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Smooth Sailing or a Sea of Change? Selected Recent Developments and Theories in Oil and Gas

W. Eric West

SMOOTH SAILING OR A SEA OF CHANGE?

SELECTED RECENT DEVELOPMENTS AND THEORIES IN OIL AND GAS

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SMOOTH SAILING OR A SEA OF CHANGE - SELECTED DEVELOPING TRENDS OR THEORIES IN OIL AND GAS LAW

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I. INTRODUCTION

Over the years it has been interesting to try to identify developing trends or theories in the area of oil and gas law. Some trends originate in other areas of the law and have migrated toward the oil and gas arena. Certain of these trends or theories are developed out of thin air by ingenious attorneys representing parties who feel aggrieved. Still others arise as a result of new forms of technology and their impact on law and society. Trends even evolve from the political arena in response to direct or indirect claims of constituents.

Early forecasting of a trend or theory and the path of its development or demise is akin to gazing into a crystal ball or reading tea leaves. Unquestionably the birth of a trend causes uncertainty in the law and therefore an increased level of risk in the investment community. This paper is an attempt to identify several possible trends and surmise whether they will result in smooth sailing or a tidal wave of change for the oil and gas industry, including attorneys, landmen and the investment community.

While there are a number of potential trends or developing theories, many of which I probably have not identified, the following are some of the potential developing trends. At this point a caveat is in order. This paper's purpose is to raise questions and give a range of potential answers and/or problems. As you will see, this paper is general in nature and is not intended to be a treatise or law journal article. While it may seem so, the purpose of this paper is not to give the "correct" answer at this point in the evolution of these trends.

II. GEOPHYSICAL AND GEOLOGICAL ADVANCEMENTS AND THEIR IMPACT UPON THE LAW - TRESPASS, CO-TENANCY, POOLING, AND THE DOMINATE MINERAL ESTATE

Advances in geophysical and geological technology over the last decade have been substantial. Geophysical "exploration" takes many forms including

seismic, airborne or satellite technology. It's purpose is to provide information of the structural and stratigraphic composition of the earth. As you will note, I have categorized geophysical activities as "exploration". They are no more than another way of exploring for oil and gas. However, geophysical operations generally do not determine whether there is oil or gas present. It is still necessary that a well be drilled.

The most familiar geophysical operations are seismic operations. Seismic techniques generally involve the generation of energy near the surface which reflects subsurface features. They involve either the drilling of shot holes with small amounts of explosives or vibrioses with the energy source coming from a truck-mounted vibrator. The reflection of these sound waves is recorded and in many instances computer enhanced. While seismic has been around for years, it has only been within the last score of years that the quality has improved dramatically through the use of three dimensional (3-D) seismic. This movement toward 3-D seismic often requires larger acreage blocks and multiple lines of seismic. Actual use of the land is required in both regular seismic or vibrioses.

Other geology or geologic engineering advancements such as fracking (hydraulic fracturing) or horizontal drilling have given rise to new questions

in the area of oil and gas law. Each of these techniques is another form of "exploration".

Fracking is the forcing at high pressure of a fracking material (sand or chemical gel) into the potentially productive formation to increase the ability of the formation to produce. Horizontal drilling is self-explanatory - it is the drilling of a wellbore within and horizontal to the producing formation.

The legal questions arising from the use of each of these "exploration" tools are much the same as those which have historically been present. Who has the right to do what, where and when and whose permission is needed and what is the state's role through its regulatory agencies?

There is very little, if any, legal authority concerning advanced technologies like 3-D seismic, horizontal drilling and fracking. See Kendor P. Jones, Restrictions on Access and Surface/Subsurface Trespass Involving Exploration and Production Technologies, in 40 Rocky Mt. Min. L. Inst. 20-1 (1994). There is, however, general law developed earlier in this century dealing with older technology. Phillips Petroleum Co. v. Cowden, 241 F.2d 586 (5th Cir. 1957); Wilson v. Texas Co., 237 S.W.2d 649 (Tex. Ct. App. 1951). This law is a patchwork involving the interweaving of the theories of

trespass, co-tenancy, pooling, and the dominant mineral estate. Appendix A to this paper is a visual overview of examples.

The courts have generally held that the mineral owner, not the surface owner, has the right to conduct exploration activities whether geophysical or geological. 1 Eugene Kuntz, A Treatise On the Law of Oil and Gas § 3.2 (1987). Generally courts have stated that the right of geophysical exploration is a valuable right which belongs to the mineral estate and that the owner of these rights has an action to protect them. Id. at § 3.2(d)(1), at 91. However, the courts have also generally held that no relief is available where there has been no physical trespass and courts have had great difficulty in determining the nature and measure of damages. Id. at § 12.7, at 348; Kendor P. Jones, Restrictions On Access and Surface/Subsurface Trespass Involving Exploration and Production Technologies, in 40 Rocky Mt. Min. L. Inst. 20-1, 20-28 (1994). A key question has and should continue to be whether there was a physical trespass on the land.

At this point you might ask what is new about this situation? The answer is the way the actual gathering of the information occurs on the ground (See Appendix A), the scope of the information revealed and the suggestion by some that the courts look beyond the limitations of prior law to "create a right". These new rights are generally in the nature of analogies to

the law of trade secrets, wrongful appropriation or interference with valuable property rights. See generally Mark D. Christiansen, Note, Oil and Gas: Improper Geophysical Exploration -- Filling In the Remedial Gap, 32 Okla. L. Rev. 903 (1979); James W. Griffin, Note, Protectable Property Rights, Trade Secrets and Geophysical Data After City of Northglen v. Grynberg, 71 Denv. U. L. Rev. 527 (1993); Robert J. Rice, Wrongful Geographical Exploration, 44 Mont. L. Rev. 53 (1983); Slater, Note, The Surrepitious Geophysical Survey: An Interference With Prospective Advantage, 15 Pac. L.J. 381 (1984); Thomas M. Warner, Jr., Note, Oil and Gas: Recovery for Wrongful Geophysical Exploration -- Catching Up With Technology, 23 Washburn L.J. 107 (1983). While there are law journal articles proposing these arguments, until recently this author is not aware of a case extending these theories to geophysical or geological "exploration".

It is my understanding that a trial court judge in Texas in a case entitled Burr Ranch v. BGM Airborne Services, Inc. has indicated that he may rule based on one of these type theories that a landowner is entitled to recovery for airborne geophysical surveys over his property.

With regard to fracking and horizontal drilling techniques I recommend a very good discussion in 33 Washburn L. J. 492 (1994) by Jacqueline Lang Weaver entitled The Future Course of Oil and Gas Jurisprudence: The

Politics of Oil and Gas Jurisprudence: The Eighty-Six Percent Factor. This article discusses Geo Viking, Inc. v. Tex-Lee Operating Co. 817 S.W.2d 357 (Tex. Ct. App. 1991) rev'd per curiam, 1992 WL 80263 (Tex. Apr. 22, 1992), per curiam decision withdrawn and writ of error denied as improvidently granted, 839 S.W.2d 797 (Tex. 1992). This case involved a suit by Tex-Lee against Geo Viking for failure to properly fracture a well and the concurrent loss of oil as a result. This case and the discussion in the referenced article certainly place into question what happens if fractures or horizontal drilling invade an adjoining mineral estate owned or leased by others. Included in this article is a discussion of the policy, consequences and need for the appropriate regulatory or legislative changes to encourage new or improved technologies like horizontal drilling or fracturing. Other sources of information on horizontal drilling trends are Patricia A. Moore, The Legal Implications of Horizontal Drilling, in 1991 Arkansas Natural Resources Law Institute, and Patricia A. Moore, Horizontal Drilling - New Technology Bringing New Legal and Regulatory Challenges, in 36 Rocky Mt. Min. L. Inst. 15-1 (1990).

Under a claim for trespass by fracking an adjoining owner, I assume, would have difficulties with the proof of damages and proof of a physical invasion. A valid defense in some circumstances seems to be the rule of capture. However, after first examination the rule of capture may not be an

adequate defense if physical invasion of others properties occurs. I refer you to the old slant hole or directional drilling cases. See 1 Howard R. Williams & Charles J. Meyers, Oil and Gas Law, § 227 (1990).

Up to this point the discussion has involved rights of the mineral owner, and lessee/operator but has not addressed the rights of the surface owner. As earlier stated the mineral estate is the dominate estate and has the right to make reasonable use of the surface without payment to the surface owner. 1 Eugene Kuntz, A Treatise On the Law of Oil and Gas § 3.2(a), at 87-88 (1987). While it has been custom and practice in the industry to pay the surface owner for shot holes or surface access it has not been compelled by law. However, recently statutes have been enacted providing for the possible rights of surface owners for use of the surface and seismic operations. See Ark Code Ann. §§ 15-71-114, 15-72-213 and 214 and 15-72-203 (1994), also see Debbie C. Fritsche, The Inner-Workings of the Arkansas Oil and Gas Commission, in 1993 Arkansas Natural Resources Law Institute concerning some of these statutes and the Oil and Gas Commissions Rules (B-10, B-42). With great deference to the authors of these statutes and the regulations, many questions remain as to their application including their constitutionality. Can the state force an owner to pay a third party for a right that he already owns? Do these statutes or regulations attempt to do so? Is that a constitutional taking? Another interesting twist on the enactment of such statutes is

the question of whether the entering of the state into the arena precludes a mineral owner from exercising his rights with regard to unauthorized seismic exploration across his minerals. That is, if the seismic company pays the surface owner as arguably required by statute, does the fact that the statute exists preclude the mineral owner, who has not given permission, from recovery? A sort of preemption argument.

Pooling either voluntary or statutory, especially if inadequate, necessarily have a bearing on "exploration" including the use of new technology. For example in Reimer v. Gulf Oil Corp., 664 S.W.2d 456 (Ark. 1984) the Arkansas Supreme Court stated that where a lease provided that a well site within the same drilling unit as the lease premises would be considered to be located upon the leased premises, a rig could be transported across the leased premises to a well site which was located on an adjacent tract in the same unit. See also Acree v. Shell Oil Co., 548 F. Supp. 1150, 75 O.&G.R. 85 (M.D. La. 1982) aff'd, 721 F.2d 524 (5th Cir. 1983). Although the general rule is that there is no implied right to use the surface estate of a leased tract to benefit operations on an adjacent or nearby tract, a valid pooling or unitization order issued by state conservation agency will serve to create such a right. 2 Bruce M. Kramer and Patrick H. Martin, The Law of Pooling and Unitization § 20.06[1] (3d ed. 1990). Such a construction is also supported by the fact that these orders are based on the states' police powers,

as well as by the fact that courts tend to favor conservation measures. If the unit operator were not permitted to use unit lands, the purpose of the state conservation order could not be effectuated. A particular problem arises when an unleased tract is located within a forced pool unit. If the pooling or unitization order did not, as a matter of law, confer upon the unit operator the right to surface access and use of the lands located within the unit, the operator's use of an unleased owner's land may constitute a trespass, possibly exposing the unit operator to both actual and punitive damages. The courts that have considered the issue hold that a pooling or unitization order serves to insulate an operator from a trespass claim by an unleased owner who has been force pooled. The question arises whether such statutes, regulations or orders from a conservation agency will protect persons involved in the use of enhanced technology. A problem pointed out in the Weaver article is the lack of appropriate statutes, rules and regulations providing for the use of enhanced technology.

Other authors note changes in the law concerning the use of the surface estate in exploration. John F. Welborn, Changes In the Dominant/Servient Relationship Between the Mineral and Surface Estate, in 40 Rocky Mt. Min. L. Inst. 22-1 (1994); William F. Blair, Surface Rights and Conflicts: How Dominant is the Mineral Estate, in 1994 Eastern Mineral Law Foundation Special Institute, Four Corners and Good Intentions: Construing

Property Rights Under Oil and Gas Instruments. The Welborn article places emphasis on certain changes in federal law which have occurred. The author and others have argued that the rights of the surface owner in reference to the dominant mineral estate are changing and/or developing to give surface owners more rights. However, I do not believe that the changes in these federal rules and regulations should be so deemed. They should be viewed as a mineral owner placing restrictions upon itself and its lessees as to how the mineral estate will be developed with due regard to the surface owner. They do, however, show a relevance to the idea that society (as represented by government) is giving additional consideration to restrictions on the development of minerals in favor of the surface owner. But see Part IV of this paper on takings.

A few states, including Arkansas, have created a duty to restore the surface. The majority of jurisdictions hold that an oil and gas lessee or mineral owner has no implied obligation to restore the surface. However, the Arkansas in Bonds v. Sanchez-O-Brien Oil and Gas Co., 715 S.W.2d 444, 91 O.&G.R. 11 (Ark. 1986) after recognizing the majority rule held otherwise. See also Fox v Nally, 805 S.W.2d. 661 (Ark. Ct. App. 1991) where the court held that a damage release does not negate the duty to restore the surface. Professors Williams and Myers in their treatise state that there is no implied duty of surface restoration as a general matter. 1. Howard R. Williams and

Charles J. Myers, Oil and Gas Law, § 218.12 (1990). It may be argued that the breach of a regulatory order or statute creates a separate ground for recovery when recovery would otherwise not be available. However, application of these cases to seismic operations where the use of surface is limited and short-termed is questionable. If the seismic operation in fact created no damage (surface is restored and no collateral damage occurs), then what is the surface owner's basis for recovery? The surface owner may argue for recovery under Ark. Code Ann. §§ 15-72-213 and 214 and/or 15-71-114 or 15-72-203 (1994), providing for a surface owner's lien for damages caused by operator neglect, a surface owners claim for damages caused by operator neglect, permit required for field seismic operations, and notice to surface owners. However, do these statutes create a cause of action if there are no damages? This and other questions remain unanswered.

III. OPERATING AGREEMENTS, FARMOUT AGREEMENTS, DRILLING AND OTHER CONTRACTS AND THE ENFORCEMENT OF THEIR PROVISIONS - TREND OR NO TREND

The contractual agreements generally used in the oil and gas industry are classified as operating agreements, farmout agreements and drilling contracts along with miscellaneous other type contracts. The development of the law as it relates to these contracts over the last ten (10) years is difficult to categorize. As one can imagine the cases go all over the place with

different results on similar issues depending on the jurisdiction and court. If there is a trend over the past five (5) years the trend would be classified as two-pronged. The trend over the more recent years appears to be that courts are going to enforce the contracts as written, with limitation. The limitation some courts seem to be applying is that in certain instances they will try to give relief to parties who, when entering contracts, knew they either did not intend to, or could not, carry them out. In my humble opinion the limitation applied by the courts in these cases is not appropriate.

These cases deal with a variety of operating agreements, farmout agreements and drilling contract provisions including the indemnity provisions of the operating agreement, the COPAS accounting statement, performance of drilling contracts and others.

A good illustration of this trend is exemplified by two cases from Texas. Stine v. Marathon Oil Co., 976 F.2d 254 (5th Cir. 1992) and Dresser Industries, Inc. v Page Petroleum, Inc., 853 S.W.2d 505 (Tex. 1993). In Stine a non-operator sued the operator, Marathon, for breach of the operating agreement. The lower court awarded substantial damages to the non-operator based on breach of the operating agreement by the operator. The Fifth Circuit Court of Appeals construed the exculpatory clause found in the operating agreement which protects the operator for all action undertaken

except those which amount to "gross negligence or willful misconduct". The Fifth Circuit stated that the protection extended under the JOA to the operator includes all action performed under the JOA including administrative and accounting matters. Stine represents that portion of the trend stated as "courts will enforce the contract as written".

However, Dresser Industries represents the "with limitations" portion of the trend enunciated above. In Dresser at issue were the provisions of a drilling contract and certain releases. The Texas Supreme Court reversed the Court of Appeals, holding that the fair notice requirements (consumer protection legislation) applicable to indemnity/exculpatory agreements applied. This case appears to mean that consumer type protection including large or color print or type size are important in joint operating agreements and drilling contracts if you want the exculpatory provisions or releases to apply.

In criticizing the holding in this case and the underlining anti-indemnity legislation I do so without the knowledge of Texas practitioners who have a better feel for their meaning and interpretation. See Jeanmarie B. Tade, Texas Indemnity, Anti-Indemnity and Contribution Law, in 43 S.W. Inst. 7-1 (1992). It appears to this writer that while consumers may need such protection, persons engaged in the day to day business of the oil and gas

industry such as drilling contractors, operators and non-operators should be bound by their contracts. They should not be relieved because the provisions which impact them are not in bold or colored print.

Courts differing approaches to such issues are exemplified by Caddo Oil Company, Inc. v. O'Brien 908 F.2d 13 (5th Cir. 1990); Exxon Corporation v Crosby-Mississippi Resources, Ltd. 775 F.2d 969 (S.D. Miss. 1991), aff'd in part, 1995 WL 305 (5th Cir. Jan. 3, 1995); Texstar North America, Inc. v. Ladd Petroleum Corp., 809 S.W.2d 672, (Tex. Ct. App. 1991), writ denied Oct. 9, 1991; Petrocana, Inc. v. Amargo, 577 So.2d 274 (La. 1991); Davis v. TXO Production Corp., 929 F.2d 1515 (10th Cir. 1991); versus Texas Oil & Gas Corporation v. Hawkins Oil & Gas, Inc., 668 S.W.2d 16 (Ark. 1984) .

All of the cases first set out above enforce the operating agreement or contract as written. These cases, in one form or the other, are on the opposite end of the spectrum from Hawkins with which many of you are familiar. In Hawkins the Arkansas Supreme Court said that there was some sort of "fiduciary" duty between an operator and a non-operator. If the court in Hawkins wanted to hold as it did it should have done so on other grounds rather than establish a fiduciary duty between operators and non-operators. The Hawkins case seems to be out of the main stream of cases dealing with

operating agreements and is another example of the "limitations" placed upon the above theory.

Authors writing on the area of joint operating agreements are all over the spectrum. Many do not espouse imposing a fiduciary duty, especially where the model form JOA is used. See Stine, Exxon, Ernest Smith, The Purpose and Effect of the Operating Agreement, in 32 Rocky Mt. Min. L. Inst. 12-1 (1986), Lynn P. Hendrix & Staunton L. T. Golding, The Standard of Care in the Operation of Oil and Gas Properties: Does the Operator Owe a Fiduciary Duty to Non-Operators?, in 44 S.W. Inst. 10-1 (1993). However, other writers state that there should be a fiduciary duty. See Susan Webber Wright, Fiduciary Duties Arising From Ownership of Oil and Gas Interests, 1985 Arkansas Natural Resource Law Institute. Still others are uncertain of any conclusion with all the confusion arising from the various cases. See David M. Jones, Nonoperators Versus the Operator--Are Nonoperators Becoming More Willing To Sue Operators?, in 43 S.W. Inst. 10-1 (1992) for a good general discussion.

Courts that find a fiduciary relationship tend to focus on the existence of certain attributes which would tend to indicate that it is a joint venture or a partnership. The problem with these cases and articles is they often ignore the actual terms of the agreement between the parties. Where a model form

JOA is used these authors and courts completely ignore the provisions which provide that it is not a joint venture or partnership, the risk of loss provisions, the exculpatory provisions and all of the other matters specifically addressed in the operating agreement. Such an approach avoids the intention of the parties as exhibited by the agreement, even where the agreement deals with the specific problem. In addition these cases and articles also seem to ignore the fact that the parties to the JOA may have originally been competitors or adversaries. They may have been integrated and/or forced under an operating agreement by competitive factors. The point being, either the agreement should be enforced as written or the courts should come up with some method of recovery based on something other than changing the theory of liability or the relationship of the parties.

Many of the old cases which find that a joint venture existed did not involve a form JOA. Therefore those courts were left with the job of figuring out if, as a matter-of-fact, there was a joint venture. One can obviously see the problem with applying these old joint venture decisions to cases where a form joint operating agreement was negotiated. Many times one of the included provisions in the JOA is that it is not a joint venture. The reason for this is no one wants to be an operator if they are going to be placed under a fiduciary obligation which requires them to act against their own best interest or to be a guarantor of results. The obvious inference being if a state wants

to discourage people from being operators then do as the Arkansas Supreme Court did. If a state wants to encourage people to become operators, by letting the parties know their agreements are binding and can be depended upon, then do as other states.

A second or collateral theory which is present or derivative from the Hawkins case and other cases seems to be as follows. Where there is no basis in law or the contract the court may impose secondary or collateral duties on an operator to achieve a desired result. Both the Hawkins and Dresser Industries cases are examples of this.

Claims of bad faith in operating agreement and contract litigation are becoming more and more prevalent. See generally Mark Pennington, Punitive Damages for Breach of Contract: A Core Sample From the Decisions of the Last Ten Years, 42 Ark. L.R. 31 (1989), [Citing Delta Rice Mill, Inc. v. General Foods Corp., 763 F.2d 1001 (8th Cir. 1985) (Interpreting Arkansas Law)]. This appears to be a third trend among the cases. The following situations, which I categorize as double bad faith, do not arise from the above judicial decisions but rather from other cases with which I am familiar.

Over the last ten years there have been a number of cases brought by persons whom I classify as "bad actors". These cases typically involved a "bad

actor" arguing that he is entitled to something, or doesn't have to pay because the operator was grossly negligent or mean or just didn't do right. It is usually alleged that the operator acted in bad faith thus entitling the "bad actor" to certain advantages. The advantages are that by claiming bad faith they avoid case law to the contrary, invoke equitable principles, claim punitive damages, prejudgment interest, attorneys fees and the like. Several examples are pertinent. All of these are unreported cases which have terminated by some series of events with no judicial decision being rendered.

In one case an operating agreement was entered into and, the operator drilled the well as required. Unfortunately the target zone was only minimumly producible and the costs of a deep well were substantial. The non-operator, being in financial difficulty, argued that the operator ruined or destroyed the reservoir and did so in bad faith. This argument and others were advanced even though the non-operator had promised to pay and had in fact paid a minimal amount, but when he saw the results of the log and core analysis he decided he would not pay any more. The non-operator argued for duties other than those set out in the operating agreement and simply tried to avoid the exculpatory provisions of the JOA by arguing bad faith. The party attempted to get punitive damages with the possibility of prejudgment interest, attorneys fees and the like. The bad faith claim in this instance was couched in terms of gross negligence and intentional misconduct.

After several years of litigation making the same type of claims against several operators on different wells, the non-operator eventually went bankrupt.

A second example deals with the sale of producing properties. The "bad actor" had, on several occasions when companies sent out sale letters claimed to be interested. He submitted the high bid and when he couldn't produce the money and fulfill the terms of the buy-sell agreement, claimed that the seller breached the contract in bad faith. The "bad actor" claimed a right to either get the properties for free or extract monetary damages. Such a claim obviously delays the ultimate sale of the properties and causes additional losses resulting from litigation costs, even if settled.

These are two situations which have occurred which are brought to your attention so that you may be prepared if they arise.

IV. THE REAWAKENING OF THE FIFTH AMENDMENT TAKINGS CLAUSE - PROPERTY OWNERS REVOLT

A rapidly growing trend in the natural resource arena involves Article V of the Constitution which prohibits governments from taking property without compensation. Article V of the Constitution provides "nor shall private property be taken for public use without just compensation". In the last few years growing resentment has developed among citizens, including companies

and individuals as a result of the government's taking their property through laws and regulations, primarily environmental in nature. In just the last several months I have noticed no less than five articles in the Wall Street Journal detailing new foundations or groups of citizens banding together to insist upon their Fifth Amendment Rights under the Constitution. These groups generally appear to be private citizens with grievances against the government for regulating their property into non-existence. The law as it applies to this trend is undergoing a re-emergence.

This trend was last addressed by our U. S. Supreme Court in Lucus v South Carolina Coastal Council, 112 S.Ct. 2886 (1992) and Dolan v. City of Tigard, 114 S.Ct. 2309 (1994). A number of cases on the takings issue have been decided by the Federal courts in recent years. See Florida Rock Industries, Inc. v. United States, 8 Cl. Ct. 160 (1985) aff'd in part and vacated in part, 791 F.2d 893 (1986), and cert. denied, 479 U.S. 1053 (1987). Loveladies Harbor, Inc. v. United States, 21 Cl. Ct. 153 (1990). Two excellent articles dealing with this trend are Martha Phillips Allbright and Thomas E. Root, Government Taking of Private Water Rights, 39 Rocky Mt. Min. Inst., 20-1 (1993) and Mark L. Pollot, Making the Right Choices: Strategy, Tactics and the Law In Property Rights Cases, in 40 Rocky Mt. Min. L. Inst., 1-1, (1994).

As a practical matter individual citizens are obviously becoming sick and tired of the arrogance of the government in trampling on their rights. This government arrogance is reflected in a quote (and inference) out of the Allbright and Root article on page 20-4 as follows:

> Bruce Babbit, Secretary of the Interior, would replace the concept of "multiple use" developed during the use-management phase of public land law development with a new concept, that of "dominant use." His rationale is as follows: "Multiple Use skirts the reality that in the new urbanizing west, there is no longer enough space to accommodate every competing use on every section of public domain."

The dominate idea behind this attitude is environmentalism has first call on the land, and property rights owners be dammed. The property owner's response has been, the Constitution says if you want to take my property you have to pay for it. This attitude has been growing over the recent years and has been aggravated by the National Environmental Policy Act (NEPA), local zoning ordinances and other environmental statutes. A specific example is the Endangered Species Act, 16 U.S.C. § 1531 et seq. (1985) with its impact on logging in the Northwest via the spotted owl. While many are aware of the above "endangered" specie and others like the

american burying beetle, the gopher tortus and the red cockaded woodpecker, they are not aware that many hundreds of other species are in the process of being classified endangered. Also in this web of regulation is the Clean Water Act, 33 U.S.C. § 1251 et seq. (1986), with its wetlands provisions, scenic rivers acts and others. Specifically in the oil and gas area, many of you are familiar with the delay and headache accompanying the discovery of the american burying beetle at Fort Chaffee. In other states in this region you find similar situations with the red cockaded woodpecker, the gopher tortus and others. I am sure that there are likewise many other species in other oil and gas producing states. In the south you have the additional problems arising from "wetlands" and their effect on operations. Do these statutes, regulations and their enforcement constitute a taking of private property rights?

An interesting case along these lines out of Michigan is Miller Brothers v. Dept. of Natural Resources. 513 N.W.2d 217 (Mich. Ct. App. 1994). In this case a regulatory agency would not allow a permit to drill wells in a 4500 acre area because of the environment. As a result the operator brought suit under the takings clause and was successful in obtaining a judgement in the amount of 71 million dollars plus interest and attorney fees. The court reasoned that by taking away the right to drill several prospects a takings had occurred. The court then looking at the value of the potential reserves, found the state had

taken this value and was thus obliged to pay. On appeal this approach to the calculation of damages (permanent vs temporary) was rejected but the takings holding upheld.

Many of you are probably familiar with current litigation and/or problems surrounding off-shore leases in Florida and off the east coast where takings claims are involved. Another natural resource takings case is Tarrant County Water Control and Improvement District Number One v. Haupt, Inc. 854 S.W.2d. 909 (Tex. 1993). In this case the local water district condemned and flooded the surface of certain lands to create a reservoir for drinking water. However, the water district did not condemn the mineral interest under the lands and the mineral owners filed suit for inverse condemnation. The Texas Supreme Court remanded the case for a determination of whether there is a reasonable alternative for producing the minerals. If there is not a reasonable alternative then inverse condemnation has occurred and the mineral estate must be paid for.

This area of the law will continue to unfold with additional cases pending before the U. S. Supreme Court and other courts as well as a new congress possibly undertaking a reduction of government regulation.

V. ENTERPRISE LIABILITY - A CLAIM WITHIN A THEORY

An interesting concept is beginning to make rumblings in the natural resources area. This theory is enterprise liability. There are topics on this theory planned for the upcoming Eastern Mineral Law Foundation Annual Institute. See generally Timothy J. Gillick, The Essence of Enterprise Liability, or the True Meaning of "We're All In This Together", 16 Forum 979 (1981); Tort Reform Symposium: Perspectives on the American Law Institute's Reporters' Study on Enterprise Responsibility for Personal Injury, 30 San Diego L. Rev. 213 (1993) for example. It is my understanding that this theory is somewhat as follows. If a person or people are injured then everyone in the chain of commerce is responsible for that injury. For example, in the energy area, parties all the way from mineral owners through exploration companies, producers, purchasers and end users could be responsible for damages arising to parties anywhere in the chain of commerce. This is no doubt an interesting societal/political claim. It will be interesting to see if it develops. However, it seems if everyone is liable in some form or fashion for everything that happens everywhere to anybody then we should all have a cause of action against each other for everything and as a result everything will washout. The only problem is that plaintiffs' lawyers will own 1/3 of all commerce.

VI. ROYALTY ON TAKE OR PAY SETTLEMENTS OR CONTRACT BUY-DOWNS

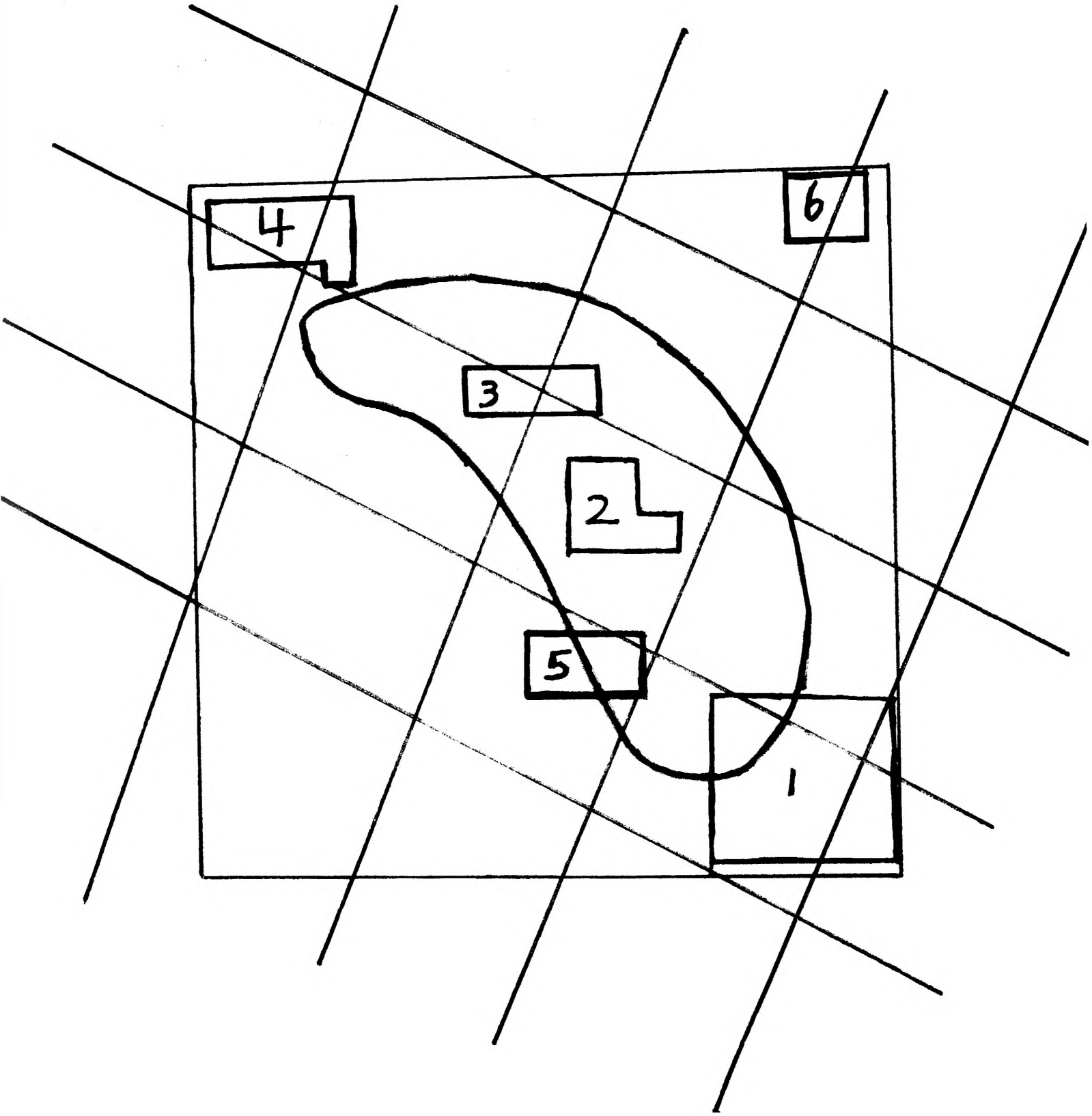
There is a pending trend of cases involving royalty owners claims to proceeds on take or pay settlements or gas contract buy-downs. This type claim was addressed in the Bruni decision out of Texas where the Texas Supreme Court held that royalty owners were not entitled to relief. Killiam Oil Company v. Bruni, 806 S.W.2d 264 (Tex Ct. App 1991) error denied sub nom. Hurd Enterprises, Ltd. v. Bruni, 828 S.W.2d 101 (Tex. Ct. App 1992). The Frey decision out of Louisiana held that royalty owners are entitled to part of the proceeds of take or pay claims or contract buy-downs. Frey v. Amoco Production Co. 943 F. 2d 578 (5th Cir. 1991), withdrawn in part 951 F.2d 67 (5th Cir. 1992), certifying questions to 603 So.2d 166 (La 1992). In Arkansas Klein v. Jones, 980 F.2d 521 (8th Cir. 1992) ren'g denied Jan. 22, 1993, is ongoing and I will not report on it assuming that it will be reported on under the recent developments part of the program later. It is my understanding that there are other cases pending or in the process of being readied on this issue in other states. It will be interesting to watch the development of these cases to see if there is a trend one way or the other. In the meantime you may want to review these three decisions in order to be better prepared.

VII. CONCLUSION

In junior high school one of my teachers was fond of saying "the first sign of intelligence is the ability to follow directions". My instructions were to write and present a paper of this type for the benefit of the audience. I think I have followed the instructions and given you something useful. This same teacher often followed her first statement with "the second sign of intelligence is the ability to identify the question or problem". I believe I have identified some of the possible future trends and the problems they may cause for the oil and gas industry be they landmen, attorneys, geophysical personnel, or companys with investments in this industry.

This paper identifies five (5) potential legal trends concerning the oil and gas industry. While this paper does not attempt to give you the correct answer it does provide general legal principles to the extent they exist on these areas. Hopefully each of us can take these general principles and formulate a proper application if the situation arises. In law school credit is given for correctly identifying the question, the pertinent facts and the law, even if the answer is wrong. Unlike law school, if we apply these principles incorrectly I am sure the courts, with no hesitancy, will let us know.

APPENDIX "A"



1. All 2. None 3. Surface - Yes, Minerals - No

4. Surface - Yes, Minerals - No 5. Surface - Yes, Minerals - 1/2

6. Surface - No, Minerals - Yes