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ENERGY LAW UPDATE - MT, ND & WY

I. Montana Legal Update

A. Case Law Update

Montana Environmental Information Center v. Montana Department of Environmental Quality et al., 2016 MT 9

On January 12, 2016, the mining industry scored a victory when the Montana Supreme Court upheld a Montana Department of Environmental Quality (DEQ) determination in face of a challenge based on state constitutional provisions and statutes. Back in 2012, the Golden Sunlight Mine (GSM), near Whitehall, Montana, applied to expand its mining operation to develop a nearby smaller pit. In response to the submitted reclamation plan, the DEQ issued an environmental impact statement with several alternatives. Ultimately, the DEQ rejected all alternatives requiring complete backfilling in favor of an alternative that allowed for partial backfilling and installation of an in-pit sump to prevent pollution to local aquifers. The Montana Environmental Information Center (MEIC) challenged DEQ's decision on grounds of being "arbitrary and capricious" and that "full reclamation", as contemplated in Article IX, Section 2 of the Montana Constitution, requires complete backfilling. Previously, in 2011, MEIC had challenged a mine expansion at GSM on similar constitutional grounds but had lost and failed to appeal. Judge Loren Tucker, Fifth Judicial District, granted summary judgement for the mine finding the DEQ's determination was reasonable and the constitutional challenge was precluded as the issue had already been decided in 2011. On appeal, the Montana Supreme Court affirmed Judge Tucker, stating that the constitutional challenge was precluded and the DEQ had acted reasonably in choosing the partial backfill alternative. By choosing to not overturn the lower court and require complete backfilling, the Montana Supreme Court's demonstrated judicial restraint that resulted in a victory for GSM and a victory for mining throughout the state.

Interstate Explorations, LLC v. Morgen Farm and Ranch, Inc., 2016 MT 20

In Interstate Explorations, LLC v. Morgen Farm and Ranch, Inc., the Montana Supreme Court held that a surface owner is not required to exhaust administrative remedies prior to commencing an action for damages to the surface caused by a mineral lessee.

In this case, Interstate Explorations (Interstate) owned a leasehold interest in the minerals underlying the surface estate of Morgen Farm and Ranch, Inc. (Morgen). Interstate filed an action against Morgen claiming that Morgen had wrongfully denied Interstate an easement necessary for a power line to operate Interstate's well. Morgen then counterclaimed concerning alleged spills by Interstate. Interstate moved to have Morgen's claim dismissed for a failure to exhaust administrative remedies, but the District Court denied Interstate's motion. On appeal, the Montana Supreme Court affirmed the District Court's decision to deny the motion. Interstate argued that as a claim under the Montana Surface Damages Act, Morgan was required by the Montana Administrative Procedure Act to first pursue its claim before the Montana Board of Oil and Gas Conservation. The Court pointed out, however, that the Surface Damages Act is found in Chapter 10 of Title 82 of the Montana Code while the Board gets its authority from Chapter 11. According to the Court, then, the Surface Damages Act is not subject to an agency or administrative proceeding that must be exhausted before commencing litigation. Further, the Court added that the Surface Damages Act, by its very language, does not require any acts prior to initiating litigation.

II. North Dakota Legal Update

A. Case Law Update

Fleck v. Missouri River Royalty Corp., 2015 ND 287

In Fleck v. Missouri River Royalty Corp., 2015 ND 287, the Supreme Court of North Dakota reviewed an entry of summary judgment dealing with the interpretation of "production" in an oil and gas lease. The Court ultimately reversed and remanded the case concluding that the lower court misapplied the law, misinterpreted the oil and gas lease in question, and that material issues of fact existed rendering summary judgment inappropriate.

This case involved a mineral owner, Fleck, whose predecessors in interest had granted an oil and gas lease in 1972. The lease is now held by the defendant, and is for a primary term of 10 years and as long thereafter as oil or gas is produced. The lease also contains a savings clause which states that it will not expire after the primary term based on a lack of production if the lessee resumes operations to drill a well or restore production within ninety (90) days. Fleck sued to extinguish the lease based on a failure to produce in paying quantities. The district court, however, granted the defendant's motion for summary judgment stating that the lease required only production, not production in paying quantities, and sufficient, continuous production existed to hold the lease.

In reversing and remanding to the district court, the Supreme Court reiterated that in North Dakota "production," when used to define the duration of the secondary term of an oil and gas lease, generally means "production in paying quantities." Because the district court did not interpret the lease this way, the Supreme Court concluded it had misapplied the law in interpreting the lease. The Court then moved on to define how "production in paying quantities" is determined in North Dakota. After noting the tests used in other states, the Court adopted the approach that "production in paying quantities" is based on "whether the well yielded a profit over operating costs over a reasonable period of time and whether a reasonable and prudent operator would continue to operate a well in the manner in which the well was operated under the relevant facts and circumstances." Because this standard presented the court with a genuine issue of material fact, summary judgment was inappropriate.

Finally, the Court also addressed the savings clause and resuming operations, holding that production must be interpreted the same in the saving clause as it was earlier in the lease. As a result, under the savings clause, if production in paying quantities ceases after the primary term, the lease will expire unless the lessee resumes operations to drill a well or restore production within ninety days. This does not require production in paying quantities be restored within ninety days, rather just beginning these operations.

B. Regulatory Update

The Oil and Gas Division of the North Dakota Industrial Commission is proposing a number of new regulations. The proposed rules were released to the public in late February and four public hearings were held around the State on April 11-14, 2016.

Most of the public attention so far has been focused on a proposed definition of "interested party" to be an individual with a "property interest or management interest in or adjacent to the subject matter." Environmental groups, labor unions, and members of the general public have interpreted this proposal as an attempt to keep them from participating in hearings. This has not been a major issue for industry.

More substantively, the proposed rules would substantially increase the regulation of oil, gas and produced water "gathering" pipelines. 2015 House Bill No. 1358 authorized the Commission to require certain filings by operators of gathering lines, including the filing of a bond. The proposed rules would require all such operators to file a detailed notice of intent with the Commission prior to commencing construction of certain gathering lines, to follow certain design and construction practices, and to utilize third-party construction inspectors. The proposed rules also require gathering lines to have a "leak detection and monitoring plan and a spill response plan and pressure testing is required after construction or any repair. Finally the proposed rules include requirements for abandonment of gathering line.

The proposed rules also include a regulatory scheme for "saltwater handling facilities" which is patterned after the existing regulatory scheme for treating plants. The proposed definition of "saltwater handling facility" is very broad and includes any "container and site used for the handling, storage, disposal of deleterious substances" in connection with oil and gas operations. Saltwater handling facilities would need to be applied for and approved separately from the "UIC" or underground injection control permit currently required. All saltwater handling facilities would be required to be bonded unless "already bonded as an appurtenance."

The proposed rules also include a number of new requirements for operators. Gas-oil ratio tests would need to be performed when the pool reaches bubble point or when "there is a significant change." All storage facilities and production sites, including, per the face of the rule, existing facilities and sites, would need to be surrounded by an impermeable perimeter berm at least one foot in height.

The comment period on the rules ended on April 25, 2016. It is expected that final rules will be promulgated sometime in the third quarter of this year.

III. Wyoming Legal Update

A. Case Law Update

Pennaco Energy, Inc. v. KD Co. LLC, 2015 WY 152

On December 2, 2015, the Wyoming Supreme Court issued an opinion upholding the law of assignor liability by holding Pennaco Energy, Inc. liable for its assignee's failure to pay under several surface use and damage agreements. The Court affirmed that a party who assigns a contractual duty remains responsible for performance of that duty, unless the contract contains an exculpatory clause excusing liability after assignment. Assigning parties may also be relieved of assignor liability by obtaining consent to the assignment from the other party to the contract, transferring contractual duties to the new assignee (called a novation). The Court issued its decision in an opinion covering appeals consolidated in two different, but factually similar cases: Pennaco Energy, Inc. v. KD Company LLC (S-15-0019) and Pennaco Energy, Inc. v. First Northern Bank of Wyoming, as Trustee (S-15-0020). In each of these cases, Pennaco Energy, Inc. ("Pennaco") held several oil and gas leases in northeastern Wyoming. Pennaco entered into contracts with the surface landowners, which granted Pennaco access to and use of the landowners' land for exploration and production under the leases. In the agreements, Pennaco committed to pay for damages and for use of the land and, when operations ceased, to restore the land as nearly as possible to its prior condition. Pennaco developed its coalbed methane operation and made the required payments for several years. It then assigned its interest in the surface use and damage agreements to CEP-M Purchase, LLC, which re-assigned those interests to High Plains Gas, Inc. Since Pennaco's assignment, neither Pennaco nor the assignees had made any of the payments to the landowners required under the agreements, nor had they reclaimed any of the land. The surface use and damage agreements at issue did not contain exculpatory clauses relieving Pennaco of liability upon assignment, and the parties did not agree to a novation upon assignment. Pennaco nonetheless argued that the agreements were covenants running with the land, and should only be enforced against the party in privity of estate with the landowners. Pennaco asserted that its privity of estate ceased when it assigned the agreements, and that only Pennaco's assignees should remain liable after the assignment. The Wyoming Supreme Court disagreed with Pennaco, holding that the plain language of the surface and damage agreements entered into between the landowners and Pennaco required Pennaco to perform certain obligations until the coalbed methane operations ceased and the lands were reclaimed. Those agreements did not contain language indicating any intent that Pennaco would be discharged from its obligations upon assignment to a third party. To the contrary, the surface use and damage agreements contained numerous indications that Pennaco's contractual obligations continued even after assignment. According to the Court, under established principles of contract law, and because there was no express clause that terminated Pennaco's obligations upon assigning the agreements to a third party, Pennaco remained liable to the landowners to perform the covenants in the event its assignee defaulted.

B. Legislative Update

Continued Participation in the Energy Producing States Coalition

House Bill 0011 provides funding for the continued participating of Wyoming legislators in the Energy Producing State Coalition. The bill requires that a report be submitted each October which shall include any suggested legislation.

Permit Required for Long Term Storage of Carbon Dioxide Where Increased Risk to

Water Sources

Senate Bill 0028 provides that an operator must now acquire a geological sequestration permit for the injection of carbon dioxide as long-term storage in circumstances where it would pose an increased risk to an underground source of drinking water.

Electronic Recording

House Bill 0107 enacts the Uniform Real Property Electronic Recording Act which authorizes the recordation of instruments signed and notarized electronically and electronic scans of previously authorized instruments.

C. Regulatory Update

On February 10, 2016, the Wyoming Oil and Gas Conservation Commission modified its current flaring rules. Of particular note, the new flaring rules require operators to report the compositional analysis of the gas being emitted. This analysis will be required within 6 months of final rule approval (April 1, 2016) for existing and new wells flaring and venting under the low rate casing head gas rules, and within 3 months of authorization to flare or vent under application (authority) to flare. Further, the new rules decrease the daily venting volume limit from 60 MCF to 20 MCF at lease facilities. The limit on daily flaring volume will remain at 60 MCF for individual oil wells, but is set at 20 MCF per day for venting of casing head gas. In addition to the requirement to file monthly flaring and venting reports, upon completion of flaring authorized by the Supervisor and/or the Commission, a final report shall be submitted to the Supervisor.