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Tennessee Oil and Gas Update

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TENNESSEE OIL AND GAS UPDATE

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I. INTRODUCTION OF OIL AND GAS DEVELOPMENT

This Article provides an annual update regarding developments in the oil and gas industry in the State of Tennessee covering the period from August 1, 2011, through July 31, 2012, with a focus on major state legislative and regulatory proposals and enactments and developments in the common law.

II. LEGISLATIVE UPDATES

A. *Proposed House Bill 3199*

Introduced January 25, 2012, proposed House Bill 3199 would amend Tennessee Code Annotated, title 59 and title 69, relative to the mining industry.[2] The proposed bill enacts the Responsible Coal Op-

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2. H.B. 3199, 107th Gen. Assemb., 2nd Reg. Sess. (Tenn. 2012).

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erators Act of 2012 ("Act").[3] The Act authorizes the Commissioner of Environment and Conservation ("Commissioner") to consider past practices when deciding whether to issue, renew, or deny a permit issued under the Water Quality Control Act for a coal mine.[4] The proposed bill would amend section 69-3-108(f) of the Tennessee Code Annotated by adding a new subdivision (3) thereto. In making the decision to issue, renew, or deny any such permit, the Commissioner shall determine pursuant to subdivision (f)(3) whether any material misrepresentation, concealment, conviction, or adjudication demonstrates a disregard for environmental regulations or a pattern of prohibited conduct. The Commissioner shall consider the following factors in making any finding under subdivision (f)(3):

(a) The nature and seriousness of the offense;

(b) The circumstances in which the offense occurred;

(c) The date of the offense;

(d) Whether the offense was an isolated offense or part of a series of related incidents;

(e) The applicant's environmental record and history of compliance regarding waste management in this state;

(f) The number and types of facilities operated by the applicant;

(g) Any evidence that the applicant reported or investigated the offense itself and took action to halt or mitigate the offense;

(h) Disassociation from any persons convicted of felony environmental criminal activity;

(i) The payment by a party convicted of felony environmental criminal activity of restitution to any victims of such criminal activity, remediation of any damages to natural resources and the payment of any fines or penalties imposed for such conduct; and

(j) Other corrective actions the applicant has undertaken to prevent a recurrence of the offense, including, but not limited to, the establishment and implementation of internal management controls.[5]

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3. *Id.*

4. *Id.*

5. *Id.* (explaining that the applicant, defined as any person, under section 69-3-103, making application for the approval of a permit pursuant to this part may submit information or documentation related to the factors).

Proposed House Bill 3199 is currently in the House Interim Committee on Conservation and Environment for a summer study.[6]

B. *Proposed House Bills 3203 & 3204*

Proposed House Bill 3203 and Proposed House Bill 3204, both introduced January 25, 2012, propose to amend Tennessee Code Annotated, title 60, chapter 1 and title 69, chapter 3, part 1, relative to the oil and gas industry. Proposed House Bill 3203 would amend section 60-1-104 of the Tennessee Code Annotated and direct the state oil and gas board to adopt regulations and governing standards for groundwater protection.[7]

Subsection (b) would provide that

> [t]he board shall adopt regulations governing standards for groundwater protection including documentation of produced and waste fluids, their testing, their volume, their treatment, their disposition with chain of custody and volume and testing results reported to the supervisor in a timely basis. The initial regulations required by this section shall be effective no later than November 1, 2012.[8]

Proposed House Bill 3204 amends section 60-1-101 of the Tennessee Code Annotated to include a definition of "fracking" and "trade secret," adds a second section that creates a notice requirement and prior approval from the state oil and gas board before any chemicals are injected into the wells, and establishes a disclosure process if any injection is confidential or involves trade secrets.[9] Due to the extensive disclosure requirements involved in the permit application process, the proposed bill provides that

> [o]nly upon written request to the supervisor associated with an application for permit to drill that justifies and documents the nature and extent of the proprietary information, confidentiality protection shall be provided for stimulation fluid information claimed to be a trade secret. If any claimed trade secret is contained in records of the department and disclosure is sought under the public records laws, the disclosure or non-disclosure of such claimed trade secrets shall be determined by a proceeding under § 10-7-505.[10]

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6. *Id.*

7. H.B. 3203, 107th Gen. Assemb., 2nd Reg. Sess. (Tenn. 2012).

8. *Id.*

9. H.B. 3204, 107th Gen. Assemb., 2nd Reg. Sess. (Tenn. 2012). "Fracking" means the process of directing pressurized substances, which may contain foam, gases, water, hydrocarbons, proppant, and any added chemicals, into a well whose casing is perforated, allowing these substances to leave the well bore. *Id.* "Trade secret" means information, including a formula, pattern, compilation, program device, method, technique, or process, that: (A) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means, by other persons who can obtain economic value from its disclosure or use; and (B) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. *Id.*

10. *Id.*

Both of the proposed house bills are currently in the House Interim Committee on Conservation and Environment.

C. *Proposed House Bill 3474*

Relating to gas, petroleum products, and volatile oils, proposed House Bill 3474 was introduced January 26, 2012.[11] As introduced, the bill would amend Tennessee Code Annotated, section 60-1-401(g), by extending the period of time from twenty to thirty days to file a written notice of appeal before a citation or assessment for a violation of the rules and regulations promulgated by the oil and gas board becomes final.[12] Proposed House Bill 3474 has been in the House Interim Committee on Conservation and Environment since February 1, 2012.[13]

III. COMMON LAW UPDATES

There were no major developments in the common law directly relating to oil and gas during the relevant time period of this Article. Although the Tennessee courts were not as active as the state legislature regarding developments in oil and gas law, the United States District Court in the Eastern District of Tennessee did address a matter of first impression in *Heineman v. Terra Enterprises, LLC,* concerning the interpretation of the term "mineral" in a deed reservation.[14] The pertinent issue in *Heineman* was whether sandstone was included as part of a mineral rights reservation in a deed.[15]

In *Heineman*, property owners, John and Lisa Heineman (collectively "Plaintiffs"), brought action against the holder of a deed to minerals located on or under the property subject to the suit, Terra Enterprises, LLC ("Defendant Terra Enterprises"), and lessee of mineral rights, Melinda Stokes ("Defendant Stokes"), to seek a declaratory judgment to quiet title, to enjoin a trespass, and recover damages resulting from defendants' removal of sandstone from their property.[16] Plaintiffs had a property interest in and to approximately 225 acres situated in Marion County, Tennessee.[17] Defendant Terra Enterprises was the holder of the deed to the "minerals" located on or under the property, which states in pertinent part:

> The grantor SEWANEE FUEL & IRON Company, reserves to itself, its successors and assigns, the coal, oil, gas and any and all other minerals of any nature whatsoever which may be upon or under the above described parcel of land, and the right to mine or

11. H.B. 3474, 107th Gen. Assemb., 2nd Reg. Sess. (Tenn. 2012).
12. *Id.*
13. *Id.*
14. Heineman v. Terra Enters., LLC, 817 F. Supp. 2d 1049 (E.D. Tenn. 2011).
15. *Id.* at 1056.
16. *Id.* at 1052.
17. *Id.*

> otherwise remove the [same] without liability for any damage to the surface rights, and the grantor reserves unto itself, also full rights of ingress, egress, regress and all rights-of-way for railways, tramways, wagon roads, power and telephone lines and many and all other rights-of-way which may be [necessary] or convenient in mining, drilling or otherwise [recovering] any of the mineral interests in said land and transporting the same to market or to manufacturing or refining plants [where] any of said materials may be prepared for market, including pipe lines; and this reservation [of] rights-of-way is to be equally valid whether such rights-of-way are used in connection with the mineral interests in the above tract of land or in connection with mineral interests on other lands of the grantor, its successors and assigns. (Court File No. 36–2 at 4).[18]

In March 2008, Defendant Stokes, as owner and operator of S & S Stone, entered into a mineral lease with Terra Enterprises, as mineral rights holder, to mine "fieldstone" (in this case sandstone) from the property.[19] Around July 18, 2008, Plaintiffs discovered damage on their property and filed suit, asserting six causes of action.[20]

Most importantly, Plaintiffs urged they were "entitled to a declaratory judgment quieting title to their property by interpreting the scope of the mineral rights held by Defendant [Terra Enterprises] under Tennessee law such that 'minerals' d[id] not include sandstone and other rocks on or near the surface of Plaintiffs' property[.]"[21] In order for the court to determine the rights and obligations of the parties as delineated in the deed, it looked to the language of the deed itself to ascertain the intentions of the parties.[22] Plaintiffs argued a distinction between rocks and minerals and called an expert to state, "while a rock may consist of one or more minerals, among other things, a rock is not a mineral."[23] Defendants argued the ordinary and common meaning of the word "mineral" clearly included stone and cited *Black's Law Dictionary* and *Webster's New International Dictionary*.[24] Defendants also presented that "the Tennessee Surface Mining Law of 1972 and the Mineral Test Hole Regulatory Act both advance[d] broad definitions of the word 'mineral.'"[25]

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18. *Id.* at 1053 ("The mineral rights on the property belonging to Plaintiffs were severed from the surface estate in 1928 when Sewanee Fuel & Iron Company retained for itself the mineral rights, after it sold the remainder of the property to Lewis D. Johnson & Sons, Inc.").

19. *Id.*

20. *Id.* at 1053–54. Defendant Terra Enterprises subsequently filed a counter-complaint against Plaintiffs for inducement of the breach of an enforceable contract and interference with a prospective economic advantage.

21. *Id.* at 1054.

22. *Id.* at 1057 ("Because it is almost impossible to ascertain the intent of the original parties to the 1928 deed in this case, all of the parties have relied on technical definitions of the word 'mineral,' as well as expert opinions.").

23. *Id.* at 1057.

24. *Id.*

25. *Id.* at 1057 (citations omitted).

Even though the court admitted that the Defendants' arguments were "superficially appealing," it could not agree that the term "mineral" was so "widely divergent."[26] By considering the dictionary meanings of mineral, sandstone, and rock; the meaning of each word in light of the deed as a whole; and the effect each party's interpretation would have on the actual conveyance, the court concluded that "substances such as sand, gravel[, sandstone,] and limestone [were] not minerals within the ordinary and natural meaning of the word unless they [were] rare and exceptional in character or possess[ed] a peculiar property giving them special value."[27] Thus, the court held that sandstone was not a part of the mineral reservation.

26. *Id.* at 1058 ("This case is somewhat analogous to *Campbell v. Tenn. Coal, Iron & R. Co.* . . . which involved the question of whether limestone was intended by the original parties to be included in the mineral estate. There, the court held limestone was not intended to be a part of the mineral reservation. However, the court did not base its decision on the technical meaning of the word 'mineral'; rather, it based its decision on the fact that 'if the reservation [was] construed to include limestone, it [would destroy] the conveyance, for by quarrying the limestone the entire surface would be made way with.'") (citations omitted).

27. *Id.* at 1059. *See also* Hart v. Craig, 216 P.3d 197, 198 (Mont. 2009) (quoting Heinatz v. Allen, 217 S.W.2d 994, 997 (Tex. 1949)).