Mixing Surface Development with Oil and Gas Operations—Part II

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Part I of this article, published in the May 2005 issue, outlines an oil and gas operator's rights to use the surface estate, associated environmental and operational effects on surface development, and the potential liabilities of the surface owner or developer related to those impacts. This Part II discusses the obligations of the oil and gas operator related to those impacts and the steps a surface owner or developer may take to limit potential liability.

Part I of this article, which was published in the May 2005 issue,[1] discussed the mineral interest owner's or lessee's rights to the surface estate in developing its interest, possible environmental and operational impacts of oil and gas operations, and the potential liabilities of the surface owner related to those impacts. Liability risks to a surface owner associated with onsite oil and gas operations that were discussed in Part I of this article include potential for statutory liability under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA");[2] Resource Conservation and Recovery Act ("RCRA");[3] Oil Pollution Act ("OPA")[4] and Clean Water Act;[5] or state law. In addition, a surface owner could face tort liability to future purchasers and tenants in certain circumstances related to both operational and environmental impacts of oil and gas development.

Part II discusses the obligations of the mineral lessee or operator[6] to limit environmental and operational impacts and its potential liability for those impacts. Part II also discusses steps a surface owner or developer may take to limit potential liability. This article should be of interest to natural resources, real estate, environmental, and business attorneys representing mineral and surface estate owners and developers, as well as to lenders, insurers, and other parties who are involved in real property development projects where surface and mineral estates are severed.

REQUIREMENTS APPLICABLE TO A LESSEE/OPERATOR

The liability risks discussed in Part I of this article are heightened by the broad rights of the mineral interest holder to develop the mineral estate. These risks, however, are tempered in two ways by the obligations of the lessee/operator to address environmental contamination and accommodate surface development. First, assuming that the lessee/operator conducts its operations in compliance with legal requirements, the potential impacts to surface development that give rise to liability are mitigated. Second, to the extent injunctive relief or monetary damages are available to the surface owner if the lessee/operator violates these legal obligations, the surface owner's associated damages can be limited or offset.

Thus, the common law and regulatory requirements imposed on the mineral lessees/operator provide some level of protection from liability risks to a surface developer. During the due diligence process and negotiation of project contracts, such as the purchase agreement for a site, a surface developer must weigh the availability of protections provided by the common law and regulatory scheme against the likelihood of liability.

Regulatory Jurisdiction

Oil and gas exploration and production activities are regulated under federal, state, and local law, but regulatory authority in Colorado falls principally with the Colorado Oil and Gas Conservation Commission ("COGCC"). COGCC rules ("COGCC Rules") cover permitting, well-siting, pollution, environmental remediation, public health and safety, well abandonment, and flow lines, among other aspects of oil and gas exploration and pro-

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duction.[7] At the local level, many cities and counties have adopted regulations that also apply to oil and gas operations, although local regulations are subject to potentially significant limitations on enforceability. Local regulations are discussed in more detail later in this Part II.

With respect to environmental matters, at the federal level, oil and gas exploration and production waste is exempt from regulation as a hazardous waste, but is regulated as a solid waste under RCRA.[8] The environmental impacts of these activities also are regulated under the Clean Water Act, Emergency Planning and Community Right-to-Know Act ("EPCRA"), and the Clean Air Act.[9]

Under implementing state regulatory schemes, requirements applicable to oil and gas production facilities (such as wells) include: (1) air pollution emission notices (known as "APENs"); (2) point source[10] discharge permits for discharges to surface water and stormwater discharge permits; and (3) spill prevention plans in certain circumstances that may or may not be triggered in this instance.[11] In addition, under EPCRA, facility owners are subject to reporting obligations for accidental releases of certain hazardous substances and may be subject to annual reporting requirements if "extremely hazardous substances" are or become present at a site in excess of threshold levels.[12] State requirements for solid waste, including hazardous waste, also apply to wastes that do not qualify as exploration and production wastes.[13]

In implementing federal and state environmental requirements, regulatory authority of the COGCC overlaps with authority of the Colorado Department of Public Health and Environment ("CDPHE") to regulate solid and hazardous waste and air and water quality in certain circumstances, as well as with the Colorado Department of Labor and Employment, Division of Oil and Public Safety ("OPS") authority to regulate underground and aboveground storage tanks.[14] As relevant to oil and gas wells, OPS has jurisdiction except with respect to "aboveground storage tanks associated with natural gas liquids separation, gathering, and production" or underground storage tanks used as "a liquid trap or associated gathering lines directly related to oil or gas production and gathering operations."[15]

The overlapping authority of the CDPHE and COGCC is addressed in two Memoranda of Agreement and a Memorandum of Understanding (together, "MOAs") between the two agencies that outline the regulatory jurisdiction of the CDPHE Hazardous Materials and Waste Management Division ("HMWMD") and Water Quality Control Division ("WQCD") and the COGCC. The MOAs provide that the HMWMD will defer to the COGCC with respect to regulation of disposal of exploration and production wastes from oil and gas operations injection wells and commercial injection well disposal sites, and exercise its authority over such wastes as "solid waste" when disposed at other commercial disposal sites.[16]

In two separate MOAs, the WQCD, the Water Quality Control Commission ("WQCC"), and the COGCC agreed that the WQCC will be responsible for water quality standards and classifications for state waters and the WQCD will be solely responsible for issuance and enforcement of permits authorizing all point source discharges to surface waters.[17] Spills or releases to surface waters must be reported to both the WQCD and the COGCC, but the WQCD is responsible for enforcement action related to spills or releases that violate discharge permits.[18]

Lessee/Operator Liability for Environmental Contamination

Under the regulatory scheme described above, an oil or gas well lessee/operator is liable for environmental contamination associated with its operations. However, the source of liability and relief available to a surface owner depends on the type of contamination at issue.

Under the Colorado Oil and Gas Conservation Act ("Conservation Act"),[19] the COGCC may order a "responsible party" to mitigate, or bear the cost of any action taken by the COGCC to mitigate, adverse environmental impacts from its operations that were in violation of applicable COGCC requirements. Alternatively, the COGCC is authorized to use funds available from a state oil and gas environmental response fund where the responsible party cannot be identified or does not perform as required.[20] Specifically, CRS § 34-60-124 provides:

> (7) If the commission [COGCC] determines that mitigation of a significant adverse environmental impact on any air, water, soil, or biological resource is necessary as a result of the conduct of oil and gas operations, the commission shall issue an order requiring the responsible party to perform such mitigation. If the responsible party cannot be identified or refuses to comply with such order, the commission shall authorize the necessary expenditure from the fund. The commission shall bring suit in the second judicial district to recover such expenditures from any responsible party who refuses to perform such mitigation or any responsible party who is subsequently identified, such action to be brought within a two-year period from the date that final expenditures were authorized. Moneys recovered as a result of such suit shall first be applied to the commission's legal costs and attorney fees and shall be credited to the fund.
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> (8)(a) For purposes of this section, "Responsible party" means any person who conducts an oil and gas operation in a manner *which is in contravention of any then-applicable provision of this article, or of any rule, regulation, or order of the commission, or of any permit* that threatens to cause, or actually causes, a significant adverse environmental impact to any air, water, soil, or biological resource. "Responsible party" includes any person who disposes of any other waste by mixing it with exploration and production waste that threatens to cause, or actually causes, a significant adverse environmental impact to any air, water, soil, or biological resource.[21] (*Emphasis added*.)

Nevertheless, landowners (including both the surface estate and mineral estate owners) are specifically exempted from the definition of "responsible party" as long as they do not "engage in, or assume responsibility for, the conduct of oil and gas operations."[22]

In addition to enforcement by the COGCC, the Conservation Act authorizes suits on behalf of the COGCC for injunctive relief. Specifically,

> in the event the commission fails to bring suit to enjoin any actual or threatened violation, . . . then any person or party in interest adversely affected and who has notified the commission in writing of such violation or threat thereof and has requested the commission to sue, may, to prevent any or further violation, bring suit.[23]

However, this provision also requires that any injunction be issued as though the COGCC had at all times been the complaining party.[24]

The Colorado Supreme Court has held that this provision does not provide a private right of action for violations of the

Conservation Act or COGCC Rules.[25] However, it also has found that the Conservation Act does not preclude tort claims by any person, including a surface owner.[26] Tort claims available to the surface owner include negligence claims for which the COGCC Rules have been held to provide evidence of the relevant standards of care applicable to an oil and gas operator.[27] Therefore, a surface owner may have some basis in tort law for seeking private damages where those damages arise from operations that are not in compliance with the COGCC Rules.

COGCC environmental requirements cover well permitting, construction, operating, and closure requirements for pits, methods of exploration and production waste management, procedures for spill/release response and reporting, and sampling and analysis for remediation activities.[28] Exploration and production wastes to which these requirements apply are defined as "those wastes that are generated during the drilling of and production from oil and gas wells or during primary field operations and that are exempt from regulation as hazardous wastes under [RCRA Subtitle C]."[29] These wastes would include most of the wastes noted in Part I of this article,[30] such as produced water, drilling fluids, drill cuttings, pit sludges, workover wastes, hydrocarbon-bearing soil conditioning wastes, pipe scale and deposits removed from piping, and liquid hydrocarbons.[31]

Wastes not "intrinsically related" to the production of oil and gas are not covered by the COGCC Rules, but are subject to regulation as solid or hazardous wastes by the CDPHE under the state RCRA program.[32] Among the wastes described in Part I, these wastes would include used lubrication oils, waste solvents, spilled chemicals, and waste acids.[33] Disposal of these wastes is prohibited except at licensed disposal sites.[34] The CDPHE also has authority to require cleanup of these wastes if they have been disposed of (including by accidental release) in violation of the statutory prohibition.[35]

In addition to liability under the Conservation Act and state RCRA program, the well operator is responsible for remediation of releases from any underground or aboveground storage tanks regulated by the OPS.[36] Well operators and lessees also could face potential owner and/or operator liability (along with the surface owner) for: (1) response costs incurred by the Environmental Protection Agency ("EPA"), the state, or a surface owner under CERCLA caused by release of hazardous substances (with certain limitations created by the petroleum exclusion described in Part I);[37] (2) performing cleanup and certain other costs associated with releases causing "imminent and substantial endangerment" under RCRA; and (3) cleanup costs under the Clean Water Act and OPA for releases of hazardous substances or oil to surface water.[38]

Pitfalls for Surface Owners

With respect to existing wells, whether active or abandoned, protection to the surface owner under this liability scheme may be limited or problematic in a number of respects:

Evolving Regulations: The current COGCC environmental regulations applicable to exploration and production waste provide that closure of pits and produced water vessels and associated remediation conducted prior to December 30, 1997, were not subject to its requirements covering exploration and production waste management.[39] For pits closed prior to December 30, 1997, the COGCC Rules required only that pits be reclaimed consistent with COGCC reclamation requirements.[40]

The COGCC's reclamation regulations authorize the COGCC to inspect and presumably impose additional requirements when an oil or gas operation "could result in a significant adverse environmental impact."[41] Nevertheless, reclamation requirements applicable prior to December 30, 1997, allowed drill cuttings and drilling fluids to be buried on site without testing. They focused principally on avoiding loss of topsoil, subsidence, and compaction.[42]

Adequacy of Financial Assurances: Financial assurances and funding for remediation of exploration and production waste may not be sufficient to cover remediation activities if the operator is insolvent or uncooperative. Financial assurances are required in the amount of $2,000 per well for non-irrigated lands or $5,000 per well for irrigated lands or a blanket financial assurance of $25,000 for all of the operator's wells statewide. These

assurances must be made prior to commencing operations with heavy equipment for purposes of protecting the surface owner from "unreasonable" land damage.[43]

Additional financial assurances are required to ensure proper abandonment, exploration and production waste management, reclamation, and compliance with flow line requirements in the amount of $5,000 per well or blanket assurances of $30,000 for operators with fewer than 100 wells statewide or $100,000 for operators with more than 100 wells statewide.[44] Insurance coverage for property damage and bodily injury to third parties is required in a minimum amount of $500,000 per occurrence or $1 million per occurrence in high-density areas.[45] These amounts may or may not be sufficient to cover remediation requirements and other damages incurred by the surface owner or a subsequent purchaser or tenant in the event contamination associated with the wells is discovered in the future.

Variations Among Remediation Criteria: Remediation standards and guidance criteria vary depending on the type of waste or release and associated regulatory agency jurisdiction over that waste or release. Spills and releases of exploration and production wastes governed under COGCC Rules must be remediated to standards that are sometimes less and sometimes more stringent than standards and guidance criteria applied to comparable constituents that fall outside COGCC jurisdiction.[46] COGCC Rules also reflect a relatively limited suite of contaminants for which sampling requirements and standards apply.[47]

Notably, under COGCC Rules, land treatment of oily waste is allowed without prior surface owner approval in areas being used for oil and gas operations.[48] Total petroleum hydrocarbons allowed to remain in place under COGCC Rules may be as high as 10,000 mg/kg, while OPS regulations use a standard of 500 mg/kg as a screening level triggering analysis for additional contaminants not required under the COGCC Rules.[49] Similarly, the residential criterion for arsenic in soil under CDPHE guidance is .39 mg/kg, while 41 mg/kg is the standard under COGCC Rules.[50] Further, there are no requirements to sample soils or groundwater for solvents or other constituents that might be present due to improper disposal practices.[51]

The differences among the regulatory requirements of agencies with jurisdiction over potential environmental contamination associated with oil and gas operations have two principal implications. First, oil and gas well operators have no regulatory obligation to clean up exploration and production waste constituents to more stringent standards than apply under the COGCC Rules. This is true unless cleanup falls within the jurisdiction of another regulatory or statutory program (or judicial or administrative order for relief) that imposes higher standards.

Second, the limited suite of contaminants covered under the COGCC rules may result in contaminants remaining onsite and unidentified after well closure and remediation activities because those contaminants are ones that do not meet the definition of exploration and production waste or are the result of improper disposal practices. Therefore, independent testing or remediation by a surface owner may be necessary to address contaminants not regulated under the COGCC scheme, or for which more stringent standards may be necessary to support the end land use. This is the case unless the surface owner can negotiate alternative contractual standards for testing and cleanup with the oil and gas lessee/operator.

Accommodation of Surface Development

In a 1997 case, the Colorado Supreme Court adopted a "due regard" concept of what uses constitute "reasonable use" of the surface estate by a mineral interest holder:[52]

> This "due regard" concept of reasonable use requires accommodation of surface owners to the fullest extent possible consistent with their right to develop the mineral estate. . . . [A] trespass occurs at the point when the holder exceeds the legal authorization permitting mineral development activities.[53] (*Citations omitted.*)

Further, the Court stated, "when reasonable alternatives are available to the lessee, the doctrine of reasonable surface use requires the lessee to adopt an alternative means."[54]

This common law obligation to exercise "due regard" is supplemented by both statutory and regulatory requirements under House Bill 01-1088 ("H.B. 1088"), discussed below, and COGCC Rules intended to regulate the relationship between surface and mineral development and, in some localities, by local zoning code requirements. Further, as a matter of practice, surface and mineral interest holders typically enter into surface use agreements that further define the extent to which the mineral interest holder must accommodate surface development.

H.B. 1088

The Surface Development Notification Act, more commonly known as H.B. 1088, was enacted by the Colorado General Assembly, effective July 1, 2001.[55] The statute is intended to protect surface developers from the threat of suit by a mineral interest owner or lessee who has received notice related to surface use. It also protects oil and gas companies that wish to avoid unexpectedly coming across a subdivision at their next drilling site.[56] H.B. 1088 requires: (1) written notice to mineral owners and their lessees of impending surface development;[57] (2) notice to surface owners prior to commencement of oil and gas operations;[58] and (3) title insurance companies or licensed title insurance agents to include statements regarding the rights of a severed mineral interest owner to enter a surface estate to develop its property when the mineral estate has been severed from the surface.[59]

When a surface development is planned on a parcel where mineral interests (including leased interests) have been severed from the surface estate, the surface developer is required to send notice by first-class mail to the owners of severed mineral interests and the lessees of those severed mineral interests. Such notice must be sent at least thirty days before the initial public hearing by the local government on an application for development.[60] The notice is to contain the time and place of the initial public hearing, nature of the hearing, location of the property that is the subject of the hearing, and the name of the applicant.[61]

The surface developer also is required to notify the local government hearing the application of the names and addresses of the owners of severed minerals and the lessees of those severed mineral interests.[62] To determine the identity of the owners of severed mineral interests and/or the lessees of those severed mineral interests (collectively defined as "mineral estate owners"), the surface developer must examine the records of the county in which the property is located, using certain prescribed methods.[63] Before the local government can approve an application for surface development, the surface developer must certify that the required notice has been provided to the owners of severed minerals and the lessees of those severed minerals.[64]

If a surface owner provides the required notice in a timely manner, the mineral estate owners that appear on the list are deemed to have constructively received the notice and the surface developer will be deemed to have satisfied the statute's notice requirements.[65] In that event,

> the surface owner shall not have any liability to any mineral estate owner or any other party deemed to have constructively received such notice for any legal or equitable remedy or relief arising from, in connection with, or otherwise relating to the application for development, any development activities commenced on the surface of the real property, any inability or hindrance to drilling operations or other development of the mineral estate or any portion thereof, or any actual failure to receive notice.[66]

This limitation on liability does not apply if the mineral estate owner provides written notice of objection prior to the final approval of the application for development, in which case the mineral estate owner and all other parties may seek whatever legal or equitable relief that may be available to them.[67]

In addition, the limitation on liability does not apply if the mineral estate owner commences an action seeking compensatory monetary damages before the later of the following dates:

1) one year after the final approval of the application for development;

or

2) sixty days after the commencement of development activities with heavy equipment or the posting on the surface of the property that the local government has given final approval to the development application.[68]

However, to recover any damages, the mineral interest owner must allege *and the court must find* that: (1) notice was required to have been sent to the mineral interest owner; and (2) the required notice was not sent. The statute provides that in such an action, the mineral interest owner may seek to recover compensatory monetary damages in connection with the failure to provide the required notice, but is not entitled to recover special, punitive, or other extraordinary damages, nor will the mineral interest owner be entitled to any equitable remedy or relief.[69]

As important, if the surface owner has certified that it complied with notice requirements and that no mineral interest owner provided written notice of any objections to the approval of the development application, other benefits follow. Specifically, no permit approved by the local government agency or any activities subsequent to the final approval of the application for development will be rescinded, curtailed, abrogated, or otherwise restricted in connection with alleged noncompliance with notice requirements.[70]

Accordingly, compliance with H.B. 1088 requirements can provide valuable assurance to a surface owner. H.B. 1088 provides that mineral interest owners will not be able to enjoin or claim monetary damages related to surface development that interferes with the right of existing or future oil and gas lessees/operators to "reasonable use" of the surface estate.[71]

COGCC "High Density" Requirements

The COGCC has a grant of authority to promulgate regulations "to protect the health, safety and welfare of the general public in the conduct of oil and gas operations."[72] Thus, it has promulgated aesthetic and safety standards for oil and gas well operations in "high density areas," which are likely to be triggered by commercial or residential development. Depending on the sequence of oil and gas operations and commercial or residential development, and also on the type of commercial or residential development, these regulations could limit or possibly preclude new oil and gas development because of safety concerns in certain locations.[73] COGCC Rules also may provide evidence of the relevant standard of care in the event a surface owner sustains damage as a result of violations of these rules.[74]

The COGCC Rules state that "high density" rules apply in areas where thirty-six or more actual or platted building units are within the 1,000-foot radius or eighteen or more building units are within any semi-circle of the 1,000-foot radius from a wellhead or production facility.[75] Where platted building units are the basis for the "high density" designation, at least 50 percent of the units must be under construction or constructed.[76]

An area also is considered high density if an educational facility, assembly building, hospital, nursing home, board and care facility, or jail is located within 1,000 feet of a wellhead or production facility.[77] These requirements also apply to "designated outside activity" areas. These areas include playgrounds, recreation areas, outdoor theaters, or other places of public assembly that meet certain occupancy criteria.[78]

High density requirements include setbacks for wellheads and production equipment, requirements for blowout preventer equipment, fencing, control of fire hazards, loadlines, removal of surface trash, berm construction, tank specifications, access roads, time limits for clearing the well site after abandonment, identification of plugged and abandoned wells, and development from existing well pads.[79] COGCC Rules also address aesthetic and noise impacts.[80]

The COGCC identifies high density areas at the time it issues a well permit. However, with certain exceptions, the COGCC Rules also make high density requirements apply where development encroaches on existing oil and gas wells.[81] The explicit exceptions are setbacks for wellheads, setbacks for production equipment, fencing requirements, and access for road maintenance.[82] In addition, requirements for berm construction and tank specifications apply only to berms and tanks that are installed subsequent to the determination that an area is a high density area.[83] Also notable, noise

limitations apply only with respect to noise in excess of ambient levels.[84] These exceptions may limit a developer's desire to rely solely on the operator's obligation to comply with COGCC Rules as a means to mitigate the adverse operational impacts and risks to neighboring development from an operating well.

Local Regulation

In addition to state and federal requirements, oil and gas operations may be regulated to some extent under local city and county regulations. Local regulations may serve to mitigate possible adverse operational impacts and risks to neighboring development from an operating well. However, local regulations are subject to significant limitations on their enforceability.

Local power to regulate oil and gas operations is closely circumscribed. The Colorado Supreme Court has ruled that local regulations that attempt to ban oil and gas operations within a local jurisdiction are preempted by the Conservation Act.[85] Local regulations that "conflict in operation" with the Conservation Act or the implementing COGCC Rules also are preempted.[86]

Colorado courts have not clearly defined what types of regulations may present preempted "operational conflicts." Nevertheless, the Colorado Supreme Court has suggested that local regulations would be preempted that impose "technical conditions" on the drilling or pumping of wells under circumstances where no such conditions are imposed under the state statutory or regulatory scheme, or that impose safety regulations or land restoration requirements contrary to those required by the Conservation Act or COGCC Rules.[87] However, local regulations focused on mitigating potential land-use conflicts between oil and gas development and other existing and planned land use would not be preempted.[88] A subsequent Colorado Court of Appeals decision has suggested that any local regulation that applies standards that are more stringent than comparable COGCC Rules would require—or that attempts to penalize operators for failure to comply with COGCC Rules—may not survive challenge.[89]

Many localities have adopted regulations that may require approval of development plans and impose other limitations on oil and gas development activity.[90] These regulations typically contain "grandfather" or nonconforming use clauses that expressly except wells approved or developed prior to the effective date of the current regulations. However, as noted above, the scope of local regulatory authority has been and is likely to be an ongoing subject of litigation.

A surface developer evaluating a potential development site should determine first whether the local jurisdiction has adopted land use regulations covering oil and gas development. It is important then to evaluate the extent to which those regulations are likely to be: (1) sufficient to mitigate potential adverse impacts of existing and future oil and gas development on planned surface development; and (2) enforceable against current and/or future lessee/operators.

Mineral Leases and Surface Use Agreements

As discussed in Part I of this article, Colorado law provides that mineral interest owners have a right to "reasonable use" of the surface estate to access and develop the mineral interest without compensation to the surface owner.[91] As a

practical matter, however, most operators attempt to enter into an agreement with the surface owner ("Surface Use Agreement") to establish in writing certain terms and conditions that will govern operations. Where the surface owner also is the mineral owner, the Surface Use Agreement may be part of the mineral lease. The Surface Use Agreement may accomplish the following:

- Establish a payment structure for wellsites, access roads, and pipelines
- Identify the routes of access across the property and the location of any pipelines
- Establish the location of any tank batteries or other associated equipment
- Impose other limitations on the lessee/operator and the use of the surface
- Grant such easements and other authority to the lessee/operator to use the surface.

The advantage of a Surface Use Agreement to a surface developer is that there is agreement in advance as to how operations are to be conducted. The advantage of a Surface Use Agreement to a lessee/operator is that there is a contractual agreement as to the reasonable use of the surface regarding those matters covered by the agreement. For the surface developer and the lessee/operator, a Surface Use Agreement establishes a contractual arrangement between the parties that can be enforced.

The rights and obligations of the lessee/operator under any existing Surface Use Agreement are thus centrally important to the prospective surface developer. Likewise, negotiating a Surface Use Agreement that adequately accommodates a surface developer's proposed plans is an important method of allocating and mitigating potential liabilities associated with mineral interest development.

Surface Use Agreements are not typically recorded. Under Colorado bona fide purchaser provisions, an unrecorded instrument is not

> valid against any person with any kind of rights in or to such real property who first records and those holding rights under such person, except between the parties thereto and against those having notice thereof prior to acquisition of such rights.[92]

However, if there is some indication in the recorded documents of interests that may affect title, the purchaser is obligated to investigate or is charged with knowledge of the facts that would have been indicated by investigation.[93] Therefore, a prospective surface developer always should attempt to inquire of the mineral interest holders in writing as to whether such an agreement exists.

STEPS TO LIMIT LIABILITY

As described above, state and federal law impose obligations on lessees/operators to accommodate surface development and impose liability for certain adverse environmental and operational impacts on surface development. Nonetheless, for the reasons discussed above and in Part I of this article, past environmental releases, as well as ongoing operations, remain potentially significant sources of liability to a surface developer. There are a number of steps a developer can take to limit its potential liability, beginning with the due diligence process and continuing on to the conveyance of property to third-party purchasers after development activity is complete.

During the Due Diligence Process

One of the first steps a developer can take is to develop a good understanding of any past or present oil and gas operations, the legal obligations of the lessee/operator under state and local law, and any applicable lease or Surface Use Agreement. This understanding provides the basis for evaluating potential liabilities and developing a strategy for managing those liabilities associated with oil and gas operations on a prospective development site. In addition, developers should consider the following:

1. The prospective surface developer should investigate the cost of simply purchasing the mineral interests on the site. Where current operations are marginal, or the mineral interests are not currently economically feasible to develop, the most cost-effective liability management simply may be to acquire the mineral interests.

2. Another step in limiting environmental liability related to current or historical operations is to perform environmental due diligence prior to purchasing a site so as to qualify for defenses to liability under CERCLA.[94] A purchaser must perform "all appropriate inquiry" prior to purchase of a site to qualify for the "innocent landowner" or "bona fide purchaser" defenses to CERCLA liability.[95]

At this time, a Phase I Environmental Site Assessment ("ESA") that complies with the current American Society of Testing and Materials (known as "ASTM") standard is sufficient for this purpose.[96] These defenses may not be available where environmental contamination at issue is the result of ongoing oil and gas operations, either because disposal of hazardous substances happens after conveyance of title or because any mineral lease or Surface Use Agreement between the lessee/operator and the surface owner may be construed as a form of "contractual relationship," precluding the defenses.[97] However, if the required actions discussed above are taken at sites where oil and gas operations have taken place in the past, the surface owner should be able to assert one of these defenses in the event historical contamination is discovered after taking title to a site.

With respect to ongoing oil and gas operations, a Phase I ESA also can provide a baseline evaluation of environmental conditions prior to conveyance of the property. This baseline evaluation can assist in identifying cleanup required prior to purchase or in order to allocate liability in the event contamination is discovered later.

In the Purchase Agreement

The purchase agreement for the surface estate is an important tool in managing potential liability. There are a number of risk-shifting terms that a prospective purchaser may attempt to negotiate in its purchase agreement. Obtaining these terms clearly will depend on the leverage of the purchaser and may not be possible without making financial concessions in return. Nevertheless, the prospective purchaser should consider the following:

1. Indemnifications, bonding, insurance, or other assurances are contractual requirements that a purchaser can seek to cover the costs and liabilities associated with environmental contamination and other aspects of oil and gas operations. Where oil and gas operations may continue on a site and historical contamination may be difficult to identify before purchase, ideally the seller (or lessee/operator) should remain contractually liable for third-party claims and for the costs of, or for performing, additional remediation associated with preexisting contamination.

2. A number of regulatory standards could be applied in the event remediation is required on a site either before or after conveyance. Accordingly, the purchase agreement ideally should identify remedi-

al standards (including procedures) acceptable to the developer that would apply: (1) if remediation is required as a condition of conveyance to the developer; or (2) for any remediation conducted or funded by the seller after conveyance.

3. The most significant potential environmental liability to a surface developer associated with ongoing oil and gas operations probably would devolve from the surface developer's status as an "owner" of the property under CERCLA.[98] The ongoing nature of the operations may disqualify a surface developer from defenses to CERCLA liability related to the ongoing oil and gas operations for the reasons discussed above and in Part I of this article.[99] Therefore, as an alternative to taking title to a well site, when feasible, the surface developer should consider leaving title to the portion of the site where active wells or other production facilities are located with the seller until after oil and gas operations have ceased, the lessee's rights have been released, and the site has been remediated to standards acceptable for planned development.

4. Additional or alternative operational constraints and requirements may be necessary to ensure that ongoing or future oil and gas operations are compatible with planned development, regardless of whether the developer takes title to the well site. Therefore, as discussed in more detail below, the surface developer also should consider making the negotiation of a satisfactory Surface Use Agreement (or amendments to any existing Surface Use Agreement) a condition of conveyance.

In the Surface Use Agreement

The Surface Use Agreement may be the most important tool available to a surface developer to make sure that issues associated with its planned development are adequately addressed. The practitioner should be aware that most of these recommendations are likely to meet with resistance from the oil and gas lessee/operator. Obtaining favorable terms, again, will depend on the leverage of the purchaser and may not be possible without making potentially significant financial concessions in return. That said, the developer should consider the following:

1. To clarify whether there is an existing, enforceable Surface Use Agreement, the developer should specifically inquire of the current lessee or operator, and request a response in writing, as to whether a Surface Use Agreement exists or whether there have been any unrecorded amendments to an identified Surface Use Agreement or any superseding agreements.

2. The applicable COGCC environmental and operational standards (such as noise limitations, limitations on hours of operation, or environmental standards for reclamation and environmental cleanup) may not be sufficiently stringent to accommodate planned development. Operational and environmental standards should be specified in the Surface Use Agreement, even if simply to give the surface developer a contractual right to require compliance with otherwise applicable regulatory standards.

3. The surface developer should seek an indemnification from the lessee/operator that covers third-party claims and cleanup costs, even if incurred in the absence of a third-party claim or regulatory action. The indemnification clause also should cover CERCLA liability. If the lessee/oper-

ator does not appear to be financially sound or has a history of regulatory violations or litigation, this obligation ideally should be backed by insurance, a bond, or other financial assurance from the lessee/operator.

4. If the surface developer and the lessee/operator have negotiated an acceptable Surface Use Agreement, the lessee/operator should not be entitled to any other recourse with respect to the development of the surface estate. Therefore, a developer also should consider seeking a provision in any Surface Use Agreement that waives the lessee/operator's rights to assert any claims (except contractual claims) associated with the development of the surface estate, including notice rights and rights to object to the development plan for the site under H.B. 1088.[100]

During Development Planning

During development planning, the developer should consider taking five principal steps:

1. H.B. 1088 provides significant protection to surface developers from mineral estate owners' claims (including claims from mineral lessees/operators) that surface development has impaired their ability to develop the mineral estate. Accordingly, the developer should observe the notice procedures under H.B. 1088 as a means to protect against claims from mineral estate owners after development has begun.[101]

2. H.B. 1088 also assures that mineral estate owners have notice and an opportunity to object prior to final local government approval of surface development plans. To make sure the current lessee/operator does not object to its development plan, the developer should consider working with the lessee/operator before submitting its plans to a locality for approval. Once any potential objections have been resolved, the developer should attempt to include a provision in any Surface Use Agreement waiving (or seeking a separate waiver) of the lessee's/operator's rights under H.B. 1088, as noted above.

3. Certain COGCC health and safety regulations and the development standards for oil and gas operations under local land use codes, such as setbacks and fencing, could be treated as evidence of the standard of care for surface development in any tort action against the developer of a site, even if they are not directly applicable to existing oil and gas operations.[102] Therefore, the developer should consider incorporating relevant standards, such as setbacks and other appropriate health and safety standards, into the development plan for the site, or ensure that it can substantiate any decision not to do so.

4. In addition to making "all appropriate inquiry" prior to taking title to a site, to qualify for CERCLA defenses, a property owner also must take appropriate care with respect to any known or subsequently identified contamination on the property after taking title.[103] A number of potential environmental conditions are not uncommon on oil and gas development sites, such as production pits and releases from flowlines and condensate tanks. The developer should consider preparing materials management procedures for contractors to follow during intrusive site preparation and development activities. This approach will ensure that any contamination encountered is appropriately segregated, characterized, removed, or otherwise managed and disposed of prior to further development.

5. Although costly, and not common, environmental insurance policies are available that cover surface owner liability for first-party cleanup and third-party claims for bodily injury and property damage associated with ongoing and past oil and gas operations.

At the Time of Subsequent Conveyance to Third Parties

As a final mechanism for limiting potential liability to subsequent purchasers of a site, a surface developer should consider a combination of limitations on liability in its purchase and sales agreements and broad disclosure. Contractual limitations on liability could include "as is" clauses,[104] and disclaimers of warranties and representations regarding the condition of the site. Limitations also can include a release by the purchaser of any claims associated with environmental conditions or oil and gas operations on the site and express acknowledgment that such conditions are or may be present.

Although such clauses are effective in foreclosing claims based on known conditions, they are not always successful against claims that a seller has failed to disclose facts that are neither known nor readily ascertainable by the buyer and that materially and adversely affect the value or desirability of the property.[105] Therefore, the developer also should consider disclosing the presence of and types of oil and gas operations that will continue at the site, as well as any other known environmental conditions that could be considered "latent defects."[106]

CONCLUSION

Whether past or present—or merely a possibility due to severed mineral interests—oil and gas operations may create operational and environmental impacts that adversely affect surface development and result in liability to the owner of the

surface estate. Common law and regulatory requirements imposed on the mineral lessees/operator provide some level of protection to a surface developer from liability risks. Nonetheless, the best approach to successfully mixing surface development with oil and gas operations starts with developing a good understanding of any past or present oil and gas operations, including thoughtful environmental due diligence.

Then, if existing conditions are not inconsistent with planned development, it is prudent to take advantage of the H.B. 1088 notification procedure in the land use planning process, and attempt to negotiate a Surface Use Agreement to appropriately define the rights and liabilities of both the surface and mineral estate owners in the "reasonable use" of their property. These steps, along with disclosure to future purchasers of the presence and types of oil and gas operations that are or may be conducted at the site (as well as any known environmental conditions), can help limit a surface owner's liability risks.

NOTES

1. Jessen and Ekberg, "Mixing Surface Development with Oil and Gas Operations—Part I," 34 *The Colorado Lawyer* 11 (May 2005) (*hereafter*, "Part I").

2. 42 U.S.C. §§ 9601-9674.

3. 42 U.S.C. §§ 6972 and 6973.

4. 33 U.S.C. §§ 2701-2761.

5. 33 U.S.C. §§ 1251-1387.

6. Because the well operator typically will be either the mineral interest lessee or operating the well on behalf of the lessee, this article refers to obligations applicable to either or both as applicable to the "lessee/operator."

7. *See* 2 C.C.R. 401-1 (*hereafter*, "COGCC Regs.").

8. *See Zands v. Nelson,* 779 F.Supp. 1254, 1264 (S.C.Cal. 1991).

9. *See* Clean Water Act, 33 U.S.C. §§ 1251-1387; Emergency Planning and Community Right to Know Act ("EPCRA"), 42 U.S.C. §§ 11001-11050; and Clean Air Act, 42 U.S.C. §§ 7401-7671, respectively.

10. "Point source" means any discernible, confined, and discrete conveyance, such as a pipe, ditch, channel, tunnel, conduit, well, or discreet fissure. CRS § 25-8-103(14).

11. *See* CRS § 25-7-114.1; Colorado Air Quality Control Commission, Reg. No. 3; CRS § 25-8-501; Colorado Water Quality Control Commission (*hereafter*, "Water Commission"), Reg. No. 61 (requiring permits for discharges to surface waters from "point sources"); CRS § 25-8-205; Water Commission, Reg. No. 65 (requiring permits for discharges to storm sewers); 40 C.F.R. § 112 (requiring owners and operators of certain facilities engaged in drilling, producing, and using oil and oil products to prepare Spill Prevention, Control, and Countermeasure Plans).

12. 42 U.S.C. §§ 11002 and 11004. If a well is converted to a Class II injection well, the well also will be regulated under the federal Safe Drinking Water Act, 42 U.S.C. §§ 300(f) to -300(j)-26, as implemented by the COGCC.

13. *See* Part I, *supra*, note 1 at 18.

14. COGCC Regs. at § 324A.

15. CRS § 8-20.5-101(2)(b) and (17)(b).

16. *Memorandum of Understanding between the Hazardous Material and Waste Management Division and the Colorado Oil and Gas Conservation Commission Regarding the Disposal of Eligible Wastes at Commercial Class II Injection Wells* (Oct. 6, 2000), available at http://oil-gas.state.co.us.

17. *Memorandum of Agreement for the Implementation of S.B. 181 Amendments to the Colorado Water Quality Control Act by and between the Colorado Department of Health, Water Quality Control Commission, Water Quality Control Division, Colorado Department of Natural Resources, and the Colorado Oil and Gas Conservation Commission* (Aug. 8, 1990), available at http://oil-gas.state.co.us.

18. *Memorandum of Agreement between the Water Quality Control Division and the Oil and Gas Conservation Commission, Response to Spills/Releases to Surface Water* (Feb. 15, 2000), available at http://oil-gas.state.co.us.

19. CRS §§ 34-60-101 to -124.

20. CRS § 34-60-124(7).

21. CRS § 34-60-124(7) and (8)(a).

22. CRS § 34-60-124(8)(b).

23. CRS § 34-60-114.

24. *Id.*

25. *Gerrity Oil & Gas Corp. v. Magness*, 946 P.2d 913, 919 (Colo. 1997).

26. CRS § 34-60-114; *Gerrity, supra,* note 25 at 919.

27. *Id.* As discussed in more detail in the section entitled "Nuisance and Trespass" in Part I of this article, available tort claims also may include trespass to the extent that the use of the surface is not "reasonable." Part I, *supra*, note 1 at 19.

28. COGCC Regs. § 901(a).

29. CRS § 34-60-103(4.5).

30. *See* Part I, *supra*, note 1 at 14.

31. See 53 Fed. Reg. 25446 and 25452-54 (July 6, 1988).

32. 53 Fed. Reg. 25446 (discussing "associated wastes").

33. *See* 53 Fed. Reg. at 25453-54.

34. CRS §§ 25-15-201 (hazardous waste); 30-20-102 (solid waste).

35. CRS §§ 25-15-308 (hazardous waste); 30-20-114 (solid waste).

36. 7 C.C.R. 1101-14, Art. 4.

37. *See* Part I, *supra*, note 1 at 16.

38. *See generally* Pierce, "Structuring Routine Oil and Gas Transactions to Minimize Environmental Liability," 33 *Washburn L.J.* 76 (Fall 1993). The recent U.S. Supreme Court ruling in *Cooper Indus., Inc. v. Aviall Servs., Inc.*, No. 02-1192 (S.Ct. 2004), held that a private party who has not been sued under CERCLA § 106 or 107 may not sue other liable parties under CERCLA § 113(f)(1) for contribution to its costs. It is yet not clear to what extent this ruling will preclude a CERCLA-responsible party (including surface owners who may attempt to recover from a lessee/operator) from recovering cleanup costs in the absence of an agency order or suit (*i.e.*, voluntary cleanup costs).

39. COGCC Regs. § 911(f)(4).

40. COGCC Regs. § 911(f)(2).

41. COGCC Regs. § 1001(b).

42. COGCC Regs. §§ 1001 through 1004. Operators could argue that as long as historical pits were reclaimed in accordance with the then-applicable reclamation requirements, they have no further remedial obligations. However, the COGCC considers other general requirements to authorize COGCC to enforce its current standards against operators responsible for historical pits, including general requirements under COGCC Regs. § 324A to

> take precautions to prevent significant adverse environmental impacts to air, water, soil, or biological resources to the extent necessary to protect public health, safety and welfare, by using cost-effective and technically feasible measures to protect environmental quality and to prevent the unauthorized discharge or disposal of oil, gas, E&P waste, chemical substances, trash, discarded equipment or other oil field waste.

Conversation with Debbie Baldwin, Environmental Supervisor**,** COGCC (Aug. 26, 2004).

43. COGCC Regs. § 703.

44. COGCC Regs. § 706.

45. COGCC Regs. § 708. *See* discussion of high density requirements in the section entitled "COGCC 'High Density' Requirements" in text accompanying notes 72-84, *infra*.

46. *Compare* COGCC Regs. Table 910-1 *with* 7 C.C.R. 1101-14, § 5-3 *and* Colorado Dept. of Labor and Employment, Div. of Oil and Public Safety, *Petroleum Storage Tank Owner/Operator Guidance Document* at § 4 (1999) *and* CDPHE, *Soil Remediation Objectives Policy Document*, Table 1 (June 2004 draft) (*hereafter*, "*Soil Remediation Policy*"), available on request from the CDPHE Hazardous Materials and Waste Management Division Technical Assistance Line, (303) 692-3320.

47. COGCC Regs. § 910(b)(3), Table 910-1.

48. COGCC Regs. § 907(e).

49. *Compare* COGCC Regs. at Table 910-1 *with* 7 C.C.R. 1101-14, § 5-3.

50. *Compare* COGCC Regs. at Table 910-1 *with Soil Remediation Policy, supra*, note 46. CDPHE criteria for arsenic in soil are acknowledged as being below naturally occurring levels in many parts of Colorado.

51. *See* COGCC Regs. §§ 906(d), 909(b), and 910.

52. *Gerrity, supra*, note 25 at 927.

53. *Id.*

54. *Id.*

55. 2001 Colo. Sess. Laws 152.

56. *See* Bate, "Oil and Gas Title Searches and Notice Under the Surface Development Notification Act," 31 *The Colorado Lawyer* 113, 114 n.9 (Oct. 2002).

57. *See* CRS § 24-65.5-103.

58. *See* CRS § 34-60-106(14).

59. *See* CRS § 10-11-123.

60. CRS § 24-65.5-103(1).

61. *Id.*

62. *Id.*

63. CRS § 24-65.5-103(2).

64. CRS § 24-65.5-103(4).

65. CRS § 24-65.5-104(3).

66. CRS § 24-65.5-104(2).

67. *Id.*

68. *Id.*

69. *Id.*

70. CRS § 24-65.5-104(3).

71. As of the date this article was written (April 2005), no challenges to H.B. 1088 have been recorded.

72. CRS § 34-60-106(11).

73. That said, the COGCC does not interpret its regulations as defining the extent to which mineral rights owners must accommodate surface owners. *See* COGCC, "Typical Questions from the Public about Oil and Gas Development in Colorado," available at http://oil-gas.state.co.us/general/typquest.html. If these regulations constrain, or possibly prohibit, future development or limit activities associated with the operation of existing wells, the mineral interest lessee may be able to assert claims for injunctive relief and damages against the surface interest holder for allowing future development to move forward without taking into consideration the right of the mineral interest owner to develop its mineral interests. Therefore, the existence of these requirements does not make surface owner liability limitations under H.B. 1088 any less significant.

74. *See Gerrity, supra*, note 25 at 931.

75. COGCC Regs. § 603(b). A building unit is defined as a "building or structure intended for human occupancy. A dwelling unit is equal to one (1) building unit, every guest room in a hotel/motel is equal to one (1) building unit, and every five thousand (5,000) square feet of building floor area in commercial facilities, and every fifteen thousand (15,000) square feet of building floor area in warehouses, or other similar storage facilities, is equal to one (1) building unit." COGCC Regs. § 100.

76. *Id.*

77. COGCC Regs. § 603(c).

78. COGCC Regs. § 100 ("a well-defined outside area (such as a playground, recreation area, outdoor theater, or other place of public assembly) that is occupied by twenty (20) or more persons on at least forty (40) days in any twelve (12) month period or by at least five hundred (500) or more people on at least three (3) days in any twelve (12) month period").

79. COGCC Regs. § 603(e)(2)-(17).

80. COGCC Regs. §§ 801 through 804.

81. To make these regulations apply to an existing well, the surface owner would seek a ruling by the COGCC that the area had become a high-density area by filing an application for a ruling from the COGCC. *See* COGCC Regs. § 503.

82. COGCC Regs. § 603(e)(1). Even when applicable at the time the new permit is issued, setback requirements may be waived if the well meets the location requirements of COGCC Regs. § 318 and the operator has obtained waivers from all owners of occupied buildings within 350 feet of any occupied building or building permitted for construction. Also, the well must meet all other safety requirements. COGCC Regs. § 603(e)(6).

83. COGCC Regs. § 603(e)(12)-(13).

84. COGCC Regs. § 802(a)(5).

85. *See Voss v. Lundvall Bros., Inc*., 830 P.2d 1061, 1062 (Colo. 1992) (ban on drilling preempted).

86. *See Bd. of County Comm'rs v. Bowen/Edwards Assocs., Inc.*, 830 P.2d 1045, 1059-60 (Colo. 1992) (local regulation presenting operational conflicts with state statutory or regulatory scheme preempted).

87 *Id.* at 1060.

88. *Id.*

89. *See Town of Frederick v. North Amer. Res. Co.*, 60 P.3d 758, 765 (Colo.App. 2002) (increased local setbacks and more stringent noise regulations preempted).

90. *See, e.g.*, City of Westminster Municipal Code, Chap. 4, Zoning ("Westminster Code"), § 11-4-14. The Westminster Code states: "Within all zoning districts, it shall be unlawful for any person to drill a well, or reactivate a plugged or abandoned well, or extract resources from a well, or install accessory equipment or pumping systems unless an Official Development Plan . . . authorizing such activity or use has first been granted by the City in accordance with the procedures defined in this Chapter." Westminster Code § 11-4-14(C)(1).

91. Part I, *supra*, note 1 at 12.

92. CRS § 38-35-109(1).

93. *See Collins v. Scott*, 943 P.2d 20, 22 (Colo. App. 1996); *Enerwest, Inc. v. Dyco Petroleum Corp.*, 716 P.2d 1130, 1131-32 (Colo.App. 1986); *cf*. CRS § 35-38-108.

94. *See* Part I, *supra*, note 1 at 16-17.

95. *See id.*

96. *See id.*

97. *See id.*

98. *See id.*

99. *See id.*

100. *See* discussion entitled "H.B. 1088" in text accompanying notes 55-71, *supra*.

101. *See id.*

102. *See* Part I, *supra*, note 1 at 18-19.

103. *See id.* at 16-17.

104. *See id.* at 19.

105. *See id.*

106. *See id.* ■

CBA Water Law Section Donates $2,000 To Delph Carpenter Papers Restoration Project

The Colorado Bar Association Water Law Section raised $2,000 to assist Colorado State University ("CSU") with the restoration of the papers of Delph Carpenter. Carpenter's papers are central in the negotiations of the Colorado River Compact and preserve other vital Colorado water-related history. The Carpenter collection is included among other valuable documents in the Water Resources Archive at CSU's Morgan Library. The Carpenter documents soon will be made available for use by students, researchers, faculty, staff, the water community, and the general public.