

FINAL EXAMINATION
MINING, OIL & GAS LAW

P.N. Davis

Tuesday, May 14, 2002
8:30 - 11:00 AM

THIS IS A TWO AND ONE-HALF (2½) HOUR EXAMINATION.

THIS EXAMINATION CONTAINS SEVEN (7) PAGES.

THIS EXAMINATION CONTAINS FIVE (5) QUESTIONS.

I = 20 min. II = 20 min. III = 40 min. IV = 40 min. V = 30 min.

FILL IN YOUR EXAMINATION NUMBER ON THE BLUEBOOK STICKER.

Instructions:

1. These questions will be graded on the basis of the times indicated with each questions. The indicated time for the questions total 2½ hours. You will be given 2½ hours to write the examination. Budget your time carefully or you may not finish.
2. Be sure to state a result whenever a question asks for one. Merely stating the arguments on both sides of a legal issue will result in only partial credit because you will not have completed the analysis required by that type of question.
3. If you find it necessary to make factual assumptions in order to answer a question, be sure to state the assumption.
4. Do not assume additional facts for the purpose of avoiding a legal issue or making its resolution easier.
5. Comment briefly on each legal issue reasonably raised by the questions and on each reason for your answer, even when you decide that one legal issue or reason controls the result.
6. The difference between triumph and disaster may lie in a **careful** reading of the questions.

I.
(20 minutes)

Defendants, Larry and Betty Foster, executed an oil and gas lease to plaintiff Show-Me Oil Company. The granting clause in the lease gave Show-Me the right to drill a well and lay pipelines. Pursuant to the lease, plaintiff drilled a natural gas well and laid a pipeline from the well across defendants' property. (The well was capable of producing in paying quantities. The pipeline was necessary to connect the well to the interstate natural gas pipeline system.) Because of a dispute about plaintiff's restoring the surface along the pipeline route, defendants refused to allow plaintiff access to the well by blocking the road leading to the well site.

Plaintiff filed suit to enjoin defendants from blocking its access to the well. Defendants filed a counterclaim seeking damages for injury to the surface by the pipeline construction.

Trial court denied plaintiff's request for an injunction and entered judgment for defendants in the amount of \$600.00.

On appeal, should the court uphold or reverse the trial court's denial of the injunction and the granting of damages? Discuss all relevant legal issues. State a result on each the remedy rulings.

II.
(20 minutes)

In 1990, plaintiffs, Ethel Robinson and Lilly Brewster (tenants in common), executed an oil & gas lease with Show-Me Oil Company. The lease contained a production in “paying quantities” clause, a 60-day cessation of production clause, a continuous operations clause, and a “reasonable prudent operator” clause.

Show-Me drilled a natural gas well which it connected through a lateral pipeline to the interstate natural gas pipeline system. This lateral pipeline served several other natural gas wells in the vicinity. For several years, the gas well pressure was high enough that gas flowed naturally through the lateral pipeline. By 2000, however, the gas well pressure had dropped to the point where it was equal to the pressure in the lateral pipeline and gas stopped flowing out of the Robinson-Brewster well, as well as out of some of the other wells in the vicinity. After an interval of 59 days, Show-Me began installation of a compressor on the lateral pipeline to boost its pressure; that installation was completed 7 months later. Three interruptions in installation work of 2 weeks each occurred during those 7 months: (1) heavy rainfall preventing heavy construction equipment from working at the compressor site, (2) the usual annual vacation break for construction workers, and (3) unavailability of a critical compressor component (although ordered in a timely manner). Thereafter, the Robinson-Brewster well again flowed, and, in fact, had the highest rate of flow in its history.

In July 2001, plaintiffs brought suit against Show-Me to cancel the lease for failure to produce for more than a period of 60 days stipulated in the lease. They also sought conversion damages for gas production followed the date of lease termination. Defendants argued the lease had not terminated because it installed the compressor with due diligence.

Should the court hold that the lease was terminated for failure to produce natural gas for more than 60 days, or not terminated? Discuss all relevant legal issues. State a result.

III.
(40 minutes)

The State of Jefferson Oil & Gas Commission established a set of spacing units and imposed compulsory pooling in each of those spacing units. Each 80-acre spacing unit consisted of one 40-acre tract where a well could be drilled and one adjacent 40-acre tract where no drilling from the surface was allowed. Show-Me Oil Company held the lease for the east 40-acre tract, where drilling was allowed. Ferrell Oil held the lease for the west 40-acre tract, where drilling was not allowed. Show-Me Oil proposed to drill a horizontal well beginning with a vertical bore on its own tract to a depth of 9,200 feet and then a horizontal segment west through the Blue River "B" formation into Ferrell Oil's tract and terminating there. The purpose of the horizontal well is to better drain the crude oil from the entire pooled tract.

The Oil & Gas Conservation Law of the State of Jefferson empowers the Oil & Gas Commission to establish spacing units for a pool, "when necessary to prevent waste, to avoid drilling of unnecessary wells, or to protect correlative rights." The Commission may establish the size, shape, location, and boundaries of each spacing unit, "in accordance with a reasonably uniform spacing plan." Each pooling order must provide that the owner of each tract or interest in the spacing unit should recover, "without unnecessary expense, his just and equitable share." Furthermore,

"operations incident to the drilling of a well upon any portion of a spacing unit covered by a pooling order must be deemed, for all purposes, the conduct of such operations upon each separately owned tract in the drilling unit by the several owners thereof. That portion of the production allocated to each tract included in a spacing unit covered by a pooling order must, when produced, be deemed for all purposes to have been produced from such tract by a well drilled thereon."

The Commission created the subject spacing unit under this statute.

Ferrell Oil refused to agree to the proposed horizontal well and when it appeared that Show-Me Oil was going to proceed with its drilling, Ferrell Oil brought suit against Show-Me Oil to enjoin trespass by the horizontal well within its leasehold. Furthermore, Ferrell Oil sought a declaration that drainage of oil from under its leasehold would constitute a conversion. In the alternative, Ferrell Oil sought a declaration that it was entitled to one-half the gross revenues from the well, free of costs.

Show-Me Oil counterclaimed for a declaration that it was entitled to drill the horizontal well under Ferrell Oil's tract and to drain oil from it, subject to payment of a 1/8th royalty on one-half the production from the well, free of costs.

Should the court rule that Show-Me Oil's horizontal well would be or would not be a

trespass if it is drilled under Ferrell Oil's tract? Should it rule that drainage of oil from under Ferrell Oil's tract would be a conversion? What share of gross revenues should the court rule is Ferrell Oil's share, and what portion, if any, of Show-Me's drilling and production costs can be deducted from Ferrell Oil's share of gross revenues? Discuss all relevant legal issues. (Assume that the spacing unit/compulsory pooling statute and regulations thereunder are valid.) State a result for each question.

IV.
(40 minutes)

National Mining Company had acquired its mineral rights and incidental easements for mining phosphate rock on a 75-acre tract in 1943 from the then owners of the fee, Henry Horton and Stella Horton. The conveyance, in the form of a deed, provided:

“[T]he time for mining, quarrying and removing said phosphate rock and phosphatic material ... is to be unlimited, and the same may be mined, quarried, and removed as and when the grantee, its successors and assigns, may elect, without limit as to the time, and all the rights and easement ... may be exercised without limit as to time”

The conveyance provided a specific method for abandonment, that is, the grantee giving written notice to grantors or their successors, removing their equipment, surrendering possession to grantors or their successors, and executing a “proper” written release of all future claims and rights.

During the remainder of the 1940's, National Mining conducted surface and pit mining operations on a portion of the tract. By 1950, it had ceased mining and had removed all of its mining equipment. It did not give written notice or execute a release to grantor. It did remove its gate and “no trespassing” signs. It conducted no mining operations thereafter.

In 1975, Show-Me Mining Company purchased the mineral rights in the tract from National Mining Company.

In 1977, the Holts conveyed the fee to Edward Bonner and Julia Stern (husband and wife).

In 1980, Bonner and Stern reclaimed the surface and established a cattle breeding operation on the tract. In addition to the reclamation, they invested in barns, corrals, feed lots, grain bins, and other out buildings.

In 1998, Show-Me Mining gave Bonner and Stern written notice of its intention of prospect for phosphate material on the tract, “for the purpose of verifying the quality and quantity of remaining phosphate rock on the property.” The notice explained that prospecting would consist of drilling 5-inch holes at random locations throughout the tract, particular in areas not previously mined by National Mining. When Show-Me Mining’s representatives arrived at the tract to carry out the prospecting, Bonner and Stern refused them entry, stating that such drilling would interfere with their cattle breeding operations and would expose their cattle to the risk of stepping in holes and breaking their legs. Assertions by Show-Me Mining’s representatives that they would backfill the holes did not persuade Bonner and Stern to allow them entry.

Thereafter, Show-Me Mining sued Bonner and Stern for an injunction allowing them entry for prospecting. Bonner and Stern counterclaimed for a declaration that the mineral rights had been abandoned by National Mining after mining had ceased about 1950.

V.
(30 minutes)

Briefly define the following terms:

- (1) Pugh clause
- (2) “lands unsuitable for mining”
- (3) “paying quantities”
- (4) nonparticipating royalty
- (5) unitization
- (6) reasonable prudent operator rule
- (7) SMCRA ownership consent alternatives
- (8) delay rental
- (9) “maximum efficient rate”
- (10) open mine doctrine

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I. (20 min.)

Injunction: right of access

- mineral lessee obtains several implied rights: right to explore, right to mine/drill well, right of access to minerals/oil & gas, right to produce
 - here, *right of access* is involved
 - lessee has a *right to produce*, which requires construction of a pipeline to connect the well with the interstate pipeline system
- mineral lease is dominant estate; surface interest is servient estate
- thus, lessor must allow access to minerals at reasonable locations
- blocking access and preventing production both violate lease, and may be enjoined

Damages: right to surface restoration

- common law does not recognize an implied right to surface restoration
 - that obligation must be expressly provided for in lease
- but a couple of states now recognize that implied covenant
 - because of heightened judicial awareness of environmental values
- surface degradation, here along route of pipeline, interferes with useability of surface
- *result*: (may decide either way on \$600 damage award)

II. (20 min.)

cessation of production

- if lessee fails to produce for an unreasonably long period, the lease is terminated
 - often, a lease will define the cessation of work period
 - here, it is 60 days
- lessee is obligated to begin production again within that period

continuous operations clause

- this clause requires lessee to be drilling, producing, or reworking a well by the end of the primary term and thereafter, without a gap of more than a specified period
 - here, that period is defined by the lease as 60 days
- installing a pipeline compressor to enable a gas well to flow is the functional equivalent to reworking a well
- due diligence is required during drilling and reworking
 - continuous work on installation is due diligence
 - normal vacation periods are allowed
 - interruptions due to weather are allowed

result: thus, the court should hold that the lease has not terminated

III (40 min.)

trespass

- ordinarily, a well driller cannot bottom a well under another's tract; that would be a trespass
- however, the spacing unit/compulsory pooling statute provides that oil & gas operations in the spacing unit are "deemed, for all purposes" to be conducted by the several owners thereof
- thus, drilling by Show-Me Oil is treated as drilling by Ferrell Oil
- a person cannot trespass on his own land
- thus, Show-Me Oil's horizontal well would not be trespassing

conversion

- there are 2 ways of looking at the drainage issue:
 - (1) *rule of capture* allows drainage of oil from an adjacent tract
 - drainage by a horizontal well could be so regarded, since it is taking oil from one tract to another
 - (2) typical spacing unit law holds that production from a well is treated as uniformly produced from all tracts and proportionately attributable to each
 - thus, drainage of oil from Ferrell Oil's tract is treated as drainage on behalf of Ferrell Oil, and not by Show-Me Oil on its own behalf
 - the spacing unit/compulsory pooling statute so provides
- thus, there is no conversion

compensation

- a nonoperating lessee within a spacing unit has a choice of participating in operations with the operator or not
 - if it chooses to participate, it is entitled to its proportionate share of gross revenues, subject to its proportionate share of drilling and operating costs
 - if it chooses not to participate, it is entitled to be treated as a grantor of a nonparticipating royalty interest to the operator; as such, it is entitled to a royalty on its proportionate share of production (typically a 1/8th share)
- the critical issue is when the nonoperating lessee must decide whether to participate
 - in majority rule states, the choice can be made after it is determined whether the well is a producer in paying quantities
 - in Oklahoma, the choice must be made at the time the operator decides to begin drilling
- assuming that the majority rule prevails in the State of Jefferson, Ferrell Oil can elect to participate after the horizontal well is completed; then it is entitled to one of the two forms of compensation mentioned above
 - since Show-Me Oil and Ferrell Oil have equal size tracts, the gross production for purposes of the compensation calculations, will be divided in half
 - in no case will Ferrell Oil be entitled to one-half the gross revenues free of costs
 - Show-Me Oil will not be entitled at this time to a declaration imposing a nonparticipating royalty interest on Ferrell Oil

IV. (40 min.)

right to prospect and explore

- a mineral grantee and mineral lessee have several implied rights (access to the minerals, development, production)
- among them is the right to explore and prospect for minerals
- this includes a right to do further exploration and prospecting after mining has begun
- this right continues as long as the mineral rights remain effective
- thus, grantor cannot deny access to grantee/lessee for purposes of exploration and prospecting
 - the mineral grantee/lessee has the dominant interest; the grantor/surface owner has the servient interest
 - to deny access is to violate the dominant right of grantee/lessee
- here, Show-Me Mining is entitled to an injunction allowing access for exploration and prospecting

abandonment

- the access right is retained by grantee/lessee until the mineral interest is terminated
- a mineral grant cannot be lost by abandonment through non-exercise of the mineral right
 - it can be lost only by an affirmative abandonment or release
- by contrast, a mineral lease can be lost by abandonment by non-use for a period of time
 - the period of time typically is the period of the statute of limitations
 - here, the statutory period is not specified; in no state does it exceed the common law period of 21 years
 - here, the non-use continued from about 1950 to 1987 (when the notice of exploration was sent), a period of about 37 years (well beyond 21 years)

mineral fee or mineral lease?

- the abandonment issue is determined by whether National Mining acquired a mineral fee or mineral lease
- a mineral fee lasts in perpetuity; a mineral lease lasts for a reasonable period for mining to begin + the period of mining + a reasonable period of cessation of mining
- factors:
 - the conveyance was by deed
 - mining specifically was allowed “without limit as to time”
 - [the granting clause is not described]
- “deed” implies that typical “grant, bargain, sell and convey” language was used
 - thus, in form it would look like conveyance of a mineral fee
- the right to mine was in perpetuity
- thus, this looks like a conveyance of a mineral fee in perpetuity

result

- the conveyancing factors resulting in conveyancing of a mineral fee mean that the mineral right cannot be lost by nonuse
- thus, there can be no abandonment
- thus, Show-Me Mining has a right to enter the Barton/Stern tract for exploration
- the requested injunction should be granted; the requested declaration of abandonment should be denied

V. (30 min.)

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