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Florida Oil and Gas Update

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FLORIDA OIL AND GAS UPDATE

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I. CASE LAW

A. *Relocation of a Gas Pipeline in Response to Pending Construction is Not an Abnormally Dangerous Activity Subject to Strict Liability*

In *Peoples Gas System v. Posen Construction, Inc.*, a case of first impression in Florida, the United States District Court for the Middle District of Florida held that relocation of a gas pipeline in response to pending construction is not an "abnormally dangerous activity" subject to strict liability.[1]

Peoples Gas System, a division of Tampa Electric Company ("Peoples Gas"), owns, operates, maintains, and controls natural gas distri-

1. Peoples Gas Sys. v. Posen Const., Inc., No. 2:11-cv-231-FtM-29SPC, 2012 WL 2358161, at *4 (M.D. Fla. June 20, 2012).

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bution facilities throughout Florida.[2] Posen Construction, Inc. ("Posen") is a heavy construction contractor who was awarded a construction contract to widen a road in Fort Meyers, Florida, under which lay an eight-inch gas main belonging to Peoples Gas. While the exact sequence of events is unclear from the court's opinion, it appears that at some point prior to the start of the road construction, but after the work was planned, Peoples Gas had relocated its gas pipeline to under the area Posen planned for the road construction, "making it all but certain it would be struck during construction."[3] Peoples Gas did not notify Posen that it had relocated the pipeline into the planned construction area.[4] Thereafter, while performing the road construction, Posen struck the pipeline, igniting the gas.[5]

Peoples Gas sued Posen;[6] Posen counterclaimed that Peoples Gas should be held strictly liable on grounds that its relocation of the gas line into a zone of planned construction was "abnormal and unusual, and uncommon."[7]

While recognizing the relevant precedence establishing that (a) distribution of gas is not considered an "abnormally dangerous activity" for purposes of strict liability and (b) that installation of natural gas lines is considered an "inherently dangerous activity" in the context of simple negligence, the court considered six factors to determine whether relocation of a gas pipeline is an "abnormally dangerous activity" subject to strict liability:

(1) Existence of a high degree of risk and likelihood of harm;
(2) Likelihood of great harm;
(3) Inability to eliminate risk by the exercise of reasonable care;
(4) Uncommonness of the activity;
(5) Inappropriateness of the location;
(6) Extent to which the danger outweighs the value to the community.[8]

Considering all of these factors, the court held that relocation of a gas pipeline "does not constitute an abnormally dangerous activity subject to strict liability."[9]

2. *Id.* at *1.
3. *Id.* (describing allegations contained in defendant Posen's amended counterclaim).
4. *Id.*
5. *Id.*
6. The substance of Peoples Gas's complaint is not described in the opinion. *Id.*
7. *Id.* (describing allegations contained in defendant Posen's amended counterclaim).
8. *Id.* at *2.
9. *Id.* at *4.

B. *Contract Dispute Over Payment of Cost to Relocate a Gas Pipeline Due to Turnpike Expansion Project*

The case of *State v. Florida Gas Transmission Co., LLC* is, essentially, a contract dispute between the Florida Department of Transportation ("Florida DOT") and Florida Gas Transmission Company ("Florida Gas") over which party is responsible for paying the costs to relocate a gas pipeline to allow construction of a turnpike expansion project.[10]

Florida DOT appealed a declaratory judgment setting the width of a gas pipeline easement and a damages judgment for the cost of relocating a gas pipeline located in the path of a turnpike expansion project. Florida DOT argued that the trial court erred when it (1) submitted unambiguous contract language to the jury for interpretation, resulting in the jury finding that Florida Gas was entitled to reimbursement for its pipeline relocation costs and (2) granted Florida Gas a uniform permanent easement width and temporary work space rights. Florida Gas filed a cross-appeal on other issues.[11]

1. Background

Construction of Florida's Turnpike began in the mid-1950s and was completed in 1957, with various additions and expansion projects occurring in later years.[12] In 1958 and 1967, Florida DOT and Florida Gas entered into two easement agreements under which Florida Gas would be allowed to—and did—construct, maintain, and operate two natural gas pipelines within the Turnpike right-of-way.

In 1958, the Florida Turnpike Authority (a sub-agency of Florida DOT) entered into an easement agreement with Houston Gas (a predecessor of Florida Gas)[13] allowing the gas company to lay, construct, maintain, and operate a natural gas pipeline within the Turnpike right-of-way. Pursuant to the easement agreement, Houston Gas installed an eighteen-inch pipeline along 109 linear miles of the Turnpike. The easement contained a metes and bounds description with a starting and ending point, but it did not (1) specify where within the easement the pipeline would be located; (2) specify a uniform ease-

10. State v. Fla. Gas Transmission Co., LLC, No. 4D11–2567, 2012 WL 2014755, at *1–4 (Fla. Dist. Ct. App. June 6, 2012).

11. *Id.* at *5–6. On cross-appeal, Florida Gas argued that the trial court erred in (1) requiring Florida Gas to pay the cost of relocating the pipeline in the future if it did not consent to Florida DOT paving over the pipeline, and (2) failing to find that mechanically-stabilized earth walls always constitute interference with Florida Gas's easement rights. *Id.* at *7–8.

12. *Florida's Turnpike: Providing Transportation Alternatives for 55 Years!*, FLORIDA'S TPK. ENTER., http://www.floridasturnpike.com/about_history.cfm (last visited Nov. 1, 2012).

13. *Fla. Gas Transmission*, 2012 WL 2014755, at *1. Houston Gas became known as Florida Gas Transmission in 1962. *Id.*

ment width; or (3) guarantee a minimum amount of temporary work space.[14]

In 1967, the Turnpike Authority entered into a second easement agreement that allowed Florida Gas to lay a second, twenty-four-inch pipeline in the Turnpike right-of-way. Like the 1958 easement, the 1967 easement did not specify a location for the pipeline within the right-of-way.[15] The 1967 easement required Florida Gas "to conduct its activities in connection with the construction and operation of any and all pipelines which have been, or may be, constructed and operated by [Florida Gas] in such a manner as to interfere to the least possible extent with the overall operation of the [Turnpike]."[16] Importantly, the 1967 easement specified that Florida Gas would be responsible for its own expenses should a Turnpike expansion require relocation of a pipeline.[17]

In 1987, the parties amended the 1967 easement to clarify the rights of the parties with respect to pipeline relocation costs. Following the 1987 amendment, section 10 of the 1967 easement read as follows:

> In the event it shall become necessary to rearrange or relocate the pipeline system to accommodate changes or improvements on or to the [Turnpike] and such rearrangements and relocations are reasonably required for such purposes, they will be made by [Florida Gas] at its own expense. . . . The determination of what changes and improvements are to be made on or to the [Turnpike] is reserved solely to [Florida DOT].[18]

Like the original 1967 easement, the amendment also required Florida DOT to "fully cooperate" with Florida Gas to consider alternatives that would allow the pipeline "to remain in place or with a minimum disturbance."[19]

Subsequently, in 1992, Florida Gas and Florida DOT entered into two additional agreements relating to the pipeline easements. The first one applied to Florida Gas's facilities located within the state right-of-way pursuant to a permit or license, and it specified that Florida Gas would not be reimbursed for relocation of those facilities (the

14. *Id.* The 1958 easement directed that the pipeline and necessary appurtenances were "to be constructed in the most practicable and workable locations, consistent with usual pipeline construction procedures, by and with the consent of [the Turnpike Authority] and its engineers." *Id.* The easement also specified that the pipeline would be located "at a distance of not less than 40 feet from the outer edge of the pavement of [the Turnpike], except where structures and topographical features shall require a lesser distance, as permitted by [the Turnpike Authority] or its engineers." *Id.*

15. *Id.* Like the 1958 easement, the 1967 easement also contemplated that Florida Gas would install the pipeline at least forty feet from the outer edge of the pavement, unless the Turnpike Authority granted a variance. *Id.*

16. *Id.* at *2.

17. *Id.*

18. *Id.*

19. *Id.*

"Non-Reimbursable Agreement"). The second one applied in situations where the Florida DOT requested, and Florida Gas agreed, to relocate pipeline facilities located "along, over and under property in which [Florida Gas] holds a compensable interest" (the "Reimbursable Agreement").[20] Under the terms of the Reimbursable Agreement, Florida DOT agreed to reimburse Florida Gas "for all costs incurred by it in each such relocation of said facilities."[21]

2. The Dispute

Florida DOT initiated Turnpike widening projects in 2000, which required Florida Gas to relocate some of its pipeline facilities. Florida Gas sought reimbursement from Florida DOT for the pipeline relocation costs, in reliance on the Reimbursable Agreement. Florida DOT refused to pay, arguing that the Reimbursable Agreement did not apply. The crux of the dispute centered around the term "compensable interest" and whether Florida Gas indeed had such interest in the property from which the pipeline was relocated so as to trigger the Reimbursable Agreement.

Florida Gas sued, seeking reimbursement of the pipeline relocation costs and determination of both a permanent easement width and temporary workspace rights. Florida DOT counterclaimed that Florida Gas had breached the easement agreements and sought damages for delays and for having to remove Florida Gas's old pipelines.[22] Following a jury verdict in favor of Florida Gas, the trial court awarded the gas company a permanent easement width and temporary workspace rights. The jury also found that Florida DOT had breached the Reimbursable Agreement. The trial court awarded Florida Gas $82,697,567 in damages.

The Florida DOT appealed, and Florida Gas cross-appealed, each arguing that the trial court had erred in adjudicating the meaning of the contract language at issue.[23]

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20. *Id.* Paragraph 1 of the Reimbursable Agreement incorporated the terms of the Utility Accommodation Guide, which defines "compensable interest" as "having established real property rights." *Id.* at *3.

21. *Id.* at *2.

22. *Id.* at *3.

23. *Id.* at *4. The Florida DOT argued that the trial court erred in allowing the jury to interpret the meaning of the term "compensable interest" as used in the Reimbursable Agreement and for allowing consideration of extrinsic evidence (Florida DOT's own 2004 Utility Accommodation Guide) to do so. *Id.* at *4, *6. Florida Gas argued that the trial court misconstrued the rights and obligations of the parties if Florida DOT should wish to pave over Florida Gas's pipelines and erred "in failing to find that mechanically-stabilized earth walls always constitute a material interference with [Florida Gas's] easement rights." *Id.* at *4.

3. The Outcome

The Fourth District Court of Appeals held that defined easement space was not contemplated by the parties at the time the subject easement was created and, thus, overturned the trial court's determination of a permanent easement width and temporary workspace rights.[24] The appellate court also directed the trial court, upon remand, to revise the part of the final judgment that failed to make reference to Florida DOT's obligation to seek reasonable alternatives to requiring pipeline relocation.[25] The appellate court affirmed the remaining parts of the trial court's judgment, holding that the trial court properly allowed the jury to consider the context of the testimony and the contractual language in order to ascertain whether the agreement was breached and to determine the proper amount of damages.

II. Legislative Actions

A. *New Law*

The 2012 regular session of the Florida Legislature began on Tuesday January 10, 2012, and ended on Friday, March 9, 2012. Only one oil-and-gas-related bill was passed during the survey period:

House Bill ("HB") 7087—Economic Development (Ch. 2012-32)—is designed to promote economic development in the State of Florida by, among several tax relief provisions, incentivizing production from the state's older, "mature" oil fields by applying a lower-tier severance tax rate. HB 7087 passed the Florida Legislature on March 9, 2012, and went into effect on July 1, 2012. The bill contains several provisions designed to encourage economic development, including amendments to the previously existing tax regime on severance and production of oil.

Section 211.02 of the Florida Statutes provides for a severance tax levied upon production of oil within Florida for sale, transport, storage, profit, or commercial use. The tax is measured by the value of the oil produced and saved or sold during a month. Prior to passage of HB 7087, the tax rate for small well oil[26] was 5% of the gross value. The tax rate for tertiary oil[27] varied based on the gross value of the oil and applied as follows: 1% of the gross value of oil on the value of oil

24. *Id.* at *6, *8.

25. *Id.* at *7.

26. "Small well oil" is defined as "oil produced from a well from which less than 100 barrels of oil per day are severed, considering only those days of the month during which production of oil from the well actually occurred." Fla. Stat. Ann. § 211.01(21) (West 2012).

27. "Tertiary oil" is defined as "the excess barrels of oil produced, or estimated to be produced, as a result of the actual use of a tertiary recovery method in a qualified enhanced oil recovery project, over the barrels of oil which could have been produced by continued maximum feasible production methods in use prior to the start of tertiary recovery. A 'qualified enhanced oil recovery project' means a project for enhanc-

$60 dollars and below; 7% of the gross value of oil on the value of oil above $60 and below $80; and 9% of the gross value of oil on the value of oil $80 and above. The tax rate for all other oil was 8% of the gross value. The severance tax collected on oil and gas production in Florida is placed in the state's Oil and Gas Tax Trust Fund.

HB 7087 amended section 211.02 to define a new class of oil, "mature field recovery oil," defined as "the barrels of oil recovered from new wells that begin production after July 1, 2012, in fields that were discovered prior to 1981."[28] The new law applies lower tiered tax rates to the classes of both "tertiary oil" and the newly defined "mature field recovery oil," constituting 1% of the gross value of oil on the value of oil $60 dollars and below; 7% of the gross value of oil on the value of oil above $60 and below $80; and 9% of the gross value of oil on the value of oil $80 and above.[29] The new law effectively makes it more cost effective for producers to extract additional oil from declining or abandoned fields in Florida that might otherwise be deemed economically prohibitive.

According to the Florida Department of Environmental Protection's 2010 Oil, Gas, and Water Production Data for the State of Florida, there are twenty-two oil fields in Florida, sixteen of which are "mature" fields discovered prior to 1981.[30] Seven of those mature fields are currently plugged and abandoned.[31]

The law also changed the distribution of the severance tax collected on small well oil, tertiary oil, and mature field recovery oil production to 63.5% to General Revenue (reduced from 67.5%) and 16.5% to the Minerals Trust Fund (increased from 12.5%), while the 20% distributed to the board of county commissioners of the county where the oil is produced remains unchanged.[32]

HB 7087 went into effect on July 1, 2012.

B. *Proposed Legislation*

Two other notable bills concerning oil and gas were proposed by the Florida Legislature in 2012, but not enacted:

Senate Bill 1158 and House Bill 695—Development of Oil and Gas Resources—if passed, would have authorized Florida land management agencies to enter into public–private partnerships with business entities to develop oil and gas resources on state-owned lands if the

ing recovery of oil which meets the requirements of 26 U.S.C. s. 43(c)(2) or substantially similar requirements." FLA. STAT. ANN. § 211.02(3)(a) (West 2012).

28. *Id.* § 211.02(4).

29. *Id.* § 211.02(1)(b).

30. OIL & GAS SECTION, BUREAU OF MINING & MINERALS REGULATION, STATE OF FLORIDA OIL, GAS, AND WATER PRODUCTION DATA COMPILED BY FIELD AND REGION (2010), http://www.dep.state.fl.us/water/mines/oil_gas/reports/oil_gas_wtr_prod.xls.

31. *Id.*

32. FLA. STAT. ANN. § 211.06 (West 2012).

development would yield near-term revenues for the state. Amid concerns from environmental groups, state regulators, and the Governor's office, particularly surrounding the bill's effect on state control over environmentally sensitive lands, the bill died in committee.

In the ongoing battle over oil drilling in Florida state waters, House and Senate Joint Resolution, HJR 23/SJR 928—Ban of Oil Exploration, Drilling, Extraction, and Production in Territorial Seas—proposed an amendment to section 7, article II of the Florida Constitution to prohibit the exploration, drilling, extraction, and production of oil beneath Florida waters between the mean high-water line and seaward limit of Florida's boundaries.[33] The proposed constitutional amendment would exempt transportation of oil produced outside of state waters. While drilling in state waters is currently prohibited by Florida law, that prohibition has been under attack in recent years, including a vote by the Florida House of Representatives to lift the statutory ban on drilling in state waters during the 2009 Legislative Session. A 2011 joint resolution proposing to similarly amend the Florida Constitution was also unsuccessful.[34]

33. Florida state waters extend approximately three miles into the Atlantic Ocean and ten miles into the Gulf of Mexico.

34. H.R.J. Res. 383, 113th Reg. Sess. (Fla. 2011); S.J. Res. 928, 113th Reg. Sess. (Fla. 2011).