for the National Energy Technology Laboratory, June 2012.

101 GAO-12-156, Energy-Water Nexus, at 33.

102 *Id*. at 34.

make more fresh water (which is possible and costly under measures such as desalination) — there is only so much freshwater in a drought-potential world with interconnectivity on water on an international scale. This measure is currently being studied around the world. We suggest that water, similarly to food, is a national security matter as well as an economic development sustainer and basic human necessity. All of these items are similar to oil — hence, is water the new oil?

Chapter 27

Clearing the Path to Unionizing America's Workforce: The NLRB's New Rules Governing Union Elections and Bargaining Units

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§ 27.01. Introduction.

Section 7 of the National Labor Relations Act (the NLRA) ensures private sector employees the right "to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing . . . [and] to refrain from any or all of such activities."[1] In cases where employers and employees disagree over the question of unionization, Section 9 of the NLRA provides the National Labor Relations Board (the Board or the NLRB) with authority to resolve "questions of representation" by holding union representation elections.[2]

The basic representation election procedures are set forth in Section 9, and clarified in corresponding regulations. The overall framework established in Section 9 is relatively straightforward. First, an employee, group of employees, or labor organization must file a petition for certification alleging that a "substantial number" of employees "wish to be represented for collective bargaining and that their employer declines to recognize their representative."[3] Once a petition has been filed, one of the Board's regional

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1 29 U.S.C. § 157.
2 *Id*. § 159(b).
3 *Id*. § 159(c)(1)(a).

directors reviews the petition and determines, among other things, whether the union seeks to represent an "appropriate" bargaining unit.[4] In determining whether a petitioned-for unit is appropriate, the regional director considers whether the employees in the unit have shared interests.[5] At this stage, the employer may suggest that, even though the employees in the proposed unit have such shared interests, the unit is nonetheless inappropriate because it excludes other employees with similar interests. In many cases, if these other employees have similar interests to those in the petitioned-for unit, the regional director would not approve the smaller, petitioned-for unit.

If the regional director is satisfied that the union has support from at least 30 percent of an appropriate bargaining unit of employees and that the petition presents a "question of representation," it will then direct an election or approve an election agreement.[6] The resulting election, completed through secret ballot, typically takes place at the employer's place of business.[7] Following the election, the Board certifies the election's results, and business at the (potentially unionized) workplace resumes as normal.[8]

While most employers are familiar with the basic concepts of bargaining units, union representation, and collective bargaining, the filing of an election petition under Section 9 can still come as a surprise. Employers are often blindsided by a union petition, and it can take several days to begin developing a response strategy. Because elections have historically been held approximately 40 days following the filing of a petition, employers have traditionally had sufficient time to develop a strategic campaign.[9]

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4 *Id*. § 159(b).

5 *See, e.g.,* American Cyanamid Co., 131 N.L.R.B. 909, 910 (1961); Chrysler Corp. (Detroit, Mich.), 76 N.L.R.B. 55, 59 (1948) ("The principal criterion used by the Board in grouping employees for bargaining purposes has been community of interest. The Board has generally held that employees with similar interests shall be placed in the same bargaining unit.").

6 29 U.S.C. § 159(c).

7 *Id*.

8 *Id*.

9 NLRB, *Summary of Operations, 2002-2012 Reports*, National Labor Relations Board, https://www.nlrb.gov/reports-guidance/reports/summary-operations (last visited Aug. 15, 2015) (demonstrating that elections traditionally occurred within thirty-eight days following the filing of the petition).

Unfortunately for employers, this is no longer the case. On April 14, 2015, the NLRB enacted new regulations that significantly altered the procedures governing representation elections.[10] While these new rules affect many aspects of the union election process, they have the largest impact on the overall election timeframe. For instance, elections held under the new rules can take place as little as 10 to 12 days following the petition's filing.[11] The Board has also developed a new test that makes it much easier for a union to demonstrate that smaller employee groups are appropriate for purposes of allowing a representation election to proceed. Taken together, these new rules have cleared the path to the unionization of America's workforce.

This chapter will examine the effects that the Board's new rules governing union elections and bargaining units will have on employers' ability to respond effectively to union organization efforts. Section 27.02 will address the rules — past and present — governing representation elections. This section will review the traditional election procedure rules, offer background information regarding the Board's rule-changing process, and provide an in-depth look into the specific procedures and processes mandated by the new rules. This section will also address the many legal attacks currently being levied against the Board's new rule in federal courts across the country. Section 27.03 will focus on the Board's 2011 *Specialty Healthcare* decision, which dramatically changed the standard that the Board has traditionally relied upon to determine bargaining unit appropriateness.[12] This part will review the traditional appropriateness analysis, discuss the radically different test first articulated in *Specialty Healthcare* but subsequently applied in many

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10 Representation — Case Procedures; Final Rule, 79 Fed. Reg. 74308 (Dec. 15, 2014), *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-12-15/pdf/2014-28777.pdf; NLRB, *Representation Case Rules Effective April 14, 2015*, National Labor Relations Board, https://www.nlrb.gov/what-we-do/conduct-elections/representation-case-rules-effective-april-14-2015 (last visited Aug. 15, 2015).

11 *Ambush Election Update; 40 Percent Reduction in Campaign Time, Almost 100 Percent More Petitions*, Hunton Employment & Labor Perspectives (May 12, 2015), http://www.huntonlaborblog.com/2015/05/articles/nlrb/ambush-election-update-40-percent-reduction-in-campaign-time-almost-100-percent-more-petitions/.

12 *In Re* Specialty Healthcare & Rehab. Ctr. of Mobile, 357 N.L.R.B. No. 83 (Aug. 26, 2011).

additional contexts, and analyze the potential import of these changes on organizing efforts. Finally, Section 27.04 will demonstrate why the Board's dramatic departure from traditional procedure and precedent — in regards to both representation elections and bargaining unit appropriateness — necessitates that employers take steps to prevent unionization *before* unions file election petitions.

§ 27.02. Rules Governing Representation Elections: From Efficient and Fair to a Total Ambush.

[1] — Representation Elections Prior to April 14, 2015.

Before the new ambush election rules were enacted on April 14, 2015, representation elections were governed by a set of regulations that not only struck a fair balance between employer and union interests, but also ensured elections were conducted in an efficient manner without unnecessary delay. Under these traditional rules, elections were held an average of 38 days following the filing of the election petition — a number that fell below the Board's internal target of 42 days.[13] This period gave both employers and unions sufficient opportunity to adequately present their positions and provided employees enough time to make reasoned and well-informed decisions — all within a relatively condensed timeframe. This section will address several procedural components of representation elections held under the traditional rules, including the election petition, the pre-election board hearing, statements of employer position, and disclosure of employee information.

[a] — The Election Petition.

Under the traditional rules, the election process began with the filing of an election petition by a group of employees or a union. Within 48 hours of filing the petition, the union was required to furnish "showing of interest documentation" evidencing that at least 30 percent of the employees in the proposed bargaining unit supported the petition.[14] Such support could be

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13 *See Summary of Operations, 2002-2012 Reports*, *supra* note 9.

14 29 C.F.R 101.17 (2014) [Reserved by 79 FR 74476]; *Id*. § 101.18(a) (2014) [Reserved by 79 FR 74476].

demonstrated by producing a signed petition, authorization cards, union membership cards, or dues receipts.[15]

Parties were not permitted to file representation documents, including the initial petition, electronically. As a result, election petitions were required to be filed in hard-copy form or by facsimile.

[b] — The Pre-Election Hearing.

After a petition had been filed, the Board would organize a pre-election hearing. The timing of this pre-election hearing varied depending on the Board's regional practices, but the majority of hearings were held approximately 10 days following the filing of the petition.[16] At this hearing, a regional director determined whether or not to direct an election or to approve an election agreement. Both the employer and the union were permitted to raise important issues relevant to "questions of representation," including voter eligibility and the appropriateness of a proposed bargaining unit.[17] The ability to raise such issues at the pre-election hearing was important, as the resolution of such questions was critical in helping the regional director determine whether to hold an election in the first place. Parties did not, however, waive such questions if they failed to raise them during the hearing. This allowed both the employer and the union to take post-hearing action if new relevant circumstances or factors were uncovered later in the election process.

Within seven days following the pre-election hearing, both the union and the employer were permitted to file a brief.[18] Either party was able to request an extension of 14 days or more in order to ensure that their briefs were accurate, informative, and helpful to the regional director.[19]

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15 Archibald Cox, *et al.*, *Labor Law: Cases and Materials* 227 (15th ed. 2011).

16 Representation — Case Procedures, 79 Fed. Reg. 74309 (Dec. 15, 2014) ("[I]n some regions, . . . hearings were routinely scheduled to open in seven to ten days. However, practice was not uniform among regions, with some scheduling hearings for ten to twelve days, or even longer.").

17 29 C.F.R. §§ 102.64(a), 102.66(a) (2014) [Amended by 79 FR 74482, 74483].

18 *Id*. § 102.67(a) (2014) [Amended by 79 FR 74484].

19 *Id*. § 102.67(a) (2014) [Amended by 79 FR 74485].

After considering the pre-election hearing and the parties' corresponding briefs, the regional director decided whether to direct an election or approve an election agreement. Once the regional director issued its pre-election decision, parties had the opportunity to challenge this decision by requesting that the Board review the decision before the election took place.[20] Under the traditional rules, all requests for review of a pre-election decision had to be made before the election took place. In order to allow the Board adequate time to consider potential requests for review, the regional director could reasonably delay or "stay" an election for a short period of 25 to 30 days.[21]

[c] — Statement of Employer Position.

Under the traditional rules, prospective voters received limited information regarding the employer's position until the regional director directed an election following the pre-election hearing.[22] This was helpful to the employer because it provided time to craft meaningful and accurate position statements without feeling exceedingly rushed. This was also helpful to employees in that it delayed an over influx of information before an election had even been ordered in the first place.

[d] — Disclosure of Voter Information.

The employer was not required to share a list of prospective voters with the Board's regional office until after the regional director explicitly directed an election. Within seven days of the regional director's decision to hold an election, however, the employer was directed to share information sufficient to allow the union to communicate with voters. Generally, the employer provided a list of employee names and addresses.[23] In order to protect employee privacy, this list did not include sensitive information like personal phone numbers or e-mail addresses.

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20 *Id*. § 102.67(b) (2014) [Amended by 79 FR 74485].

21 NLRB, *NLRB Representation Case-Procedures Fact Sheet*, National Labor Relations Board, https://www.nlrb.gov/news-outreach/fact-sheets/nlrb-representation-case-procedures-fact-sheet.

22 *Id*.

23 *Id*.

[2] — The Board's Efforts to Change Representation Election Rules.

[a] — Labor Organizations Attempt to Effect Change.

Although the Board's traditional representation procedures typically produced fair election results, labor organizations have complained for many years that the election period should be shorter. Unions claimed that the median election timeline — wherein an election was held approximately 40 days following the filing of an election petition — allowed employers to pressure employees to vote against unionization. These claims seem unfounded given that unions won approximately 70 percent of representation elections under the traditional election rules.[24]

[b] — The 2011 Not-So-Final Final Rule.

Notwithstanding organized labor's healthy win rate under the old rules, the Board issued a Notice of Proposed Rulemaking on June 22, 2011.[25] The notice indicated the Board was proposing amendments to its rules and regulations governing representation case procedures. According to the Board, the proposed amendments were intended to enable the Board to effectively administer the NLRA by modernizing election processes, enhancing transparency, and eliminating unnecessary delay.[26] As part of its rule-making process, the Board provided a total of 74 days for comments and reply comments and held a two-day public commentary period.[27] On November 30, 2011, the Board members engaged in public deliberations and voted on whether to draft and issue a final rule. This Final Rule was circulated for approval on December 16, 2011 using the agency's electronic

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24 *Union Election Win Rate Continues Upward in 2009 – 73% Win Rate Casts Further Doubt on Need for EFCA*, Hunton Employment & Labor Law Perspectives (Nov. 24, 2009), http://www.huntonlaborblog.com/2009/11/articles/efca/union-election-win-rate-continues-upward-in-2009-73-win-rate-casts-further-doubt-on-need-for-efca/.

25 Representation — Case Procedures; Notice of Proposed Rulemaking, 76 Fed. Reg. 36812 (June 22, 2011), *available at* http://www.gpo.gov/fdsys/pkg/FR-2011-06-22/pdf/2011-15307.pdf.

26 *Id*.

27 Representation — Case Procedures; Final Rule, 76 Fed. Reg. 80142 (Dec. 22, 2011), *available at* http://www.gpo.gov/fdsys/pkg/FR-2011-12-22/pdf/2011-32642.pdf.

Judicial Case Management System.[28] On December 22, 2011, the Final Rule was formally enacted.[29]

The 2011 Final Rule, however, did not stay in place for long. After the rules were enacted, various organizations representing business interests challenged the rules in federal court. These organizations levied multiple substantive and procedural attacks against the election rules, including claims that the Board lacked the required three-member quorum when it enacted the rules.[30] In May of 2012, the U.S. District Court for the District of Columbia reviewed these attacks. The court determined that when the Final Rule was circulated on December 16, only two board members actually voted using the case management system; the third member, who believed no action was required of him since he did not wish to vote in favor of the rule, did not actually participate in the final vote. As such, the court held that the Board lacked a proper quorum when it officially passed the election rules and, as a result, that the Final Rule was invalid.[31] However, the court did not consider the organizations' other merit-based arguments, and suggested that "nothing appears to prevent a properly constituted quorum of the Board from voting to adopt the rule if it has the desire to do so."[32]

[c] — Trying Again in 2014.

Following this initial setback, the Board issued a second notice of proposed rulemaking on February 5, 2014.[33] The proposed rule contained the same proposals as the 2011 rule, and was admittedly "in substance . . .

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28 Chamber of Commerce of U.S. v. NLRB, 879 F. Supp. 2d 18, 23 (D.D.C. 2012).

29 Representation — Case Procedures; Final Rule, 76 Fed. Reg. 80138 (Dec. 22, 2011).

30 New Process Steel, L.P. v. NLRB, 130 S. Ct. 2635 (2010) (requiring a three-member Board quorum and cautioning that a member may not be counted toward a quorum simply because he holds office).

31 Chamber of Commerce of U.S., 879 F. Supp. at 30.

32 *Id*.

33 NLRB, *The National Labor Relations Board Proposes Amendments to Improve Representation Case Procedures*, National Labor Relations Board (Feb. 5, 2015), https://www.nlrb.gov/news-outreach/news-story/national-labor-relations-board-proposes-amendments-improve-representation.

identical to the representation procedure changes first proposed in June of 2011."[34]

The Board provided an additional sixty-seven-day period for interested parties to submit comments and reply comments and held two more days of oral hearings.[35] The Board assured interested parties that it would review all comments issued in response to the 2011 proposals and explained that duplicate comments need not be submitted a second time.[36] Following this process, the Board issued the "Final Rule" on December 15, 2014.[37] The Final Rule became effective on April 14, 2015. According to the Board, the Final Rule "is designed to remove unnecessary barriers to the fair and expeditious resolution of representation questions."[38]

Members Philip A. Miscimarra and Harry I. Johnson III dissented from the Final Rule.[39] They categorized the rules' foolhardy purpose as one focused solely on ensuring that"[i]nitial union representation elections . . . occur as soon as possible" at all costs.[40] Members Miscimarra and Johnson criticized the Board majority's "election now, hearing later" and "vote now, understand later" mentality. Explaining that the Board had been "extremely successful" in resolving representation disputes and conducting elections without significant delay under the traditional rules, Members Miscimarra and Johnson stated that "[t]he Board would better serve employees, unions and employers — and the public interest in general — by undertaking a more neutral, limited, and even-handed approach."[41]

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34 Representation — Case Procedures; Notice of Proposed Rulemaking, 76 Fed. Reg. 7318 (Feb. 6, 2014), *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-02-06/pdf/2014-02128.pdf; *The National Labor Relations Board Proposes Amendments to Improve Representation Case Procedures*, *supra* note 33.

35 Representation — Case Procedures; Final Rule, 79 Fed. Reg. 74331 (Dec. 15, 2014).

36 *Id*.

37 *Id*.

38 *NLRB Representation Case-Procedures Fact Sheet*, National Labor Relations Board, *supra* note 21.

39 Representation — Case Procedures; Final Rule, 79 Fed. Reg. 74430 (Dec. 15, 2014) (Miscimarra and Johnson, dissenting).

40 *Id*.

41 *Id*. at 74460.

[3] — "Ambush Election" Procedures Under the New Rule.

According to the Board, the new rules "streamline Board procedures, increase transparency and uniformity across regions, eliminate or reduce unnecessary litigation and delay, and update the Board's rules on documents and communications in light of modern communications technology."[42] In actuality, the new NLRB rules have one principle effect: they significantly shorten the election process. In doing so, the rules reduce representation election procedures to meaningless formalities, effectively eliminate an employer's ability to adequately defend against a union organizing effort, and prevent employees from making reasoned decisions. As part of their streamlining effect, the new rules also substantially increase the authority of regional directors, decrease Board oversight of the election process, and prevent employers from litigating certain important issues during the election. This section will examine the new rules and, when appropriate, compare the new procedures with those under the traditional election rules.

[a] — The Election Petition.

The first major change effected by the new rules concerns the election petition itself. Under the new rules, the union may now file the election petition electronically to the appropriate NLRB regional office.[43] At the time it files the election petition, the union is required to demonstrate a sufficient "showing of interest."[44] In other words, unions must meet the 30 percent employee-signature requirement at the time of filing instead of 48 hours later as required under the traditional rules. The Board enacted this change in order to increase efficiency, but in reality, this change has little to no practical significance. Many unions wait to file an election petition until after they have already amassed substantial employee support and, in most cases, compile the requisite showing of support *before* filing the petition.

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42 *NLRB Representation Case-Procedures Fact Sheet*, National Labor Relations Board, *supra* note 21.

43 29 C.F.R. § 101.26 (2015).

44 *Id*. §§ 102.61(a)(7), 102.61(f).

The union is also required to fax a copy of the filed petition to the employer, who is required to post and distribute initial notice of the election petition to employees.[45] In addition to posting notice of the election in the workplace, the employer must also submit notice of the election petition to its employees electronically, if it customarily communicates with its employees through electronic means.[46]

[b] — Statement of Employer Position.

Following the filing of the election petition, but before the pre-election hearing, the employer is now required to file a statement of position. Generally, this statement of position must be produced within seven days of the Union's filing of the petition.[47] The statement of position must identify any issues the employer has with the union's petition and must contain a statement of the employer's position regarding the proposed unit.[48] The employer will be forced to waive all issues not raised in its initial statement of position,[49] and the employer may only amend its initial statement of position upon a "showing of good cause."[50]

In addition, the statement of position must contain a list of the names of all employees in the petitioned-for unit, along with their classification, shift, and work location.[51] The employer must separately indicate if it believes any employees on the list should be excluded from the proposed unit, and must specifically list individuals whose eligibility it intends to contest at the hearing.[52]

The employer must also use its statement of position to propose details regarding election logistics, including potential dates, times, and locations.[53]

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45 *Id*. § 102.63(a)(2).
46 *Id*.
47 *Id*. § 102.63(b)(1).
48 *Id*. § 102.63(b)(1)(i).
49 *Id*.
50 *Id*. § 102.66(b).
51 *Id*. § 102.63(b)(1)(iii).
52 *Id*.
53 *Id*. § 102.63(b)(1)(i).

If an employer fails to propose such information, it may lose the ability to provide future input regarding these important matters.[54]

[c] — The Pre-Election Hearing.

Pre-election hearings will commence eight days after the filing of the election petition.[55] Hearings will now continue "day to day until completed," and continuances will not be granted but for extraordinary circumstances.[56]

At the beginning of the hearing, the union is now required to respond directly to any issue raised by the employer in its statement of position.[57] As explained above, parties will not be permitted to take any position inconsistent with and in addition to those raised in their statements of position — regardless of any information potentially disclosed by the other party during the hearing.[58] If there is a dispute between the parties, the hearing officer has total discretion to allow each party to make an offer of proof, or to describe the evidence it has compiled in support of its position.[59]

Following the hearing, parties are no longer permitted to file briefs without obtaining express approval from the regional director.[60] Instead, both the employer and the union will be provided with an opportunity to present oral argument at the close of the hearing.[61]

Once the parties have presented their issues, the regional director has full discretion to determine if any voter eligibility issues should be litigated before the election takes place.[62] The regional director has full authority to defer litigation of eligibility and inclusion issues if it believes those issues do not need to be resolved in order to determine if an election should be held.

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54 *Id*. § 102.66(d).
55 *Id*. §102.63(a).
56 *Id*. § 102.64(c).
57 *Id*. § 102.66(b).
58 *Id*.
59 *Id*. § 102.66(c).
60 *Id*. § 102.66(h).
61 *Id*.
62 *Id*. § 102.67(a).

This is a dramatic departure from the traditional rules, under which all issues regarding voter eligibility were litigated prior to the election.

As was the case under the traditional election rules, the hearing officer determines whether there is a "question of representation" and decides whether or not to direct an election or approve an election agreement at the conclusion of the pre-election hearing. However, the new rules dramatically alter the procedures governing Board review of pre-election decisions. While both the employer and the union may still request a review of the regional director's decision under Section 3(b) of the NLRA, parties are now free to request such review at any time throughout the proceedings — including after the election takes place.[63] Moreover, the Board will only grant such requests for review "for compelling reasons."[64] In addition, elections will no longer be delayed in anticipation of requests for review.[65] As a result, in the few instances where the Board does review pre-election decisions, such review will take place *after* the election.

[d] — Disclosure of Voter Information.

Under the new rules, the employer is required to provide the union with a list of prospective voters within two days (as opposed to seven days under the traditional rules) of the regional director's election direction.[66] Not only is the employer required to provide employee names, but it must also provide "modern forms of contact information" including phone numbers and personal e-mail addresses.[67] While the Board asserts this disclosure is necessary "to permit non-employer parties to communicate with prospective voters about the upcoming election using modern forms of technology," the disclosure simply provides the union with avenues to disrupt employees' lives by allowing personal communication without the employees' consent.[68]

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63 *Id*. § 102.67(c).

64 *Id*. § 102.66(d).

65 *Id*. § 102.67(c).

66 *Id*. § 102.67(l).

67 *Id*.

68 *NLRB Representation Case-Procedures Fact Sheet*, *supra* note 21.

An election may not be scheduled for a date earlier than 10 days after this list is provided to the union, but the union is able to waive this right.[69] As a result, the union has the power to accelerate the election timeline. In cases where the union is already familiar with the majority of employees in the bargaining unit, waiving this right will cause the union no detriment but will significantly hurt employers already scrambling to respond to the union's organizing efforts.

[4] — The New Rule Faces Federal Litigation.

[a] — A Myriad of Legal Challenges.

As was the case in 2011, the passage of these new ambush elections rules has been met with significant criticism. While the Board took extra caution to ensure it acted with a proper quorum in enacting the new rules, interested parties are still attacking the rules on a variety of substantive legal grounds. While a complete overview of these attacks is outside the scope of this chapter, this section will briefly address the primary concerns raised by critics of the new ambush election rules.

[i] — NLRA Concerns.

Most fundamentally, critics claim that the new rules are in violation of several important aspects of the NLRA. First, many believe that the rules' focus on accelerating the election process runs contrary to the legislative history of the NLRA. This history clearly indicates that Congress believed at least thirty days should pass between the filing of the election petition and the election itself in order to ensure that employees have time to become adequately informed before casting their vote.[70] By reducing the election timeline to a very short period of 10 or 12 days, these critics believe the Board

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69 Representation — Case Procedures; Final Rule, 79 Fed. Reg. 74360 (Dec. 15, 2014) (explicitly explaining that the 10-day waive rule, as articulated in The Ridgewood Country Club, 357 N.L.R.B. No. 181, n.8 ((2012)), now applies in all cases).

70 Brief of Plaintiff at 15, Chamber of Commerce v. NLRB, No. CV 15-0009 (ABJ), 2015 WL 4572948 (D.D.C. July 29, 2015).

has deprived employees of the ability to make meaningful and well-informed decisions about unionization.

For example, many assert that the new rules "truncate[] informed debate regarding union representation, contrary to Sections 8(c) and 9(b) of the NLRA."[71] By dramatically shortening the election timeline, the Board has also dramatically reduced opportunity for the exchange of ideas and meaningful debate. In doing so, critics claim that "the Final Rule subverts the Act's primary purpose — to permit sufficient time and information to "assure . . . the fullest freedom in exercising the rights guaranteed by [the] Act."[72]

In addition, the rules may violate Section 9(c)(1)'s requirement that parties receive an "appropriate" pre-election hearing.[73] As critics point out, the rules "improperly limit[] pre-election hearings by allowing hearing officers to exclude evidence regarding issues fundamental to the election, such as whether certain employees or groups of employees are eligible to vote in the election."[74] This limitation arguably prevents parties from receiving appropriate pre-election hearings. Relatedly, critics also assert that that the rules violate Section 9(b), which grants parties the right to request Board review of "any action of a regional director." Because the new rules only allow appeals to the Board in "extraordinary situations" where a party has obtained "special permission" to appeal, critics believe the rules deny parties this important right guaranteed in Section 9.

[ii] — APA Concerns.

The Administrative Procedure Act (the APA), which governs the way United States administrative agencies propose and establish new rules and regulations, prohibits agencies from engaging in action that is "arbitrary and capricious."[75] Agency action is considered arbitrary and capricious when it is not based on "reasoned decisionmaking." Critics of the new rules assert

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71 *Id*.

72 *Id*.

73 *Id*. at 16.

74 *Id*. at 15.

75 5 U.S.C. § 706(2)(A).

that its provisions are arbitrary and capricious in violation of the APA. The argument is the Board not only ignored its "undisputed success" in holding timely elections in order to "unnecessary abandon" established election procedures, but also failed to consider the ways in which the new rules will actually *increase* litigation related to representation elections.[76]

[iii] — Free Speech Concerns.

The new rules may also infringe on both employers' and employees' free speech rights. The attacks regarding employers' free speech rights are two-fold. First, the rules infringe on employers' First Amendment right to free speech by requiring employers to post a post-petition, pre-election notice in the workplace.[77] In addition, because the rules dramatically limit the time in which employers can communicate with their employees between the filing of the petition and the election itself, some claim that the rules also impose upon employer's Section 8(c) right to communicate its views to its employees.[78]

Also affected by the new rules are employees' abilities to make use of their own speech rights. Critics explain that employees' right to bargain collectively through the representative of their choosing is only meaningful if they are able to make informed decisions about unionization.[79] Because the election rules radically reduce the time employees have to make representation decisions and limit employees' abilities to receive information about their employer's position, the rules also prevent employees from effectively utilizing their right to choose a representative.

[iv] — Miscellaneous Concerns.

The rules' critics have levied a myriad of additional legal attacks against the ambush election rules. For example, critics claim that rules violate employers' Fifth Amendment due process rights by requiring pre-hearing statements of position and severely limiting the hearing and

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76 Brief of Plaintiff at 32-34, Chamber of Commerce v. NLRB.

77 *Id*. at. 42.

78 *Id*. at. 26.

79 *Id*. at. 27.

review process.[80] In addition, critics assert that the rules violate the Federal Regulatory Flexibility Act. Under this law, the Board is required to analyze both the number of small businesses affected by a given proposal and the economic impact of this proposal on these small employers.[81] Critics claim that the Board failed to adequately consider this impact in adopting the new rules. Another common criticism of the rules concerns the requirement that employers provide unions with employee phone numbers and personal e-mail addresses.[82] The Board itself admitted the risks that this new requirement places on employees, including the risks of identity theft and invasion of privacy.[83]

[b] — Federal Courts Weigh In.

Business organizations have attempted to attack the new ambush election rules in federal court. On January 13, 2015, a group of plaintiff organizations, including the Associated Builders and Contractors of Texas, Inc., filed a lawsuit in the Western District of Texas officially challenging the rules. Specifically, the plaintiffs asserted that the rules violate the National Labor Relations Act and the Administrative Procedure Act by exceeding the Board's statutory authority, violating employees' privacy rights, interfering with protected speech during election campaigns, and being arbitrary and capricious and an abuse of agency discretion.[84] On June 1, 2015, the court rejected each of the plaintiff organizations' arguments, noting that they "have failed to show the new rule, on its face, is a violation of the [NLRA] or the APA."[85]

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80 *Id*. at. 15.

81 5 U.S.C. §§ 603, 604.

82 *Id*. at. 40.

83 Representation — Case Procedures; Final Rule, 79 Fed. Reg. 74341-32. (Dec. 15, 2014).

84 *NLRB Ambush Election Rules Upheld by Federal Court*, Hunton Employment & Labor Perspectives (June 2, 2015), http://www.huntonlaborblog.com/2015/06/articles/nlrb/nlrb-ambush-election-rules-upheld-by-texas-federal-court/.

85 Associated Builders & Contractors of Texas, Inc. v. NLRB, No. 1-15-CV-026 RP, 2015 WL 3609116, at *17 (W.D. Tex. June 1, 2015).

Another group of plaintiff organizations, including the United States Chamber of Commerce, filed a similar challenge in the District of D.C. on January 5. On July 29, 2015, the D.C. court reached the same decision as its Texas counterpart, contending that the organizations did not adequately identify "which provisions of the Final Rules violated which provisions of the NLRA and the Constitution and how."[86] While the D.C. District court did acknowledge that the plaintiffs' "policy objections" may be "sincerely held and legitimately based," it claimed that these objections amount to nothing more than a simple "disagreement with choices made by the agency entrusted by Congress with broad discretion to implement the provisions of the NLRA and to craft appropriate procedures."[87]

The Associated Builders and Contractors of Texas has already filed an appeal asking the Fifth Circuit to overrule the lower court's decision, and the Chamber of Commerce is expected to take similar action.[88]

§ 27.03. Appropriate Bargaining Units: *Specialty Healthcare* and the Micro-unit Nightmare.

The enactment of the ambush election rules is not the only way in which the Board has recently departed from previously controlling procedures and precedent. In addition, a recent Board decision has dramatically changed the way in which employees are grouped together into "appropriate" bargaining units.

Generally speaking, an appropriate bargaining unit is a group of two or more employees who share a community of interest and may reasonably be grouped together for purposes of collective bargaining.[89] Under Section 9(b)

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86 Chamber of Commerce of U.S. of Am. v. Nat'l Labor Relations Bd., No. CV 15-0009 (ABJ), 2015 WL 4572948, at *10 (D.D.C. July 29, 2015).

87 *Id*. at *1.

88 *Small Business Disappointed by Ruing in Ambush Election Case But Pledges to Appeal*, NFIB (June 1, 2015), http://www.nfib.com/article/nfib-vows-federal-appeal-on-texas-ambush-ruling-69515/.

89 NLRB, Basic Guide to the National Labor Relations Act: General Principles of Law Under the Statute and Procedures of the National Labor Relations Board 12 (1997), *available at* https://www.nlrb.gov/sites/default/files/attachments/basic-page/node-3024/basicguide.pdf.

of the NLRA, whenever a union files an election petition, the Board must determine whether the petitioned-for unit of employees is a unit "appropriate" for collective bargaining.[90] In many cases, the employer will contend that a petitioned-for unit is inappropriate because it excludes other employees with sufficiently similar interests. In doing so, the employer will effectively propose a larger, more inclusive unit of employees. By seeking to include as many employees in a single bargaining unit as possible, employers seek to eliminate the administrative nightmare that comes with potentially negotiating and administering several separate collective bargaining agreements across a single facility or workplace.

Ultimately, the determination of whether a petitioned-for unit is appropriate is left to the Board's discretion. This discretion, however, is not unbridled. Indeed, the Board is still required to adhere to the language of the NLRA and to follow its own precedent regarding the appropriateness of bargaining units. Despite these requirements, in *Specialty Healthcare*, the Board contravened both the explicit language of the NLRA and well-established Board precedent.

[1] — Determining Appropriateness Before *Specialty Healthcare*.

[a] — Section 9(c)(5).

When determining whether a proposed unit is appropriate, Section 9(c)(5) of the NLRA prohibits the Board from giving controlling weight to the extent to which employees within the unit have already organized.[91] This limitation on the Board's authority to determine appropriate bargaining units was not expressly described in the Wagner Act, passed in 1935. However, at the time the Act was passed, Congress did express concern regarding the scope of the Board's authority to determine appropriateness based on the extent of organizing:

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90 29 U.S.C. § 159.

91 *Id*. § 159(c)(5) ("In determining whether a unit is appropriate for the purposes specified in subsection (b) [of this section] the extent to which employees have organized shall not be controlling.").

> The major problem connected with the majority rule is not the rule itself, but its application. The important question is to what unit the majority rule applies . . . If the employees themselves could make the decision [regarding unit composition] without proper consideration of the elements which could constitute the appropriate units they could in any given instance defeat the practical significance of the majority rule; and, by breaking off into small groups, could make it impossible for the employer to run his plant.[92]

In other words, Congress was worried that if employees could effectively self-select and choose their own small bargaining units, workforces would become divided into unmanageable "micro-units" and labor disputes would subsequently increase — ultimately hurting American commerce. The Senate's final report to the Wagner Act's passage reflects Congress' intent that the Board avoid reliance on the extent of organization in unit determination:

> Section 9(b) empowers the [Board] to decide whether the unit appropriate for purposes of collective bargaining shall be the employer unit, craft unit, plant unit or other unit. Obviously, there can be no choice of representatives and no bargaining unless units for such purposes are first determined. And employees themselves cannot choose these units, because the units must be determined before it can be known what employees are eligible to participate in a choice of any kind.[93]

Early Board decisions, however, disregarded this clear guidance. The Board issued a line of precedent that condoned reliance on the extent of organizing as a basis for determining unit appropriateness.[94] For example, in *Garden State Hosiery Co.*, the Board expressly justified its use of extent

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92 Hearing on S. 1958 Before the Committee on Finance, Education and Labor, Indian Affairs, and Manufacturers, 74th Cong. 1458 (1935) (Testimony of Francis I. Biddle) (emphasis added).

93 S. Rep. No. 74-573 (1935) (emphasis added).

94 *See, e.g.*, Botany Worsted Mills, 27 N.L.R.B. 687 (1940) (deeming a unit of trappers and sorters, a single department in employer's plant, appropriate).

of organization as a principal factor for bargaining unit determinations.[95] In a vigorous dissent, Member Reynolds commented that:

> [N]o minority group — either pro-union or anti-union — may be permitted to manipulate the boundaries of the appropriate [unit or group] for the sole purpose of constructing another [unit or group] wherein it comprises a majority. Obviously indulgence in such tactics —commonly referred to in political science as 'gerrymandering' — makes a mockery of the principle of majority rule.[96]

As a result of those Board decisions, Congress amended the Act in 1947 to codify the proscription against reliance on the extent of organization in unit determinations. Hence, Section 9(c)(5) became law as part of the Taft-Hartley amendments. The House report on this provision confirms that Section 9(c)(5) was drafted in response to the Board's use of the extent of organization as a primary factor:

> Section 9[(c)(5)] strikes at the practice of the Board by which it has set up as units appropriate for bargaining whatever group or groups the petitioning union has organized at the time. Sometimes, but not always, the Board pretends to find reasons other than the extent to which the employees have organized as ground for holding such units to be appropriate. [citations omitted]. While the Board may take into consideration the extent to which employees have organized, this evidence should have little weight, and as section 9 [(c)(5)] provides, is not controlling.[97]

This overview in mind, the legislative history both of the Wagner Act and the Taft-Hartley amendments thus reflects Congress' intent that the extent of union organizing should be given little (if any) weight and should never control the outcome of a unit determination.

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95 Garden State Hosiery Co., 74 N.L.R.B. 318 (1947).

96 *Id*. at 326.

97 1 NLRB, Legislative History of the Labor Management Relations Act, 1947, at 328 (1947) (House Report No. 245, April 11, 1947) (emphasis added).

[b] — Traditional Community of Interest Standard.

Since the passage of the Taft-Hartley amendments, including Section 9(c)(5), the Board has followed a relatively simple rule for analyzing potential bargaining units. In determining whether a proposed unit is appropriate, the Board has considered any history of collective bargaining between the parties, the desires of the employees, and — although it was not given controlling weight — the extent to which employees had organized.[98] In addition, the Board considered whether the employees in the petitioned-for unit shared a "community of interest" with each other and/or with the employer's other employees (*i.e.,* those excluded from the unit).[99]

Employees share a community of interest if they perform similar job functions, receive similar methods of compensation and benefits, work similar hours, require the same training and skills, and are subject to similar degrees of supervision.[100] If the included and excluded employees shared sufficient community of interest factors, the Board would not consider the petitioned-for unit appropriate unless the Union could demonstrate that the included employees' interests were "sufficiently distinct" from those of the employer's other employees.[101]

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[98] Pac. Sw. Airlines v. NLRB, 587 F.2d 1032, 1038 (9th Cir. 19780); *see also* T.L. Grooms, "The NLRB and Determination of the Appropriate Unit: Need for a Workable Standard," 6 *Wm. & Mary L. Rev.* 13 (1965) (discussing each of these traditional factors).

[99] Trident Seafoods, Inc. v. NLRB, 101 F.3d 111, 118 n. 11 (D.C. Cir. 1996) ("Under the community-of-interest test, the Board evaluates unit appropriateness based on "the degree to which a group of employees share a 'community of interests' distinct from the interests of other employees.'" (quoting Banknote Corp v. NLRB, 84 F.3d 637 (2d Cir. 1996)).

[100] Banknote Corp v. NLRB, 84 F.3d 637 (2d Cir. 1996) ("The degree to which employees share a community of interests is measured by a number of factors, including whether, in relation to other employees, they have different methods of compensation, hours of work, benefits, supervision, training and skills; if their contact with other employees is infrequent; if their work functions are not integrated with those of other employees; and if they have historically been part of a distinct bargaining unit.").

[101] Seaboard Marine, Ltd., 327 N.L.R.B. 556 (1999*); see also* Colorado Nat'l Bank of Denver, 204 N.L.R.B. 243 (1973) (explaining that petitioned-for units are not appropriate if they are "too narrow in scope" in that they "exclude employees who share a substantial community of interest with employees in the unit sought" (internal quotations omitted)).

[2] — The *Specialty Healthcare* Effect.

In *Specialty Healthcare*, the Board considered the appropriateness of a petitioned-for bargaining unit of certified nursing assistants.[102] While the regional director had found such unit appropriate, the employer argued that the only appropriate unit containing the certified nursing assistants in question must also include all other nonprofessional service and maintenance employees at its facility.[103]

The Board's holding in *Specialty Healthcare* was divided into two parts. First, it overruled precedent that had created a special test for determining unit appropriateness in non-acute health care facilities.[104] This holding was extremely limited and, moreover, was all that was required to decide that case.

But the Board then went much further, dramatically altering the generally applicable unit determination standard in a manner that cuts across all industries. Purporting to "make clear" the law on this subject, the Board created an entirely new test. It ruled that when a union seeks representation of a "readily identifiable" group of employees that share "a community of interest," it "will" find such a unit appropriate for bargaining unless the employer can "demonstrate that the excluded employees share an overwhelming community of interest with the included employees."[105]

The Board ruled that additional employees share an "overwhelming" community of interest with petitioned-for employees only when there "is no legitimate basis upon which to exclude [the] employees from" the unit because the community of interest between included and excluded employees "overlap[s] almost completely."[106] According to the *Specialty Healthcare* Board, the analysis of whether a petitioned-for unit is appropriate begins solely with a review of that unit and no other employees outside the unit. "If

102 *In Re* Specialty Healthcare & Rehab. Ctr. of Mobile, 357 N.L.R.B. No. 83 (Aug. 26, 2011).

103 *Specialty Healthcare*, slip op., at 1.

104 *Id*. at 4-8.

105 *Id*. at 10-11.

106 *Id*. at 11-13.

that unit is an appropriate unit, the Board proceeds no further" unless the employer meets its new burden.[107]

The *Specialty Healthcare* Board claimed that its decision merely "clarified" the existing rules for bargaining unit determination.[108] But, the Board's so-called clarification was in fact a radical change that established a completely new rule for determining what constitutes an appropriate bargaining unit — and blatantly ignored both Section 9(c)(5) and decades of precedent in the process. For one, by essentially applying a presumption of appropriateness absent a showing of overwhelming community interest between the included and excluded employees, the Board "effectively accorded controlling weight to the extent of union organization . . . because 'the union will propose the unit it has [already] organized.'"[109]

This result not only contravenes Congress's clear legislative intent, but also expressly violates Section 9(c)(5). In addition, the new "appropriateness threshold" analysis, which focuses exclusively on the interests of the employees in the petitioned-for unit and ignores any consideration of the interests of the employer's other employees, does not remotely resemble the Board's traditional approach for correctly analyzing appropriateness in a unit determination proceeding. As Member Hayes noted in his *Specialty Healthcare* dissent:

> In a correct application of the traditional community of interest test, the Board 'never addresses, solely and in isolation, the question whether the employees in the unit sought have interests in common with one another. Numerous groups of employees fairly can be said to possess employment conditions or interests 'in common.' Our inquiry — though perhaps not articulated in every case — necessarily proceeds to a further determination whether the interests of the

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107 *Id*. at 12.

108 *Id*. at 1.

109 NLRB v. Lundy Packing Co., 68 F.3d 1577 (4th Cir. 1995) (overturning a previous Board decision, which attempted to establish a standard similar to that established in *Specialty Healthcare*).

group sought are sufficiently distinct from those of other employees to warrant the establishment of a separate unit.'[110]

Despite the broad scope of its radical decision, the Board emphasized that, other than for non-acute health care facilities, its holding was "not intended to disturb any rules applicable only in specific industries."[111] However, ignoring its pledge not to extend *Specialty Healthcare* beyond the health care industry, the Board has applied *Specialty Healthcare* to determine the appropriateness of petitioned-for units across a wide range of industries.

For example, in *Northrop Grumman Shipbuilding, Inc*., the Board determined that a unit of 220 radiological control technicians was appropriate simply because they worked in the same department.[112] In doing so, the Board explicitly applied *Specialty Healthcare* and held that the employer had failed to establish a group of excluded technicians shared an "overwhelming community of interest" with the radiological control technicians — despite an abundance of evidence regarding the high level of integration among and similarities between all of the technicians working at the employer's nuclear shipbuilding operation. In *Macy's & Local 1445*, the Board applied *Specialty Healthcare* and held that a unit composed solely of fragrance and cosmetics associates was appropriate, despite the fact that these employees made up a small fraction of the sales associates working at Macy's.[113] The Board has also applied *Specialty Healthcare* to determine the appropriateness of units comprised of car rental service agents,[114] cement masons,[115] dog handlers,[116]

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110 *Specialty Healthcare*, slip op. at 19 (Hayes, dissent) (quoting Newton-Wellesley Hospital, 250 N.L.R.B. at 411-412 (1980) (emphasis added)).

111 *Id*. at 13. n. 29.

112 Northrop Grumman Shipbuilding, Inc., 357 N.L.R.B. No. 163 (December 30, 2011).

113 Macy's & Local 1445, 361 N.L.R.B. No. 4 (July 22, 2014).

114 Dtg Operations, Inc. & Teamsters Local Union No. 455, Int'l Bhd. of Teamsters, 357 N.L.R.B. No. 175 (Dec. 30, 2011).

115 Baker Dc, LLC Employer & Operative Plasterers & Cement Masons Int'l Ass'n, Local 891 Petitioner, 05-RC-135621, 2014 WL 5390197, at *1 (DCNET Oct. 23, 2014).

116 Guide Dogs for the Blind, Inc. & Office & Prof'l Employees Int'l Union, Local 29, 359 N.L.R.B. No. 151 (July 3, 2013) (holding that other excluded dog handlers did not share an overwhelming community of interest with guide dog handlers).

and a variety of other types of employees. Each of these cases demonstrates how difficult it is for employers to prove that excluded employees share an "overwhelming community of interest" with a group of employees who have already been found to be "readily identifiable."

[3] — The Creation of Pro-Union Bargaining Units Under *Specialty Healthcare*.

As has probably always been the case, petitioning unions are incentivized to propose smaller bargaining units comprised of few employees. For one, the smaller the proposed unit, the easier it is for a union to gather pre-petition support from a majority of included employees. If specific employees or groups of employees appear uninterested or against union representation, the union can propose a smaller unit that specifically excludes these potentially anti-union employees. Before *Specialty Healthcare*, the Board would not find such unit appropriate without first considering any excluded (and, coincidentally, any anti-union) employees. However, under the Board's new *Specialty Healthcare* rule, it will make its initial determination of appropriateness without regard to any excluded employees. So long as (1) the petitioned-for unit contains an identifiable group of employees with similar interests, and (2) the interests of the excluded employees do not overlap completely with those of the included employees, the Board will find the likely already-pro-union unit appropriate.

§ 27.04. Preparing the Workplace for the Board's New "One-Two Punch."

The Board's new ambush election rules and *Specialty Healthcare* decision are dramatic departures from previous Board procedure and precedent. They also work together to deliver a "one-two punch" that clears the path towards creating a unionized American workforce.

The new election rules greatly accelerate the representation election process and provide employers with less time to meaningfully respond to union attacks. In other words, under the new election rules, employers have less time to inform employees about the benefits of remaining a union-free workplace and to persuade employees to vote against unionization. *Specialty*

Healthcare amplifies this effect, as units deemed appropriate under its new rules will likely be comprised of dedicated union supporters (or, at the very least, not be comprised of employees who are solidly against unionization). In essence, *Specialty Healthcare* allows unions to propose (and secure) micro-units of pro-union employees, and the new ambush election rules make it next to impossible for employers to persuade these already pro-union employees against unionization. Employers will simply be unable to combat an already well-establish pro-union bias in the new 10- to 12-day election timeframe.

This "one-two punch" will make the fight against unionization exceedingly difficult. As a result, employers must take three important steps *now* — before the union begins organizing, before the Board determines if a proposed unit is appropriate, and before the petition has been filed — to prevent future unionization. First, employers must prioritize improving employee relations. Second, employers must take steps to prevent potentially problematic groups of employees from becoming "readily identifiable" bargaining units under *Specialty Healthcare*. Finally, employers must also take proactive measures to devise a campaign game plan that will allow them to best utilize their limited time during a representative election. The remainder of this chapter will address specific and realistic actions employers can take to achieve both of these important goals.

[1] — Improving Employee Relations Before the Union Begins Organizing.

[a] — Focus on Worker Satisfaction.

Because satisfied employees are less susceptible to unions' organizing efforts, non-union employers should take proactive efforts to ensure that their employees are, and remain, content with their employment. In order to do so, employers must not only make it a priority to *listen* to their employees' concerns, but must also take action to address these concerns and make employees feel *heard*.

First and foremost, employers should communicate with employees about their workplace experiences in order to assess workers' potential concerns or complaints. There are numerous ways to gather data regarding employees' overall levels of workplace satisfaction. For example, employers can be hands-

on, such as by holding quarterly one-on-one meetings with every employee to discuss his or her evolving concerns. On the other end of the spectrum, employers can afford interested employees with the opportunity to share their thoughts by creating an anonymous complaint system.

Regardless of the information-gathering procedures an employer chooses to utilize, employers must synthesize, and react to employee concerns. Simply gathering information is not enough; employers must take action to respond to employee complaints. By demonstrating that they value their employees' opinions and are committed to timely addressing employee concerns, employers may reduce employees' incentive to unionize in the first place.

[b] — Educate the Workforce About Union Issues.

It is also important for employers to devote time and resources towards educating supervisors *and* employees about various issues relating to unionization and collective bargaining.

First, employers should educate managers and supervisors to recognize the early signs of organization. Signs of unionization include noticeable changes in employee morale or behavior towards management, an increase of employee questions about company policies, and the appearance of an employee "spokesperson" who begins speaking "on behalf of" his fellow employees. If a manager or supervisor notices these signs, or any other unusual employee behavior, he may be able to help address the employees' underlying issues — or, at the very least, put the employer on notice of a possible union campaign.

Employers should also teach managers and supervisors effective complaint-resolution skills. Often, the desire to unionize can spring from a single concern or complaint made by an individual worker. When not addressed appropriately, the concern can grow, spreading unrest through the workforce like wildfire. As a result, it is key that managers and supervisors act as a first line of defense, treating complaints as the potential sparks of unionization. By educating managers and supervisors not only to recognize the types of complaints that can evidence a desire to unionize, but also to treat these concerns appropriately, employers may be able to prevent the spread of pro-union sentiment.

In addition, employers should make efforts to educate employees about the benefits of remaining union-free. Employers often wait until after an election petition has been filed to provide their employees with information about the downsides of union representation. Most fundamentally, unionization interferes with employers' abilities to focus on each employee's individual needs and developments.

For example, without a union, employees may enjoy greater flexibility in terms of both scheduling and work assignments. With unionization comes standardization; once its workforce is represented by a union, employers are less able to accommodate a scheduling conflict or allow an employee to try his hand in a different position. In addition, unionization can be time-consuming. With the union as a middle man, employers' abilities to communicate directly with their employees and solve problems quickly are significant hampered. If employers make efforts to highlight the benefits of working in a non-unionized workforce *before* a union attempts to rally support, employees will be better able to see through a labor organization's claims that union representation and collective bargaining are the panacea to any and all workplace problems.

[2] — Preventing Problem Groups From Becoming "Readily Identifiable" Before the Board Determines Unit Appropriateness.

In addition to making efforts to prevent unionization generally, employers should also take measures to reduce the possibility that the Board will approve potential "micro" bargaining units. Employers should be vigilant in looking for small "pockets" of employees who seem especially dissatisfied and, subsequently, more vulnerable to unionization.

As explained above, under the new *Specialty Healthcare* standard, the Board will find a petitioned-for unit appropriate if the employees share a community of interest and are "readily identifiable." Excluded employees will only be included within the unit if the employer can makes the virtually impossible showing that they share an overwhelming community of interest with the included employees. Because it is so difficult to demonstrate that excluded employees share this overwhelming community of interest,

employers' best defense against the creation of micro-units is to ensure that small, problematic groups of employees are not "readily identifiable."

In order to do this, employers must monitor whether small groups of employees exhibit the signs of unionization discussed above. If an employer finds such a group, it can take measures to make the group less "readily identifiable." First, the employer can modify the job titles of the employees in the problematic group and make them more similar to the titles of employees in other groups. For example, if the problematic group of employees are all titled "Machine A Operators," and other, less-problematic employees are titled "Machine B Operators," the employer could consolidate both groups and give everyone the title of "Machine Operators."

In addition, employers can increase the interchange and common training between groups. The more an employer can show that the employees in a potential micro-unit interact with and complete the same tasks as excluded employees, the less likely the union will be able to show that the group is "readily identifiable." Finally, employers should take steps to ensure that all employees are working under the same terms and conditions. The more ways an employer can demonstrate that its entire workforce is subject to identical terms and conditions, the less likely the union will be able to demonstrate that its petitioned-for unit is truly distinct.

[3] — Organizing a Campaign Before the Petition Has Been Filed.

Even if employers improve employee relations and integrate potential micro-units into their larger workforce, unions can still acquire enough employee support to file an election petition. As this Chapter has demonstrated, elections that take place under the new ambush election rules can occur as soon as 10 to 12 days after the union files the initial petition. This is simply not enough time for an employer to develop a comprehensive response strategy.

This in mind, employers should take proactive steps to prepare for an election *before* a potential petition has ever been filed. As a first step, employers should organize an internal campaign team. If a petition *is* ever filed, the fact that individuals have already been designated to handle certain

election-related tasks will save time and confusion. Employers may also want to consider obtaining the services of a consultant or outside counsel. Even if an employer does not wish to incur this type of outside expense unless it faces an immediate threat of unionization, having a pre-selected experienced professional at the ready is a smart practice.

After an employer has assembled its campaign team, the team should develop an "election logistics" plan. As part of this plan, the election team should address common logistical questions that will inevitably arise during a potential election. For example, the team should decide where it would hold employee meetings, where it would conduct the vote, and where it would post any required notices. The team should also maintain a current list of employee names, phone numbers, and personal e-mail addresses so that it does not waste time compiling this information after a potential petition has been filed. Developing a plan that addresses the many logistical components of an election will allow the employer to focus on the important task of delivering its message to employees once a petition has been filed.

If possible, the employer's campaign team should also draft as much of a proposed statement of position as possible. Although employers will not be able to complete their statement of position until it learns about a specific petitioned-for unit, they can still draft a large portion of the statement regarding the nature of their business and their position regarding unionization.

While it may seem premature for a non-unionized employer to expend valuable time and resources developing an election campaign strategy when there is no immediate threat of unionization, taking these proactive steps during a period of workplace calm may be the only thing able to save an employer from the ambush election rules' aggressive timeline.

§ 27.05. Conclusion.

The Board has dramatically altered the landscape of union representation elections. By enacting the new ambush election rules and creating a new test to determine bargaining unit appropriateness, the Board has made it more difficult for employers to win elections. However, the future for employers does not necessarily mean unionization. Although the Board's recent actions

certainly present challenges, they are not insurmountable. By following the steps suggested in this chapter, employers will be able to put their best defense forward if and when the ambush election clock starts ticking.

Chapter 28

Cybersecurity in the Era of Unconventional Development: Is the Energy Sector Ready for Cyber Attacks?

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§ 28.01. Introduction.

The energy industry is vast and growing. As the industry continues to grow, it becomes a more frequent target for cybersecurity hacks and data breaches. As noted by the American Petroleum Institute: "The petroleum industry is a worldwide industry that is highly dependent on technology for its communications and operations. Technological advances that promote better efficiency and more automation within the petroleum industry also make information security an increasingly important issue." This article provides an outline of the risks in the energy sector for cyber attacks, evaluates the legal framework governing cybersecurity, identifies and evaluates insurance coverage issues, and provides general guidelines for cyber risk management that energy companies may wish to consider as they develop their cybersecurity programs.

[1] — Energy Development.

Like other industry sectors, energy companies must be aware of the looming and growing cyber threat so they can protect themselves accordingly. In general, the main industry sectors that make up the bulk of the energy industry include:

- *The Upstream Industry.* This energy sector generally consists of those companies engaged in the exploration and production phase of energy development, both on-shore and off-shore. This

includes lease and mineral rights acquisition, exploration efforts (including seismic), well site construction, drilling, casing/ cementing, stimulation, and production.

- *The Midstream Industry*. The midstream industry generally consists of those companies engaged in the movement of oil or natural gas, including transportation by pipeline, rail, tankers, or barge. Midstream activities may also include some treatment and processing of oil or natural gas, marketing, and storage.

- *The Downstream Industry*. The downstream industry generally consists of those engaged in the refining process, the distribution and sale of oil or natural gas to consumers (utilities), or the manufacture of products.

- *The Service Industry*. The service industry consists of those companies that provide services to oil and gas development companies, including lease brokers, geophysical exploration companies, construction companies, drilling contractors, cementing and casing service providers, and providers of completions operations (fracture stimulation).

These various industry sectors have a number of different types of data that may be desirable to entities seeking to penetrate the energy sector for commercial benefit.

[2] — Types of Data in the Energy Sector.

While the susceptible information in some industries would only include personally-identifiable information or banking information – such as credit card numbers – the energy industry is different. Potential types of data that may be breached include:

- Business Information.
- Trade Secrets.
- Operations, Communications Control Systems, and Infrastructure.
- Employee or other Personal Information.
- Contractors and Supply Chain.

In addition, the energy industry has unique considerations given its role in the nation's infrastructure and importance to the national economy and national security. Since the nation relies on different types of energy for so many critical processes at all times, a significant cybersecurity breach in the energy industry would be particularly devastating.

[3] — Types of Cyber Attacks and Risks in the Energy Sector.

The resourcefulness of hackers and variety of potential cybersecurity attacks further complicates matters because the energy industry must be prepared for an incredibly wide range of potential threats. Such threats can range from mere theft to significant energy system takeovers affecting wide ranges of the country. Such attacks can include:

- Advanced Persistent Threats (APT)
- Cybercriminals, Exploits, and Malware
- Denial of Service (DDoS)
- Domain Name Hijacking
- Corporate Impersonation and Phishing
- Employee Mobility (Disgruntled Employees)
- Lost or Stolen Laptops or Devices
- Inadequate Security and Systems Provided by Third Party Vendors

Moreover, cybersecurity threats within the energy industry create several types of significant risks to the energy industry. Some threats are seen in a variety of industries, and are not particular to the energy industry. For instance, there is a risk that a data breach could cause loss of web presence, interception of emails and data communications, or brand tarnishment and reputational harm. However, there are also several types of risks particular to the energy sector. These include loss of intellectual property and trade secrets, compromising of personal information, and legal and regulatory implications.

[4] — High-Profile Cyber Attacks on the Energy Industry.

As a whole, the energy sector (especially in the United States) has thus far dodged some of the most extensive cybersecurity attacks. However, there have been several high-profile cybersecurity attacks within the energy industry. To illustrate:

- *Operation Night Dragon*. In this attack, hackers used several locations in China to compromise servers in the Netherlands to wage attacks against global oil, gas, and petrochemical companies, and acquire proprietary and highly confidential information. The hack was elaborate and extensive, lasting approximately four years.
- *Saudi Aramco*. In this attack, hackers used malware to compromise 30,000 workstations of the Saudi company.
- *Operation "Oil Tanker": The Phantom Menace*. In May 2015, an IT (information technology) company issued a report detailing cyber attacks against ten or more companies in the oil-and-gas maritime transportation sector that were ongoing since August 2013. Panda Security reported that the unique email-based attacks against oil cargo companies did not use malware detectable by antivirus software. According to Panda Security, the companies affected are unwilling to come forward with information about the attacks for fear of bringing public attention to their cybersecurity vulnerabilities.

Although the energy industry has not been a significant victim of reported cybersecurity attacks to date, the risk of a future attack is rising given the growing flow of information within the industry. Moreover, with the positional sensitivity of the industry, a cybersecurity attack or data breach within the energy sector could be devastating.

§ 28.02. Legal Framework.

[1] — Federal Law.

There is currently no federal cybersecurity legislation that generally applies to the energy industry. However, the President has issued several

executive orders, and Congress has proposed legislation. In addition, several agencies have issued guidance or regulations dealing with cybersecurity and related security issues. Given the national implications of significant data breaches or cybersecurity attacks, many believe that federal legislation is inevitable and necessary to ensure national compliance and risk protection.

[a] — Executive Orders.

President Obama has issued three Executive Orders related to cybersecurity issues over the past few years. Most recently, on April 1, 2015, President Obama issued an Executive Order providing for the imposition of sanctions against those responsible for, complicit in, or engaged in (directly or indirectly), significant cyberattacks by foreign individuals.[1] The sanctions block the transfer of property or interests located in the United States to any such party. In order to qualify for sanctions under the order, the cyberattack must pose a significant threat to national security, foreign policy, financial stability, or economic health.[2] This Executive Order provides that the knowing use of trade secrets from cyberattacks or cyberespionage may be sanctionable as well.[3]

In addition, President Obama issued two Executive Orders promoting information-sharing practices. The first Executive Order, issued February 12, 2013, announced the policy of promoting increased information sharing.[4] In addition, the 2013 Executive Order called for the creation of a framework for entities to use when evaluating cybersecurity issues and protecting critical infrastructure. This would lead to the NIST framework.[5] The second Executive Order, announced on February 13, 2015, called for the promotion of information sharing and analysis organizations (ISAOs).[6] In addition, the Order provided that the Secretary of Homeland Security should contract with

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1 Exec. Order No. 13,694, 80 Fed. Reg. 18,077 (April 1, 2015).

2 *Id*.

3 *Id*.

4 Exec. Order 13,636, 78 Fed. Reg. 11,737 (Feb. 12, 2013).

5 *Id*.

6 Exec. Order No. 13,691, 80 Fed. Reg. 9,347 (Feb 13, 2015).

an outside ISAO standards organization, which will establish guidelines and standards for ISAOs.[7]

[b] — Proposed Legislation.

Along with the current regulations and guidance, there have been some notable federal bills proposed on cybersecurity issues. Although these bills have not been enacted yet, they provide a sense of how Congress will likely approach these issues in the future.

For instance, the *Cybersecurity Information Sharing Act* was introduced in the Senate in March of 2015.[8] The bill would combat cybersecurity breaches through enhanced information sharing of data breach events.[9] The bill also provides liability protection for those complying with the Act.[10] This element is missing from many current information-sharing requirements. The Senate recently passed this bill, but it has not yet been passed by the House or signed into law.

In addition, the *Data Accountability and Trust Act* was proposed in the House of Representatives.[11] The Data Accountability and Trust Act would require the Federal Trade Commission to promulgate regulations governing data protection.[12] The act would require each person engaged in interstate commerce that owns or possesses data containing personal information to establish specified security policies and procedures to treat and protect such information.[13]

[2] — Energy-Specific Statutes, Regulations, or Standards.

While global cybersecurity legislation (at least on the federal level) has not been passed to date, these issues have been addressed by a number of federal agencies through regulations or standards. With regard to the energy

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7 *Id*.

8 Cybersecurity Information Sharing Act of 2015, S. 754, 114th Cong. (2015).

9 *Id*. at §§ 3, 5.

10 *Id*. at § 6.

11 Data Accountability and Trust Act, H.R. 580, 114 Cong. (2015).

12 *Id*. at § 2.

13 *Id*. at § 3.

industry in particular, several agencies have issued regulations and standards related to cybersecurity and data breach issues.

[a] — Federal Energy Regulatory Commission (FERC).

As directed by FERC, the North American Electric Reliability Corporation (NERC) promulgated standards related to cybersecurity. The NERC 1300 Standards are cybersecurity standards for energy-related industries.[14] These standards address cybersecurity issues for bulk electric systems.[15] The NERC standards were approved by FERC.[16] The NERC standards deal with a range of topics, including asset identification and ranking, electronic security management, employee training, incident reporting and mitigation/cyber attack recovery.[17]

[b] — Nuclear Regulatory Commission (NRC).

The NRC promulgated standards to address cybersecurity concerns related to nuclear power plants.[18] The NRC's regulations require nuclear power plant licensees to develop and submit a cybersecurity protection plan that will minimize cybersecurity risks and mitigate damage from data breaches.[19]

[c] — Department of Homeland Security (DHS).

DHS promulgated the Chemical Facility Anti-Terrorism Standards (CFATS). First, DHS promulgated an interim final rule, which is currently in place until a final rule is published.[20] A proposed rule was published by DHS, and is currently pending review by the agency.[21] Under the CFATS rules, covered facilities include many in the energy sector and utilities. The

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14 *See* Critical Infrastructure Protection (CIP) 002-5 to CIP-011-1.

15 *Id*.

16 *See* 78 Fed. Reg. 72756 (Dec. 3, 2013).

17 *See* Critical Infrastructure Protection (CIP) 002-5 to CIP-011-1.

18 10 C.F.R. § 73.54.

19 *Id*.

20 6 C.F.R. Part 27.

21 79 Fed. Reg. 48693 (Aug. 18, 2014).

CFATS rules establish risk-based performance standards related to various aspects of a facility's security posture.[22] These include cybersecurity and other potential risks.

[d] — Department of Energy (DOE).

DOE has developed cybersecurity guidance for both the electricity and oil and gas industries. With regard to the electricity in particular, DOE published the Electricity Subsector – Cybersecurity Capability Maturity Model.[23] This guidance addresses the implementation and management of cybersecurity practices associated with information technology and operational technology specifically within the electricity industry. The guidelines help organizations evaluate their cybersecurity capabilities, communicate their capability levels, prioritize cybersecurity issues, and strengthen cybersecurity capabilities. With regard to the oil and gas industry, DOE published the Oil and Natural Gas Subsector – Cybersecurity Capability Maturity Model.[24] These guidelines are similar to those issued for the electricity subsector. The ONG-C2M2 addresses the implementation and management of cybersecurity practices associated with information technology and operational technology specifically within the oil and gas industry.

[3] — State Law.

While federal legal requirements have been slow to gain acceptance, the opposite is true on a state by state basis. Based on a survey of the National Conference of State Legislatures, 47 states have security breach notification laws and 32 states have data disposal laws.[25]

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22 *See id.*; *see also* 6 C.F.R. Part 27.

23 *See* Department of Energy, Electricity Subsector Cybersecurity Capability Maturity Model (ES-C2M2), Version 1.1 (Feb. 2014).

24 *See* Department of Energy, Oil and Natural Gas Subsector Cybersecurity Capability Maturity Model (ES-C2M2), Version 1.1 (Feb. 2014)

25 National Conference of State Legislatures, Security Breach Notification Laws, http://www.ncsl.org/research/telecommunications-and-information-technology/security-breach-notification-laws.aspx (last visited Oct. 29, 2015); National Conference of State Legislatures, Data Disposal Laws, http://www.ncsl.org/research/telecommunications-and-information-technology/data-disposal-laws.aspx (last visited Oct. 29, 2015).

[a] — Security Breach Laws.

At least 47 states have data notification laws.[26] Typical laws provide that an individual or entity that owns data including the personal information of state residents must notify those residents when a breach of personal information occurs. Laws typically only require notification of (a) the state's residents and (b) some consumer groups if a certain threshold number of residents (usually 1,000 to 10,000) are notified.

Many laws include a provision for instances where a third party is acting as custodian for the data on behalf of an individual or entity that owns the data. In those instances, the custodian is obligated to inform the owner of the date, and the owner would still have the obligation to notify state residents. Laws differ with regard to how soon notification should take place, with some laws providing a deadline, and others relying on a general statement such as "as soon as reasonably practicable." Laws also differ with regard to acceptable types of notice. These can include notice by mail, electronic mail, telephone, or public posting.

Many laws contain a provision that failure to comply with breach notification laws may result in a civil penalty and that the state attorney general may pursue a cause of action. Most, if not all, laws do not create a private cause of action.

[b] — Data Disposal Laws.

At least 32 states have passed data disposal laws.[27] Typical laws provide that businesses should have procedures for the protection and retention of personal information from customers and individuals. When these records are no longer of use to the business, the business should properly destroy the individuals/customers' personal information. Generally, data disposal laws provide that records should be destroyed by shredding, erasing, or otherwise

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26 Some examples in key energy producing states include: Pennsylvania, 73 P.S. § 2301 *et seq.*; Ohio Rev. Code § 1349.19; West Virginia, W. Va. Code § 46A-2A-103; Texas, Tex. Bus. & Com. Code § 521.053.

27 Examples include New Jersey, N.J. Rev. Stat. § 56:8-162; Florida, Fla. Stat. § 501.171; Texas, Tex. Bus. & Com. Code § 521.053.

making records indecipherable. Similar to the security breach notification laws, many data disposal laws provide a cause of action that may be enforced by a state attorney general.

[4] — Industry Standards.

As a general matter, cybersecurity issues are largely governed by a series of standards that do not have the force of law but are widely used and instructive. Given the prominence of these industry standards, energy industry companies should be aware of these standards for several reasons. First, these standards will likely inform the scope and substance of future lawmaking and regulatory efforts in this area. Moreover, for liability purposes, it is possible that courts will look to compliance with industry standards to determine whether a company took adequate steps to protect against the risk of a data breach. Lastly, on a more basic level, compliance with these standards can help protect energy companies from cybersecurity and data breach risks.

[a] — National Institute of Standards and Technology (NIST).

NIST published the Framework for Improving Critical Infrastructure Cybersecurity.[28] NIST's publication provides a framework for companies to understand and address cybersecurity risks. Using this framework, companies can improve their cybersecurity and infrastructure through the framework's principles and best practices for risk management.[29] The NIST standards identify five key steps to cybersecurity protection: Identify; Protect; Detect; Respond; and Recover.[30]

[b] — Department of Justice (DOJ) Guidance.

On April 30, 2015, DOJ released cybersecurity guidance.[31] The guidance provides a general framework for developing and implementing

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28 National Institute of Standards and Technology, Framework for Improving Critical Infrastructure Cybersecurity, Version 1.0 (Feb. 12, 2014).

29 *Id*. at 1.

30 *Id*. at 7.

31 Department of Justice, Computer Crime and Intellectual Property Section, Criminal Division, Cybersecurity Unit, Best Practices for Victim Response and Reporting of Cyber Incidents, Version 1.0 (April 30, 2015).

a cybersecurity policy. Although DOJ notes that the guidance is targeted at smaller businesses, it can be used by any business to help guide the creation of a cybersecurity policy.[32]

[c] — American Petroleum Institute (API).

The API has several guidance documents that set forth standards for the petroleum industry, including its general security guidance, pipeline cybersecurity guidelines, and SCADA guidance. In the API's Security Guidelines for the Petroleum Industry,[33] the API adopts the ISO/IEC International Standard 17799, *Information Technology – Code of Practice for Information Security Management*.[34] Moreover, the API recommends an Eight-Step Standard for Information Security Process. This includes the following steps:[35]

- Create an Information Security Policy
- Select and Implement Appropriate Controls
- Obtain Upper-Management Support
- Perform Security Vulnerability Assessments ("SVAs")
- Create Statements of Applicability for Employees
- Create an Information Security Management System
- Educate and Train Staff
- Perform Regular Audits

In addition, the API published API 1164 on pipeline cybersecurity.[36] The primary objective of this guidance is to allow pipeline operators to control their lines in a way in which there are no adverse effects on employees, the environment, the public or customers as a result of any actions of the operator or other parties. API's standard on pipeline cybersecurity developed guidelines related to supervisory control and data acquisition (SCADA) as

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32 *Id*. at 1.

33 American Petroleum Industry, Security Guidelines for the Petroleum Industry, 3rd Ed. (April 2005).

34 *See id*. at 31.

35 *Id*.

36 American Petroleum Institute Standard 1164, 2nd Ed. (June 1, 2009).

the means of remote monitoring and operation of pipeline equipment. This process is used by a variety of pipeline operators. The API recommends improving SCADA security and operations by: (a) analyzing vulnerabilities of the SCADA system that can be exploited by unauthorized entities; (b) listing the processes used to identify and analyze the SCADA system vulnerabilities to unauthorized attacks; (c) providing a comprehensive list of practices to harden the core architecture; and (d) providing examples of industry best practices.[37]

[d] — Information Sharing and Analysis Centers (ISACs).

Finally, ISACs are industry groups designed for industry-specific sharing of cybersecurity information. There are currently four energy-related ISACs. These include the Oil and Natural Gas ISAC, the Downstream Natural Gas ISAC, the Electric Services ISAC, and the Nuclear Energy Institute (NEI).

§ 28.03. Civil Litigation Resulting from Cyber Attacks.

Plaintiffs have attempted to state a variety of claims as a result of cyber attacks and data breaches. The government has also brought civil enforcement actions against companies for inadequate cybersecurity protection. Some of the potential civil causes of action are discussed below.

[1] — Civil Enforcement Actions by Government Agencies for Inadequate Cybersecurity.

Since 2002, the Federal Trade Commission (FTC) has used its authority under the FTC Act to pursue a number of actions against companies for data-security failures.[38] The FTC Act empowers the FTC to prevent companies (including oil and gas and energy companies) "from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or

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37 *Id*.

38 *See* FTC Legal Resources, https://www.ftc.gov/tips-advice/business-center/legal-resources?type=case&field_consumer_protection_topics_tid=249.

practices in or affecting commerce."[39] The FTC may levy civil penalties and bring civil actions to enjoin violations of the FTC Act.[40] Pursuant to section 45(n) of the FTC Act, the FTC may declare an act or practice unfair and unlawful if it: "[1] causes or is likely to cause substantial injury to consumers [2] which is not reasonably avoidable by consumers themselves and [3] [which is] not outweighed by countervailing benefits to consumers or to competition."[41] Deceptive acts or practices include misrepresentations or deceptive omissions of material fact.

At least one court has allowed an FTC civil complaint based on data breaches to survive a motion to dismiss. In *FTC v. Wyndham Worldwide Corp.*,[42] the U.S. District Court for the District of New Jersey held that the FTC stated a claim against Wyndham hotel-chain entities (collectively, "Wyndham") under the FTC Act where the complaint alleged that Wyndham failed to provide reasonable and appropriate security for guests' personal information stored in the computer system and, therefore, exposed the data to theft. The system suffered three data breaches in less than two years, resulting in over $10.6 million worth of fraudulent charges on guests' accounts. The court rejected Wyndham's argument that the FTC lacks authority to file a cybersecurity-based action under the FTC Act, holding that the FTC stated a claim and denying the motion to dismiss. The court held that the FTC adequately pleaded both an unfairness claim and a deception claim based on the data breaches.

In support of the unfairness claim in *Wyndham*, the FTC complaint alleged that Wyndham (a) failed to use readily available security measures, such as firewalls; (b) stored payment card information in clear readable text; (c) failed to implement adequate policies and procedures before connecting local computer networks to the main network; (d) failed to remedy known

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39 15 U.S.C. § 45(a)(2); FTC v. Atlantex Assocs., No. 87-0045, 1987 WL 20384, at *11 (S.D. Fla. Nov. 25, 1987), *aff'd*, 872 F.2d 966 (11th Cir. 1989) (holding that oil and gas companies violated § 45(a) and ordering restitution).

40 *See* §§ 45(l)-(m), 58(b).

41 § 45(n).

42 FTC v. Wyndham Worldwide Corp., 10 F. Supp. 3d 602 (D.N.J. 2014).

security vulnerabilities, putting personal information at risk; (e) allowed connection of insecure servers to the main network, including servers using outdated operating systems that could not receive security updates; (f) allowed servers to connect to the main network, although the default user IDs and passwords were enabled on the servers and easily available to hackers; (g) failed to employ commonly used methods to require complex user IDs and passwords; (h) failed to adequately inventory computers connected to the main network to properly manage devices on its network; (i) failed to employ reasonable measures to detect and prevent unauthorized access to the network or to conduct security investigations; (j) failed to follow proper incident response procedures, including failing to monitor for malware used in a previous intrusion; and (k) failed to adequately restrict third-party vendors' access to the network and property management systems.

The FTC's deception claim relied on certain representations in Wyndham's privacy policies available online, including that the Wyndham entities: "recognize the importance of protecting the privacy of individual-specific (personally identifiable) information"; "safeguard . . . personally identifiable information by using industry standard practices"; "make commercially reasonable efforts" to comply "with all applicable laws and regulations"; "utilize a variety of different security measures designed to protect personally identifiable information from unauthorized access by users"; "take commercially reasonable efforts to create and maintain 'fire walls' and other appropriate safeguards."

Wyndham appealed to the Third Circuit, but the Third Circuit affirmed the district court's decision to deny Wyndham's motion to dismiss.[43] The Third Circuit addressed only the unfairness claim; specifically whether the FTC has authority to regulate cybersecurity under section 45(n) of the FTC

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43 FTC v. Wyndham Worldwide Corp., 799 F.3d 236 (3d Cir. 2015). Similar challenges to FTC's data-security authority were dismissed in another case because FTC lodged the complaint internally, not in a federal district court. LabMD, Inc. v. FTC, 776 F.3d 1275, 1279-80 (11th Cir. 2015) (dismissing laboratory's challenge to FTC complaint, alleging data-security practices failed to prevent unauthorized access to patient information, for lack of subject-matter jurisdiction because FTC proceeding was ongoing).

Act and, if so, whether Wyndham was denied due process for lack of fair notice that its practices might violate the unfairness standard in section 45(n).

The court first rejected all of Wyndham's arguments that its alleged conduct was not "unfair" under the FTC Act.[44] Wyndham argued that the three requirements of section 45(n) (see above) are not the only prerequisites to an unfairness claim, but rather the plain meaning of "unfair" requires additional indicia of wrongdoing. The court rejected Wyndham's various arguments and affirmed that the FTC adequately pleaded an unfairness claim. In doing so, the court relied on the FTC's allegations that "Wyndham had published a misleading privacy policy that overstated its cybersecurity" and explained that such alleged facts pertain to both the deception claim and the unfairness claim.[45] Wyndham argued that unfairness requires some sort of inequity or injustice. In response, the court explained that the alleged conduct fits that meaning because "[a] company does not act equitably when it publishes a privacy policy to attract customers who are concerned about data privacy, fails to make good on that promise by investing inadequate resources in cybersecurity, exposes its unsuspecting customers to substantial financial injury, and retains the profits of their business."[46] In the court's view, such conduct would meet the plain meaning of "unfair" advocated by Wyndham. The court also rejected Wyndham's argument that recent statutes and legislation precluded the FTC's regulation of cybersecurity under the FTC Act.

The court also held that Wyndham received fair notice of the requirements of section 45(n), and was not deprived of due process, based on the court's interpretation of the FTC Act.[47] Because the FTC had not yet issued a formal interpretation concerning whether cybersecurity practices may be "unfair" under the FTC Act, the court viewed its role as interpreting "the meaning of the statute in the first instance," without any sort of deference to the agency. Instead, the court framed the issue as follows: "The relevant question is not

44 *Wyndham*, 799 F.3d at 244-49.
45 *Id*. at 245-46.
46 *Id*.
47 *Id*. at 249-59.

whether Wyndham had fair notice of the *FTC's interpretation* of the statute, but whether Wyndham had fair notice of what the *statute itself* requires."[48]

The court explained that Wyndham did not challenge whether the FTC Act itself fails to provide fair notice, but instead only challenged the standard as applied to the facts in this case. Based on the allegations of fact in the complaint that Wyndham was hacked three times and that it wholly failed to implement certain cybersecurity measures, the court held that Wyndham was on notice that its conduct would not meet the statutory standard in section 45(n). The court also noted that the FTC issued a guidebook on sound cybersecurity practices and had filed complaints and settled administrative cases related to inadequate cybersecurity, with notice provided on its website and in the Federal Register. Wyndham did not argue that it was unaware of the statute or the FTC's prior actions, but argued that it did not specifically know what the law required or which cybersecurity failures triggered the violations. Based on the standard of review, however, the court concluded that Wyndham was not "entitled to know with ascertainable certainty the FTC's interpretation of what cybersecurity practices are required by § 45(a)."[49]

Based on *Wyndham* and other cases, companies may be civilly liable for failure to implement adequate cybersecurity measures,[50] but may not yet fully understand the types of cybersecurity measures that must be implemented to avoid liability. The Third Circuit recognized in *Wyndham* that the standard of liability might be unclear, at least until the FTC issues further guidance:

> We acknowledge there will be borderline cases where it is unclear if a particular company's conduct falls below the requisite legal threshold. But under a due process analysis a company is not entitled to such precision as would eliminate all close calls. Fair notice is satisfied here as long as the company can reasonably foresee that a

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48 *Id*. at 253-54.

49 *Id*. at 259.

50 *Cf.* Patco Constr. Co. v. People's United Bank, 684 F.3d 197, 213 (1st Cir. 2012) (bank's failure to implement additional cybersecurity measures was commercially unreasonable under UCC provision applicable to financial institutions in light of the bank's knowledge of recent fraud incidents).

court could construe its conduct as falling within the meaning of the statute.[51]

Until the FTC issues additional guidance on the issue, which might limit the scope of its enforcement actions, the prior FTC complaints available on its website will serve as guidance for courts and the regulated industry concerning the types of cybersecurity deficiencies that might result in liability. For example, the Third Circuit in *Wyndham* used a 2006 FTC complaint for purposes of comparison, noting that it contained "close corollaries" to the allegations against Wyndham.[52]

In addition to potential federal enforcement, it is important to remain aware of developments at the state level. Some states have statutes that provide for enforcement by state attorneys general or government agencies.[53]

[2] — Claims Against Entities that Experienced a Data Breach.

Plaintiffs have attempted to state different types of claims against companies that experienced a data breach, leaving the plaintiffs' information vulnerable to disclosure. Some types of claims are discussed below.

[a] — Negligence for Failure to Protect Data.

Plaintiffs have successfully stated negligence claims based on companies' alleged breaches of their duties to protect data from hackers.[54] A key issue for negligence claims based on cyber attacks is whether the harm to the

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51 *Wyndham*, 799 F.3d at 255-56 (internal citation omitted).

52 *Id*. at 258.

53 *See In re* Target Corp. Data Sec. Breach Litig., No. 14-2522, 2014 WL 7192478, at *11-14 (D. Minn. Dec. 18, 2014) (explaining that some states' data-breach notification statutes allow attorneys general or government officials to enforce them).

54 *See, e.g.*, Anderson v. Hannaford Bros. Co., 659 F.3d 151, 162 (1st Cir. 2011) (plaintiffs adequately alleged negligence claim against grocery chain based on hackers' breach of electronic payment system and theft of credit and debit card information); Lone Star Nat'l Bank, N.A. v. Heartland Payment Systems, Inc., 729 F.3d 421, 423 (5th Cir. 2013) (banks successfully stated negligence claims against credit-card processor for hackers' breach of credit card processor's data systems).

plaintiffs is foreseeable, or whether the criminal activities of the third-party hackers is an unforeseeable superseding cause of the harm.[55]

[b] — Breach of Contract (Express or Implied) for Failure to Protect Data.

A company's contracts may require it to protect other persons' data, which can give rise to a breach of contract action for a data breach. Whether or not an express contract exists between a company and persons whose data is compromised as a result of a data breach, the persons may state breach-of-contract claims based on the relationship between the parties.[56]

[c] — Failure to Comply with State Statutes Related to Computers and Electronic Data.

Several states have data-breach notification laws and other statutes regulating computer-based conduct that may authorize private civil actions for lack of notice, untimely notice, or other noncompliance related to a data breach. Some state statutes do not authorize private civil enforcement or are unclear on the subject.[57]

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55 *See, e.g.*, *In re* Target Corp. Data Sec. Breach Litig., No. 14-2522, 2014 WL 6775314, at *3 (D. Minn. Dec. 2, 2014) ("Although the third-party hackers' activities caused harm, Target played a key role in allowing the harm to occur. Indeed, Plaintiffs' allegation that Target purposely disabled one of the security features that would have prevented the harm is itself sufficient to plead a direct negligence case.").

56 *See, e.g.*, *Anderson*, 659 F.3d 151, 159 (1st Cir. 2011) (class-action plaintiffs stated a claim for breach of an implied contract because a jury could reasonably conclude that the grocery chain implicitly agreed to safeguard its customers' data); *In re Target Corp. Data Sec. Breach Litig.*, No. 14-2522, 2014 WL 7192478, at *20-21 (D. Minn. Dec. 18, 2014) (holding that putative class-action plaintiffs adequately alleged breach of implied contracts, but failed to allege breach of Target's REDcard debit-card agreement provision requiring Target to "use security measures that comply with federal law").

57 *See In re Target Corp. Data Sec. Breach Litig.*, No. 14-2522, 2014 WL 7192478, at *9-14 (D. Minn. Dec. 18, 2014) (analyzing various state data-breach statutes and concluding that plaintiffs did not state a claim under the following state's statutes: Florida, Oklahoma, Utah, Arkansas, Connecticut, Idaho, Massachusetts, Minnesota, Nebraska, Nevada, Texas and Rhode Island).

[d] — Other Types of Claims Related to Data Breaches.

Other types of claims that have been asserted based on data breaches include, for example: breach of fiduciary duty/confidential relationship,[58] violation of state unfair trade practices/consumer protection statutes,[59] and privacy infringement.[60]

[3] — Shareholder Derivative and Securities Claims Resulting from Data Breaches.

Officers and directors of a company that suffers a data breach may face derivative and securities claims by shareholders of the company. In *In re Heartland*, shareholders brought a derivative action against officers and directors of Heartland for securities fraud under the Private Securities Litigation Reform Act of 1995 (PSLRA)[61] after hackers accessed internal corporate information that was confidential, including employees' names, addresses, and social security numbers.[62] The hackers also stole 130 million credit and debit card numbers.

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58 *See, e.g., Anderson*, 659 F.3d 151, 157-58 (1st Cir. 2011) (plaintiffs failed to allege breach of fiduciary duty, in part because they alleged no facts establishing the "trust and confidence" element required by Maine confidential-relationship cases).

59 *See, e.g.*, *In re* Sony Gaming Networks & Customer Data Sec. Breach Litig., 996 F. Supp. 2d 942, 966-73 (S.D. Cal. 2014) (plaintiffs alleged claims under various California consumer protection statutes).

60 *See, e.g.*, *In re* Sci. Applications Int'l Corp. (SAIC) Backup Tape Data Theft Litig., 45 F. Supp. 3d 14, 21, 29 (D.D.C. 2014) (plaintiffs alleged that data breach resulting from theft of tapes violated their expectation of privacy under statutes, state tort law, and possibly contract, but court dismissed for lack of standing claims of plaintiffs who failed to allege their data was accessed). For further examples of claims that might be alleged in a data-breach case, see generally *In re Sony Gaming Networks*, 996 F. Supp. 2d 942, 959 (S.D. Cal. 2014) ("The fifty-one claims alleged in the [complaint] can be categorized into nine sub-groups: (1) negligence; (2) negligent misrepresentation; (3) breach of express warranty; (4) breach of implied warranty; (5) unjust enrichment; (6) violation of state consumer protection statutes; (7) violation of the California Database Breach Act; (8) violation of the federal Fair Credit Reporting Act; and (9) partial performance/breach of the covenant of good faith and fair dealing.").

61 15 U.S.C. § 78u-4(b)

62 *In re* Heartland Payment Sys., Inc. Sec. Litig., No. CIV. 09-1043, 2009 WL 4798148, at *1 (D.N.J. Dec. 7, 2009).

After Heartland disclosed the data breach, its stock price dropped by almost $10 per share in less than a month. The shareholders claimed that Heartland's officers concealed the cyber attack during a conference call and made misrepresentations about the adequacy of its computer network security in statements made by its officers and in its SEC filings, which amounted to fraud because the officers "were aware that Heartland had poor data security and had not remedied the problem." The court held that the plaintiffs failed to state a claim under the heightened pleading standards for fraud under the PSLRA because the statements made by the officers were not fraudulent and the statements in the SEC filings were not false or misleading.

Shareholders have also alleged that officers' and directors' failure to protect data from hackers is a breach of their fiduciary duty, a waste of corporate assets, an abuse of control, and gross mismanagement.[63] Shareholders may also attempt to force a company's directors to bring a lawsuit on behalf of the company in response to a data breach.[64]

[4] — Claims by Hacked Entities Against Hackers (Assuming They Are Identified).

[a] — Computer Fraud and Abuse Act.

The Computer Fraud and Abuse Act (CFAA)[65] is the primary federal criminal statute that penalizes hacking. It prohibits unauthorized access of "protected computers" (*i.e*., certain computers of financial or government

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63 *See, e.g*., La. Mun. Police Employees' Retirement Sys. v. Alvarez, No. 5620, 2010 WL 3780308 (Del. Ch. Sept. 27, 2010) (approving settlement of derivative action for breach of fiduciary duty against directors for data breach involving company that operates Marshall's, T.J. Maxx, and other retail stores); Complaint, Kulla v. Steinhafel, No. 14-cv-00203 (D. Minn. Jan. 21, 2014) (alleging breach of fiduciary duty and waste of corporate assets against Target's officers and directors); Complaint, Collier v. Steinhafel, No. 14-cv-00266 (D. Minn. Jan. 29, 2014) (alleging breach of fiduciary duty, gross mismanagement, waste of corporate assets, and abuse of control against Target's officers and directors).

64 *See, e.g*., Palkon v. Holmes, No. 2:14-CV-01234, 2014 WL 5341880, at *3-6 (D.N.J. Oct. 20, 2014) (relying on the business judgment rule to grant motion to dismiss Wyndham shareholder's suit for Wyndham's refusal to follow his demand to bring a lawsuit based on data breaches).

65 18 U.S.C. § 1030.

institutions or computers connected to interstate commerce).[66] Any computer connected to the Internet is protected because such a connection means it is used in interstate commerce. The CFAA authorizes a civil action where the defendant:

- Knowingly, with the intent to defraud
- Accesses a protected computer
- Without authorization or exceeds authorized access
- Furthers the intended fraud; and
- Obtains anything of value.[67]

An action may be brought where the defendant "intentionally accesses a computer without authorization or exceeds authorized access, and thereby obtains . . . information from any protected computer."[68] A plaintiff may receive compensatory damages and injunctive or other equitable relief.[69] Damages are limited to economic damages of at least $5,000 during any one-year period, or other damages related to medical care, physical injury, a threat to public health or safety, or affecting government computers.[70] The CFAA expressly excludes any cause of action "for the negligent design or manufacture of computer hardware, computer software, or firmware."[71]

Companies have used the CFAA to pursue civil actions against employees and third-parties, alleging that they were not authorized to access their data. In *Dresser-Rand Co. v. Jones*,[72] a corporation that provides technology, products, and services to develop energy and natural resources filed a civil suit against former employees who took sensitive data on external devices upon leaving the company. The court granted summary judgment on the CFAA

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66 § 1030(a)(4), (e)(2)(B).

67 § 1030(a)(4), (g).

68 § 1030(a)(2)(C).

69 § 1030(g).

70 *See* § 1030(g), (c)(4)(A)(i)(I)-(V); Advanced Fluid Systems, Inc. v. Huber, 28 F. Supp. 3d 306, 327 (M.D. Pa. 2014) (company failed to state a CFAA claim against former employee and his new employer because company failed to allege facts supporting damages of at least $5,000, such as impairment to data or computer system or costs incurred for restoration).

71 § 1030(g).

72 *See, e.g.*, Dresser-Rand Co. v. Jones, 957 F. Supp. 2d 610, 621 (E.D. Pa. 2013).

claim in favor of the employees because one employee had not accessed Dresser-Rand's computers and the others acted within their authorization to access the computers. A key issue under the CFAA is the definition of the term "authorization," but that definition will likely not be an issue where a hacker who never had any authority to access data steals information.[73]

[b] — Wiretap Act and Electronic Communications Privacy Act.

The Wiretap Act, as amended by the Electronic Communications Privacy Act (ECPA),[74] allows private civil actions for unauthorized interception of electronic communications, as well as use or disclosure of such communications in certain circumstances.[75] The remedies include equitable or declaratory relief, damages (including statutory and punitive damages), and attorneys' fees and costs.[76] There is no liability where the interceptor is a party to the communication or received consent to the interception, "unless such communication is intercepted for the purpose of committing any criminal or tortious act."[77] Certain entities, such as providers of electronic communication services, and their agents may be immune from claims under the Wiretap Act.[78]

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73 *See id*. at 615-21 (noting a circuit split regarding the meaning of "authorization" and concluding that the company's policies did not govern access, but only use); Paradigm Alliance, Inc. v. Celeritas Technologies, LLC, 659 F. Supp. 2d 1167, 1190-92 (D. Kan. 2009) (producer of GIS for pipeline safety demonstrated genuine issue of fact regarding whether IT companies' unsuccessful attempts to log on to website with another user's ID and password was violation of CFAA).

74 18 U.S.C. §§ 2510 *et seq*.

75 18 U.S.C. §§ 2511(1)(a), 2520(a).

76 § 2520(b).

77 § 2511(2)(d).

78 *See, e.g.*, *In re* Google, Inc. Privacy Policy Litig., No. C-12-01382, 2013 WL 6248499, at *10 & n.86 (N.D. Cal. Dec. 3, 2013) ("[A]s a provider of electronic communication services, Google is immune from claims alleging interception by a 'device' based on equipment used 'by a provider of wire and electronic communication service in the ordinary course of business.'").

[c] — Stored Communications Act.

The Stored Communications Act (SCA)[79] authorizes private civil actions against any person who engages in the following activities:

- Intentionally accesses without authorization a facility through which an electronic communication service is provided; or
- Intentionally exceeds an authorization to access that facility; and
- Thereby obtains, alters, or prevents authorized access to a wire or electronic communication while it is in electronic storage in such system.[80]

Certain persons are exempt from this prohibition, including those providing a wire or electronic communications service and users of the service that made or are the intended recipients of the communication.[81] But the SCA also forbids certain conduct that may give rise to a civil action against providers of electronic communication services or remote computing services.[82]

Civil actions under the SCA are authorized only for violations committed with a knowing or intentional state of mind.[83] The SCA provides exclusive remedies (except when there are constitutional violations), including equitable and declaratory relief, damages, attorneys' fees and costs, punitive damages, and profits made by the violator from the violation.[84]

[d] — Trade Secret Protection Laws.

Depending on the sensitive nature of the information that is subject to a data breach, companies may bring claims under state laws for misappropriation of trade secrets.[85]

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79 18 U.S.C. §§ 2701 *et seq.*

80 18 U.S.C. §§ 2701(a), 2707.

81 § 2701(c).

82 *See* § 2702(a).

83 § 2707(a).

84 §§ 2707(b)-(c), 2708.

85 *See, e.g.*, *Advanced Fluid Systems, Inc.*, 28 F. Supp. 3d 306, 314-23 (M.D. Pa. 2014) (holding that a designer of hydraulic machine systems stated a claim for misappropriation

[e] — Other Types of Claims Against Hackers.

Plaintiffs may assert a variety of other types of claims, including, for example, breach of copyright and trademark protection laws,[86] violations of the Racketeer Influenced and Corrupt Organizations (RICO) Act,[87] and state-specific statutory and common-law claims.

[5] — Claims by Hacked Entities Against Cybersecurity Vendors.

[a] — Negligence for Failure to Protect Data.

Companies have stated claims against cybersecurity providers for ordinary or gross negligence for alleged breaches of their duties to protect data from hackers.[88]

[b] — Breach of Contract for Failure to Protect Data.

Companies have stated breach-of-contract claims against cybersecurity providers based on the terms and representations in the contracts governing the parties' relationship.[89]

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of trade secrets under Pennsylvania law where it alleged that a former employee saved the confidential information to an external hard drive and transmitted it to the employee's new employer).

86 *See, e.g.*, SecureInfo Corp. v. Telos Corp., 387 F. Supp. 2d 593, 610-13 (E.D. Va. 2005) (holding that cybersecurity company stated a civil claim for copyright infringement against competitors for using confidential information regarding software).

87 *See, e.g.*, *SecureInfo Corp.*, 387 F. Supp. 2d 593, 613-15 (E.D. Va. 2005) (holding that cybersecurity company failed to allege a "pattern of racketeering activity" pursuant to 18 U.S.C. § 1962(c) to state a civil claim under RICO against consultant and competitor employees for sharing and using confidential information).

88 *See, e.g.*, Baidu, Inc. v. Register.com, Inc., 760 F. Supp. 2d 312, 320 (S.D.N.Y. 2010) (claim for gross negligence based on security provider's failure to follow own protocols survived motion to dismiss, despite contractual limits on liability); *see also* Strautins v. Trustwave Holdings, Inc., 27 F. Supp. 3d 871, 881 (N.D. Ill. 2014) (plaintiff lacked standing to bring negligence claim against cybersecurity company that provided products and services to South Carolina Department of Revenue, which suffered a cyber attack).

89 *See, e.g.*, *Baidu, Inc.*, 760 F. Supp. 2d 312, 320 (S.D.N.Y. 2010) (claim for breach of contract based on cybersecurity provider's failure to follow own protocols survived motion to dismiss, but required showing of gross negligence due to contractual limits on liability).

[c] — Other Types of Claims for Failures of Cybersecurity Vendors.

Other types of claims that might be raised depending on the factual circumstances include negligent or intentional misrepresentation,[90] products liability for defective security software,[91] and state-specific statutory and common-law claims.

[6] — Barriers to Claims and Limits on Liability Related to Data Breaches.

There may be barriers to claims raised as a result of data breaches, including, most notably, Article III standing.

[a] — Standing for Asserting Claims Based on Data Breaches.

Article III standing remains a significant hurdle for plaintiffs who bring an action against a company for failure to protect their data from hackers. Many courts have held that plaintiffs' allegations of an increased risk of harm from a data breach is not alone sufficient to meet standing requirements because the mere disclosure of information, without misuse (*e.g.*, unauthorized purchases using credit card information), is not an injury in fact.[92] These

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90 *See, e.g.*, *In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 996 F. Supp. 2d 942, 974-75 (S.D. Cal. 2014) (dismissing misrepresentation claims for failure to allege pecuniary loss).

91 *But see* 18 U.S.C. § 1030(g) (CFAA exclusion for causes of action "for the negligent design or manufacture of computer hardware, computer software, or firmware.").

92 *See, e.g.*, Reilly v. Ceridian Corp., 664 F.3d 38, 42-46 (3d Cir. 2011), *cert. denied*, 132 S. Ct. 2395 (2012); Peters v. St. Joseph Servs. Corp., No. 4:14-CV-2872, 2015 WL 589561, at *4-5 & n.10 (S.D. Tex. Feb. 11, 2015) (rejecting that increased risk of future identity theft or fraud constitutes "imminent" injury, and noting that Clapper v. Amnesty Int'l USA, 133 S. Ct. 1138 (2013) "[a]rguably . . . has resolved the circuit split" on the issue); Galaria v. Nationwide Mut. Ins. Co., 998 F. Supp. 2d 646, 657 (S.D. Ohio 2014) (relying on *Clapper* to conclude that "the increased risk that Plaintiffs will be victims of identity theft, identity fraud, medical fraud, or phishing at some indeterminate point in the future does not constitute injury sufficient to confer standing where, as here, the occurrence of such future injury rests on the criminal actions of independent decisionmakers and where, as here, the Complaint lacks sufficient factual allegations to show such future injury is imminent or certainly impending"); Green v. eBay Inc., No. CIV.A. 14-1688, 2015 WL 2066531, at *5 (E.D. La. May 4, 2015) ("[T]he

courts typically hold that alleged costs incurred by plaintiffs for mitigation or prophylactic measures, such as for monitoring financial information for unauthorized activity, are insufficient to establish an actual or imminent injury as a result of a data breach.[93] Some courts have held that plaintiffs who fail to allege unreimbursed financial costs lack standing, although their data was misused to generate fraudulent charges.[94] In contrast, other courts, particularly within the Ninth Circuit, have held that an increased risk of harm from a data breach is sufficient to meet Article III standing requirements, even in light of recent Supreme Court authority that suggests otherwise.[95]

[b] — Absence of Cognizable Injury from Data Breaches.

Under state negligence and contract law, damages must generally be reasonably foreseeable for courts to allow recovery. This requirement is similar to the injury requirement for Article III standing.[96] Some courts

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potential threat of identity theft or identity fraud, to the extent any exists in this case, does not confer standing on Plaintiff to pursue this action in federal court.").

93 *Reilly*, 664 F.3d at 46; *Green*, 2015 WL 2066531, at *5.

94 *See, e.g.*, Remijas v. Neiman Marcus Group, LLC, No. 14 C 1735, 2014 WL 4627893, at *3 (N.D. Ill. Sept. 16, 2014) ("Plaintiffs have not alleged that any of the fraudulent charges were unreimbursed. On these pleadings, I am not persuaded that unauthorized credit card charges for which none of the plaintiffs are financially responsible qualify as 'concrete' injuries."), *rev'd*, 794 F.3d 688, 693-96 (7th Cir. 2015) ("The injuries associated with resolving fraudulent charges and protecting oneself against future identity theft . . . are sufficient to satisfy the first requirement of Article III standing.").

95 *See In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 996 F. Supp. 2d 942, 962 (S.D. Cal. 2014) (applying *Clapper* and holding that "Plaintiffs' allegations that their Personal Information was collected by Sony and then wrongfully disclosed as a result of the intrusion [are] sufficient to establish Article III standing at this stage in the proceedings"); *In re* Adobe Sys., Inc. Privacy Litig., No. 13-CV-05226, 2014 WL 4379916, at *8 (N.D. Cal. Sept. 4, 2014) (applying and distinguishing *Clapper* and disagreeing with *Galaria* because "the risk that Plaintiffs' personal data will be misused by the hackers who breached Adobe's network is immediate and very real" and the intent of the hackers to use the data was clear).

96 *See, e.g.*, *In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 996 F. Supp. 2d 942, 964-66 (S.D. Cal. 2014) (dismissing negligence claims based on untimely notice of data breach because, although plaintiffs had standing, they failed to allege injury from untimely notice).

have held that damages resulting from cyber attacks were foreseeable and, therefore, recoverable.[97]

Certain types of damages may be inherently speculative or relate only to future injuries, in which case courts may hold that they are not recoverable.[98] Actions under state data-breach statutes may require the unauthorized use of the information to result in *actual* damages. In *Ponder v. Pfizer, Inc.*,[99] a Pfizer employee filed a putative class action against the company, alleging that it failed to comply with Louisiana's Database Security Notification Law in response to a data breach disclosing employee information. The employee alleged that the notice letter was untimely, as nine weeks passed between the data breach and the notice. The court held that the plaintiffs failed to allege recoverable damages because there was no allegation that the information was actually used to the plaintiffs' detriment. The costs and burdens of credit monitoring, opening and closing accounts, and reviewing statements were too speculative to be recoverable.[100]

[c] — Contractual Limits on Claims Arising from Data Breaches.

Contracts may include indemnification provisions and/or limits on liability that will affect the types and extent of claims the parties may assert against each other. The "economic loss doctrine" generally requires plaintiffs to use contractual remedies to recover purely economic losses, and it may

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97 *See, e.g.*, *Anderson*, 659 F.3d 151, 164-65 (1st Cir. 2011) (holding that it was foreseeable under Maine law that a customer whose credit or debit card information was stolen and expected fraudulent charges as a result of data breach would replace the card to mitigate against misuse, and that a customer who experienced unauthorized charges would purchase insurance to protect against data misuse).

98 *See* Holmes v. Countrywide Fin. Corp., No. 5:08-CV-00205, 2012 WL 2873892, at *10 (W.D. Ky. July 12, 2012) ("Since credit monitoring expenses are not compensable injuries under these circumstances, Plaintiffs have failed to state a claim in this regard.").

99 *See* Ponder v. Pfizer, Inc., 522 F. Supp. 2d 793, 796-98 (M.D. La. 2007).

100 *Id.*; Pinero v. Jackson Hewitt Tax Serv. Inc., 594 F. Supp. 2d 710, 717 (E.D. La. 2009) ("[P]laintiff's damages are not based on an actual injury, but the speculative future injury of identity theft.").

bar negligence claims in some states depending on the circumstances.[101] Contract claims may also bar certain statutory claims as a matter of law.[102]

§ 28.04. Contracts that May Be Impacted By Data Breaches.

[1] — Contracts with Software Vendors.

There are a wide variety of software vendors available in the market. Their products range based on industry and purpose. For instance, some software is designed specifically for the oil and gas industry or utilities. Software can serve a variety of purposes, including billing, work-site management, and inventory tracking. While many of the relevant software vendors are not focused exclusively on the energy sector, there are a significant number of specific oil and gas, utility, or energy-related programs adapted and/or designed for specific industry purposes.

Although the terms of service and software contracts are subject to change and updating, there are a few typical provisions seen among contracts with regard to cybersecurity issues. For instance, many contracts provide general provisions limiting liability or indemnifying the software company for issues related to use of the software. With regard to cybersecurity in particular, some contracts note that users of their software accept the risks of using the software and that no software is perfectly secure. In addition, some terms of service/contracts have provisions related to the loss of data.

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101 *See* Lone Star Nat'l Bank, N.A. v. Heartland Payment Sys., Inc., 729 F.3d 421, 426 (5th Cir. 2013) (holding that the economic loss doctrine under New Jersey law did not bar banks' negligence claims against credit-card processor for hackers' breach of credit card processor's data systems because banks' economic losses were foreseeable and limited to the banks); *In re Target Corp. Data Sec. Breach Litig.*, No. 14-2522, 2014 WL 7192478, at *15-20 (D. Minn. Dec. 18, 2014) (analyzing application of the economic loss doctrine in various states and concluding that it barred plaintiffs' negligence claims under Alaska, California, Illinois, Iowa, and Massachusetts law); *In re Sony Gaming Networks & Customer Data Sec. Breach Litig.*, 996 F. Supp. 2d 942, 966-73 (S.D. Cal. 2014) (granting Sony's motion to dismiss negligence claims under California law based on the economic loss doctrine).

102 *See, e.g.*, Genesco, Inc. v. Visa U.S.A. Inc., No. 3:13CV202, 2013 WL 3790647, at *21 (M.D. Tenn. July 18, 2013) (explaining that breach-of-contract claim may preclude statutory claim under California Unfair Competition Law).

Overall, however, the terms of service/contracts related to many software products do not include specific cybersecurity provisions.

[2] — Contracts with Third Parties in the Supply Chain.

Companies may have contracts with various entities and oilfield service companies that may be affected by data breaches or touch on cybersecurity issues. These include master service agreements, drilling contracts, and similar common arrangements. Those contracts may not deal directly with cybersecurity beyond typical indemnity or risk-of-loss provisions.

[3] — Drafting Considerations for Contracts to Address Issues Arising from Data Breaches.

Companies must consider provisions that might protect or harm their interests when drafting or entering into contracts. For example, when entering into contracts with cybersecurity vendors that are providing the important service, companies should consider:

- Does the contract address the cybersecurity vendor's failure to prevent a cyber attack or timely repair a data breach?[103]
- Does the contract make representations about products, protections, or services that may provide the basis for a cause of action against the cybersecurity vendor?
- Is there an indemnification clause?[104]
- Are there limits on liability?[105]

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103 *See, e.g.*, INX, LLC v. Music Group Services U.S., Inc., No. C13-2126, 2014 WL 51142, at *2-4 (W.D. Wash. Jan. 7, 2014) (cybersecurity vendor demonstrated probable validity of breach of contract where company subject to cyber attack failed to pay for restoration services after cyber attack because it was not satisfied with vendor's services).

104 *See, e.g.*, Schnuck Markets, Inc. v. First Data Merchant Data Servs. Corp., No. 4:13-CV-2226, 2015 WL 224993, at *2, 8 (E.D. Mo. Jan. 15, 2015) (indemnification clause required grocery store that was target of cyber attack to indemnify transaction processing servicers for costs of fraud monitoring, card replacement, and fraud losses up to $500,000 as a result of data breach).

105 *See, e.g.*, *Baidu, Inc.*, 760 F. Supp. 2d 312, 320 (S.D.N.Y. 2010) ("While [company asserting claims against security provider for cyber attack] gave up, in agreeing to the Limitation of Liability clause, any claims for ordinary negligence or breach of contract based

When contracting with employees within the company, such as IT personnel, to protect sensitive data, it would be prudent to consider the responsibilities of those in-house IT personnel in their employment contracts, and how they compare to contracts with outside vendors.[106] When entering into contracts that relate to everyday business operations, the following matters are worth consideration:

- How will the parties proceed with business in the event of a data breach affecting operations (*e.g., force majeure*)?
- Who bears the risk of loss where sensitive data is compromised (*e.g.*, limits on liability, indemnification clause)?
- What are the company's contingency plans to meet demand/ contract terms?

§ 28.05. CyberSecurity Training/Planning/Remediation.

As a general matter, the lack of training, preparation, and awareness are major causes of data loss. Some studies have shown that four out of five losses caused by employee negligence. The loss of usernames/passwords and loss of hardware are major issues. Awareness and training are significant tools in combating cybersecurity risks. Companies in the energy industry should strive to have their own, individualized plan for cybersecurity training, planning, and remediation. However, the following general ideas highlight some of the major issues involved when conducting cybersecurity training or creating a data loss response plan.

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on ordinary negligence, it did not waive its claims for gross negligence or recklessness."); *Schnuck Markets, Inc*., No. 4:13-CV-2226, 2015 WL 224993, at *7 (E.D. Mo. Jan. 15, 2015) (omission of "data compromise losses" from limitation of liability clause evidenced parties' intent not to include data breaches in clause).

[106] *See, e.g*., Music Group Macao Commercial Offshore Limited v. Foote, No. 14-cv-03078, 2015 WL 2170121, at *3 (N.D. Cal. May 8, 2015) (addressing discovery dispute related to music company's claims against its own IT consultant for failure to prevent cyber attack, and concluding "that Defendant is entitled to discovery of the employment agreements of the relevant IT employees with the information protected by the constitutional right to privacy redacted" because "if Plaintiff specifically hired other individuals for the purposes of ensuring cyber security and preventing attacks, that could be relevant to show that Defendant was not negligent, that his acts did not cause the cyber attack, or both").

[1] — A Cybersecurity Plan.

A data loss or cyber attack will be a significant and costly event to any company. Although no plan is perfect, companies can take steps to help prevent a loss, and avoid these costs. Properly protecting your company will ensure that cyber-thieves do not view your organization as a "low-hanging" fruit. In addition, when a loss of data or cyber intrusion occurs, a fast response is critical. Having a plan in place allows for a fast and coordinated response.

[2] — Before Creating a Cybersecurity Plan.

Companies should identify critical data that must be protected/would be valuable to others. The focus should also be on the company's weak points with regard to critical data, and the reasons why it should be protected. In addition, companies should consider how the data is kept throughout its lifecycle, which includes: collection; usage; short-term and long-term storage; and destruction.

[3] — Creating a Cybersecurity Plan.

A plan should have specific step-by-step procedures for dealing with data loss or cyber attack event. A plan should account for state-specific response provisions for critical states related to the business. Companies should strive to develop standards to the strictest applicable laws to ensure compliance. In addition, it is important to set-up data collection/back-up practices early. This may include monitoring your own network, which can require consent. Furthermore, companies should back-up data and critical files in an additional secure location.

There are several legal issues to consider as well. Companies should ensure that in-house counsel and outside legal counsel are familiar with cybersecurity issues, and specifically with the cybersecurity issues related to your industry. The involvement of an attorney at an early stage is critical because of potential liability issues and shifting legal requirements. It is also important that counsel have necessary contacts with forensic teams.

Companies should work to build necessary relationships before a data loss or cyber attack occurs. Consider getting to know applicable regulators and law enforcement before a breach occurs. It is also important to determine

which crisis response vendors to choose before an attack happens to avoid making the decision on the fly.

[4] — Training.

An important step after adopting a cybersecurity plan is to conduct employee training. Training should include initial training along with periodic refreshers to ensure preparedness. Testing should be completed to verify the company's readiness for a data loss or cyber attack.

[5] — Model Plan (Adapted from DOJ Guidance).

As one example, the Department of Justice's recent cybersecurity guidance sets forth a model cybersecurity plan that companies can adapt for the specific needs within their business and industry.[107] This guidance lays out the following steps for responding to a cybersecurity attack or data breach.

Step 1 — Assess and understand the breach or threat. Is it an intentional attack or computer error? What is the scope of the problem?[108]

Step 2 — Minimize damage from the data loss or cyber attack.[109]

Step 3 — Collect critical information. This process may involve a forensic team to assess the breach and help collect data. Detailed notes should be kept on the process.[110]

Step 4 — Proceed with notification procedures, including internally, law enforcement, regulators, and customers/third parties. After notification, focus should be on continued legal compliance.[111]

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107 Department of Justice, Computer Crime and Intellectual Property Section, Criminal Division, Cybersecurity Unit, Best Practices for Victim Response and Reporting of Cyber Incidents, Version 1.0 (April 30, 2015).

108 *See id*. at 6-7.

109 *See id*. at 7-8.

110 *See id*. at 8-10.

111 *See id*. at 10-12.

[6] — Information Sharing.

In addition to dealing with a cybersecurity attack or data breach event within your own company, those in the energy industry should be aware of benefits of information sharing networks. First, alerting similarly situated companies will allow them to prepare for potential attacks, and help protect the industry as a whole. In addition, participation in information sharing networks may also give companies a forum to share tactics related to responding to data loss or cyber attack if another company has experienced a similar problem.

§ 28.06. Insurance Coverage.

Insurance can play a vital role in an organization's overall strategy to address, mitigate, and maximize protection against the legal and other exposures flowing from data breaches and other serious cybersecurity, privacy, and data protection-related incidents.

[1] — Potential Coverage Under "Legacy" Policies.

There may be significant potential coverage for cybersecurity and data privacy-related incidents under an organization's traditional insurance policies, including its Directors' and Officers' Liability, Professional Liability, Fiduciary Liability, Crime, Commercial Property and Commercial General Liability (CGL) policies. For example, there is potential coverage for data breach-related liability under CGL Coverage B "personal and advertising injury" coverage. The current ISO standard form policy states that the insurer "will pay those sums that the insured becomes legally obligated to pay as damages because of 'personal and advertising injury,'" which is defined to include "[o]ral or written publication, in any manner, of material that violates a person's right of privacy." ISO Form CG 00 01 04 13 (2012), Section I, Coverage B, Section 1.a., Section 14.e. Courts have upheld coverage for data breaches and other claims alleging violations of privacy rights in a variety of settings.

Likewise, an organization may have significant potential coverage under its Commercial Property policies for first-party property damage and business income loss.

In response to decisions upholding coverage for cybersecurity and data privacy-related risks under traditional lines of insurance coverage, however, the insurance industry has added various limitations and exclusions to traditional lines of coverage.

By way of example, Insurance Services Office (ISO), the insurance industry organization that develops standard insurance policy language, recently introduced a new series of cybersecurity and data breach exclusionary endorsements to its standard-form CGL policies, which became effective in May 2014. One of the endorsements, entitled "Exclusion - Access Or Disclosure Of Confidential Or Personal Information And Data-Related Liability - Limited Bodily Injury Exception Not Included," adds the following exclusion to the primary CGL policy:

> This insurance does not apply to:
>
> **p. Access or Disclosure of Confidential or Personal Information and Data-related Liability**
>
> Damages arising out of:
>
> **(1)** Any access to or disclosure of any person's or organization's confidential or personal information, including patents, trade secrets, processing methods, customer lists, financial information, credit card information, health information or any other type of non public information; or
>
> **(2)** The loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data.
>
> This exclusion applies even if damages are claimed for notification costs, credit monitoring expenses, forensic expenses, public relations expenses or any other loss, cost or expense incurred by you or others arising out of that which is described in Paragraph **(1)** or **(2)** above.

In connection with its filing of the endorsements, ISO stated that "when this endorsement is attached, it will result in a reduction of coverage . . . ."

Likewise, it is common for energy sector property programs to contain one of the following three "electronic data" exclusions, or other broad electronic data-related exclusions.

Institute Cyber Attack Exclusion Clause CL380

1.1 Subject only to clause 1.2 below, in no case shall this insurance cover loss, damage, liability, or expense directly or indirectly caused by, or contributed to by, or arising from, the use or operation, as a means for inflicting harm, of any computer, computer system, computer software programme, malicious code, computer virus or process or any other electronic system.

1.2 Where this clause is endorsed on policies covering risks of war, civil war, revolution, rebellion, insurrection, or civil strife arising therefrom, or any hostile act by or against a belligerent power, or terrorism or any person acting from a political motive, Clause 1.1 shall not operate to exclude losses (which would otherwise be covered) arising from the use of any computer, computer system or computer software programme or any other electronic system in the launch and/or guidance system and/or firing mechanism of any weapon or missile.

Terrorism Form T3 LMA3030 Exclusion 9 (Extract)

This Policy does not insure against loss or damage by electronic means including but not limited to computer hacking or the introduction of any form of computer virus or corrupting or unauthorised instructions or code."

Electronic Data Exclusion NMA2914

Notwithstanding any provision to the contrary within the Policy or any endorsement thereto, it is understood and agreed as follows:

a) This Policy does not insure loss, damage, destruction, distortion, erasure, corruption or alteration of ELECTRONIC DATA from any cause whatsoever (including but not limited to COMPUTER VIRUS) or loss of use, reduction in functionality, cost, expense of whatsoever nature resulting therefrom, regardless of any other cause or event contributing concurrently or in any other sequence to the loss.

ELECTRONIC DATA means facts, concepts and information converted to a form useable for communications, interpretation or processing by electronic and electromechanical data processing or electronically controlled equipment and includes programmes, software and other coded instructions for the processing and manipulation of data or the direction and manipulation of such equipment.

> COMPUTER VIRUS means a set of corrupting, harmful or otherwise unauthorised instructions or code including a set of maliciously introduced unauthorised instructions or code, programmatic or otherwise, that propagate themselves through a computer system or network of whatsoever nature. COMPUTER VIRUS includes but is not limited to 'Trojan Horses', 'worms' and 'time or logic bombs'.
>
> b) However, in the event that a peril listed below results from any of the matters described in paragraph a) above, this Policy, subject to all its terms, conditions and exclusions, will cover physical damage occurring during the Policy period to property insured by this Policy directly caused by such listed peril. Listed Perils:
>
> - Fire
>
> - Explosion

These and other newer exclusions to traditional lines of coverage provide another reason for organizations to carefully consider specialty cybersecurity insurance products.

[2] — Cybersecurity Insurance Policies

Cybersecurity insurance coverage can be extremely valuable, but choosing the right insurance product presents significant challenges. There is a diverse and growing array of products in the marketplace, each with its own insurer-drafted terms and conditions that vary dramatically from insurer to insurer — and even between policies underwritten by the same insurer. In addition, the specific needs of different industry sectors, and different organizations within those sectors, are far-reaching and diverse.

Although placing coverage in this dynamic space presents a challenge, it also presents a substantial opportunity. The cyber insurance market is

extremely competitive and cyber insurance policies are highly negotiable. This means that the terms of the insurers' off-the-shelf policy forms often can be significantly enhanced and customized to respond to the insured's particular circumstances. Frequently, very significant enhancements can be achieved for no increase in premium.

There are a number of established third-party coverages, *i.e.*, covering an organization's potential liability to third parties, and first-party coverages, *e.g.,* covering the organization's own digital assets and income loss, as summarized in the chart on the following page.

In addition to the established coverages, there are significant emerging markets providing coverage for:

- first-party losses involving physical asset damage following an electronic data-related incident;
- third-party bodily injury and property damage that may result from an electronic data-related incident; and
- reputational injury resulting from an incident that adversely impacts the public perception of the insured organization or its brand.

As privacy and electronic data-related exclusions continue to make their way into traditional property and liability insurance policies, and given that an organization's largest exposures may flow from reputational injury and brand tarnishment, these emerging coverages will be increasingly valuable.

Third Party Coverages

Type	*Description*
Privacy Liability	Generally covers third-party liability, including defense and judgments or settlements, arising from data breaches, such as the Target breach, and other failures to protect protected and confidential information
Network Security Liability	Generally covers third-party liability, including defense and judgments or settlements, arising from security threats to networks, *e.g.*, inability to access the insured's network because of DDoS attack or transmission of malicious code to a third-party network
Regulatory Liability	Generally covers amounts payable in connection with administrative or regulatory investigations and proceedings, including regulatory fines and penalties
PCI DSS Liability	Generally covers amounts payable in connection with Payment Card industry demands for assessments, including contractual files and penalties, for alleged non-compliance with PCI Data Security Standards
Media Liability	Generally covers third-party liability arising from infringement of copyright or other intellectual property rights and torts such as libel, slander, and defamation, which arise from media-related activities, *e.g.*, broadcasting and advertising

First Party Coverages

Crisis Management	Generally covers "crisis management" expenses that typically follow in the wake of a breach incident, *e.g.*, breach notification costs, credit monitoring, call center services, forensic investigations, and public relations efforts
Network Interruption	Generally covers the organization's income loss associated with the interruption of its business caused by the failure of computer systems/networks
Contingent Network Interruption	Generally covers the organization's income loss associated with the interruption of its business caused by the failure of computer systems/networks
Digital Assets	Generally covers the organization's costs associated with replacing, recreating, restoring, and repairing damaged or destroyed computer programs, software, and electronic data
Extortion	Generally covers losses associated with cyber extortion, *e.g.*, payment of an extortionist's demands to prevent to a cybersecurity or date privacy-related incident

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