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# COLORADO REAL ESTATE JOURNAL

THE COMMUNICATION CHANNEL OF THE COMMERCIAL REAL ESTATE COMMUNITY

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## Law & Accounting

### Surface developers must plan

*EDITOR'S NOTE: This is the first of a two-part article on surface development with regard to oil and gas production.*

As commercial and residential development fans out along the Front Range, developers increasingly encounter prospective sites where mineral interests have been severed from the surface estate or where mineral interests have been leased. At these sites, abandoned or active oil and gas wells — as well as the potential for future oil and gas development — are risks a surface developer disregards at its peril.

Both current and historical oil and gas development and production have operational and environmental impacts that may adversely affect planned development and could result in liability to a surface developer. While current or historical oil and gas operations may not preclude development, a surface developer is well-advised to perform careful due diligence and plan appropriately.

■ **Potential impacts.** As a general matter, 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*. This right includes the rights of ingress, egress, exploration, and surface usage as are reasonably necessary to the successful exploitation of the mineral interest.

During typical oil and gas operations, access roads and a drilling pad are constructed in the drilling and well completion phase, and remain for access during well production activities. During drilling, drill cuttings and drilling muds, used to lubricate the drill bit and remove cuttings, are brought to the surface and may contain metals and other contaminants, includ-



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acid, waste cement and metal casings, among others.

During production activities, produced water lifted from underground during oil and gas production may contain contaminants including benzene, naphthalene, toluene, metals and radionuclides. This water typically is reinjected into the ground, but also may be used as a dust suppressant on roads, allowed to percolate or evaporate, or be treated and discharged. Tanks for the temporary storage of oil, natural gas liquids (condensate) or produced water also may be located on site. The sludge that forms on the bottom of these tanks, known as "tank bottoms," requires removal and is likely to contain hydrocarbons and other contaminants that must be disposed of. Production also involves the use of machinery, including pumps, heater-treaters, and motors that produce air emissions and noise, and require fuel. Under Colorado regulations, noise associated with these operations is allowed in residential areas at levels up to 55 decibels during the day and 50 db at night, taking into account ambient noise levels.

Well maintenance activities, which are required at regular

ing mercury, cadmium, arsenic and hydrocarbons. These waste materials typically are placed on site in a reserve pit and then either moved off site for disposal or buried on site. Well completion wastes may include hydrochloric

intervals, involve use of strong acids for scale removal, paints and cleaning solvents, and use of corrosion inhibitors and simulation compounds that are flushed through the well. These materials may appear in production water, or spills at the surface. Well maintenance also may require the use of a work-over rig with attendant noise, traffic and emissions.

Spills from leaking tanks, spills during transfer of condensate and chemicals associated with production or maintenance activities, or releases from flow lines are the most common forms of accidental releases. Well blowouts also may occur and, while rare, can result in releases of pollutants as well as significant destruction of equipment and danger to workers.

When a well ceases production, if the well is abandoned, down-hole equipment is removed, the well bore is cleaned of fill, scale and other debris and cement plugs and pressurized fluid are placed in the well bore to prevent the inflow of fluid to the well casing. The well casing is cut below the surface and capped with a steel plate and the ground surface reclaimed. Associated flow lines may be abandoned by simply purging liquid hydrocarbons, cutting the line off at least three feet below the ground surface or the depth of the flow line, whichever is less, and sealing the ends. This abandoned infrastructure may require removal during site preparation and construction and may be the source of undetected releases that require remediation.

■ **Implications for developers.** Well locations, health and safety, and environmental aspects of oil and gas production operations, with some exceptions, are regulated by the Colorado Oil and Gas Conservation Commission.

Well operators are liable for their violations of commission regulations, as well as other applicable federal and state laws. However, these regulatory requirements may not be sufficient to assure that production activities are consistent with surface development or will not result in liability to a developer. Spills and practices associated with historical wells may have predated current regulatory requirements and current regulatory requirements have important weaknesses.

Further, despite the often-cited "petroleum exclusion," many of the wastes associated with oil and gas production fit the definition of "hazardous substances" that can trigger strict joint and several surface owner liability under the federal Comprehensive Environmental Response, Compensation and Liability Act if cleanup is required. Releases to surface water from old pits also have been a source of liability to surface owners. If a surface owner inadvertently exacerbates existing contamination, for example, by spreading wastes from historical operations during rough grading or surface preparation activity, liability under the Resource Conservation and Recovery Act and related state laws will follow. Lastly, purchasers may have claims against a surface developer arising out of failure to provide adequate notice of ongoing operations, failure to incorporate setbacks and other safety-related features into the development plan, or failure to adequately evaluate the environmental suitability of the site for development, among others. While a surface developer is likely to successfully assert claims for damages or contribution against the oil and gas operator in these circumstances, litigation may be the only, and a costly, recourse.▲



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*EDITOR'S NOTE: This is the second of a two-part article on surface development with regard to oil and gas production.*

A new bill introduced in the Colorado General Assembly in February could help to mitigate some of the impacts to surface owners associated with future oil and gas development. The bill would require an operator to attempt to negotiate a surface use agreement with the surface owner as a condition of obtaining a permit to drill and to compensate the surface owner for loss of value associated with surface damage. The bill would require the surface use agreement to address facility location, reclamation, and means of minimizing surface damages, among other issues that the parties may identify. At the time this article is written, the future of the bill is not clear, however.

■ **Minimizing risks.** Keep in mind that many of the steps that a surface developer can take to minimize liability risks will carry associated costs and must be evaluated in the context of the specific transaction. That said, the following are some recommendations to consider:

■ Develop a good understanding of any current oil and gas operations, and the applicable legal obligations of the mineral lessee/operator under state and local law and any existing lease or surface use agreement. This understanding provides the basis for developing a strategy for managing potential liabilities associated with oil and gas operations on a prospective development site.

■ Investigate the cost of simply purchasing the mineral interests associated with the site, particularly where current operations are marginal, or the mineral interests are not currently economically feasible to develop.

■ As an alternative to taking title



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to the immediate area affected by a well, when feasible, consider leaving title to the well site parcel with the seller until after oil and gas operations have ceased, any mineral lessee rights have been released, and the site has been remediated to standards acceptable for planned development.

■ Perform environmental due diligence prior to purchasing a site designed to qualify for defenses to liability under the Comprehensive Environmental Response, Compensation and Liability Act related to preexisting contamination. Prior to purchase of a site, to qualify for the "innocent landowner" or "bona fide purchaser" defenses to CERCLA liability, a purchaser must perform "all appropriate inquiry." At this time, a Phase I Environmental Site Assessment that complies with the 2000 American Society of Testing and Materials standard is sufficient for this purpose. This investigation also will be the basis for planning any additional investigation that may be merited as well as managing construction activities to avoid exacerbating any later-discovered contamination.

■ Observe the notice procedures under House Bill 1088 (C.R.S. § 24-65.5-101 et seq.). HB 1088 is an important statutory effort to preclude claims by mineral interest owners (including claims from mineral lessees) that surface development has impaired their ability to develop the mineral estate, as long as the surface owner has observed specified notice provisions.

to the immediate area affected by a well, when feasible, consider leaving title to the well site parcel with the seller until after oil and gas operations have ceased, any mineral lessee rights have been released, and the site has been remediated to stan-

■ HB 1088 also assures that mineral interest owners have notice and an opportunity to object prior to final local government approval of surface development plans. So, it also is important to work with the mineral owner/lessee before submitting development plans to the local land-use jurisdiction for approval. As a practical matter, negotiation with the mineral owner/lessee should result in a surface use agreement with the surface owner that will determine "reasonable use" of the surface and accommodate development of both estates. The surface use agreement should include waiver of the lessee/operator's rights to object to development plans under HB 1088.

■ Where there is an existing surface use agreement, specifically inquire in writing of the mineral interest owner, or any current leaseholder, whether there have been any unrecorded amendments or superseding agreements to assure that the existing surface use agreement is enforceable.

■ Specify environmental and operational standards (such as noise limitations, limitations on hours of operation, or environmental standards for reclamation and environmental cleanup) in a surface use agreement, even if simply to give the surface developer a contractual right to require compliance with applicable regulatory standards.

■ Seek an indemnification from the lessee/operator in the surface use agreement 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/operator does not appear to be financially sound nor 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.

■ As an alternative to indemnifications, which may be difficult to negotiate, consider purchasing or requiring the seller or mineral interest owner to provide an environmental insurance policy to 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.

■ In the purchase agreement or any surface use agreement, identify remedial standards (including procedures) acceptable to the surface developer that would apply if remediation is required as a condition of conveyance to the developer or for any remediation conducted or funded by the seller after conveyance.

■ Incorporate relevant standards, such as setbacks and other relevant health and safety standards into the development plan for the site or assure that any decision not to do so can be substantiated.

■ Prepare materials management procedures for contractors to follow during intrusive site preparation and development activities to assure that any contamination encountered is appropriately segregated, characterized, removed or otherwise managed and disposed of prior to further development.

■ As a final mechanism for limiting potential liability to subsequent purchasers of a site, consider the combination of limitations on liability in purchase and sale agreements and complete disclosure. Contractual limitations on liability could include "as is" clauses, disclaimers of warranties and representations regarding the condition of the property, and express acknowledgements of, and releases from the purchaser of any claims associated with, environmental conditions or oil and gas operations generally. ▲