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* ARTICLE *

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LIABILITY OF OIL AND GAS INTEREST OWNERS UNDER HAZARDOUS SUBSTANCE LAWS

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I. "STATUS" LIABILITY. The newest breed of environmental laws seek to achieve their goals by imposing liability on persons that have a certain relationship with property where a hazardous substance is found. Typically this relationship is "ownership" or "operation" of *the property*. However, it also includes those having a relationship with *the hazardous substance* that is found on the property: those who created ("generated") the substance and those who had a role in moving the substance to the property ("arrangers" and "transporters"). The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), is the primary law that gives rise to this sort of "status" liability. However, the Resource Conservation and Recovery Act (RCRA), the Clean Water Act (CWA), and the Oil Pollution Act (OPA) each impose their own brand of status liability that may pick up situations that are not otherwise

operation of oil and gas interests.

II. THE MIRAGE OF EXCLUSIONS AND EXEMPTIONS. Many persons in the oil and gas industry believe that the "petroleum exclusion" under CERCLA and the exploration and production "associated waste exemption" under RCRA effectively remove oil and gas properties and operations from the hazardous waste arena. Although each law contains special exceptions from its application to the oil and gas industry, the courts have generally held that each statute, and its associated exemption, does not apply to other statutes that could otherwise be used to address the situation. For example, the petroleum exclusion under CERCLA does not limit the Environmental Protection Agency (EPA) or third parties from addressing petroleum under the OPA, CWA, and RCRA. Similarly, wastes excluded from hazardous waste regulation under RCRA may nevertheless create liability under CERCLA or the CWA or OPA. *See generally, Zands v. Nelson*, 779 F. Supp. 1254, 1257 (S.D. Cal. 1991) (RCRA applied to CERCLA-excluded petroleum).

III. CERCLA LIABILITY. CERCLA liability is triggered whenever there is a release, or threat of a release, of a hazardous substance. The presence of the hazardous substance generally defines the

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covered by CERCLA liability. Each of these laws can apply to the ownership, development, and

"facility" that necessitates a cleanup to protect public health or the environment. The potentially responsible parties include persons having any one of the following relationships with the "facility":

1. Present "owners" or "operators" of the facility;
2. Owners or operators at any time hazardous substances were disposed of at the facility;
3. Persons who generated hazardous substances found at the facility;
4. Persons who arranged for disposal of hazardous substances at the facility;
5. Persons who transported hazardous substances to the facility and selected the facility;
6. Interim owners of the property who did not own it at the time of disposal, but discovered that disposal had taken place on the property and then failed to disclose this fact to their purchaser.

This article addresses the extent to which owners of oil and gas interests could come within one or more of the CERCLA responsible party categories. CERCLA § 107(a)(1)-(4), 42 U.S.C. § 9607(1)-(4) (1988); § 101(35)(C), 42 U.S.C. § 9601(35)(C) (1988).

A. RELATIONSHIP WITH A "FACILITY". The first step in identifying responsible parties is to identify the "facility" at which hazardous substances have been placed. In the oil and gas context the facility could be an abandoned or active drilling, reserve, evaporation, or other type of pit where a hazardous substance has been placed. It could include areas at or near the well site where chemicals have been used in reworking, testing, fracing, acidizing, or otherwise treating the well. It could be a compressor, dehydrator, separator, storage tank, or processing plant site where chemicals have been used or wastes disposed through the years. It could be a

site where oil and gas drilling or operation wastes have been taken for disposal. Liability for these substances does not require any sort of unlawful or improper disposal activity. In most instances, the disposal practices of the industry giving rise to liability will be the result of lawful conduct that complied with the appropriate industry standards, and all applicable environmental laws, at the time of disposal. This further demonstrates the "status" aspect of the liability: you may not have caused the pollution, you didn't do anything morally or legally "wrong"--you just happen to have the requisite statutory status with the property.

If the requisite status is found, the person will be liable for the cost of whatever cleanup is deemed necessary to protect public health and the environment. Although the statute provides a mechanism for recouping cleanup costs from other responsible parties for their contribution to the problem, if such parties are unable to pay their share of the costs, the responsible parties who can pay will often be required to pick up the total cleanup tab.

The concept of "owner" under CERCLA can include persons who merely own an interest in a facility. To date, courts have generally looked to a person's ownership interest to evaluate the degree of control that interest permits them to exercise over the property. For example, even though the owner of a severed surface interest may have no ownership interest in the mineral estate, activities on the surface to develop the mineral estate can impose CERCLA liability on the surface owner--as well as the mineral interest owner. If there is an abandoned pit on the property, or other contamination associated with oilfield development, the surface owner will have a substantial amount of control over the site and, for CERCLA purposes, is an "owner" of the facility. *See generally, Quaker State Corp. v. U.S. Coast Guard*, 681 F. Supp. 280 (W.D. Pa. 1988) (surface owner held to be "owner" under Clean Water Act and therefore responsible for cleanup of oil containment pit).

B. CERCLA "OWNERS" IN AN OIL AND GAS CONTEXT. The "owners" in the oil and gas context can include: surface owners, mineral owners, oil and gas lessees, assignees, farmees, interest owners in a "contract area" under an operating agreement, and interest owners in a

pooled or unitized area. Indeed, a plausible argument can be made that every party that comes into contact with the development process can become some sort of CERCLA owner, operator, generator, arranger, or transporter. The only party that escapes liability will be the end user who merely purchases or acquires the product--regardless of how contaminated the "facility" is from which the production was obtained.

An owner of a nonparticipating royalty (conveyed by the mineral interest owner), or an overriding royalty (conveyed by the working interest owner), may be able to escape liability by arguing they do not own an interest in the contaminated "facility." Instead, they own only a right to a share of production, or money measured by production. However, to the extent local law gives them the right to compel development of the property to generate the production or money, the party granting the interest may be viewed as their contractor for development. This could impute the mineral interest or working interest owner's CERCLA liability to the otherwise "passive" royalty or overriding royalty interest owner.

C. CERCLA "OPERATORS" IN AN OIL AND GAS CONTEXT. Liability as an "operator" would include the oil and gas lessee--arguably even if they are merely a nonoperating working interest owner in a designated "contract area." For CERCLA purposes, the operator designated in the operating agreement will most likely be viewed as the other working interest owners' contractor to develop the property for their benefit. The acts of the operator, and the contractors it hires (such as drilling contractors and service companies), will be imputed to all parties to the operating agreement. *See generally, Branch v. Mobil Oil Corp.*, 788 F. Supp. 531, 533 (W.D. Okla. 1991) (nuisance law).

However, the actions of the oil and gas lessee, and its contractors, might not be imputed to its lessor. Most oil and gas leases give the lessee the *option* to develop the leased land. The oil and gas lease is more in the nature of a distinct property interest that, once granted by the lessor, is not under the lessor's control. Although the lease may terminate if the lessee fails to develop, the lessee is under no obligation to develop. As long as this element in the relationship exists, courts will have

a difficult time in characterizing the lessee as the lessor's contractor. However, this will not impact the lessor's potential liability as an "owner" of the surface estate and mineral estate. It will merely relieve the lessor of liability as an operator, generator, arranger, or transporter. If the lessee is viewed as the lessor's contractor, the lessor's liability would be expanded to include off-lease sites where the lessee takes hazardous substances for disposal.

The concept of "operator" under CERCLA has proven to be very broad and generally includes anyone that exercises control, or has the right to control, the facility. *See Nurad, Inc. v. William E. Hooper & Sons Co.*, 966 F.2d 837 (4th Cir. 1992). As noted previously, this could include a nonoperating working interest owner authorizing development through a designated operator. It would certainly include the designated operator. It could also include the bulldozer contractor hired to prepare a drill site--since they have, for a brief moment, limited control over the work site. The drilling contractor, and other service contractors, could also be considered operators if they exercise control, or have the authority to control, when the disposal activity takes place. *See Kaiser Aluminum & Chemical Corp. v. Catellus Development Corp.*, 976 F.2d 1338 (9th Cir. 1992).

IV. MANAGING STATUS LIABILITY. The technique for managing status liability prospectively is simple to state, but difficult to follow: **Avoid the "status" by not becoming an owner or operator of property where hazardous substances exist or will be generated.** To practice this technique, it requires information about the environmental condition of the property you plan to acquire. This information can be obtained through contractual representations by the current owner and independent investigation by the prospective owner. If the property presents a problem, avoid purchasing, leasing, drilling, or otherwise having any sort of interest in the property; consider whether the problem area can be excised from the balance of the property interests. For example, suppose you want to lease Section 30 but there is an old oil and gas development site in the Northwest Quarter that may be an environmental problem. In the lease you could provide for the exclusive right to extract oil and gas from Section 30 but disclaim any right to enter or use the

surface and subsurface area where the suspected contamination is located. The lessee in such a case would arguably have no ownership interest in the problem "facility" nor would they have any "right to control" the facility.

A second management technique, which could apply to existing as well as prospective relationships, requires: **Vigilant policing of activities conducted on the property by anyone having a concurrent right in the property.** Since any activity on property in which you have an interest could give rise to your status liability, you want to try and control what others do on the property. When creating new interests in the property, such as conveying or leasing a mineral interest, the grantee's rights should be tailored to limit or control their ability to increase your environmental liability. This can be done by limiting the scope of the rights granted and through restrictive covenants. For existing interests, the focus will be on what is "reasonable use" of the granted interest in conducting development.

A third management technique, when acquiring new property interests or permitting others to use your property interests, requires: **Precise allocation of known and unknown environmental liabilities among the parties supplemented with agreements to reimburse (indemnify) one another for defined situations.** The mineral deed, oil and gas lease, assignment, farmout, operating agreement, drilling contract, unitization agreement, and other conveyances or contracts affecting the property should address which party will be responsible for existing and future environmental

conditions on the property. Although these agreements will not in any way relieve a party from liability to the government or third parties, they will be effective to define the rights of the parties to the transaction. Once the liabilities are allocated, the parties can define to what extent they will reimburse one another in the event a problem arises. Contractual indemnities are often used to leverage known and unknown environmental risks associated with a transaction. As with any contract, however, the indemnity is only as good as the party making the promise to indemnify.

V. CONCLUSION. Persons owning or participating in the development of oil and gas interests are subject to significant environmental risks. However, proper transaction planning and property management can substantially reduce the risks. At this stage of the industry's environmental

NEXT ISSUE:

An Overview of Stormwater Permitting in the Energy Industry

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evolution, the key will be recognizing the potential for such liabilities so they can be addressed or avoided.

*** JUDICIAL DEVELOPMENTS ***

1. **Bank's claims against gas company for environmental damage dismissed.** *City of Minneapolis v. Arkla, Inc.*, 1993 WL 61827 (D.Minn. Feb 18, 1993).

Minnegasco, a division of Arkla, Inc., owned and operated a gas plant in Minneapolis until 1961. During its operations, Minnegasco disposed of contaminants on part of the property. Through mesne conveyances, the Minneapolis Parkland Recreation Board became owner of the property under note and mortgage to First Bank,

N.A. The Recreation Board subsequently ceased making payment on the note and sued Minnegasco for response costs and damages when it later determined the property was contaminated. First Bank intervened in the case and asserted causes of action for: violation of the Minnesota Environmental Response and Liability Act (MERLA); strict liability; nuisance; and, negligence. The court dismissed the claims finding: the MERLA claim was barred by the statute of limitations; the strict liability claim is only available to adjoining or neighboring landowners; the nuisance claim re-

NOTE:

CAA - Clean Air Act

**CERCLA - Comprehensive
Environmental Response,
Compensation and
Liability Act**

CWA - Clean Water Act

**RCRA - Resource Conservation
and Recovery Act**

quired the right to use, enjoy or possess the property and First Bank's security interest did not satisfy any such right; and, any injury to First Bank under the negligence claim was not foreseeable.

2. **Florida Supreme Court reverses itself on application of pollution exclusion.** *Dimmitt Chevrolet, Inc. v. Southeastern Fidelity Insurance Corp.*, No. 78,293 ___ S.E.2d ___ (Fla. July 1, 1993).

On motion for rehearing, the Florida Supreme Court reversed its position on the meaning of the phrase "sudden and accidental" as used in the pollution exclusion of the applicable insurance policies. The court found the phrase to be unambiguous and meaning abrupt and unintended thus precluding coverage for long term pollution. The court previously determined the word "sudden" to be ambiguous and found the exclusion did not preclude coverage for pollution caused by long-term pollution from the disposal and leakage of waste oil. (See No. 4, Judicial Developments, Vol I. No. 4, page 4, for a synopsis of the court's earlier decision).

3. **CAA does not preempt state common law claims against oil companies.** *Gutierrez v. Mobil Oil Corp.*, 798 F.Supp. 1280 (W.D. Texas 1992).

The plaintiff landowners commenced this action against six oil companies which allegedly own and operate a large, multi-tank storage facility for gasoline, petroleum, and other fuel products. The plaintiffs allege gross negligence, nuisance and trespass by the companies for permitting toxic substances to escape from the facility and contaminate their air, land and water. The plaintiffs also seek injunctive relief to stop the use of the facility. The defendants removed the case to federal court asserting the plaintiffs' claims are preempted by

the CAA and, therefore, a federal question exists. The federal court subsequently remanded the action to state court finding that the CAA does not preempt purely state common-law claims involving non-diverse parties. The federal court noted the defendants' only use of the CAA will be defensively through evidence of their compliance with the CAA.

4. **Successor corporation liable for response costs under CERCLA.** *HRW Systems Inc. v. Washington Gas Light Co.*, No. S-91-3143, (D.C. Md. June 9, 1993).

Corporate predecessors to Washington Gas Light Co. operated a gas plant which allegedly caused hazardous waste contamination. Washington Gas was sued on claims under CERCLA based on successor liability. The court granted partial summary judgment against Washington Gas finding it engaged in substantially the same business and there existed a continuity of enterprise between Washington Gas and its predecessor. Specifically, the court found Washington Gas assumed both the assets and liabilities of its predecessors and there was substantial continuity of directors and complete continuity of officers and employees.

5. **Offshore lessee has cause of action for loss profits under the Oil Pollution Act.** *Sekco Energy, Inc. v. M/V Margaret Chouest*, 820 F.Supp. 1008 (E.D. La. 1993).

Sekco Energy, Inc. owned and operated a leasehold interest and drilling platform off the coast of Louisiana. While towing seismic cable, the defendant companies allowed cable to strike the Sekco platform. The cable ripped open spilling Isopar M oil into the surrounding waters. The defendants did not report the spill but third parties noticed the oil sheen and reported it to the Minerals Management Service. The MMS shut-in the platform to investigate the pollution. Sekco sued the defendants on several causes of action, including Sekco's right to loss profits under the Oil Pollution Act of 1990 during the shut-in time period. On motions for summary judgment, the court found such action can be maintained citing 33 U.S.C. §§ 2702(b)(2)(E):

(E) Profits and earning capacity

Damages equal to the loss of profits or impairment of earning capacity due to the injury, destruction, or loss of real property, personal property, or natural resources, which shall be recoverable by any claimant.

6. **Insurer prejudiced by pipeline's late notice of PCB contamination.** *In re Texas Eastern Transmission Corp.*, No. 92-1638, MDL No. 764, _____ F.2d. _____, 1993 (3rd Cir. May 28, 1993).

Texas Eastern Transmission Corp. asserted that its insurers should be responsible for \$750 million in cleanup costs associated with 89 PCB-contaminated compressor sites. The appeals court, however, affirmed the district court's earlier decision that Texas Eastern's eight month delay in notifying its insurers of the contamination prejudiced the insurers and relieved them from coverage liability. The prejudice resulted from Texas Eastern's field investigations and extensive negotiations with the EPA prior to notification. (See No. 6, *Judicial Developments*, Vol. I No. 2, page 4, for a synopsis of the district court's decision).

7. **Oil spill raises several issues under federal and state water pollution acts.** *In Re Oriental Republic of Uruguay*, 821 F.Supp. 928 (D. Del. 1992); 821 F.Supp. 934, 941, 946, and 950 (D. Del. 1993).

In 1989, an oil tanker owned and operated by the government of the Oriental Republic of Uruguay ran aground in the Delaware River. The tanker's hull ruptured discharging approximately 200,000 gallons of oil into the water. The oil spill resulted in extensive damage to the shores and waters of the United States, Delaware, New Jersey and Pennsylvania and required massive cleanup. Further, a substantial amount of private property damage resulted from the spill. In response to numerous legal actions, Uruguay instituted an action seeking exoneration from or limitation of liability pursuant to the Limitation of Liability Act, 46 U.S.C.A. § 183(a). Various governmental entities and private parties filed claims against Uruguay in the action. The United States Court for the District of Delaware issued five opinions relative to these claims. The findings in these opinions are set forth as 1 through 5 hereafter: (1) 821 F.Supp. 928. The United States moved for

partial summary judgment for recovery of its response costs under the CWA. Uruguay asserted the discharge was caused solely by a third party - a temporary river pilot. The court granted judgment on liability finding the pilot was an agent of Uruguay - and not a third party - and any acts were directly attributable to Uruguay. The court also granted Delaware partial summary judgment on liability under the Delaware Oil Pollution Liability Act (DOPLA); (2) 821 F.Supp. 946. For liability under the DOPLA, the court imposed civil penalties for each day during which oil was discharged from the vessel and not for each day oil was in the water. (3) 821 F.Supp. 934. Sun Refining and Marketing Company and Sun Oil Trading Company own and operate a refinery and terminal on the river. Sun claimed damages from physical property damage and other economic loss damages unrelated to the property damage. On cross motions for summary judgment, the court held Sun could only recover economic loss damages derived directly from the physical property damage caused by Uruguay's negligence and not otherwise; (4) 821 F. Supp. 941. On motion for reconsideration, the court affirmed its early opinion at 806 F.Supp. 42 finding that Uruguay's intentional or unintentional spill of oil into the waters of New Jersey constituted a violation of the New Jersey Water Pollution Control Act and the New Jersey Spill Compensation and Control Act warranting civil penalties; and, (5) 821 F.Supp. 950. Owners of boatyard and restaurant claimed damages for deaths of ducks and economic loss damages for lost business. The court found the owners had no property interest in the ducks and thus no action existed. Further, the owners failed to establish that the economic loss damages were derived directly from physical property damage caused by Uruguay's negligence.

8. **Landowners' damages under nuisance theory limited to fair market value of property.** *Briscoe v. Amoco Production Company*, No. CIV-91-2072-L (W.D. Okla. June 7, 1993), reconsidered (July 6, 1993).

Plaintiff landowners sued Amoco Production Company for recovery of damages from alleged oilfield pollution. The plaintiffs acquired the property in April, 1991 at a cost of \$24,000 and are requesting recovery in excess of \$300,000. Amoco moved for partial summary judgment on: (1) the measure of damages under the plaintiffs'

nuisance and unjust enrichment theories; (2) liability for prepurchase damages; and, (3) the right to conduct saltwater disposal on the property. With respect to the measure of damages, the court found the costs of cleanup far exceed the diminution in the fair market value of the property and thus the proper measure of damages is the diminution in the value of the property caused by the alleged pollution, and not the actual costs of cleanup. The court noted, however, the finding did not reach any obligation Amoco may have to remediate the property. Further, on rehearing, the court found that recovery under the unjust enrichment theory is not limited to the diminution in the value of the property; rather, the recovery is measured by the amount saved by Amoco through its alleged use of the property without appropriate compensation. With respect to liability for prepurchase damages, Amoco argued that recovery of damages must be confined to the difference in the value of the property when purchased and the value at the time the action was commenced, *i.e.*, excluding any damages prior to purchase. The court denied Amoco's motion on this issue finding that such principle does not apply to plaintiffs'

theories of temporary or public nuisance. With respect to the saltwater disposal issue, the court granted the motion finding that Amoco is authorized to dispose of saltwater in the saltwater disposal wells on the property based on the underlying oil and gas lease, unitization agreement, and Oklahoma Corporation Commission Order authorizing disposal.

9. **Contract language not broad enough to transfer CERCLA cleanup liability.** *John S. Boyd v. Boston Gas Co.*, 992 F.2d 401 (1st Cir. 1993).

The United States Court of Appeals for the First Circuit affirmed an earlier district court decision finding that a pre-CERCLA purchase agreement does not transfer CERCLA cleanup liability unless the language is broad enough to transfer unforeseen environmental liability. The court found the predecessor and related companies - and not the buyer - were liable for cleanup of the subject coal and oil and gas waste facility. (See No. 5, Judicial Developments, Vol. I No. 2, page 4, for a synopsis of the district court's decision).

* FEDERAL REGULATION *

1. **Further correction to rule for recycled and used oil.** 58 FR 33341 (June 17, 1993).

A correction in the used oil management standards appearing at 58 FR 26420 (May 3, 1993) inadvertently amended several sections of Part 279 dealing with notification requirements for used oil handlers. This action corrects this error and restores the original language from the final rule at 57 FR 41566 (September 10, 1992).

2. **Coast Guard prepares draft guidelines for oil spill response training.** 58 FR 38450 (July 16, 1993).

The Coast Guard has developed draft guidelines for oil pollution response training for personnel involved in operations at deepwater ports and marine transportation-related facilities, and for vessel owners and operators. The Coast Guard is conducting a workshop on the draft guidelines August 27, 1993 as outlined in the notice. Also, written comments on the draft

guidelines must be received on or before September 1, 1993.

3. **Coast Guard requests comments on financial responsibility regulations for vessels.** 58 FR 38993 (July 21, 1993).

On September 26, 1991, the Coast Guard published notice of proposed rulemaking (56 FR 49006) to implement the financial responsibility requirements for certain vessels under Section 1016 of the Oil Pollution Act of 1990 and Section 108 of CERCLA. The notice listed three methods to demonstrate financial responsibility: insurance, surety bond, and financial guaranty. In response to comments on the notice, the Coast Guard prepared a Preliminary Regulatory Impact Analysis which addresses possible economic impact from the financial responsibility requirements. The Coast Guard is now seeking comments on the RIA. Comments must be received on or before September 20, 1993.

4. Department of Interior reopens comment period on natural resource damage rule. 58 FR 39328 (July 22, 1993).

On April 29, 1991, the Department of Interior issued a notice of proposed rulemaking (56 FR 19752) to revise the natural resource damage assessment regulations. The regulations establish procedures for assessing damages for injury to natural resources resulting from the discharge of oil under the CWA or the release of hazardous substances under CERCLA. The Department has developed two types of assessment procedures: standard procedures for simplified assessments requiring minimal field observations (type A rule); and site specific procedures for detailed assessments in individual cases (type B rule). The Department is now reopening the comment period for the proposed rulemaking. Written comments must be received on or before September 7, 1993.

5. Criminal fines and civil penalties up for 1992:

The EPA's 1992 *Enforcement Accomplishments Report* issued June 18, 1993 indicates a major increase in 1992 for criminal fines and civil

penalties for environmental violations. Civil penalties increased to a record \$78.7 million (\$50.7 million in civil judicial penalties and \$28 million in administrative penalties). Criminal fines increased fourfold in 1992 to \$62.9 million. Nearly all criminal fines were under the CWA or RCRA. The *Report* further indicates that state enforcement actions far exceeded those of the EPA. A copy of the *Enforcement Accomplishments Report* and appendix - *The National Penalty Report* - can be ordered from the EPA Public Information Center (202) 260-2080.

This publication is not intended as a legal or technical opinion for a given situation. Rather, it is intended to provide general information only. One should consult a licensed professional for advice or opinions on a particular issue or problem.

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