Attachment 1

UNITED STATES
DEPARTMENT OF THE INTERIOR
OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20240

MAY 2 1983

Memorandum

To: Eastern States Director, Bureau of Land Management

From: Associate Solicitor, Energy and Resources

Subject: Federal Jurisdiction over Acquired Private Leases in Ohio

The inquiry regarding federal jurisdiction over acquired private leases arises out of the situation found in the Wayne National Forest in Ohio. The United States, for a number of years, has been acquiring lands which are subject to recorded mineral (usually oil and gas) reservations. In purchasing the land, the United States has acquired mineral rights incident to the property and has received the lessor's interest in the leasehold estate. In the past, in assuming its role as lessor, the Bureau of Land Management has assigned government lease serial numbers to the acquired leases and forwarded the leases to the United States Geological Survey (USGS) for supervision of the leasehold operations. 1/ Operations supervisors have asked whether or not the current federal statutory scheme, 30 U.S.C. § 181 et seq., and accompanying regulations, 30 CFR Part 221 and 43 CFR Group 3100, could be applied in the administration of these leases.

We conclude that the current federal regulatory scheme cannot be applied to those leases acquired by the purchase of the land (or mineral estate) they are part of. This conclusion, however, does not mean that the government is precluded from supervising. the leasehold estates in a meaningful fashion; rather, we conclude that the government has a number of rights granted either explicitly or implicitly by the leases themselves as well as those rights which flow inherently from a lessor-lessee relationship. These rights provide the government with authority to administer the leases in keeping with

1/ By Secretarial Order No. 3087, 48 Fed. Reg. 8983 (March 2, 1983), these functions were transferred to the Bureau of Land Management.

the government's interest in the land. The basis for our conclusion and an outline of those rights vested in the United States as lessor are set out below.

I. Applicability of the Federal Regulatory Scheme.

As a purchaser of land subject to an existing leasehold the government's rights are limited. Where a lessor sells his interest in the leasehold, the purchaser steps into the shoes of the lessor and acquires no greater nor lesser rights in the lease than the prior lessor had. 4 Summers, Oil and Gas, S 652 (1962). Thus, the fact that the purchaser is the government does not automatically make the leases subject to current government regulations. Instead the government must step in and administer the leases under the same rights and limitations the prior lessor possessed. Under the leases acquired by the government, the rights and limitations to which the government has acceded would be only those which flow from the terms of the leases themselves or the common law rights created by the lessor-lessee relationship.

A review of the individual leases you submitted reveals that almost nothing was specified by the original parties to the leases as to the form or the content of lessor's administration of the leases. Moreover, there is no provision in the leases which would make them subject to the federal regulatory scheme. Reference to the Mineral Leasing Act of 1920,
30 U.S.C. § 181 et seq. (MLA), and the rules and regulations promulgated thereunder makes it clear that these acquired leases cannot be administered on the same basis as a federal lease. The current regulations, 30 C.F.R. Part 221, which lay out the operating rules for oil and gas leases, make it clear in their definitions of "lease," "leased land," "leasehold", and "lessee" that only leases issued by the government and specifically made subject to the regulations found in the Code of Federal Regulations can be governed by these rules. Since these leases were not made subject to the federal regulations either by express provisions or *by* the mere fact that the government acquired them, they are excluded from the operation of the current federal regulations.

In addition, the recently enacted Federal Oil and Gas Royalty Management Act, Pub. L. No. 97-451, 96 Stat. 2447 (1983), would not apply to the administration of these leases. That Act applies only to leases issued under "mineral leasing laws," id. § 3(5), which in turn are defined as laws authorizing disposition of oil and gas. Id. § 3(8).

The rights the government can enforce under the leases will be outlined below. It must be observed that all of the rights of the government under instruments such as the acquired leases are based on common law principles as articulated by the courts. In outlining these rights, Ohio cases, where available, will be referred to and discussed. Where Ohio courts have not addressed certain pertinent rights, reference will be made to available, nearby precedent, which are instructive on the approach the Ohio courts would use. Since the core of rights the government possesses are based on common law principles or judicial construction, the remedy available for a lessee's violation of a governmental interest is a judicial procedure in the form of a suit for damages, or to have the lease cancelled, or an action for an injunction to prevent continuation of the harm, or any combination of these remedies. This does not mean, however, that the only means of enforcing the government's rights is in the form of a court action. As the landlord, the government can promptly notify the lessee of uses which we consider unnecessary, wasteful or negligent and which could or do interfere with the government's responsibility to preserve the surface estate. The government should then move to work with the leaseholder to negotiate a remedy before any court action is taken. Obviously, this course of action strengthens the government's position as a reasonable lessor should a lawsuit prove necessary.

II. The Government's Rights Under the Leases

The rights which the government possesses are necessary implications to the lessor-lessee relationship created by the nature of the oil and gas lease. While in most instances the government can require the lessee to comply with standards which generally parallel the requirements found in the existing regulatory scheme for federal leases, the government's ability to enforce compliance is restricted to judicial action. The rights of the government can best be understood in the following way.

Where there is a severance of mineral ownership or operating rights from the rest of the estate, the owner of the severed mineral estate has certain surface rights, e.g.., necessary access to develop the minerals, or else the ownership rights would be meaningless. Mineral ownership will of necessity carry with it inherent surface rights to accomplish that development. From this the courts have recognized that the mineral owner has what is termed the dominant estate, that is, the mineral owner or lessee has rights to utilize the surface

which are dominant to the surface owner's rights to exercise his control over the same surface area. The surface estate is servient or, in other words, charged with a servitude for the essential purpose of development. Kinney-Coastal Oil Company v. Kieffer, 277 U.S. 488 (1928) (an oil and gas estate reserved in a homestead under the Act of July 17, 1914, and leased under the MLA creates a dominant estate of the subsurface minerals and a servient estate in the surface; here the mineral holder succeeded in enjoining the surface owner's use of the land where his use was inconsistent).

The question is what is appropriate and what is inappropriate use of the surface to develop the mineral estate. If the use is inappropriate, the government has a cause of action either to enjoin the practice or to recover money damages. The first place to look to establish the extent of the permitted uses of the surface estate by the lessee would be the provisions of the lease. The leases you have provided are completely devoid of relevant language which would serve as a means of defining the extent of the lessee's right to use the surface area. Where the relationship has not been set out in the contract, the courts have established the following standards to answer the questions of how much of the surface can be used and which uses are proper.

First, the mineral rights holder can use and occupy only so much of the surface as is reasonably necessary or incident to enable him to find, develop and produce his leasehold. 1 Thornton, The Law of Oil and Gas, S 131 (Willis, 5th ed. 1932); Kunz, Oil and Gas Rights, S 10.28 (1954). Second, where the mineral operator's basic right to the surface use is established, and that he is occupying only so much of .the surface as is reasonably necessary to accommodate his particular operation, then in developing the mineral holding the operator must behave with proper regard or due care for the surface
owner's rights. 1 Williams and Meyers, Oil & Gas Law, S 218 (1983); Kulp, Oil and Gas Rights, § 10.58 (1954); 53 A.L.R. 3d 16 (1954). A breach of either of these two standards--reasonable use and due care--entitles the surface owner to either damages or injunctive relief. While these two standards have been applied on a case-by-case basis the following guidelines can be gleaned from the cases. While there are some court decisions which run counter to the cases outlined below (see generally 53 A.L.R. 3d 16 (1954)), these cases present the strongest precedent for lessor control, and support the government's position of taking an active role in protecting the leasehold.

A. Flow of Deleterious Materials onto the Surface of the Leasehold. In a number of jurisdictions the courts have considered the flow of deleterious materials such as oil and salt water from the well or pits onto parts of the land not essential to the operation of the wells. An oil and gas lessee has the right to go upon the land for all reasonable purposes to explore and drill, but he cannot intentionally or negligently damage any more of the land surface than is necessary to accomplish his purpose. Any flow of harmful materials onto land adjacent to the lessee's operation that is intentional, careless *or* negligent and that does damage to the surface of the land not necessary for development or maintenance of the well can be prevented by the lessor. See Blue v. Charles F. Hayes & Associates, Inc., 215 So. 2d 426 (Miss. 1968); *Currey* v. Ingram, 397 S.W.2d 484 (Texas Ct. App. 1965).

B. Waterflooding Operation. In a Kentucky case, the court held that the use of the surface by the lessee in connection with a water flooding operation which was not contemplated or addressed by the parties at the time the mineral estate was leased was not a reasonably necessary use of the land and could be prohibited by the lessor. Wise Oil Co. v. Conley, S.W.2d 718 (Ky. 1960). Since none of the leases you ~provided makes any reference to waterflooding the government can prohibit the use of the surface for such activities and enforce that prohibition by judicial action.

C. Use of the Surface for Exploratory and Seismic Operations.
In the following case the court found that the use of the surface of the land overlying the minerals by the defendant in connection with seismographic operations, generally an acceptable use, exceeded the general rights of the lessee to occupy the surface because the lessee constructed a landing strip to aid in performing the seismographic operation. United Geophysical Corp. v. Calver, 394 P.2d 393 (Alaska 1964)." This case may be factually inapplicable to the leases at issue, but it illustrates the principle that even permissible activities can be done unreasonably, and thus all activities of the lessee can be carefully monitored.

D. Use of the Surface for Location, Construction and Maintenance of Wellsites and Production-related Facilities. While it is generally the case that the construction or maintenance of wellsites, slush pits, ditches, storage tanks, reservoirs and pickup stations are within the general rights given lessees to develop the mineral estate, there are some instances where the manner in which they

are maintained is inappropriate, and can give rise to an action by the lessor to prevent damage to the surface estate because of those conditions.

For example, in Smith v. Schuster, 66 So.2d 430 (La. App. 1953), an action was brought by the lessor to recover damages allegedly caused by the drilling and production operations of the mineral leaseholder. The court allowed the lessor to recover his expenses for leveling and filling pits which were no longer required and for clearing off debris left as a result of the drilling operations. The court applied the principle that a mineral lessee has no right to extend his operations on the lease beyond that was reasonably necessary to produce minerals effectively under the terms of his lease, and should restore the premises to the condition in which he found them. Although this kind of approach is rarely used by the court, the government should be mindful that the courts can be asked to go so far as to require restorative work.

It should also be noted that the courts have held that where the wellsites or pits are too large, the lessee's action can be enjoined or damages assessed. Union Producing Co. v. Pittman, 146 So.2d 553, 245 Miss. 427 (1962) (wellsite too large); Wilcox Oil Co. v. Lawson, 301 P.2d 689 (Okla. 1956) (slush pit too large). Other courts have held that the choices of sites for the well can be inappropriate. Reading & Bates Offshore Drilling Co. v. Jergenson, 453 S.W.2d 853 (Tex. 1970): (well placed within three feet of ensilage pit over surface owner's protest): Gulf Pipe Line Co. .v. Pawnee Tulsa Petroleum Co., 34 Okla. 775, 127 P. 252 (1912) (well placed within a few feet of a manifold pit). In short, the lessor can have an active, though limited, role in how the surface is utilized to fulfill the lessee's need to develop the mineral estate.

E. Construction and Maintenance of Buildings. As a general proposition the courts have allowed the lessee to build structures necessary for the. development of the leasehold. The courts have been restrictive, however, in allowing. the use of the leasehold for residence purposes absent a strong reason to the contrary. See Fowler v. Delaplain, 79 Ohio 279, 87 N.W. 260 (1909): Atlantic Refining Co. v. Bright & Schiff, 321 S.W.2d 167 (Tex. Ct. App. 1959): Tomlinson v. Bailey, 289 P.2d 384 (Okla. 1954). These cases indicate that only where it is necessary for the supervision of the well and production therefrom is there sufficient reason to allow construction of a dwelling: mere convenience is not enough. See also Kinney-Coastal Oil Co. v. Kieffer, 272 U.S. 488 (1928).

F. Use of the Surface for Construction and Maintenance of Pipelines. Construction of pipelines or collection systems is an appropriate use of the surface estate, but the courts have found that where the construction was needlessly destructive, Kentucky West Virginia Gas Co. v. Cruss, 258 Ky. 508, 80 S.W.2d 537 (1935), or where the pipeline is carelessly installed, Tomlinson v. Bailey, 289 P.2d 384 (Okla. 1954): Texaco, Inc. v. Joffrion, 363 S.W.2d 827 (Tex. Ct. App. 1962), the lessor can seek damages or other relief.

G. Use of the Surface for Roads and Vehicular Traffic. The lessee has an implied right of access for ingress and egress and may use a reasonable area of the surface for that purpose. Rohner v. Austral Oil Exploration Co., 104 So.2d 253 (La. 1958): Central Co. v. Shows, 246 Miss. 300, 149 So.2d 306 (1963): Sun Oil Co. v. Namary, 251 Miss. 631, 170 So.2d 24 (1964): Gulf Oil Corp. v. Whitaker, 257 F.2d (5th Cir. 1958). But where too much land is used, Arkansas Louisiana Gas Co. v. Wood, 240 Ark. 948, 403 S.W.2d 54 (1966), or where a roadway is negligently built or maintained, Illinois Basin Oil Assoc. v. Lynn, 425 S.W.2d 555 (Ky. 1968), Hurley v. Northern P.R. Co., 153 Mont. 199, 455 P.2d 321 (1969), or where unnecessary roads are constructed, Denver Producing & Refining Co. v. Muker, 188 P.2d 858, 199 Okla. 588 (1948), the courts have awarded damages or injunctive relief to the injured lessor.

H. Use of the Surface for Storage. The construction of storage facilities on the lease premises is a proper use of the surface, but the courts have considered what is a reasonable use on a case-by-case basis. See Luttrell v. Parker Drilling Co., 341 P.2d 244 (Okla. 1959): Schlegel v. Kinzie, 148 Okla. 93, 12 P.2d 223 (1932). Essentially the courts have awarded damages where the storage area was. either larger than necessary or negligently maintained.

I. Depository for Unused or Unwanted Material. Use of the surface of the land by the lessee as a depository for unused or unwanted materials and debris was found to be a clear misuse of the surface estate. The courts have found that both a cause of action for damages and for injunctive relief are appropriate. Illinois Basin Oil Assoc. v. Lynn, 425 S.W.2d 555 (Ky. 1968) (litter and burned pieces of cable, timber and pipe were left): Schlegel v. Kinzie, 148 Okla. 93, 12 P.2d 223 (1932) (injunctive relief to remove trash, pipe, structures, and odds and ends).

J. Surface Use for Shutdown and Removal Operations. The lessee can properly use that portion of the surface estate necessary for removal of any materials used in the development of the mineral estate, McLeod v. Cities Service Gas Co., 131 F. Supp 449, aff'd, 223 F.2d 242 (lOth Cir. 1955); Rennie v. Red Star Oil Co., 78 Okla. 208, 190 P. 391 (1920), but must do so in a workmanlike fashion. As mentioned in paragraph D above, the courts have been reluctant to enforce an implied requirement that that the lessee restore the surface to a pre-exploration and development condition. Warren Petroleum Corp. v. Monyingo, 304 S.W.2d 362 (Texas 1957); Daubrer v. Lee, 137 Cal. App. 2d 797,291 P.2d 73 (1955); Oceana Oil Producer, Inc. v. Portland Silo Co., 229 Ind. 656, 100 N.W. 2d 895 (1959). But see Smith v. Schuster, 66 So.2d 430 (La. App. 1953) (lessee required to restore the land to predevelopment conditions).

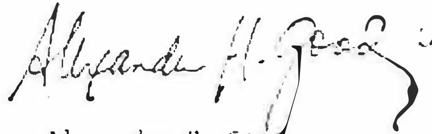
K. Right to Verify Production and Accounting Records. Where .the landowner is the recipient of royalties under the leases, the courts have recognized a limited right of inspection and accounting with regard to the production from as the property. 1 Summers, Oil and Gas, S 31 (1954). Where the government suspects that the oil and gas resources are being wasted or improperly reported a receiver can be requested, or injunctive relief can be applied for. Id. § 30 and § 35.

III. Conclusion

The current regulatory scheme applied to federal oil and gas leases cannot be applied to private leases acquired by the United States. As lessor, the United States has certain rights to the surface of the land and a clear interest in regulating its use. The United States has all the powers reserved to it by the lease, and all powers necessarily implied from the common law lessor-lessee relationship. The courts have outlined. which actions by the lessee can or cannot be prohibited by the lessor. All of the lessees' actions should be weighed against the general standards of reasonable necessity and due care. Where, in your opinion, the lessee's actions go beyond generally recognized uses, or the use is excessive, it can be a violation of the government's rights, and you can take appropriate action. Also, if the United States, as lessor, is in the position of receiving the royalty payments provided for under the lease, the government can make reasonable demands for accounting of production and limited monitoring privileges incidental to the right to receive payment.

Two possible approaches to handling the problem of administration of these acquired leases are readily open. First, the present lessees could be encouraged to exchange their current leases for federal leases which conform to current regulations, thus clearly establishing the rights and duties of both the government and the lessee. These outstanding interests can
in our view be treated under section 5 of the Mineral Leasing Act for Acquired Lands, 30 U.S.C. S 354, and future interest leases can be issued for the oil and gas interest the United States will have upon relinquishment or expiration of the private lease. The lessees cannot be compelled to "exchange" their current leases through future interest lease applications, but if they are agreeable, you can proceed under those rules. 43 CFR Subpart 3150. Second, in keeping with the law as it now exist, and as outlined above, you may draft operational guidelines which can be given to the lessees clarifying what the government expects of these acquired lessees. Such an outline could be a general recitation of the government's concepts of "due care" and "reasonably necessary" surface use, incorporating requirements found in the current regulations as appropriate. If the lessee were willing to agree to such an outline or description of due care, it would alleviate the need for legal action to vindicate the government's rights.

If you have further general questions, or you need assistance in action with respect to specific leases, please contact David Thomas of the Branch of Onshore Minerals, who has studied this matter.



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cc: Director, BLM (530)