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## Estoppel of the Government to Collect Mineral Royalties: A Blind Alley

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# ESTOPPEL OF THE GOVERNMENT TO COLLECT MINERAL ROYALTIES: A BLIND ALLEY\*

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## I. INTRODUCTION

The last thirty years have witnessed an explosion in governmental activity. Not surprisingly, one of the results has been an enormous increase in the number of lawsuits brought by or against the government.<sup>1</sup>

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1. An item of federal legislation that has sparked a significant increase in litigation involving

In such litigation the individual plaintiff or defendant often alleges that the government is precluded from asserting a particular claim or defense because of estoppel.

This article focuses on whether federal or state governments should be subject to being estopped from collecting mineral royalties from mineral lessees. Part II explains the nature of equitable doctrine of estoppel. Part III illustrates the principal approaches to governmental estoppel in general. Each federal appellate circuit has interpreted the Supreme Court's pronouncements in different ways at different times. Additionally, each of the states has the latitude to fashion its own rules concerning the estoppel of state government institutions. State courts have often looked to conservative federal authorities. Part IV analyzes the approaches of jurisdictions where governmental royalty collection has been litigated or made the subject of legislation. Courts and legislatures tend to reject governmental estoppel in the area of mineral royalty. To protect the public fisc and prevent corruption, governmental estoppel is currently and should remain a blind alley for oil and gas producers and operators.

## II. ESTOPPEL IN A NUTSHELL

The doctrine of estoppel is an instrument of equity which is invoked by parties and applied by courts for the express purpose of accomplishing justice.<sup>2</sup> Although courts have expressed a variety of formulations of the doctrine, the United States Supreme Court has recently described estoppel as follows:

[T]he party claiming the estoppel must have relied on its adversary's conduct 'in such a manner as to change his position for the worse,' and that reliance must have been reasonable in that the party claiming the estoppel did not know nor should it have known that its adversary's

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the government is the Federal Tort Claims Act, 28 USC §§ 1346(b), 2671-80 (1989 & Supp. 1990). See *OPM v. Richmond*, 496 U.S. 414, 431 (1990).

2. *Heckler v. Community Health Services*, 467 U.S. 51, 59 (1984) (stating that estoppel is an equitable doctrine invoked to avoid injustice in particular cases). The essential elements of equitable estoppel are that the offender has made a false representation or concealment of facts; he must have known or should have known the facts and he must have intended for the offended party to act on the information; the offended party must have been unaware of the true facts and must have relied on the misinformation to his disadvantage. 31 C.J.S. *Estoppel* § 67 (1988). It is useful to elicit other definitions of estoppel given in *Corpus Juris Secundum*:

Equitable estoppel is defined in many cases as the effect of the voluntary conduct of a party whereby he is absolutely precluded, both at law and in equity, from asserting rights which might perhaps have otherwise existed, either of property, or of contract, or of remedy, as against another person who in good faith relied on such conduct, and has been led thereby to change his position for the worse, and who on his part acquires some corresponding right either of contract or of remedy . . . .

conduct was misleading.<sup>3</sup>

Thus, in order to protect an honest party, a court of equity will estop a malefactor from asserting an otherwise enforceable right.<sup>4</sup>

### III. THREE APPROACHES TO GOVERNMENTAL ESTOPPEL IN GENERAL

It is widely accepted that government estoppel raises considerations which are not present when a private party is sought to be estopped from enforcing his legal rights. Clearly, estoppel of the government involves or may involve issues such as the sovereignty of the state, public finance, and possible corruption of governmental officials.

American courts and legislatures have taken three basic approaches to governmental estoppel. A conservative view states that the federal government may never be subject to estoppel, or, if it is, only in truly exceptional circumstances. A more liberal view, favored by the Ninth Circuit, holds that the government may be estopped in cases of "affirmative misconduct," or other injustice. Louisiana, interestingly, has no concept of governmental estoppel, as distinct from ordinary, private estoppel. However, Louisiana does possess "mandatory" or "prohibitory" laws, where no one may raise the defense of estoppel. This effectively means that the Louisiana government may not be estopped to enforce any law of public significance.

It should be emphasized that the following brief review of the three approaches is illustrative only. Governmental estoppel as a general topic is a vast field, in which particular areas of governmental activity, such as tax, social security, immigration, and criminal enforcement, raise different sub-issues and nuances. Additionally, the United States Supreme Court has not always been entirely consistent on government estoppel, as evidenced by the occasional ambiguous language of the Court. Consequently, this has encouraged the federal appellate circuits to adopt their own interpretations of the law. However, some brief explanation of the main approaches to governmental estoppel is necessary to understand the issue of governmental estoppel in the context of mineral royalty collection.

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3. *Heckler*, 467 U.S. at 59 (footnote omitted) (quoting 3 J. POMEROY, EQUITY JURISPRUDENCE § 805 (S. Symans ed., 1941)).

4. Different from estoppel, contemporaneous construction can be pled when a contract is vague, and is used to determine whether a legal right ever existed. Estoppel, and the other equitable defenses such as waiver, ratification, acquiescence, and laches, on the other hand, are used to defeat an otherwise enforceable legal right.

### A. *The Conservative Approach*

The conservative view, as expressed by several United States Supreme Court decisions, is that the federal government may never be subject to estoppel. However, if estoppel of the federal government could exist as a viable defense, it could only be pled in truly unusual circumstances.

A leading case on federal governmental estoppel is *Federal Crop Insurance Corporation v. Merrill*.<sup>5</sup> *Federal Crop* involved government insurance of a wheat crop. A government agent erroneously advised a farmer that his crop was insurable. But certain regulations precluded the particular crop from qualifying for insurance.<sup>6</sup> Consequently, the crop was lost and the government refused to pay. Subsequently, the farmer brought suit, trial proceeded, and the jury returned a verdict in favor of the plaintiff. The Supreme Court of Idaho affirmed on the theory that, had the agent been acting for a private insurance company, the company would have been liable. But the United States Supreme Court reversed, rejecting the availability of estoppel against the government:

If the Federal Crop Insurance Act has by explicit language prohibited the insurance of spring wheat which is reseeded on winter wheat acreage, the ignorance of such a restriction, either by the respondents or by the Corporation's agent *would be immaterial* and recovery could not be had against the Corporation . . . .<sup>7</sup>

The *Federal Crop* decision could be interpreted as prohibiting governmental estoppel in all instances. The Court focused on the fact that the government must be allowed to enforce the law untrammelled by the erroneous or fraudulent statements of its agents: “[a]nyone entering into an arrangement with the government takes the risk of having accurately ascertained that he who purports to act for the government stays within the bounds of his authority.”<sup>8</sup>

Subsequent to *Federal Crop*, the Supreme Court adopted a softer but still hostile view of governmental estoppel. Dicta in some later cases have suggested, contrary to the holding in *Federal Crop*, that there *might* be situations in which a government agent's actions could give rise to an estoppel. However, the Court has reversed every lower court finding of estoppel it has reviewed.<sup>9</sup>

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5. 332 U.S. 380 (1947).

6. *Id.* at 385.

7. *Id.* at 384.

8. *Id.*

9. *OPM v. Richmond*, 496 U.S. 414, 427, 430 (1990); *see, e.g., INS v. Miranda*, 459 U.S. 14

The issue of governmental estoppel was again raised in *Heckler v Community Health Services*.<sup>10</sup> In *Heckler* a government agent, Travelers Insurance Company, had wrongly advised Community Health Services (CHS) that it could receive a dual reimbursement under two government programs for the cost of training and compensating economically disadvantaged employers.<sup>11</sup> CHS relied on the erroneous oral advice, substantially expanded its operations, and claimed twice for its costs. Travelers subsequently attempted to reclaim the unauthorized portion. The Third Circuit Court of Appeals found that Travelers' erroneous advice constituted "affirmative misconduct" and ruled the government's agent estopped.<sup>12</sup>

The Supreme Court reversed, finding that the facts could not even support an ordinary private estoppel.<sup>13</sup> In fact, the *Heckler* Court held that it is tenable that the government may never be subject to estoppel. Further, even if the government may be estopped, it could not be on the same terms as any other individual.<sup>14</sup> Still further, governmental estoppel can never be applied relating to public funds,<sup>15</sup> even if it were possible in other circumstances. Finally, the court declared that governmental estoppel cannot be invoked on the basis of oral representations.<sup>16</sup>

Most recently, the Supreme Court has reiterated the conservative principles of *Heckler*. The issue in *Office of Personnel Management v Richmond* was whether oral and written advice given by a government employee to a benefits claimant may give rise to an estoppel against the

(1982); *Schweiker v. Hansen*, 450 U.S. 785 (1981); *INS v. Hibi*, 414 U.S. 5 (1973); *Montana v. Kennedy*, 366 U.S. 303 (1961).

10. 467 U.S. 51 (1984).

11. Travelers incorrectly advised CHS that CETA funds were seed money to be reimbursed under medicare even though the same costs were already funded by other government programs. *Id.* at 55-56.

12. *Community Health Services v. Califano*, 698 F.2d 615, 620 (3d. Cir. 1983).

13. The Court found that the element of reasonable reliance was lacking for three reasons: The government cannot be expected to ensure that every tiny bit of informal advice given by its agents is sufficiently reliable to justify the expenditure of substantial sums of money; CHS knew that Travelers was acting as an intermediary and consequently not authorized to resolve a policy question; and, Travelers' advice was oral. *Heckler*, 467 U.S. at 65.

14. *Heckler* echoed earlier Supreme Court authorities in setting forth the strong policy arguments against governmental estoppel, but reserved the issue whether the government can ever be estopped. *Id.* at 60-61; see *Payne v. Block*, 751 F.2d 1191, 1192 (11th Cir. 1985) (distinguishing *Heckler*).

15. "Protection of the public fisc requires that those who seek public funds act with scrupulous regard for the requirements of law." *Heckler*, 467 U.S. at 63. An even more direct statement was made in 1990 when the Supreme Court said that "estoppel cannot be entertained [against the government] where public money is at stake. . . . Extended to its logical conclusion, operation of estoppel against the government in the context of payment of funds from the Treasury could in fact render the Appropriations clause a nullity." *OPM v. Richmond*, 496 U.S. 414, 428 (1990).

16. *Heckler*, 467 U.S. at 65.

government and so entitle the claimant to monetary payment not otherwise permitted by law.<sup>17</sup>

Richmond was given unauthorized and erroneous advice from a federal employee regarding a disability annuity. Relying on the incorrect information, Richmond exceeded the statutory limit on earnings and lost six months worth of benefits. Claiming estoppel against the government, he sought benefits notwithstanding the plain language of the statutory limit. The Court of Appeals for the Federal Circuit<sup>18</sup> focused on *Heckler's* decision not to adopt a flat rule against governmental estoppel,<sup>19</sup> and found the facts to be sufficiently extreme to apply estoppel.<sup>20</sup> Overturning the decision, the Supreme Court seemed to regard the appellate court's decision as an indicator of the need for stronger direction:

[C]ourts of appeals have taken our statements as an invitation to search for an appropriate case in which to apply estoppel against the government. . . . The extraordinary number of [summary reversals by the Supreme Court] . . . provides a good indication that our approach to these [estoppel] cases has provided inadequate guidance for the federal courts . . . .<sup>21</sup>

Although the *Richmond* Court again refused to embrace a flat prohibitory rule, it referred with approval to the "clarity of earlier decisions" such as *Federal Crop*.<sup>22</sup> But the Court did hold that estoppel does preclude any monetary claims against the government.<sup>23</sup> Two crucial reasons were given: first, to prevent fraud, corruption, and collusion;<sup>24</sup> and second, to assure that public funds are spent in accordance with congressional intent for the common good, rather than for individual complaints.<sup>25</sup>

Noting that no High Court case has ever sustained a claim of governmental estoppel for the payment of money, the Court referenced the need<sup>26</sup> and historical motivation<sup>27</sup> for a check upon any potential avenue of corruption regarding public revenues. In short, the conservative rule

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17. 496 U.S. 414 (1990).

18. *Richmond v. OPM*, 862 F.2d 294 (Fed. Cir. 1988), *rev'd*, 496 U.S. 414 (1990).

19. *Heckler*, 467 U.S. at 51; *see Richmond*, 862 F.2d at 294 (indicating that "the Supreme Court has clearly left open the possibility that estoppel may be invoked against government agencies in some . . . circumstances. In [*Heckler*] the . . . Court specifically declined an invitation to announce a flat rule against governmental estoppel."). *Id.* at 296-97.

20. *Richmond*, 496 U.S. at 419.

21. *Id.* at 422-23.

22. *Id.* at 421.

23. *Id.* at 427, 434.

24. *Id.* at 426-27.

25. *Id.* at 428, 433.

26. *Id.* at 426; *see Heckler v. Community Health Services*, 467 U.S. 51, 63 (1984).

27. *Richmond*, 496 U.S. at 427.

of *Richmond* is a rule against abuse and functions to protect the public interest.<sup>28</sup>

### B. *A Liberal Approach*

As alluded above, the liberal view of governmental estoppel can be justified on the basis of the Supreme Court's refusal to unequivocally establish that the government may "never" be estopped.<sup>29</sup> A case exemplary of this more liberal approach is *United States v. Lazy FC Ranch*.<sup>30</sup> In *Lazy FC Ranch*, a county official of the Agriculture Stabilization & Conservation Service of the Department of Agriculture (ASCS) informed the partners of the Lazy FC Ranch partnership that if they would subdivide the Ranch's land into smaller parcels, they could qualify for financial benefits under the maximum payment limitation of the government's Soil Bank conservation program.<sup>31</sup>

Additionally, the same government agent assisted the partners in arranging separate leases. The partners then entered into contracts with the federal government, with approval by the state ASCS office, to begin participation in two Soil Bank programs in 1957. In 1958 the United States closed one of the programs before the end of the contract term. The Ranch subsequently attempted to terminate the other contracts, but state ASCS officials denied the request. In 1961 the Ranch was sold in its entirety, terminating the residual contracts.

A few months later, the State Committee of the ASCS ascertained that the contracts were in violation of the prohibition against the use of partnership leasing as a means to circumvent the maximum payment limitation. However, the regulations in effect at the creation of the contracts did not expressly forbid such division of lands. Therefore, the regulations were amended in 1958, during the lease term, to clearly state that a partnership shall be considered one producer. Despite finding no evidence of collusive intent, an administrative hearing denied permission for the Ranch to keep the unauthorized payments as equitable relief. The

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28. Various federal appellate circuits have shared the Supreme Court's conservative approach to governmental estoppel. *See, e.g.,* *EEOG v. Huber* 927 F.2d 1322, 1331 (5th Cir. 1991); *Triplett v. Heckler*, 767 F.2d 210, 213 (5th Cir. 1985); *Walls v. Mississippi State Dept. of Public Welfare*, 730 F.2d 306, 324 (5th Cir. 1984); *Emery v. UMW*, 744 F.2d 1411 (10th Cir. 1984); *Heiks v. Harris*, 606 F.2d 65 (5th Cir. 1979). However, these circuits have not been entirely consistent. *See, e.g.,* *Penny v. Guiffrida*, 897 F.2d 1543 (10th Cir. 1990) (involving affirmative misconduct); *Duthu v. Sullivan*, 886 F.2d 97 (5th Cir. 1989) (involving affirmative misconduct).

29. *See* *Johnson v. Williford*, 682 F.2d 868 (9th Cir. 1982) (indicating that equitable estoppel is not available as a defense, generally, especially where the government is acting pursuant to its sovereign capacity; however, estoppel may attach when equity demands).

30. 481 F.2d 985 (9th Cir. 1973).

31. However, all the funds were treated as partnership income. *Id.* at 986 n.1.



United States then brought suit to recover the funds, and the Ranch claimed an estoppel defense.

Choosing a fairness rationale, the appellate court applied estoppel. Citing a line of Ninth Circuit cases which allow an estoppel defense against the government, even in its sovereign role, the *Lazy FC Ranch* court stated that two requirements must be met: First, the Government's wrongful conduct must threaten to work a serious injustice, and second, the public's interest must not be unduly damaged by the imposition of estoppel.<sup>32</sup>

Significantly, the court did not consider the unauthorized payments of public funds to be significantly contrary to public policy in this context. The liberal rule expressed in *Lazy FC Ranch*, then, is applied by the Ninth Circuit only in circumstances where the public interest is not threatened.<sup>33</sup>

### C. *The Louisiana Approach*

Because Louisiana is an important petroleum-producing state, and because there are Louisiana statutes, discussed later, that bear directly on the government's ability and duty to collect mineral royalties, it is worthwhile understanding Louisiana's approach to estoppel of state government. In Louisiana the government can be estopped in the same manner as any individual.<sup>34</sup> Everyone, including the government, is "at liberty to renounce what the law has established in its favour,"<sup>35</sup> because governmental estoppel is not expressly or impliedly prohibited by law.<sup>36</sup> However, estoppel of the government, or indeed of any party, is not permitted if its effects are contrary to the public interest.<sup>37</sup>

The sources of the state's public policy are its constitution, laws, and state supreme court holdings.<sup>38</sup> Most importantly for this general discussion, parties are not ever bound by any agreement which is in violation of

32. *Id.* at 989.

33. See Kathleen L. Nutt, *Estopping the State: Just and Equitable Considerations*, 34 DRAKE L. REV. 197, 216 (1984-85).

34. *State ex rel. Shell Oil Co. v. Register of State Land Office*, 192 So. 519, 520 (La. 1939) (stating it is well-settled that the doctrine of estoppel applies to the State just as it does to individuals); see also *State v. Texas Co.*, 30 So. 2d 107, 112 (La. 1947) (estopping the State from asserting that certain land was not included in a lease); *J.D. Adams Co. v. Jackson Parish*, 5 So. 2d 892 (La. 1942) (estopping governmental body from denying a contract after its terms were fulfilled); *Rodgers v. First Sewerage Dist.*, 171 So. 2d 820 (La. Ct. App. 1965) (estopping government agency for an irregular exercise of a granted power).

35. LA. CIV. CODE ANN. art. 11 (1870 & West 1972) (revised by LA. CIV. CODE ANN. art. 7 (1987 & West 1993)).

36. *Id.* (indicating that the law allows that which it does not forbid).

37. LA. CIV. CODE ANN. art. 7 (1993).

38. *Id.*; see also *Slayton v. Newton*, 299 F. 279, 280 (5th Cir. 1924).

a prohibitory law.<sup>39</sup> “Whatever is done in violation of a prohibitory law is void.”<sup>40</sup> Estoppel may never be invoked to impair the effect of a prohibitory law,<sup>41</sup> also known as a mandatory law.<sup>42</sup>

Any law enacted for the protection of the public interest<sup>43</sup> qualifies as a “prohibitory law.”<sup>44</sup> Laws regulating the public fisc are subject to great protection.<sup>45</sup> The term “mandatory law” is defined by statute as any legislative prescription that uses the word “shall.” *Louisiana Revised Statutes Annotated* article 1:3 states, “The word ‘shall’ is mandatory and the word ‘may’ is permissive.”

Thus, Louisiana law creates a paradox. The state can be estopped like any individual except where “mandatory,” or “prohibitory” laws are concerned.

#### IV. A JURISDICTIONAL ANALYSIS OF WHETHER THE GOVERNMENT CAN BE ESTOPPED FROM COLLECTING MINERAL ROYALTIES

##### A. *Federal Authorities*

Several federal courts, appellate and district, have considered the issue of whether federal agencies can be estopped to collect mineral royalties. In every case, the equitable defense has been rejected. The principles of *Federal Crop* seem to hold particular sway on public lands.

The federal government has authority to lease vast tracts of public lands for mineral exploration and development. These lands are located both on and offshore. The federal authorities are authorized to lease onshore by virtue of the Minerals Lands Leasing Act (MLLA)<sup>46</sup> and, offshore, under the Outer Continental Shelf Lands Act Amendments (OCSLAA).<sup>47</sup> The MLLA specifically authorizes the Secretary of the Interior to reduce consideration exigible from certain federal mineral leases when, in his judgment, such a reduction would promote development.<sup>48</sup>

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39. *Oil Field Supply & Scrap Material Co. v. Grifford Hill Co.*, 16 So. 2d 77, 78 (La. Ct. App. 1942).

40. LA. CIV. CODE ANN. art. 12 (West 1992); *see also Cilluffa v. Monreale Realty Co.*, 24 So. 2d 606, 609 (La. 1946) (quoting *Rhodes v. Miller*, 179 So. 430, 432 (La. 1938)).

41. *Cilluffa*, 24 So. 2d at 609 (quoting *Rhodes*, 179 So. at 432). “Where a statute makes no exceptions the Supreme Court cannot do so.” *Owles v. Jackson*, 7 So. 2d 192 (La. 1942).

42. LA. CIV. CODE ANN. art. 7 (West 1993).

43. *See American Waste & Pollution Control v. Louisiana*, 588 So. 2d 367, 372-73 (La. 1991).

44. LA. CIV. CODE ANN. art. 7 cmt. (West Supp. 1993) (defining prohibitory law).

45. *State Bond Comm’n v. All Taxpayers*, 525 So. 2d 521 (La. 1988) (illustrating Louisiana’s position that there may be no withdrawal from the public treasury without a specific appropriation).

46. 30 U.S.C. §§ 181-287 (1986 & Supp. 1992).

47. 43 U.S.C. §§ 1331, 1356 (1988 & Supp. II 1990).

48. 30 U.S.C. § 209.

The leading case on estoppel of the federal government to collect mineral royalty is *Atlantic Richfield Company v. Hickel*.<sup>49</sup> In *Atlantic Richfield* the plaintiff oil company obtained two "non-competitive" oil and gas leases on January 1, 1940. Both leases contained a "step scale" royalty clause, under which royalty increased from 12-1/2 to 32%, as production rose. In 1946 the MLLA was amended to make the 32% royalty rate ineffective in certain cases. The new exceptions were created to encourage further oil and gas exploration. Atlantic Richfield, however, discovered new oil and gas within the horizontal limits of a previously known oil and gas deposit. These deeper zones had been discovered by drilling outside the lease acreage. Subsequent judicial proceedings determined that Atlantic Richfield had not, in terms of law, met the statutory requirements for a reduction in royalty, by virtue of producing this type of oil.

The two formations at issue, the Madison and the Cambrian, were discovered in 1948. That same year, the Regional Director of the USGS, pursuant to a request by Atlantic Richfield, purported to determine that the relevant lands were "outside and not within the productive limits of any producing oil or gas deposit lying below the base of Tensleep formation, as such productive limits were known to exist on August 8, 1946, as authorized by Section 12 of the Act of Congress approved August 8, 1946."<sup>50</sup> Under the terms of the amendments, the natural implication of this finding was that oil produced from the Madison and Cambrian formations were royalty based on 12-1/2%. A USGS supervisor even signed a division order to that effect.

Thirteen years later, the regional supervisor of the USGS advised Atlantic Richfield that "back royalties due according to the [32%] step-scale provision were being demanded from April 1, 1948 to September 30, 1961, as to production from the Madison and Cambrian formations."<sup>51</sup> Atlantic Richfield filed administrative appeals, all of which were lost. It then filed for relief in district court and lost there, too. The Tenth Circuit affirmed the decision of the district court.

First, the Tenth Circuit determined that the oil and gas deposits in the Madison and Cambrian formations were indeed not covered by any of the exceptions enumerated in the 1946 Amendment.<sup>52</sup> However, Atlantic Richfield argued that under the circumstances, the government

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49. 432 F.2d 587 (10th Cir. 1970).

50. *Id.* at 589.

51. *Id.*

52. *Id.* at 590-91.

was estopped from collecting the extra royalties. The court decisively rejected this argument by holding that an “administrative determination running contrary to law will not constitute an estoppel against the federal government.”<sup>53</sup> *Atlantic Richfield* further asserted that the government should be estopped for its agents’ actions within the scope of their employment. The court, however, held that the Secretary was without authority to accept less than the step-scale provision of the lease. The fact that the government agents had accepted a lesser royalty for thirteen years was not a justification for altering the obligation of the Secretary nor for estopping the government.<sup>54</sup> Relying on *Federal Crop*, the *Atlantic Richfield* court expressed its *duty* to “observe the conditions defined by Congress for charging the public treasury.”<sup>55</sup>

The *Atlantic Richfield* court’s holding on estoppel may be summarized as follows: One, an agent of the government never acts within the scope of his authority when he purports to release payments of mineral royalty otherwise due to the government; two, the mineral lessee is, like all other citizens, deemed to know the law and may not take advantage of the mistake or fraud of the agent of the government; and finally, the issue of mineral royalty estoppel is peculiarly sensitive because such a defense, if successful, would directly prejudice the public fisc. These reasonings have been repeated time and again in subsequent jurisprudence dealing with estoppel of the government to collect mineral royalties.

The Tenth Circuit recently used the *Atlantic Richfield* rule to decide a case involving royalty estoppel. In *Jicarilla Apache Tribe v. Supron Energy Corporation*,<sup>56</sup> the Secretary of the Interior was found negligent for failing to protect the tribe’s interest in a mineral lease by not requiring “dual accounting” of the oil and gas lessee.<sup>57</sup> As a result, the tribe was underpaid on royalties. The lessee argued that the government, because of equitable considerations, should be held liable for any additional royalties assessed. The Tenth Circuit disagreed, stating that the Secretary’s breach of a fiduciary duty to enforce the leases did not excuse the lessees from obeying the lease terms and pay the royalty amounts owed.<sup>58</sup>

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53. *Id.* at 591.

54. *Id.*

55. *Id.* at 591-92 (citing *Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 385 (1947) (emphasis added)).

56. 793 F.2d 1171 (10th Cir. 1986) (en banc).

57. *Id.* at 1172.

58. *Id.*; see *Atlantic Richfield Co. v. Hickel*, 432 F.2d 587, 592 (10th Cir. 1970); see also *Trapper Mining, Inc. v. Lujan*, 923 F.2d 774, 781 (10th Cir. 1991) (indicating DOI would not be estopped from readjusting term of hard mineral lease, when such power was granted by statute, even though DOI official had earlier represented that readjustment would not take place for another ten years,

Another federal appellate case, which does not directly involve royalties, but articulates useful principles, is *Union Oil Company of California v. Morton*.<sup>59</sup> In *Union Oil* four oil companies (Union Oil) obtained a very lucrative federal oil and gas lease in the Santa Barbara Channel off the coast of California. The lease, which cost \$61 million, was granted by the Secretary of the Interior under the legislative predecessor of the OCSLAA.<sup>60</sup> The lease gave Union Oil broad development rights, including the right to erect and station drilling platforms, subject to the provisions of the OCSLAA and "reasonable regulations."<sup>61</sup> Union Oil proceeded to erect two major platforms, A and B. In September 1968, Union Oil sought and obtained permission to erect a third platform, C. In January 1969, as platform C was being installed, a massive blowout occurred on one of platform A's wells. Thus ensued the notorious Santa Barbara oil spill.<sup>62</sup>

Shortly thereafter, the Secretary suspended all activities on the lease while environmental studies were carried out. On the completion of these studies in late 1971, the Secretary announced that Union Oil would be prohibited from erecting platform C because of possible environmental risks. Additionally, he ordered that all activity on platforms A and B be suspended pending legislative cancellation of the lease. Union Oil filed suit.

On appeal, the issue was whether the order denying permission for Union Oil to install platform C was valid. The Union Oil lease granted the lessee "the right to construct or direct [drilling platforms]." The Secretary, however, was granted broad conservation powers over offshore natural resources by virtue of the OCSLAA.<sup>63</sup> An earlier Ninth Circuit decision in the same controversy, *Gulf Oil Corporation v. Morton*, had held that the words "conservation of the natural resources" were wide enough to cover broad environmental, and not just narrow mineral, concerns.<sup>64</sup> Therefore, the *Gulf Oil* court had held that the Secretary had been empowered, prior to the issuance of the 1968 lease, to protect the environment of the OCS.

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and lessee had relied thereon); *Enfield v. Kleppe*, 566 F.2d 1139, 1142-43 (10th Cir. 1977) (holding that oil and gas lessee's reliance on invalid regulation was irrelevant).

59. 512 F.2d 743 (9th Cir. 1975).

60. The particular lease in *Union Oil* was granted pursuant to the Outer Continental Shelf Lands Act, which predated the 1978 Amendments.

61. *Union Oil*, 512 F.2d at 746.

62. *Id.*

63. 43 U.S.C. § 1334(a)(1) (1986); *Union Oil*, 512 F.2d at 748-49 (indicating that the Secretary shall pass regulations providing for the conservation of Outer Continental Shelf natural resources).

64. 493 F.2d 141 (9th Cir. 1973).

Union Oil argued that the subsequent regulation, under whose authority the Secretary had canceled Union Oil's "right" to erect Platform C, was invalid as being contrary to the express language of the lease. The Ninth Circuit rejected this argument, stating that the "terms inconsistent with the lease are invalid." Citing *Federal Crop*, the court made clear that Congress retained the power to amend existing rules for the protection of the public interest in conserving natural resources.<sup>65</sup>

Union Oil also argued that its reliance on the terms of the lease should estop the DOI "from enforcing statutory provisions contrary to the lease."<sup>66</sup> In the Ninth Circuit, the government generally can be estopped, even in its sovereign capacity, on an "affirmative misconduct" standard.<sup>67</sup> Nevertheless, the Ninth Circuit held in *Union Oil*:

We are very reluctant to apply estoppel against the [g]overnment in cases involving rights to public land. Furthermore, in this case, the costs to the public could be enormous if the Secretary were estopped to maintain continuing, vigorous regulation of Union's drilling, including suspension of its operations and of its installation of new platforms when appropriate. The costs to Union would be merely the loss of anticipated profits if its leases were canceled, or postponement of those profits if its operations were suspended. The equitable considerations which underlie application of estoppel dictate that the doctrine should not be applied in the circumstances of this case.<sup>68</sup>

Although *Union Oil* did not concern estoppel of the government to collect mineral royalties, the case does reflect some important principles. First, the court emphasized, even in the context of the liberal Ninth Circuit, how unwilling a federal court should be to apply estoppel against the government in cases involving federal natural resources.<sup>69</sup> Secondly, the court discounted the significance of the lessee's anticipated profits.<sup>70</sup> This latter point is all the more significant in that, within the circumstances of *Union Oil*, the lessee did genuinely anticipate making profits from the uninterrupted operation of its mineral leasehold rights. In the case of royalty estoppel, the lessee may never legitimately anticipate greater profits accruing from the underpayment of royalty.

The Department of the Interior (DOI) determined in the early 1980's that the collection of oil and gas royalties from federal onshore

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65. *Union Oil*, 512 F.2d at 748-49.

66. *Id.* at 748 n.2.

67. *See, e.g.*, *United States v. Lazy FC Ranch*, 481 F.2d 985, 989 (9th Cir. 1973).

68. *Union Oil*, 512 F.2d at 748-49 n.2.

69. *Id.* at 748 n.2.

70. *Id.* at 749 n.2.

lands was "archaic and inadequate."<sup>71</sup> Accordingly, the Federal Oil & Gas Royalty Act (FOGRA) was enacted with a view for rectifying the situation.<sup>72</sup> Among other things, the new statute directed the Secretary of the Interior to "establish a comprehensive inspection, collection and physical and production accounting and auditing system to provide the capacity to accurately determine oil and gas royalties, interest, fines, penalties, fees, deposits, and other payments owed, and to collect and account for such amounts in a timely manner."<sup>73</sup> The response of the Secretary was to grant principal responsibility for onshore royalty collection to the Minerals Management Service (MMS). Formerly, the United States Geological Survey (USGS) possessed this responsibility. Additionally, new regulations were enacted relative to the definition of market value for mineral royalty purposes. In particular, it was provided:

The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the Associate Director [of the regional MMS]. . . . Under no circumstances shall the value of production of any of the said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee . . . .<sup>74</sup>

In this regulatory context, a dispute arose between Marathon Oil Company and the United States regarding royalty payments on certain federal leases in Alaska.<sup>75</sup> In 1959 Marathon had discovered natural gas in the Kenai Field. Production began in 1961. The federal leases provided for a one eighth royalty "on the reasonable value of production."<sup>76</sup> In 1977 the USGA tackled Marathon on the issue of royalty on natural gas liquids. Marathon had been selling the liquids to customers in Japan, but had been computing the royalty on the basis paid for fuel gas under a long-term contract with Alaska Pipeline Company. The USGS insisted that royalty should have been paid on the sales price received from the Japanese customers, less certain deductions.

In an effort to resolve the dispute, Marathon and the USGS entered into a settlement agreement in 1981, providing that royalties were to be computed on "thirty-six percent of the per MMBtu price receipt in Japan for the LNG (less certain adjustments)."<sup>77</sup> This compromise agreement

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71. Federal Oil and Gas Royalty Management Act of 1982, 30 U.S.C. §§ 2(a)(2), 1701(a)(2) (1982).

72. 30 U.S.C. § 1701.

73. 30 U.S.C.A. § 1711(a).

74. 30 C.F.R. § 206.103 (1979).

75. *Marathon Oil Co. v. United States*, 604 F. Supp. 1375 (D. Alaska 1984).

76. *Id.* at 1375.

77. *Id.* at 1377.

further provided that the settlement would be effective “until such time as changes in market conditions, State or Federal law, or regulations adopted thereunder . . . necessitate a revision in the methods used to determine the wellhead value.”<sup>78</sup>

By early 1983, when the MMS entered the scene, it notified Marathon that royalty values would have to be redetermined. The MMS wanted to change the formula to allow for altered “costs and prices due to economic conditions.”<sup>79</sup> The MMS’s formula would have involved valuing the gas delivered to the LNG plant at \$3.00 per MCF. By contrast, under the settlement agreement, Marathon had been valuing such gas at \$1.71 per MCF. The MMS, getting no cooperation from Marathon, entered a series of orders directing Marathon to pay royalty as requested. Marathon filed suit for relief in federal court.

Marathon argued both constitutional and contractual positions. However, the court recognized that the federal oil lease statutes and regulations gave the MMS the authority to compute royalties by determining the reasonable value of gas production. Consequently, it concluded that the settlement agreement could not restrict the proper exercise of the agency’s statutory authority.<sup>80</sup>

From 1976 to 1981, the General Accounting Office issued a series of reports regarding management and collection problems in federal oil and gas royalties. In October of 1981, one such report declared that many financial management problems that existed twenty years ago still persisted. The report also speculated that the government’s failure to place higher priorities on oil and gas royalties resulted in a yearly loss of millions of dollars in uncollected royalty income and an increase in interest costs.

The Secretary of the Interior established the Linowes Commission<sup>81</sup> in order to investigate this problem. The Commission’s report, issued in January of 1982, stated that the government’s royalty record-keeping for Federal and Indian oil and gas leases was in such disarray that the exact amount of underpayment was unknown. It estimated that because of the government’s poor management, hundreds of millions of dollars due to the United States Treasury, the States, and Indian tribes were going uncollected each year. The Commission concluded that the government’s entire royalty management system needed a “thorough overhaul” and

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78. *Id.*

79. *Id.*

80. *Id.* at 1378-79.

81. Formally referred to as the Commission on Fiscal Accountability of the Nation’s Energy Resources.



provided a list of sixty recommendations for doing so.<sup>82</sup>

Relying on the 1981 Settlement Agreement, and on an internal USGS memo (Duletsky Memorandum) which observed that it was "impractical" to apply the net back method evaluation (which took the Japanese liquid sales into account) to the Marathon LNG situation, Marathon argued estoppel.<sup>83</sup> The court rejected this plea, constantly noting the mandatory language of FOGRA and its subsidiary administrative regulations. The court noted that the doctrine of equitable estoppel applied to the government only in unusual circumstances, and that it was reluctant to estop the government in cases which involved the rights to public lands. It stated that "[e]stoppel will be applied only if the government's wrongful conduct threatens to work a serious injustice and if the public's interest would not be unduly damaged."<sup>84</sup>

The district court's decision was affirmed by the Ninth Circuit Court of Appeals.<sup>85</sup> The *Marathon Oil* case is important because the court found that even using the liberal Ninth Circuit definition of governmental estoppel, which allows for estoppel in cases of affirmative misconduct, there was no injustice in this mineral law case, and that equitable considerations would not be allowed to override the authority vested in the Department of the Interior and the MMS. Importantly, the court equated loss of royalties to prejudice to the "public treasury."<sup>86</sup> Neither did the court attribute much weight to Marathon's alleged loss of profits.

A subsequent case, involving an implicit estoppel argument, was *Pennzoil Exploration & Production Company v. Lujan*.<sup>87</sup> *Pennzoil*, unlike *Marathon*, was a lessee on federal offshore lands leased under the authority of the OCSLAA. That statute provides that royalties are to be paid on "the amount or value of the production saved, removed or sold."<sup>88</sup> The Secretary of the Interior is given authority to prescribe rules and regulations in order to administer the royalty provision.<sup>89</sup> In 1979, the Secretary issued a regulation that provided:

The value of production shall never be less than the fair market value . . . under no circumstances shall the value of production be less than the gross proceeds accruing to the lessee from the disposition of the

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82. *Marathon Oil*, 604 F. Supp. at 1380-81.

83. *Id.* (indicating that Marathon did not place great reliance on the USGS's long period of acquiescence from 1959 to 1977).

84. *Marathon Oil*, 604 F. Supp. at 1384.

85. *Marathon Oil Co. v. United States*, 807 F.2d 759 (9th Cir. 1986).

86. *Marathon Oil*, 604 F. Supp. at 1384.

87. 751 F. Supp. 602 (E.D. La. 1990).

88. 43 U.S.C.A. § 1334(a) (West 1986).

89. *Id.*

produced substances or less than the value computed on the reasonable unit value established by the Secretary.<sup>90</sup>

From August 1980 through January 1981, Pennzoil sold oil under an OCS lease pursuant to a scheme known as the Tertiary Incentive Program. This program had as its objective the encouragement of production from depleted oil resources. The recovered oil was permitted to be sold at free market values. Otherwise, oil prices were still generally subject to regulation. While Pennzoil sold the oil at the free market rate, it paid royalties only on the rate it would have received for the oil had it not participated in the Tertiary Oil Program.

Not surprisingly, the MMS objected and ordered Pennzoil to pay royalties on the correct legal basis, which, in this case, was gross proceeds. Pennzoil's defense was that it should be allowed to pay a royalty on the regulated price because it was using some of the receipts from the sale of the oil to pay for the expensive technology required to produce tertiary oil. Judge Schwartz dismissed this defense summarily: "[I]t is superfluous that Pennzoil may have used some of its receipts to pay for tertiary recovery projects since there is no authority to allow the DOI to assess royalties on a lower basis than the gross proceeds."<sup>91</sup>

Pennzoil also tried to argue that the Department of Energy Tertiary Oil Incentive Program "should implicitly overrule the DOI regulation."<sup>92</sup> Judge Schwartz again rejected the argument, holding that Pennzoil's position was based on general policy considerations which were not compelling enough to overrule the Secretary of the Interior's statutory authority to regulate the basis for assessing royalties.<sup>93</sup>

Although the Pennzoil case did not explicitly involve an estoppel argument, the case is pertinent because Pennzoil made the sort of "pro-development" argument often asserted by producers. Namely, Pennzoil argued that it was economically wise for it to be allowed to a royalty on less than market value. The Eastern District of Louisiana rejected this notion on the simple basis that whatever general economic considerations might dictate, the DOI had no authority to charge less royalty than that required by regulation.

## B. *Texas*

In Texas the situation is made complex due to the fact that several

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90. 30 C.F.R. 206.150 (1979).

91. *Pennzoil Exploration & Prod. Co. v. Lujan*, 751 F. Supp. 602, 605 (E.D. La. 1990).

92. *Id.* at 606.

93. *Id.*

mineral agencies have authority to regulate oil and gas operations on various types of state lands.<sup>94</sup> However, the Texas mineral leasing statutes generally impose strict requirements regarding length of primary term and minimum royalties.<sup>95</sup> On the one occasion that it has been raised, the defense of estoppel of the government to collect royalties was rejected.<sup>96</sup> Texas courts, like their federal counterparts, have accorded great importance to the state's interest in its natural resources.

For example, the Texas Supreme Court strongly expressed this sentiment in *Grayburg Oil Company v. Jiles*, in which an oil and gas lessee obtained a mineral lease on a river bottom.<sup>97</sup> At the time of the issuance of the lease, it was required that a \$2.00 per acre fee be paid throughout the ten years of the primary term. However, a subsequent statute provided that the \$2.00 per acre per annum fee could be discontinued if five wells had been drilled in the lease premises and \$100,000.00 had been spent. The new statute, however, only applied to "leases of bays, marshes, reefs, salt water lakes or other submerged lands." Therefore, the principal issue was whether a river bottom was a "submerged land." The Texas Supreme Court adopted a narrow interpretation of "submerged land" and held that a riverbottom did not fit within the category. The court held that as a matter of long held policy, "river beds and channels of navigable streams should be held by the State in trust for the whole people" and that explicit language is the only acceptable means of authorizing a sale to lease. The court used two additional factors in construing the narrow interpretation: first, any statutes relating to the sale or lease of such land should be strictly construed in favor of the state; and second, the public policy rationale that any ambiguity must be construed in favor of the state.<sup>98</sup>

There is only one instance where a Texas oil and gas lessee has tried to argue that the state is estopped to collect royalty. In *Grayburg Oil Company v. State*<sup>99</sup> the General Land Office leased a portion of the Pecos riverbed for oil and gas operations. The lease was dated January 13,

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94. See, e.g., J.D. Adams, Jr., *Oil and Gas Leasing Upon Texas State Lands*, 47 TEX. B.J. 18 (1984) (noting that Texas owns or possesses an interest in over 22.5 million acres and that such lands are administered by various agencies, many possessing separate and distinct oil and gas leasing requirements).

95. See, e.g., TEX. NAT. RES. CODE ANN. §§ 52.021-022 (Vernon Supp. 1991) (indicating that the primary term "shall be" for period not to exceed five years, and royalties "shall" be based on "1/8 of gross production of gas produced and sold in the area."). *Id.* The statutes apply to certain defined land and pertain to the authority of the School Land Board. *Id.*

96. *Grayburg Oil Co. v. State*, 50 S.W.2d 355 (Tex. Ct. App. Austin 1932).

97. 186 S.W.2d 680 (Tex. 1945).

98. *Id.* at 682.

99. 50 S.W.2d 355 (Tex. Ct. App. Austin 1932).

1927. Through a process of assignment, Grayburg Oil obtained an executive interest in the lease. Interestingly, the oil was extracted by digging trenches in the riverbed, into which oil then seeped. Not surprisingly, this unusual operation caused significant environmental problems.

The Game, Fish, and Oyster Commission and the Texas Railroad Commission proceeded to treat the escaping oil as waste. Both agencies knew of and acquiesced in the attempts of an earlier assignee of the oil and gas lease to gather the oil and sell it as his own. But neither the Game, Fish, and Oyster Commission nor the Texas Railroad Commission possessed any authority to collect royalties in this situation. Grayburg Oil, the subsequent assignee, argued that such state inaction served to estop the General Land Commission from collecting royalties on oil so gathered.

The Texas Court of Civil Appeals rejected this estoppel defense. The court reasoned that the departments involved had no authority to determine, waive, or collect royalties. Several statutes explicitly delineated the royalty amounts and terms to be contained in state leases. Even with actual knowledge of the facts, the land Commissioner had no authority to suggest that the state had no right to royalties. Such a statement would be a mistake of law or an ultra vires act. Therefore, the state would not be estopped.<sup>100</sup>

The facts in *Grayburg Oil* were certainly unusual in that the agencies alleged to have created the estoppel lacked any positive authority whatsoever to collect royalties. Nonetheless, the court's characterization of the acts giving rise to the alleged estoppel as being either a mistake at law or an ultra vires act aptly reasoned away the lessee's estoppel arguments.

### C. *Louisiana*

The viability of the defense of estoppel of the government to collect royalty has not been resolved in a Louisiana court. However, the legal position in Louisiana is clearly delineated by statute. *Louisiana Revised Statutes Annotated* sections 30:129A and 136A serve to defeat any possible defense of estoppel of the government to collect royalties, because these statutes are "prohibitory laws."

The Louisiana State Mineral Board was created to be the "central agency for leasing state lands."<sup>101</sup> The general supervisory authority of

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100. *Id.* at 357-58 (citing *Carothers v. Rogan*, 96 Tex. 113 (1902)); see also *Jeems Bayou Fishing & Hunting Club v. United States*, 260 U.S. 561 (1922).

101. William O. Bonin, Comment, *Public Mineral Leasing in Louisiana*, 27 TUL. L. REV. 246, 247 (1953).

the Mineral Board is set forth in *Louisiana Revised Statutes Annotated* section 30:129A, which states:

**Powers, Duties, and Authority of Board; Pulling Agreements; Operation Units.**

A. The Board shall have full supervision of all mineral leases granted by the state, in order that it may determine that the terms of these leases are fully complied with, and it has general authority to take any action for the protection of the interest of the state. The Board shall take all appropriate action, including the recovery of nonproducing leased acreage whenever possible, to assure that undeveloped or non-producing state lands and water bottoms are reasonably and prudently explored, developed, and produced for the public good. It may institute actions to annul a lease upon any legal ground. The Board has authority to enter into agreements or to amend a lease. However, the Board shall not extend the primary term of any lease. Furthermore, the Board shall not, except as to unitization and pooling agreements, amend a lease by reducing the amount of bonus, rental, royalty, or other considerations stipulated in the lease.<sup>102</sup>

This language gives the Mineral Board complete authority to determine that mineral leases are complying with lease terms and to take "any action for the protection of the state." However, the Mineral Board is expressly prohibited from "reducing the amount of bonus, rental, royalty or other considerations stipulated in the lease." The word "amend" is not a term of legal art in Louisiana. According to the *Louisiana Civil Code*, such words are given their plain and ordinary meaning.<sup>103</sup> Clearly, in this instance, the word "amend" extends to any kind of alteration of the terms of a mineral lease, including any actions which might otherwise be considered to amount to an estoppel. *Louisiana Revised Statutes Annotated* section 30:129A is clearly a "prohibitory law" as that term is used in Louisiana. Obviously, the law is intended for the "preservation of the public interest." Additionally, the statute uses, in pertinent part, the word "shall," which is unequivocally "mandatory" in effect.<sup>104</sup>

Additionally, the Louisiana Legislature further clarified the Mineral Board's authority by the following provision:

**Funds, Disposition and Appropriation of; Penalties.**

A. (1) All bonuses, rentals, royalties, shut-in payments or other sums payable to the state as the lessor under the terms of valid existing mineral leases entered into under this subpart or previously granted by the state and under the supervision granted by the State and under the

102. LA. REV. STAT. ANN. § 30:129A (West 1992).

103. *Id.* § 1:3 (referencing "common and approved usage.").

104. *Id.*

Board or from leases hereafter granted shall be paid to the Office of Mineral Resources, and all such payments if made payable to the Registrar of the State Land Office as previously required, may be endorsed and otherwise processed by the Secretary of the Department of Natural Resources pursuant to his general authority in regard to the functions of that office as provided in R.S. 36:921 through R.S. 36:926. . . . The failure or delay of the Board to take any action or perform any function with respect to any payment shall not affect the validity of any payment made or tendered.<sup>105</sup>

This provision covers problems arising from the payment of bonuses, rentals, and royalties. The last sentence preserves the Board's right to pursue lessees for underpaid royalties, notwithstanding the fact that the Board may have accepted earlier incorrect payments. And again, the statute uses the word "shall." In sum, it is clear that the Mineral Board may not be estopped to collect mineral royalties.

#### D. *Utah*

Utah has supplied what is probably the best recent discussion of government royalty collection estoppel. As in all the other jurisdictions reviewed, the defense was rejected. The discussion of governmental royalty collection estoppel can be found in the case of *Plateau Mining Company v. Utah Division of State Lands and Forestry*.<sup>106</sup> In that case, the State of Utah leased certain school trust lands to four different mining companies in the 1960's. A standard lease form was used on each occasion. The royalty clause was as follows:

The Lessee, in consideration of the granting of the rights and privileges aforesaid hereby covenants and agrees as follows: SECOND: To pay to Lessor quarterly, on or before the 15th day of the month succeeding each quarter, royalty (a) at the rate of 15& per ton of 2000 lbs. of coal produced from the leased premises and sold or otherwise disposed of, or (b) at the rate prevailing, at the beginning of the quarter for which payment is being made, for federal lessees of land of similar character under coal leases issued by the United States at that time, whichever is higher . . . .<sup>107</sup>

The lessees operated the coal mines on the leasehold premises into the mid 1980's. Royalty was paid at the rate of 15& per ton, except for one of the lessees, Consolidation Coal Company, which paid at the rate of 17.5&. Up until 1979, this did not cause a problem as the "federal rate prevailing" was about 15& per well. In 1979, however, the Secretary of

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105. *Id.*

106. 802 P.2d 720 (Utah 1990).

107. *Id.* at 723.

the Interior, pursuant to the authority vested in him by virtue of the Federal Coal Leasing Amendment Act, raised the federal rate to eight percent of the value of the coal produced from federal coal mines.<sup>108</sup> The new eight percent figure represented a major increase. The Utah lessees, however, continued paying royalty at the low rate of 15% and 17.5%, even though the leases clearly required payment at the *higher* of the two possible methods.<sup>109</sup>

In the 1980's, Utah advised the lessees that their leases were in good standing.<sup>110</sup> In late 1984, however, Utah began a proper audit of its coal leases, with an attendant analysis of prevailing federal rates.<sup>111</sup> The result was that the State made demand "for delinquent royalties, interest and penalties for the period April 1, 1979, to December 31, 1984."<sup>112</sup> The Utah lessees requested and lost in hearings before the Board of State Lands. They then filed suits alleging that the State's decisions were invalid. The Utah lessees won in district court on the grounds, *inter alia*, that: "the State was estopped from collecting past royalties through a retroactive audit."<sup>113</sup> The Utah Supreme Court reversed.

The court first found that the royalty clause was unambiguous.<sup>114</sup> This was not a situation, the court held, where an ambiguous provision could be interpreted by the subsequent conduct of the parties.<sup>115</sup> Similarly, the lessees had a plain contractual duty to ascertain the applicable rate and pay it.<sup>116</sup>

The court then proceeded to flatly reject the estoppel argument. The rule in Utah is that the State may be estopped in its governmental capability only in "unusual circumstances," where failure to do so "would result in injustice, and there would be no substantial adverse effect on public policy."<sup>117</sup> The court found at the outset that there was "no injustice in requiring the plaintiff to pay royalties at the prevailing federal rate when they knew that the lease required them to pay at the "prevailing rate."<sup>118</sup> The court also noted that in this type of case, Utah

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108. 43 C.F.R. § 3473.3-2(a)(3) (1979).

109. *Plateau Mining Co.*, 802 P.2d at 724.

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.* at 725.

114. *Id.* (indicating that the lease provision clearly states that the higher of the two rates should be paid to the State).

115. *Id.* at 727.

116. *Id.* at 728.

117. *Id.* (citing *Celebrity Club, Inc. v. Utah Liquor Control Comm'n*, 602 P.2d 689, 694 (Utah 1979)).

118. *Id.*

was in the position of a trustor and could not simply give away trust assets.<sup>119</sup> The court also held that in these circumstances, estoppel would work to undermine constitutional provisions mandating that state lands “shall be held in trust for the people, to be disposed of as may be provided by law, for the respective purposes for which they have been . . . granted.”<sup>120</sup> Lastly, the court noted that the State’s long acquiescence in the royalty payments could not amount to an estoppel because such a holding would be inconsistent with the legislative intent granting the State the right to audit lessee records in order to ensure lease compliance.<sup>121</sup>

The court also rejected the Utah lessee’s waiver arguments, noting jurisprudence from other states that held that acceptance of royalty underpayments did not serve to waive the rights of private lessors.<sup>122</sup> Thus the court reversed the awards of summary judgment made in favor of the Utah lessees in the district court. Bearing in mind the test for governmental estoppel in Utah, however, the court remanded the issue of estoppel back to the district court.<sup>123</sup> The court did not wish to foreclose the Utah lessees from having the opportunity of showing new facts which might meet their high standard of proof.

#### V. POLICY ARGUMENTS SUPPORTING THE NO-ESTOPPEL RULE IN THE REALM OF MINERAL ROYALTY

Whether the federal government may ever be subject to estoppel is still an open question.<sup>124</sup> However, the writers argue that, as a matter of policy, governments, whether federal or state, should not be estopped to collect mineral royalties. In such circumstances, holdings of estoppel would operate to defeat the public interest.

Clearly, the government has an initial interest in the mineral leasing of its state lands.<sup>125</sup> Mineral royalties are often a vital source of government revenue. As shown above, protection of the public fisc is at the heart of the policy disfavoring governmental estoppel. Therefore, the policy issue raised by a defense of governmental estoppel to collect royalty is really the same issue as that raised in *Heckler* and *Richmond*.

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119. *Id.* at 729.

120. *Id.* (citing UTAH CONST. art. XX, § 1).

121. *Id.* at 730 (citing UTAH ADMIN. R. 632-5-4 (1990)).

122. *Id.* (citing *Holmes v. Kewanee Oil Co.*, 133 Kan. 544, 664 (1983), *cert. denied*, 474 U.S. 953 (1985)).

123. *Id.*

124. *OPM v. Richmond*, 496 U.S. 414, 423 (1990).

125. *See* *Marathon Oil Co. v. United States*, 604 F. Supp. 1375 (1985); *see also* Mary Gilliam Zuchegno, *How New Rules Affect Existing Oil and Gas Leases*, 19 COLO. LAW. 2073 (1990).



Apart from serving to rob the public fisc, government royalty collection estoppel would undermine the lawfully determined method of resource allocation chosen by both federal and state governments. Almost all mineral leases in the United States, federal or state, are awarded on the basis of public tender. The integrity of the bidding system requires that successful bidders abide rigorously to the original contract terms agreed to by them in the face of competition. And it should be noted that state royalty payors *never* acquire a legitimate interest in underpaying royalty.

It may well be, of course, that a government might work to reduce royalty so as to spur mineral development.<sup>126</sup> But no honest government would ever wish to reduce royalty by way of a collection estoppel. If royalties are to be reduced, this should be done in an open legal way after there has been the opportunity for review and debate. On the other hand, if the government could be estopped to collect royalty, there would be an open invitation for fraud and collusion involving state officials.

It would also be particularly harsh to estop a government from collecting mineral royalty for operational reasons. States such as Texas, Louisiana, and Alaska employ a relatively small number of officials to police oil and gas operations on state lands. Producers and operators are in a much stronger position, having full knowledge of their own extensive operations and complex accounting systems. Such companies can, if they so desire, do much to shield their internal workings from outside review. In fact, a high degree of continuing technical and legal evaluation is often required for royalty payment compliance, especially regarding what operational expense deductions, if any, are allowable. In such circumstances, the burden to make proper royalty payments should be placed on the lessee, not the regulatory authority. Where legal ambiguities are alleged to exist, the company should be required to seek clarification.

## VI. CONCLUSION

There is a considerable legal debate as to when, if ever, the federal or state governments should be subject to the equitable defense of estoppel. After *Heckler* and *Richmond*, it seems as if a conservative approach that focuses on applying the law, discouraging fraud and corruption, and protecting the public fisc has gained ascendancy, at least in federal courts.

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126. The federal government, for example, has just announced that it will exercise its legal powers to reduce royalties in Gulf of Mexico federal leases where the water is between 200-400 meters deep. See *Newsletter*, OIL & GAS J., Feb. 25, 1993, at 2.

However, in the relatively narrow area of governmental activity that is the subject of this article, it is clear that courts and legislatures, federal and state, have simply rejected estoppel. A conservative approach to governmental estoppel is particularly justified in the areas of royalty collection and conservation. Public resources, the public fisc, and the public's health are at issue. A contrary policy would provide a strong incentive for fraud and corruption.

Courts and legislatures have found these considerations paramount. The result has been that estoppel of the government to collect mineral royalty has proven to be a blind alley for those attempting to assert it.

