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Montana Oil and Gas Update

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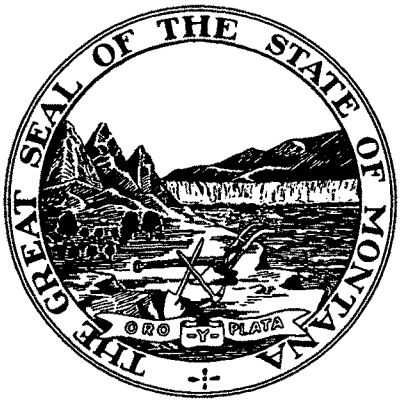

By: Stephen R. Brown[1]

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I. MONTANA SUPREME COURT

The Montana Supreme Court did not issue any decisions in 2012 addressing oil and gas leasing or ownership issues. However, in *Montana Wildlife Federation v. Montana Board of Oil & Gas Conservation*, the Court issued a decision addressing the relationship between the statute governing drilling permit approvals by the Montana Board of Oil and Gas Conservation ("MBOGC") and the Montana Environmental Policy Act ("MEPA").[2]

Montana Wildlife Federation involved the issue of whether the MBOGC had conducted proper environmental assessments under MEPA before it issued drilling permits under MEPA.[3] The case arose out of proposed new drilling activities in the Cedar Creek Anticline ("CCA").[4] The CCA is a geologic feature that extends for more than 100 miles in eastern Montana and into North Dakota.[5] The CCA has

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2. Mont. Wildlife Fed'n v. Mont. Bd. of Oil & Gas Conserv., 280 P.3d 877 (Mont. 2012); MONT. CODE ANN. § 75-1-101 to -110 (2011).

3. *Mont. Wildlife Fed'n*, 280 P.3d at 880.

4. *Id.*

5. *Id.*

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been producing natural gas since before 1920 and oil since the 1950s.[6] Over this time period, the CCA has been the largest producing field in Montana and continues to be a significant source of production, especially for natural gas.[7]

The MBOGC regulates oil and gas production in Montana under the provisions of the Montana Oil and Gas Conservation Act (the "Conservation Act").[8] Before an oil and gas developer can operate a well, the operator must apply for and receive a drilling permit from the MBOGC.[9] As with all other administrative agencies in Montana, the MBOGC's actions also are governed by the MEPA.[10] MEPA is the Montana analog to the federal National Environmental Policy Act ("NEPA").[11]

Fidelity Exploration and Production Company ("Fidelity") is the largest oil and gas operator in the CCA with several hundred operating gas wells and thousands of acres of land under lease.[12] In 2008, Fidelity submitted applications to the MBOCG to drill twenty-three additional gas wells in the CCA.[13] After receiving the applications, the MBOGC prepared environmental assessments for each application and issued the permits.[14]

The Montana Wildlife Federation and the National Wildlife Federation challenged the issuance of the permits on the grounds that the environmental assessments prepared by the MBOCG failed to comply with MEPA.[15] The concerns of the two organizations (which the Montana Supreme Court referred to collectively as the "Federations") stemmed from potential effects to the sage grouse, which depends on sagebrush habitat for its survival.[16] Although the sage grouse is not a listed species under the federal Endangered Species Act, it has been identified by the United States Fish and Wildlife Services as a species for which listing is warranted, but it is precluded by higher priority listing activities.[17] The Federations contended in this case that the proposed new wells would be located in proximity to several sage grouse breeding grounds, which also are known as "leks."[18]

Before addressing the merits of the case, the Montana Supreme Court evaluated the type of evidentiary record that applied in the

6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.* at 881; MONT. CODE ANN. § 82-11-111 (2011).
10. *Mont. Wildlife Fed'n*, 280 P.3d at 881.
11. *Id.* at 886.
12. *See id.* at 880.
13. *Id.*
14. *Id.*
15. *Id.* at 884.
16. *Id.*
17. *Id.* at 881.
18. *Id.* at 881, 884.

case.[19] Typically under both Montana MEPA and federal NEPA cases, courts are limited to reviewing the administrative record developed at the agency level absent certain special circumstances.[20] However, the Conservation Act conflicts with this provision by stating that an action challenging a decision by the MBOGC "shall be tried de novo and disposed of as an ordinary civil suit and not upon the record of any hearing before the board."[21] The district court had held that this section controlled and allowed discovery and evidence outside the administrative record to be considered.[22] The Supreme Court agreed, ruling that because the Federations' lawsuit was one challenging the issuance of permits, the provisions of the Conservation Act trumped the typical review conducted under MEPA.[23] Thus, the Court ruled that it was proper for the district court to consider evidence outside the record even though the Federations' contention was based on an alleged MEPA violation.[24]

On the merits of the case, the Federations raised three arguments: (1) that the MBOGC improperly "tiered" its environmental assessments to two old environmental impact statements, (2) that the MBOGC failed to consider the "cumulative impacts" of the effects of the additional wells on sage grouse, and (3) that the increased well density in the CCA triggered an obligation for the MBOGC to conduct a "programmatic" environmental impact statement. The district court rejected each of these arguments, and the Montana Supreme Court affirmed.[25]

The Federations' first argument was based on a criticism that the MBOGC relied on so-called "checklist" environmental assessments that incorporated by reference two older environmental impact statements without actually referencing the prior statements.[26] The MEPA allows agencies to build on prior environmental analysis through a process called "tiering," which is intended to avoid the need to continuously repeat environmental review that already has been conducted.[27] The environmental assessments performed for the Fidelity permits were limited to a checklist form, but the MBOGC claimed the checklists were tiered to detailed statements conducted in 1989 and 2003.[28] Because of its ruling that the district court could consider evidence outside the administrative record, the Montana Supreme Court

19. *Id.* at 885.
20. MONT. CODE ANN. § 75-1-201(6)(a)(iii) (2011); Ravalli Cnty. Fish & Game Ass'n v. Mont. Dept. of State Lands, 903 P.2d 1362, 1366 (Mont. 1995).
21. MONT. CODE ANN. § 82-11-144 (2011).
22. *Mont. Wildlife Fed'n*, 280 P.3d at 886.
23. *Id.*
24. *Id.*
25. *Id.* at 887.
26. *Id.* at 888.
27. *Id.*
28. *Id.*

concluded that the MBOGC could submit affidavits explaining its review process even though the checklists themselves did not reference the prior statements.[29]

The Federations' second argument is a common MEPA and NEPA challenge that environmental review failed to properly consider the cumulative impacts of proposed actions in light of other connected actions.[30] On this issue, the Court considered that over a thousand wells had already been permitted in the CCA and found that these new wells "are a minor fraction" of the overall development.[31] The Court also ruled that it could review actions after the case was filed, and a smaller number of wells ultimately were permitted.[32] Again, the Court also reviewed an affidavit of an MBOGC employee, explaining the information the agency did consider even though that information was not expressly contained in the checklist environmental assessments.[33]

As to the final issue, the Federations argued that the MBOGC had an obligation to prepare a programmatic environmental impact statement on its overall application approval process for the CCA rather than rely on a series of less detailed checklist environmental assessments.[34] The Montana Supreme Court concluded that the time for such a review had passed several years ago when the MBOGC had approved Fidelity's application to increase overall well density in the CCA.[35] As the situation now stands, the Court noted that "much of the infrastructure already was in place with only minor improvements needed."[36]

Montana Wildlife Federation is an important case to the permitting of new oil and gas development in Montana for several reasons. The case indicates that the current Montana Supreme Court takes a pragmatic approach to alleged MEPA violations and will avoid finding violations based on claims that seem to be more form over substance. For example, in this case, the Court refused to invalidate the checklist environmental assessments for failure to specifically mention the earlier documents used for the tiering analysis when other evidence showed that the agency did consider those documents. Additionally, the Court's ruling allowing evidence to be considered outside the administrative record also gives the MBOGC more discretion than other Montana agencies enjoy in explaining their decisions after the environmental documents have been issued.

29. *Id.* at 888–89.
30. *Id.* at 890.
31. *Id.*
32. *Id.* at 886.
33. *Id.* at 891.
34. *See id.* at 892.
35. *Id.* at 893.
36. *Id.*

II. Federal Oil and Gas Leasing Litigation

Litigation over federal oil and gas leasing in Montana continued in 2012. As reported in the 2011 version of this update, in 2008, several environmental groups sued the United States Bureau of Land Management ("BLM").[37] The lawsuit alleged that BLM did not properly address climate change effects when it issued oil and gas leases on federal lands.[38] The parties entered into a settlement agreement, which called for an environmental impact statement ("EIS") to address climate change effects and suspension of oil and gas leases that BLM had previously sold.[39]

After BLM completed the EIS, it allowed the leases to proceed forward. The environmental groups contended that BLM had not complied with the settlement agreement and filed a new lawsuit in early 2011.[40] These same groups now contend that BLM has failed to properly address methane and other greenhouse gas emissions that may result if the leases are developed. Over the course of 2012, dispositive cross motions for summary judgment were filed, but the federal court has not yet issued rulings.

III. The Montana Legislature

The Montana legislature meets in odd numbered years and did not meet during the period between September 2011 and August 2012.

IV. Administrative Developments

The Montana BOGC did not issue any new rules in 2012. However, its parent agency, the Montana Department of Natural Resources and Conservation ("DNRC") issued several new guidance documents that address the complicated issue of water availability for new oil and gas operations. Although much of the Bakken development is occurring in North Dakota, Montana also has seen rapid development of the Bakken Formation. The hydraulic fracturing technology being used to develop the Bakken is water intensive. Eastern Montana is relatively arid with limited available water supplies.

DNRC regulates water use in Montana. In response to inquiries from developers and municipalities, in April 2011, DNRC released two guidance documents regarding water use. The first, titled "Guidance for Municipalities," clarified that it is permissible for municipalities to use their existing water rights to sell water for oil development

37. *See* Stephen R. Brown, *Montana*, 18 Tex. Wesleyan L. Rev. 547–48 (2012).

38. Complaint at 1, Mont. Envtl. Info. Ctr. v. U.S. Bureau of Land Mgmt., No. CV-08-178-M-DWM (D. Mont. Dec. 17, 2008).

39. *See* Settlement Agreement at 2, Mont. Envtl. Info. Ctr. v. U.S. Bureau of Land Mgmt., No. 08-CV-178-M-DWM (D. Mont. Mar. 11, 2010).

40. Complaint at 1, Mont. Envtl. Info. Ctr. v. U.S. Bureau of Land Mgmt., No. CV-11-26-M-DWM (D. Mont. Feb. 7, 2011).

so long as the sales do not exceed volume and flow limitations on the water rights.[41] This guidance document also explains the limitations where water can be sold. For example, if the water is not being used in the city or town, the municipality can establish a "water depot" as the point of sale, with it then being permissible for the oil developer to use the water at other locations.

The second guidance document is titled "Water Use Options for Oil Well Development," which was issued the same day as the municipal guidance.[42] This document explains several options for parties involved in oil development to obtain water and the limitations with those options. The options range from purchasing water from municipalities, to obtaining new water rights for surface water or groundwater, and purchasing existing water rights. Each of these options has limitations, which the guidance explains. In general, the two guidance documents make clear that water use for oil development must occur within the existing DNRC regulatory framework and is not subject to any special exemptions or rules.

41. *Guidance for Municipalities*, MONT. DEP'T OF NAT. RES. & CONSERVATION (Apr. 19, 2012), http://www.dnrc.mt.gov/wrd/water_rts/oil_gas_water/guidance_municipalities.pdf.

42. *Water Use Options for Oil Well Development*, MONT. DEP'T OF NAT. RES. & CONSERVATION (Apr. 19, 2012), http://www.dnrc.mt.gov/wrd/water_rts/oil_gas_water/water_options_oil_development.pdf.