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Montana

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MONTANA

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I. BACKGROUND

In 2018, Montana produced 21.5 million barrels of crude oil and 93.2 million cubic feet of natural gas. Nationally, Montana ranked thirteenth in crude oil production. Through August 2019, crude oil production declined by 587,000 barrels, and natural gas production increased by 5.5 million cubic feet when compared to the same period in 2018.[1]

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1. *See Montana Field Production of Crude Oil*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MCRFPMT2&f=M [https://perma.cc/JYT8-EBNK] (last visited Dec. 5, 2019) (displaying the annual crude oil production and the decrease in crude oil production in 2019); *See U.S. natural gas production (gross withdrawals)*, U.S. ENERGY INFO. ADMIN., https://www.eia.gov/petroleum/production/#ng-tab [https://perma.cc/N9ZU-M3LV] (follow: tab option on the screen to "Montana") (last visited Dec. 5, 2019) (indicating the increase in natural gas production).

II. MONTANA SUPREME COURT

The Montana Supreme Court only decided one oil and gas case in the last year.

A. *Ferdig Oil Co. v. ROC Gathering, LLC*

Ferdig Oil Co. ("Ferdig") and ROC Gathering, LLP ("ROC") both conduct natural gas operations in north-central Montana. Both companies own natural gas processing facilities. ROC's plant delivers processed gas to Northwestern Energy ("Northwestern"), and Northwestern then transmits processed gas to its customers. Ferdig processes sour gas at its facility. Ferdig transmits processed gas via a pipeline that interconnects with ROC's gas delivery line.

In 2006, Ferdig, ROC, and several related companies entered into a settlement agreement to resolve a variety of ongoing business disputes. The agreement contained provisions allowing Ferdig to tap into the ROC delivery line. In 2010, ROC notified Ferdig that it was terminating the right to tap, claiming that Ferdig was allowing sour gas into the pipeline. Two years later, Ferdig sued seeking a declaration of its rights. Ferdig did not serve the lawsuit until 2014. ROC then filed counterclaims.

Ferdig sought a preliminary injunction to prevent ROC from denying access to its line. When the district court denied the injunction, Ferdig built its own line to connect with Northwestern's line. Ferdig then amended its complaint adding several additional claims. The parties filed cross motions for summary judgment. After the district court ruled in favor of ROC, Ferdig appealed to the Montana Supreme Court.

The Supreme Court appeal focused on whether ROC had improperly added terms to the 2006 settlement agreement by requiring that Ferdig certify the safety of repair work Ferdig had performed to address the sour gas issue. The Court denied the appeal, finding that the request for certification was made after ROC already had alleged in litigation that Ferdig was in breach of the 2006 agreement, and therefore was not an attempt to renegotiate the existing agreement. [2]

2. Ferdig Oil Co. v. ROC Gathering, LLP, 432 P.3d 118 (Mont. 2018).

The Court also upheld most of the contract-based attorney's fees awarded by the district court.

III. NINTH CIRCUIT COURT OF APPEALS

A. *Northern Oil & Gas v. Continental*

On September 29, 2008, Northwest Farm Credit Services ("NWFCS") entered into a five-year primary term oil and gas lease with Diamond Resources, Inc. ("Diamond"). Diamond later assigned the lease to Continental Resources. The lease covered a half section in Richland County, Montana. Diamond and Continental timely paid delay rentals for the first four years.

In September 2013, Continental began drilling operations in an adjacent section. However, the adjacent section was not pooled with the leased parcel until after the end of the five-year primary term. After the primary term ended on September 29, 2013, NWFCS entered into a new lease with Northern. NWFCS and Northern then filed suit in federal court based on diversity jurisdiction to determine whether the Continental lease had terminated. By consent, the case was assigned to a United States magistrate judge.

The magistrate issued two rulings on summary judgment. First, in 2016, the court ruled that although Continental had commenced drilling operations prior to the expiration of the primary term, the operations did not occur on the leased premises, and therefore the lease expired.[3] The following year, the magistrate ruled that Northern was not required to participate in the costs associated with Continental's well, which had been included in a spacing unit established after the date of the Northern lease.[4]

The district court entered final judgment on November 17, 2017.[5] Continental then appealed to the Ninth Circuit. Continental made three arguments on appeal: (1) the lease was successfully pooled prior to the expiration of the primary term; (2) a 2014 pooling order

3. N. Oil & Gas, Inc. v. Cont'l Res., Inc., No. CV 14-90-BLG-CSO, 2016 WL 3079692, at *7 (D. Mont. May 31, 2016).

4. N. Oil & Gas, Inc. v. Cont'l Res., Inc., No. CV 14–90–BLG–TJC, 2017 WL 4287201, at *5 (D. Mont. Sept. 27, 2017).

5. N. Oil & Gas, Inc. v. Cont'l Res., Inc., No. CV 14-90-BLG-TJC, 2017 U.S. Dist. LEXIS 190778 (D. Mont. Nov. 17, 2017) (order and final judgment).

should be applied retroactively; and (3) Northern should be judicially estopped from electing a nonconsent position.

In an unpublished opinion with little analysis, the Ninth Circuit rejected each of Continental's arguments. First, Continental argued that a temporary spacing unit approved by the Montana Board of Oil and Gas Conservation ("MBOGC") several years before the lease satisfied the pooling clause. The district court applied Montana contract law and rejected this interpretation, finding that the spacing unit was entered into for a different purpose than what was contemplated under the lease. Next, the Court found there was no legal basis to apply the 2014 spacing order retroactively. Finally, the Court upheld the magistrate's determination that Northern was not judicially estopped from electing a nonconsent position because Northern did not expressly or impliedly indicate consent to participate in the costs of the well.

While the case has minimal precedential effect, it does show how a federal court interprets Montana law for purposes of parties seeking participation in costs associated with a well where a spacing unit covers multiple leases. It also provides insight as to when a pooling clause will extend a lease when drilling operations occur on an adjacent parcel shortly before the end of the primary term of a lease.

B. *Murray v. BEJ Minerals, LLC*

In a diversity jurisdiction case decided in November 2018 and reported in the update last year,[6] the Ninth Circuit held that under Montana law, dinosaur fossils are "minerals" within the meaning of a mineral reservation contained in a deed.[7] Although the surface owner in this case owns a partial interest in the mineral estate, the ruling momentarily deprived the surface owner of the value of a nearly intact set of fossils of the two dinosaurs and a nearly fully intact Tyrannosaurus rex skeleton. The fossils potentially are worth millions of dollars, so the litigation and legal wrangling did not stop with the Ninth Circuit's ruling.

Following the ruling, Mary Ann and Lige Murray, the surface owners, petitioned for rehearing. On April 4, 2019, the Ninth Circuit

6. Stephen R. Brown, *Montana*, 5 TEX. A&M J. PROP. L. 57, 59 (2019).
7. Murray v. BEJ Minerals, 908 F.3d 437, 447–448 (9th Cir. 2018).

agreed to rehear the case en banc.[8] The en banc panel determined that there was no controlling Montana Supreme Court precedent to guide the federal court, and the issue of whether dinosaur fossils belong to the surface or the mineral estate "presents important public policy ramifications for Montana."[9] The court went on to note that the combination of frequently divided ownership in Montana and the state "possesses vast deposits of valuable vertebrate fossil specimens, which are substantial issues with broad application."[10] As of the date of this update, the case remains pending before the Montana Supreme Court.[11] Additionally, as discussed below, the 2019 Montana Legislature also stepped into this fray.

IV. FEDERAL DISTRICT COURT OF MONTANA

A. *WBI Energy Transmission, Inc. v. Subsurface Easements for the Storage of Natural Gas in the Judith River Subterranean Geological Formation*[12]

The Baker Storage Field has operated as a natural gas storage field in southeastern Montana since the 1940s. In 2011, the Montana Supreme Court issued an opinion clarifying that the surface owner, not the mineral interest owner, owns the pore space and the rights to subsurface storage of natural gas.[13] As a consequence, WBI Energy Transmission, Inc. ("WBI"), the field operator, was forced to negotiate leases with the various surface owners within the storage field.

WBI successfully negotiated leases with most surface owners. A few held out, so WBI filed a condemnation action in federal district court under the Natural Gas Act.[14] The defendants counterclaimed based on trespass and other legal theories. The federal magistrate

8. Murray v. BEJ Minerals, LLC, 920 F.3d 583 (9th Cir. 2019).
9. Murray v. BEJ Minerals, LLC, 924 F.3d 1070, 1071–072 (9th Cir. 2019) (en banc).
10. *Id.* at 1072.
11. Murray v. BEJ Minerals, LLC, OP 19-0304, 2019 WL 2383604 (Mont. June 4, 2019).
12. No. CV 18-88-BLG-SPW-TJC, 2019 WL 3470742, (D. Mont. July 08, 2019).
13. Burlington Res. Oil & Gas Co. v. Lang & Sons Inc., 259 P.3d 766 (Mont. 2011).
14. *See* WBI Energy Transmission, No. CV 18-88-BLG-SPW-TJC, 2019 WL 3470742 at *1 (D. Mont. July 08, 2019).

assigned to the case recommended that the counterclaims be dismissed on the grounds that they were precluded as a matter of law under Federal Rule of Civil Procedure 71.1, which is the procedural rule governing condemnation cases.[15]

B. *Fidelity Exploration & Production Co. v. Bernhardt*

In 2005, the United States Bureau of Land Management ("BLM") approved a plan for Fidelity Exploration & Production Co. ("Fidelity") to operate a 210-well coal bed natural gas project in Big Horn County, Montana. In addition to wells on federal leases, the project also included wells on state land and private land. In 2010, the BLM notified Fidelity that it was not correctly calculating production because it was improperly commingling production records from the various wells. The BLM also notified Fidelity that it was improperly deducting production used on the leases.

Fidelity disputed the BLM's allegations and appealed to the BLM State Director, then to the Interior Board of Land Appeals ("IBLA"), both of which upheld the BLM's determination. Fidelity then appealed the IBLA decision to federal district court, where it was assigned to a magistrate judge.[16]

The primary substantive issue addressed by the court was whether the BLM had approved Fidelity commingling gas prior to measurement and also using a gas off-lease for its operations. Fidelity contended both practices had been disclosed in the plan of operations submitted to the BLM and when the BLM approved the plan, it also approved these practices. Fidelity also argued that both practices are allowed by the rules that were in place prior to 2017.[17]

The court applied an arbitrary and capricious standard of review to BLM's interpretation of its own regulations. After reviewing the entire record, the magistrate found that while the rules do allow for gas from multiple wells to be commingled prior to measurement and a federal lessee may make off-lease beneficial use of gas, both practices require prior express federal authorization and each practice must be approved individually. Under the deferential administrative

15. Fed. R. Civ. P. 71.1.

16. Fid. Exploration & Prod. Co. v. Bernhardt, No. CV 16-167-BLG-SPW-TJC, 2019 WL 2029482 (D. Mont. Jan. 24, 2019).

17. *See* 43 C.F.R. § 3162.7-3.

standard of review, the magistrate found no express reference to approval of reporting based on commingled volumes. Merely approving a plan of operations without expressly approving the two practices was not sufficient.

Fidelity objected to the magistrate's findings and recommendations, but the objection was denied by the federal district court and the findings and recommendations were adopted in full.[18]

V. LEGISLATION

The Montana legislature meets for its regular session biannually in odd numbered years.[19] The 66th Montana Legislature convened on January 7, 2019 and adjourned on April 25.

A. *Oil and Gas Taxation*

Since 1999, Montana's tax code has included an oil and gas tax "holiday," which provides for a lower tax rate during the initial period after a well begins producing. The tax also is adjusted if the price of oil or natural gas drops below certain threshold prices.[20] Critics of the holiday argue it deprives counties of valuable revenue during what often is the most productive phase in the life of a well.[21] Supporters argue it incentivizes development. A bill to end the holiday was introduced but failed in committee.[22]

Ultimately, the legislature passed two bills relating to oil and gas taxation, but they only made minor corrections. House Bill 213 changed the benchmark for purposes of tax exemption from the west Texas intermediate crude oil price to the price reported and received

18. Fid. Exploration & Prod. Co. v. Bernhardt, No. CV 16-167-BLG-SPW, 2019 WL 1149975 (D. Mont. Mar. 13, 2019).

19. MONT. CONST. art. V, § 6.

20. *See* MONT. CODE ANN. § 15-36-304(5) (2019).

21. *See, e.g.*, Montana Budget & Policy Center, *Oil and Gas Tax Holiday: Montana Cannot Afford Giving Away Millions to Oil Companies*, (Jan. 2019), https://mbadmin.jaunt.cloud/wp-content/uploads/2019/01/Oil-and-Gas-Holiday-2019-FINAL.pdf [https://perma.cc/6JQH-Y4B2]; *See also*, *e.g.*, Montana Petroleum Ass'n., *Montana Oil and Gas Tax Rates*, https://montanapetroleum.org/educational-resources/montana-oil-gas-tax-rates/ [https://perma.cc/FV3X-32DP].

22. H.B. 691, 66th Sess. (Mont. 2019).

by the producer for Montana oil.[23] This change is favorable to producers because the Montana price often is lower. House Bill 656 changed how production taxes are used by the State after they are collected.[24]

B. *Defining the Term "Minerals" in Property Transaction Instruments*

Even though the Ninth Circuit agreed to rehear the *Murray* case, which found that Montana law presumes fossils are part of the mineral estate, the 2019 Legislature stepped in with a bill to codify the opposite interpretation. House Bill 229 states that when the term "minerals" is used in a property conveyance instrument, the term is not intended to include "fossils" unless the instrument clearly and expressly states otherwise.[25] The new law also specifies that fossils are not intended to be part of the general statutory provisions that govern mineral production. The new legislation has not affected the ongoing litigation in the *Murray* case.

23. H.B. 213, Reg. Sess. (Mont. 2019).
24. H.B. 656, Reg. Sess. (Mont. 2019).
25. H.B. 229, Reg. Sess. (Mont. 2019).