

Chapter XX

IDLE AND DESERTED WELLS: WHO PLUGS AND WHO PAYS?

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§XX.01. Introduction

An old oil well, a rusting tank and some old oil field junk sit on otherwise empty grazing land in Colorado. The well hasn't produced in six years, and then it made barely two barrels a day. The operator was last heard of four years ago. Some said he went to Arizona to retire. Perhaps he died. The rancher wants the well and the tank removed. He's afraid his cattle could injure themselves on the junk left at the site, but he hasn't gotten anything from the well lately and doesn't see why he should pay to plug it.

An 18,000-foot, two-year idle well sits in the middle of an almond orchard in California's San Joaquin Valley. It was a huge producer when it first was drilled thirty years ago by a major oil company. Ten years ago the company decided that California was too hostile to oil producers. Its stringent environmental laws made production too expensive. The company sold all its California leases and concentrated its production operations in Asia. It sold this well to a small and reputable independent. The independent produced the well for four years, but when production declined to less than 20 barrels a day and crude prices plummeted, the company decided to shut-in the well. The agri-business that owns the land and the mineral interest received huge royalties when the well was in its heyday. Now it would like the well and production facilities removed so it can plant more almond trees. The well is leaking oil, and the plugging costs could exceed \$100,000.

A developer just bought 20 acres on the outskirts of Oklahoma City. It wants to build a shopping center. The location is perfect for a Wal-Mart. However, there are two oil wells on the land that a major oil company drilled forty years ago. Twenty-five years ago the major sold the wells to a large independent. The independent produced the wells until six years ago, when it shut them in. A year ago it sold the wells to a small operator. The small operator never

produced the wells and just filed for bankruptcy. The major and the large independent are still active producers in Oklahoma. The mineral interest owner is a New Jersey corporation that does no business in Oklahoma.

A large school district in Southern California bought land that once was an oil field but is now in the midst of a huge urban area. Some houses and apartments had been built there. The school district wants to build a new high school. Some of the wells in the old field were plugged in the nineteenth century before California had laws governing well plugging. There are gas leaks in the old oil field, but the source of the gas has not been determined. The operators of most of the wells have long ago gone out of business; however, the predecessor to a major oil company had operated a few of them.

Who is responsible for plugging these wells? Where is the money for the work going to come from? An equitable answer is not readily apparent, and state laws do not always provide a clear answer. Ideally, a mineral interest owner leases to a responsible operator. The operator drills a well, produces the well until it no longer is commercial and then surrenders the lease with the well properly plugged and abandoned as required by the lease terms. But reality is not always that simple. Costs rise as production declines, and the end of commercial production brings with it a very large expense just when there no longer is enough current revenue to cover it. Adding to the complexity are transfers of working and royalty interests during the life of an oil lease, as well as the severance of the surface and the mineral estates. At the end of commercial production, if a solvent operator cannot be found, everyone claims that someone else is responsible for plugging, and state regulatory agencies may have to resolve the problem.

§XX.02. Nature and Extent of the Problem

A study conducted in 1996 by the Interstate Oil and Gas Compact Commission (“IOGCC”)¹ found about 285,000 idle wells in the United States, up from about 215,000 in 1992, when the IOGCC made its first study. Over the last three years, during periods when oil prices have declined, many more wells became idle. For example, the California Division of Oil, Gas and Geothermal Resources (“DOGGR”), the state oil and gas regulatory agency, reports an increase of at least 2,000 idle wells in California since 1996.²

All idle wells are not the same. The IOGCC defines three different kinds: (1) wells not producing or injecting that have state approval to remain idle, (2) wells not producing or injecting that do not have express state approval to remain idle but have a known and solvent operator and (3) wells not producing or injecting that have neither express state approval to remain idle nor a known and solvent operator.³ The first category includes wells that are shut-in because there is no commercial market for their production.⁴ These wells may become candidates for plugging in the future, but as long as they offer commercial potential, their

¹ See Interstate Oil and Gas Compact Commission, Ad Hoc Idle Well Committee, *Produce or Plug: The Dilemma over the Nation’s Idle Oil and Gas Wells*, December 1996.

² Interview with James T. Champion, Jr., Technical Services Manager, California Division of Oil, Gas and Geothermal Resources, in Sacramento, Cal. (May 28, 1999).

³ See Interstate Oil and Gas Compact Commission, *supra* note 1, at 3.

⁴ These are not wells that have been shut-in temporarily to permit repairs, to allow reservoir pressure to build, or to enable a market for the oil or gas to be found. They also are not wells that have no prospect for restored production. See *Norman v. Apache Corp.*, 19 F.3d 1017, 1027-29 (5th Cir. 1994).

plugging would be premature. Wells in the second and third categories often are referred to as abandoned. Williams & Meyers define an “abandoned well” as one that is “no longer in use, whether because it was drilled as a dry hole, or has ceased to produce or for some other reason cannot be operated.”⁵ These wells are sometimes called deserted wells.⁶ Wells in the third category frequently are referred to as orphan wells. Like a minor child without parents, the well still needs care because it has not properly been plugged, but it has no solvent operator or other responsible party to give it that attention.⁷

⁵ 8 Williams & Meyers, *Oil & Gas Law* 2 (1998).

⁶ For example, California and North Dakota use this term to refer to those wells that may be ordered plugged and abandoned by their state regulatory agency. *See* Cal. Pub. Res. Code § 3237 (West 1984); *Amerada Hess Corp. v. Furlong Oil & Minerals Co.*, 348 N.W.2d 913, 915 (N.D. 1984).

⁷ Applying to idle wells terminology associated with responsibility for minor children has been carried further by Pierce and Flanery in their article on liability for plugging idle wells in the eastern states. *See* R. Neal Pierce & Sharon O. Flanery, “Orphans, Foundlings and Wards of the State: Plugging Liability for Orphan and Abandoned Wells in the Eastern States,” 14 *E. Min. L. Found.* ch. 19 (1993). In addition to orphans, these authors identified other types of idle wells in need of plugging: (1) foundlings, (2) latchkeys, love children and home aloners, and (3) wards of the state. “Foundlings” are unplugged or improperly plugged wells originally drilled by one entity but for which a second and solvent entity is wittingly or unwittingly responsible. The second group includes unplugged wells that either are not producing or never have produced because (1) the operator has pursued other, more economic operations (“latchkeys”), (2) the responsible operator has deliberately refused to acknowledge and assume responsibility for

Although the number of idle wells in the United States is increasing, idle wells still are not a large percentage of all wells that have been drilled. As of 1996, only 10% of all wells drilled were idle, while 55% had been plugged and 35% still were producing or injecting. Of the 285,000 idle wells in 1996, 53% were idle with state approval and 25% lacked state approval but had known and solvent operators. Only 22%, or about 63,000, were orphan wells. As expected, the states with the largest and longest history of oil production had the largest number of idle wells. Texas had the most (93,000). The other states with over 10,000 idle wells were Kansas (54,000), California (31,500), Louisiana (21,000), Kentucky (15,700) and West Virginia (14,500). Most of the Rocky Mountain states had between 1,500 and 10,000 idle wells each. The severity of the problem posed by idle wells is greater, however, in those states in which idle wells are a greater percentage of existing, unplugged wells. Although Texas had the most, the number of idle wells when expressed as a percentage of existing wells was only 26%, slightly above the national average of 22%. California, Kansas and Louisiana had the greatest number of idle wells and the greatest percentage of idle wells, over 36% of existing wells. Arizona, Tennessee and Florida were the other states with idle wells comprising over 36% of their existing wells. No more than 15% of the wells in Colorado, New Mexico, Oklahoma and the Dakotas were idle, and between 26% and 35% of the wells in Montana, Wyoming, Utah and Nebraska were idle as well.⁸

plugging them (“love children”), and (3) the responsible operator has left the state to retire or pursue other activities in more temperate climes leaving the wells unattended (“home aloners”).

“Wards of the state” are wells from any of the other groups for which a state statute places primary responsibility for plugging on the state oil and gas regulatory agency. *See id.* § 19.01.

⁸ *See Interstate Oil and Gas Compact Commission, supra note 1, at 5-6.*

All wells, even those currently producing, eventually will have to be plugged.⁹ Unplugged deserted wells can present a serious environmental hazard. Open, unsealed well bores permit the migration of fluids from hydrocarbon zones to fresh water zones and to the surface, polluting both underground and surface waters. As domestic production declines, private funds for well plugging may be harder to find. Small companies are acquiring more and more wells, and many do not or may not have the financial resources to plug all of them. If financially weak producers do not put money aside voluntarily for well plugging, states may compel them to do so. Landowners and developers may plug deserted wells if they can build on the land and recoup the plugging costs. Most oil producing operations, however, are on lands that have limited potential for real estate development. Plugging the wells to make way for other uses may not be cost effective. In some of these cases, the states will have no alternative but to use their police powers and whatever funds are available to plug the wells in order to protect their natural resources and the health and safety of their citizens.

⁹ Throughout this paper, the term “plugging” refers to “[t]he sealing off of the fluids in the strata penetrated by a well, so that the fluid from one stratum will not escape into another or to the surface.” See Williams & Meyers, *supra* note 5, at 799. “Abandonment” can have the same meaning as “plugging.” *Id.* at 4. Frequently these terms are used interchangeably or in tandem, as in the “plugging and abandonment” of a well, to refer not only to the plugging of the well, but to the removal of installations, equipment, personal property and fixtures and the termination of all operations. *Id.* at 4-6.

§XX.03. Statutory Means for Plugging Idle and Deserted Wells

[1] Imposing Responsibility for Plugging

Many states make the well operator responsible or at least initially responsible for plugging deserted wells. For example, Texas requires the operator to plug a well in accordance with the rules of the Railroad Commission.¹⁰ If the operator fails to plug the well, however, the nonoperator, that is, anyone owning a working interest but not actually in control of the well, is responsible for its proportionate share of the plugging costs.¹¹ Recently enacted legislation in California places plugging responsibility on the operator.¹² Both California and Texas define “operator” as the person who has the responsibility for or right to control the well, and who exercises operational control with the knowledge and consent of the state.¹³ Oklahoma requires the well operator to plug the well in accordance with the procedures prescribed by the Corporation Commission.¹⁴ Kansas also imposes responsibility on the operator.¹⁵ Kansas and California, however, do not limit responsibility to the current or last operator of the well. In Kansas, the original operator and any person who tampers with the well without authorization

¹⁰ See Tex. Nat. Res. Code Ann. § 89.011 (West 1993).

¹¹ See Tex. Nat. Res. Code Ann. §§ 89.012, 89.002(a)(3) (West 1993).

¹² See Cal. Pub. Res. Code § 3237 (West 1984).

¹³ See Tex. Nat. Res. Code Ann. § 89.002(a)(2) (West 1993); Cal. Pub. Res. Code §§ 3009, 3201, 3202 (West 1984).

¹⁴ See Okla. Stat. Ann. tit.17, § 53 (West 1998); *Gannon v. Mobil Oil Co.*, 573 F.2d 1158, 1162 (10th Cir. 1978).

¹⁵ See Kan. Stat. Ann. § 55-179 (1994).

also have responsibility.¹⁶ California law permits the DOGGR to pursue everyone who operated the well after January 1, 1996, until it finds a prior operator with sufficient financial resources to plug the well.¹⁷ North Dakota imposes liability on the operator and on all persons owning working interests at the time the well must be plugged. Owners of royalty and overriding royalty interests are excluded.¹⁸

The person or entity that must identify itself to the state regulatory agency as possessor of the ownership interest in the well appears to be the responsible party in Colorado,¹⁹ Montana,²⁰ New Mexico,²¹ Utah²² and Wyoming.²³ However, Colorado,²⁴ New Mexico²⁵ and Utah²⁶ require the operator to post a bond conditioned on the proper performance of the duty to plug the well, implying that the operator is the responsible party. The statutes require that the well owner be identified to the state regulatory agency and frequently define “owner” as the holder of the right

¹⁶ See Kan. Stat. Ann. § 55-179(b) (1994).

¹⁷ See Cal. Pub. Res. Code § 3237(c) (West 1984).

¹⁸ See N. D. Cent. Code § 38-08-04.8 (1997).

¹⁹ See Colo. Rev. Stat. Ann. § 34-60-106 (West 1998).

²⁰ See Mont. Code Ann. § 82-11-123 (1997).

²¹ See N.M. Stat. Ann. § 70-2-12 (Michie 1978).

²² See Utah Code Ann. § 40-6-5 (1953).

²³ See Wyo. Stat. Ann. § 30-5-104 (Michie 1977).

²⁴ See Colo. Rev. Stat. Ann. § 34-60-106(13) (West 1998).

²⁵ See N.M. Stat. Ann. § 70-2-14(A) (Michie 1978).

²⁶ See Utah Code Ann. § 40-6-5(2)(f) (1953).

to drill and produce the well,²⁷ leading to the conclusion that “owner” and “operator” are used synonymously. The requirement of ownership identification relieves the state agency of having to determine the legal owner from title documents, contracts and other agreements.²⁸ The owner is simply the entity that has identified itself to the state agency as the owner.²⁹

[2] Finding the Responsible Party

When “owner” and “operator” are used in the same statute, and used interchangeably, there may be confusion about who is primarily or initially responsible for plugging a well. Arizona’s statute is one of these, and California’s used to be. Arizona’s statute provides that the owner or operator is responsible for plugging the well, then defines “owner” as the person having the right to drill and produce, but does not define “operator.”³⁰ California’s plugging statutes

²⁷ See, e.g., Colo. Rev. Stat. Ann. § 34-60-103(7) (West 1998); Mont. Code Ann. § 82-11.101(9) (1997); Wyo. Stat. Ann. § 30-5-101(a)(v) (Michie 1977).

²⁸ See *Railroad Comm’n v. Olin Corp.*, 690 S.W.2d 628, 631 (Tex. App. 1985) (upholding the Railroad Commission’s determination that owners of a Manahan-type carried interest who had gone “non-consent” on the well, nevertheless, came within the statutory definition of “nonoperators” who were responsible for plugging the well).

²⁹ The need for the regulatory agency to deal directly with a single, known person or entity was underscored in *A.J. Morris v. State*, 894 S.W.2d 22 (Tex. App. 1995), where oil drillers claimed that the Railroad Commission’s notice of an administrative penalty hearing was insufficient notice to them. Noting that the Railroad Commission is responsible for regulating over 250,000 producing wells, the court found that providing notice only to those persons on an operator’s organization report filed with the Railroad Commission was sufficient. *Id.*

³⁰ See Ariz. Rev. Stat. Ann. §§ 27-524(E), 27-501(14) (West 1991).

used to impose responsibility on the owner or operator and then defined “owner” and “operator” in almost totally incomprehensible and not very useful ways. “Operator” was defined as “any person drilling, maintaining, operating, pumping, or in control of any well.”³¹ “Owner” includes ‘operator’ when any well is operated or has been operated or is about to be operated by any person other than the owner.”³² “Operator’ includes ‘owner’ when any well is or has been or is about to be operated by or under the direction of the owner.”³³

Under this statutory scenario, the DOGGR wanted several leaking, deserted wells near Fresno plugged and the production site cleaned up. It estimated the costs to be high, perhaps a million dollars. The wells had been drilled years ago. The lease had been held by several companies, most of which went out of business long ago. The last operator was a small company that had filed for bankruptcy. The mineral interest owner was Wells Fargo Bank (“Wells Fargo”), whose predecessor had executed the oil and gas lease and had received considerable royalties. The DOGGR believed that Wells Fargo was the only one with any interest in the production operations that had the financial resources to plug the wells and clean up the site. The DOGGR claimed that Wells Fargo became the owner of the wells upon the termination of the lease and, therefore, was responsible for plugging them. Finding the statutory definitions of “owner” and “operator” confusing and unhelpful, the California Court of Appeal in *Wells Fargo Bank v. Goldzband*³⁴ agreed with the DOGGR that Wells Fargo could be held

³¹ Cal. Pub. Res. Code § 3009 (West 1984) (amended 1996).

³² Cal. Pub. Res. Code § 3010 (West 1984) (repealed 1996).

³³ Cal. Pub. Res. Code § 3011 (West 1984) (repealed 1996).

³⁴ 61 Cal.Rptr.2d 826 (Cal. Ct. App. 1997).

responsible. Wells Fargo was an owner that had received a substantial benefit from the production of the wells.

Before the *Wells Fargo* opinion was issued, concern had spread throughout the industry in California that royalty interest owners that never had any operational role in oil production may be responsible for well plugging. The DOGGR was concerned that the exodus of major oil companies would leave few current operators with adequate financial resources to plug the wells. To make matters worse, California did not require well operators to provide security to cover the plugging of their wells, nor did it have a system for permitting wells to be left idle. The DOGGR and the industry met and agreed on compromise legislation. The only mineral interest owners who would be responsible for well plugging would be those that had operational control over the wells. The current operator of record would initially be responsible for plugging deserted wells. However, the DOGGR could pursue former operators who held or acquired their operational interest in the well after January 1, 1996, until it found one with sufficient financial resources.³⁵

Even when statutes are clearer, finding the responsible party is not always easy. Oklahoma places the burden of plugging on the person or entity operating the well at the time it was abandoned or deserted. However, the substantially more straightforward Oklahoma law did not prevent a dispute similar to that in *Wells Fargo*. In *Amax Petroleum Corporation v. Corporation Commission*,³⁶ a lessee who assigned its leasehold back to the landowner claimed it no longer was the operator, and the landowner became the operator following the assignment. The Oklahoma court, understandably, had a far easier time resolving this dispute than the California court had with the dispute in *Wells Fargo*. It concluded that the operator at the time

³⁵ See Cal. Pub. Res. Code § 3237 (West 1984); *Wells Fargo*, 61 Cal. Rptr. 2d at 847-50.

³⁶ 552 P.2d 387 (Okla. 1976)

the wells were abandoned could not relieve itself of its duty to plug them under the Oklahoma statute by releasing its leasehold interest to a landowner that never had operational control over the wells.³⁷ When the United States condemned land in Oklahoma containing many oil wells, it claimed that the plugging costs should reduce the fair market value because the owners of the condemned leaseholds were responsible for well plugging under Oklahoma law. The court in *United States v. 79.95 Acres of Land*³⁸ did not agree. It held that because the wells were not abandoned but still producing when the government condemned the property, the burden of plugging fell on the government, not the leaseholders.³⁹

When a lessee assigns its leasehold with some producing wells and some deserted wells, the new lessee may claim that it never assumed responsibility for the deserted wells because it never operated them. The state, however, may view the assignment of the leasehold as a transfer of all the wells on the lease and attempt to compel the new lessee to plug the deserted wells. When the Texas Railroad Commission attempted to do this, the court had no problem concluding that the new lessee had never operated or controlled the deserted wells and, therefore, was not responsible for plugging them.⁴⁰ In another situation, however, the Railroad Commission was able to assert successfully its claim for the costs for well plugging against a bankruptcy trustee who claimed that he never operated the wells and, therefore, was not responsible for plugging them.⁴¹

³⁷ *See id.* at 390-92.

³⁸ 459 F.2d 185, 188-89 (10th Cir. 1972).

³⁹ *See id.* at 189.

⁴⁰ *See Railroad Comm'n v. American Petrofina Co.* 576 S.W.2d 658, 659 (Tex. App. 1978).

⁴¹ *See Texas v. Lowe* 151 F.3d 434, 439 (5th Cir. 1998) (noting that trustee had sole operating

Texas holds operators primarily and nonoperators secondarily responsible for plugging wells. A nonoperator is a person owning a working interest who is not an operator. When the Railroad Commission attempts to impose well plugging liability on a nonoperator, it may involve itself in disputes regarding the nature of oil and gas interests.⁴² The courts, not state oil and gas regulatory agencies, are the ultimate arbiters of ownership interests in oil and gas properties. Statutes imposing responsibility for plugging on the basis of ownership likely will lead to more legal disputes, and certainly more complex legal disputes, than those imposing responsibility on the basis of operational control. Simply put, it is easier to find the operator than the owner.⁴³

[3] Financial Security for Well Plugging

Most regulatory statutes require the well operator to provide some form of security that will be available to the state for plugging the well if the operator has left the state or is insolvent. This usually is a bond or a certificate of deposit, conditioned on the operator's compliance with the regulatory agency's regulations, including plugging the well to the agency's standards.⁴⁴ The

interest in wells and was the operator responsible for plugging them whether or not he produced them).

⁴² See *Railroad Comm'n v. Olin Corp.*, 690 S.W.2d 628, 631 (Tex. App. 1985) (holding that because owners of a carried interest had a reversionary interest in part of the working interest when the Railroad Commission ordered the well plugged, they were responsible as nonoperators).

⁴³ Compare *Gannon v. Mobil Oil Corp.*, 573 F.2d 1158 (10th Cir. 1978) (responsibility based on control over wells) with *Wells Fargo Bank v. Goldzband*, 61 Cal. Rptr. 2d 826 (Cal. Ct. App. 1997), and *Olin*, 690 S.W.2d 628 (responsibility based on ownership interest).

⁴⁴ See, e.g., Ariz. Rev. Stat. § 27-516(A)(3) (West 1991); N.M. Stat. Ann. § 70-2-14(A) (Michie

statutes often do not specify whether a bond or other security may be submitted for each well or a blanket bond in a larger amount covering all of an operator's wells may be used. Nor do the statutes always provide for the amount of the security. These details are left to the discretion of the regulatory agency.⁴⁵

Some states have detailed security requirements. Texas requires every operator to file a bond or alternate security that "shall be conditioned that the operator will plug and abandon all wells and control, abate, and clean up pollution associated with an operator's oil and gas activities covered under the bond in accordance with the law of the state and the permits, rules, and orders of the commission."⁴⁶ Texas statutes also specify the permissible types of alternate security (individual well bond, blanket bond, nonrefundable annual fee of \$100 for operators with acceptable record of compliance, otherwise 3% of the required bond, or first lien on tangible personal property), individual bond amounts (\$2 per foot of well depth) and blanket bond amounts (\$25,000 for 10 or fewer wells, \$50,000 for 11 through 99 wells and \$250,000 for 100 or more wells).⁴⁷ Oklahoma requires well operators to provide evidence of their financial ability to plug wells and clean up production sites by showing a net worth of at least \$50,000 or providing an irrevocable letter of credit, cash, cashier's check, certificate of deposit or other

1978), Mont. Code Ann. § 82-11-123(5) (1997); Utah Code Ann. § 406-5(2)(f) (1953); Wyo.

Stat. Ann. § 30-5-104(d)(i)(D) (Michie 1977). These statutes require each well owner or operator to furnish a reasonable bond with good and sufficient surety conditioned that each dry hole or abandoned well be plugged properly.

⁴⁵ See *supra* note 44.

⁴⁶ Tex. Nat. Res. Code Ann. § 91.105 (West 1993).

⁴⁷ See Tex. Nat. Res. Code Ann. §§ 91.104, 91.1041, 91.1042 (West 1993).

negotiable instrument, or blanket surety bond of \$25,000.⁴⁸ The amount may be raised at the discretion of the state or lowered if the operator certifies that its plugging liability is less than \$25,000. The Corporation Commission may shut-in, without notice or hearing, all of an operator's wells until it provides evidence of its financial ability to plug them.⁴⁹

California, unlike many major producing states, does not require "life of the well" bonds. An operator must file a bond or other security before beginning drilling, redrilling, plugging or any other operation permanently altering the well casing. When the operation is completed satisfactorily, the security may be released at the operator's request.⁵⁰ A bond filed when a well is drilled may be released after the well has begun to produce. It will not be available years later when the well needs to be plugged. Requiring a new bond before plugging operations are begun does not address the problem of securing the financial resources to plug a deserted well if the operator has left the state, gone out of business, or is insolvent. This lack of available security has been a primary factor motivating the DOGGR to pursue those other than the current operator who benefitted from the well operations. It also has led to the recent enactment of California legislation creating a complex, but perhaps still inadequate, system imposing additional obligations on operators to encourage them to begin plugging their idle wells and to require them to set aside money for future plugging. This legislation also raised the amounts of the individual and blanket well bonds. Operators of wells without bond coverage must either pay an annual fee for every idle well (from \$100 to \$500 based on the time the well has been idle), provide a

⁴⁸ See Okla. Stat. Ann. tit. 52, § 318.1 (West 1998).

⁴⁹ See *id.*

⁵⁰ See Cal. Pub. Res. Code §§ 3204, 3205, 3207, 3208 (West 1984).

\$5,000 escrow account or a \$5,000 bond for each idle well to be maintained until the well is properly plugged, or carry out an approved plan for gradually plugging their idle wells.⁵¹

Requiring an operator to provide security, such as a bond or certificate of deposit, is the most common statutory response to the problem of assuring available funds for plugging a well at the end of its commercial life. The amount required for individual well bonds usually varies with the depth of the well, from about \$5,000 for a shallow well to about \$25,000 for a deep well. Blanket bonds range from a low of \$10,000 in Tennessee, Kentucky, and Utah (for wells under 10,000 feet) to \$1 million in Florida, with most being around \$25,000 to \$100,000.⁵² The required amounts should, but may not necessarily be sufficient to cover all the plugging costs if the operator goes out of business or becomes insolvent.

[4] Authority of State Regulatory Agency to Plug Abandoned Well

When an operator refuses or is unable to plug a deserted or abandoned well, the state will step in and do the work, especially when the well is leaking or otherwise posing a danger to public safety or the environment. For example, the Oklahoma Corporation Commission may enter private property and plug an abandoned or improperly plugged well if the well is “likely to cause surface or subsurface pollution” and the party responsible for plugging “cannot be found or is financially unable to pay the cost” of the work.⁵³ The Texas Railroad Commission may plug an improperly plugged well or a properly plugged well in need of replugging if no solvent operator or nonoperator can be found. It may plug a well that is leaking and will cause or is likely to cause pollution or injury to public health. It also may plug a “delinquent inactive well”

⁵¹ See Cal. Pub. Res. Code §§ 3204, 3205, 3206 (West 1984).

⁵² See Interstate Oil and Gas Compact Commission, *supra* note 1 at 30-34.

⁵³ Okla. Stat. Ann. tit. 52, § 310 (West 1998).

after notice to the operator and the operator's failure to plug the well.⁵⁴ California statutes authorize the DOGGR to plug "deserted" wells that the operator has failed to plug after being ordered to do so and to plug "hazardous" and "idle-deserted" wells for which there is no responsible operator.⁵⁵

[5] Sources for Funding Well Plugging by the State

When a regulatory agency plugs an abandoned well, it must have a source of funds. The bond or other security would be the most convenient source, but if it is nonexistent or inadequate, the state needs something else. If the operator is still around and solvent, the state can sue the operator to recover its costs. Some statutes, like those of Kansas, North Dakota, and Texas, expressly provide the regulatory agency with a cause of action for this purpose.⁵⁶ If the operator is not around or is insolvent but has left salvageable oil production equipment, this equipment provides a source from which the state may recover its plugging costs. Some statutes, like those of California, Kansas, Oklahoma, and Texas, give the state a lien on this equipment.⁵⁷ North Dakota gives its commission outright authority to confiscate the production equipment.⁵⁸

Lawsuits and liens do not provide state agencies with up front money to plug abandoned wells. These are after-the-fact remedies. They may be unworkable when there are no

⁵⁴ See Tex. Nat. Res. Code Ann. § 89.043 (West 1993).

⁵⁵ See Cal. Pub. Res. Code §§ 3226, 3237, 3250-58 (West 1984).

⁵⁶ See Kan. Stat. Ann. § 55-180 (1994); N.D. Cent. Code § 38-08-04.8 (1997); Tex. Nat. Res. Code Ann. § 89.083 (West 1993).

⁵⁷ See Cal. Pub. Res. Code § 3226 (West 1984); Kan. Stat. Ann. § 55-180 (1994); Okla. Stat. Ann. tit.17 § 53.3 (West 1998); Tex. Nat. Res. Code Ann. § 89.083 (West 1993).

⁵⁸ See N.D. Cent. Code § 38-08-04.9 (1997).

legislatively appropriated funds available to the state to pay the plugging costs. Furthermore, these remedies are useless when the operator has stripped the lease of all salvageable production equipment and is insolvent. Most states have provided funding sources for their regulatory agencies in this situation. The most common are plugging funds. The money usually comes from taxes on oil production, assessments on well operators and penalties imposed on well operators for statutory and regulatory violations. For example, Colorado has an oil and gas environmental response fund, supported by surcharges on oil operators and legislative appropriations, to be used for investigating and mitigating oil and gas operations that threaten to cause or are causing environmental pollution.⁵⁹ It also has a severance tax trust fund to be used by the Oil and Gas Conservation Commission for well plugging projects.⁶⁰ Montana has an oil and gas production mitigation account, the funds from which are to be used by the Board of Oil and Gas Conservation when the person responsible for plugging a well cannot be identified or located.⁶¹ Both Utah and Wyoming have created funds from oil production tax revenue for plugging abandoned wells.⁶² California may use up to \$1,000,000 per year from a fund supported by assessments on oil well operators to plug wells for which there is no responsible operator.⁶³

⁵⁹ See Colo. Rev. Stat. Ann. § 34-60-124 (West 1998).

⁶⁰ See Colo. Rev. Stat. Ann. § 39-29-109(b) (West 1998).

⁶¹ See Mont. Code Ann. § 82-11-161 (1997).

⁶² See Utah Code Ann. §§ 40-6-14, 40-6-14.5 (1953); Wyo. Stat. Ann § 30-5-104(b)(vii) (Michie 1977).

⁶³ See Cal. Pub. Res. Code §§ 3250, 3251, 3258 (West 1984).

**§XX.04. Plugging Idle and Deserted Wells from the Perspective of the State
Regulatory Agency**

**[1] Exercising the Police Power - When Does A State Regulatory Agency
Go Too Far?**

State oil and gas regulatory agencies exercise the police power to prevent waste of oil and gas and to protect public health and safety. The authority of these agencies to act pursuant to their police power to prevent waste of oil and gas without incurring liability to oil operators for limiting their production has long been recognized.⁶⁴ If someone conducts a business, engages in activity, or maintains his or her property in a condition that harms or threatens to harm public health and safety, the state may abate the offending business, activity, or condition if it constitutes a public nuisance. If the state legislature has declared something to be a public nuisance, no inquiry beyond its existence need be made, and the regulatory agency may take appropriate action to abate it.⁶⁵ For example, the California Legislature declared that wells posing a danger to life, health, or natural resources or that are deserted, and for which there is no responsible operator, are public nuisances and may be abated by the DOGGR.⁶⁶ The use of the

⁶⁴ See *Ohio Oil Co. v. Indiana*, 177 U.S. 190 (1900).

⁶⁵ Compare *Eccles v. Ditto*, 167 P. 726 (N.M. 1917) (noting that a statute making waste of artesian water a public nuisance validated supervisor's repair of leaking well as proper exercise of police power), with *Beck Dev. Co. v. Southern Pac. Transp. Co.*, 52 Cal. Rptr. 2d 518, 550-51 (Cal. Ct. App. 1996) (noting that absence of statute making oil contamination of soil a nuisance requires a showing that there was a threat to public health and safety, which showing could not be made).

⁶⁶ See Cal. Pub. Res. Code §§ 3250, 3251 (West 1984).

police power in these instances would not subject the state to liability for a regulatory taking.⁶⁷ The same might not be true for deserted wells for which there is a responsible operator who has not pursued what the state believes is a sufficiently aggressive program of idle well plugging. In this situation, there is neither a statute declaring the well a public nuisance nor an imminent danger of public harm that would validate the regulatory action.

When implementing a program for plugging long-term idle wells, state regulatory agencies may be faced with a dilemma. If they do nothing, they might allow an operator to maintain idle wells for so long that the operator will have gone out of business or become insolvent before all the wells are plugged, leaving the state with the work and possibly with inadequate funds to cover the costs. On the other hand, if they require operators prematurely to plug wells that still have commercial potential, they may be wasting the resources they are under a duty to conserve and subjecting themselves to liability for a regulatory taking.

Takings liability, however, likely would arise only when the agency undertook the plugging itself without affording the operator due process. The threat of a takings claim by the operator and the confusion and uncertainty in takings law may make the agency wary of pursuing an aggressive idle well plugging policy. While this threat and its chilling effect on agency action may not go away, the law likely would preclude takings liability for an agency's pursuit of a well plugging program in which the operator is given an opportunity to contest successfully the agency order.⁶⁸ In addition, the takings issue should not be as much of an impediment in those states that require permits for retaining an idle well, which are all the major

⁶⁷ See *Wells Fargo Bank v. Goldzband*, 61 Cal. Rptr. 2d 826, 835-36 (Cal. Ct. App. 1997).

⁶⁸ See *First English Evangelical Lutheran Church v. Los Angeles County*, 482 U.S. 304, 321 (1987).

oil producing states except California. The permitting procedure gives the operator time, while a well is idle with state approval, to analyze its commercial potential and to begin voluntarily plugging its long-term idle wells.

State and local agencies, acting in emergency situations, may destroy private property in pursuit of the valid exercise of their police powers and not subject themselves to liability for inverse condemnation.⁶⁹ In nonemergency situations, they may abate nuisances without incurring liability for inverse condemnation, provided they give the owner reasonable notice and an opportunity to be heard.⁷⁰ The exercise of the police power to abate a nuisance is not a governmental taking.⁷¹ Even though regulatory action may eliminate the only economically productive use (oil production), it does not proscribe a productive use that previously was permissible where the well has remained idle for years without state approval.⁷² The outright

⁶⁹ *See, e.g.,* *Customer Co. v. City of Sacramento*, 41 Cal. Rptr. 2d 658, 664 (Cal. 1995) (stating that destruction of contents of grocery store in course of apprehension of dangerous criminal suspect not a taking).

⁷⁰ *See, e.g.,* *Scott v. City of Del Mar*, 68 Cal. Rptr. 2d 317, 322 (Cal. Ct. App. 1997) (finding no taking where city removed seawalls and riprap encroaching on public beach after owners failed properly to challenge the administrative action).

⁷¹ *See, e.g.,* *Goldblatt v. Hempstead*, 369 U.S. 590 (1962) (preventing continued operation of quarry in residential area); *Miller v. Schoene*, 276 U.S. 272 (1928) (ordering destruction of diseased cedar trees to prevent infection of nearby orchard).

⁷² *See* *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1029-30 (1992); *Tahoe Keys Property Owners' Ass'n v. State Water Resources Control Bd.* 28 Cal. Rptr. 2d 734, 743, n.14 (Cal. Ct. App. 1994).

destruction of private property by the government, which would occur if a well were plugged, would not be found to be a regulatory taking if it is done to protect public health and safety.⁷³

The state agency, however, must show that a non-hazardous well has no future economic use when it orders it plugged. An operator may claim that the well could be productive if oil prices rose. But how far and how quickly? Is litigating whether prices will increase, and if they do, how much and how soon, or whether a particular well could become economic if the prices do increase as the operator claims, worth the effort from the agency's perspective? Maybe not. However, if wells remain unplugged, it is less likely that a responsible party with the financial resources to plug them will be around when their lack of future economic worth becomes patent.

[2] Looking for the “Deep Pocket”

Deserted wells for which there is no solvent party responsible for their plugging are called orphans. The state regulatory agency's mission is to determine whether these wells really are orphans or whether there is anybody still around who can be required to bear the plugging costs. The agency will be reluctant to spend the limited money available to it in its well plugging fund if there is someone with adequate financial resources on which it can place the plugging responsibility.

California's DOGGR was looking for a “deep pocket” when it ordered Wells Fargo, the mineral interest owner, to plug several wells and clean up a messy production site. It bypassed the current operator and made no attempt to pursue some of the individuals who had financial interests in the operating entity. It settled on Wells Fargo because it was the only one around that received some benefit from production and had enough money to plug the wells and clean

⁷³ See *Hoeck v. City of Portland*, 57 F.3d 781, 788-89 (9th Cir. 1995); *Beck Dev. Co. v. Southern Pac. Transp. Co.*, 52 Cal. Rptr. 2d 518, 537 (Cal. Ct. App. 1996).

up the site. Wells Fargo's having never operated the wells, indeed its legal inability to operate them so long as the lease was in effect, had no bearing on its responsibility to plug them under then-current California law that made well owners, as well as operators, liable.⁷⁴ Where state statutes make both the operator and the owner liable, and these are two different persons or entities, the state can pursue one or both. Even when the statute makes only the owner or only the operator liable, states have been successful in pursuing both current and prior owners and operators to find a deep pocket.

*Houser v. Brown*⁷⁵ was a dispute that arose when the Chief of the Ohio Division of Oil and Gas (Houser) ordered both the prior lessee (Brown) and the current landowner (Herold) to plug several idle wells that no longer were capable of commercial production. Houser claimed that Herold was responsible because she was the owner of the wells when the order to plug was issued even though she never produced them. Houser also claimed that Brown was responsible because he was the owner when the well became noncommercial and could not escape the duty to plug by divesting himself of the lease. The court agreed with Houser, finding that "owner" in Ohio's plugging statute includes both the person with the right to drill when the well becomes nonproductive and the current owner of the well. The court made the following statement that was music to the ears of the state regulatory agency:

The issue as to whether Herold or Brown should bear the expense of plugging the wells is not before us, this being a private matter between them. However, both have a statutory duty to the public to plug the wells. For protection of the public

⁷⁴ See *Wells Fargo Bank v. Goldzband*, 61 Cal. Rptr. 2d 826, 834-36, 843-44 (Cal. Ct. App. 1997).

⁷⁵ 505 N.E.2d 1021 (Ohio App. 1986).

interest, it makes no difference who (Brown or Herold) plugs the wells; the important issue is that one does so promptly.⁷⁶

Taking its cue from the Ohio court, the Kentucky Supreme Court in *Pro Gas, Inc. v. Har-Ken Oil Company*,⁷⁷ held that the assignee of an oil and gas lease from a trustee in bankruptcy became the new operator of the wells. As the new operator, it was required to post a bond and plug the wells even though it never produced them. Paraphrasing *Houser*, the Kentucky court said:

Any issue as to whether appellee [assignor] or appellant [assignee] should bear the expense of plugging, if necessary, is not now before us, this being a private matter between them. It makes little difference who plugs the wells, the important factor being the protection of the public interest which dictates that appellant [assignee] post the bonds statutorily required.⁷⁸

Frequently, major oil companies and large independents find that retaining leases with numerous marginal wells is not economical given their relatively high overhead. They assign the leases to small operators with less overhead who try to get the last vestiges of commercial production from some of the wells and may never produce the others. Consequently, when these wells reach the end of their economic lives, their operators may not have the financial resources to plug them. The state may try to impose plugging liability on the prior operator, especially for those wells that never were produced by the last operator. That attempt was successful in Indiana, where the court held that the prior operator was responsible for plugging wells that were

⁷⁶ *Id.* at 1024.

⁷⁷ 883 S.W.2d 485 (Ky. 1994).

⁷⁸ *Id.* at 488.

abandoned or deserted when it transferred the lease, even though the Indiana Department of Natural Resources had approved the transfer.⁷⁹

In California during the 1990's, the major oil companies transferred their leases to independents and marginal operators whose financial ability to plug the wells and clean up the production sites was less certain. Even offshore leases, with enormous well plugging and platform dismantling costs, were being assigned from the majors to small companies with limited resources. The DOGGR saw that the companies who had produced most of the oil were escaping plugging responsibility and wanted to hold prior operators with financial resources responsible for plugging the wells and cleaning up the production sites. New legislation was enacted, but it was a compromise. Because the major oil companies felt that they should be on notice that they would continue to be liable for plugging the wells when they made the transfers, the statute imposed plugging liability only on prior operators who transferred their wells after January 1, 1996.⁸⁰

A well owner or operator may try to avoid plugging costs by filing for bankruptcy. However, this strategy may not always work in a reorganization, and the state will be able to pursue the trustee in bankruptcy for these costs. The Fifth Circuit upheld the Texas Railroad Commission's attempt to impose the plugging costs on a Chapter 11 trustee that took over the wells but never produced them.⁸¹ The Railroad Commission also was successful in recovering

⁷⁹ See *Jarvis Drilling, Inc. v. Midwest Oil Producing Co.*, 626 N.E.2d 821, 827 (Ind. App. 1993).

⁸⁰ Interview with Hal Bopp, Deputy State Oil and Gas Supervisor, California Division of Oil, Gas and Geothermal Resources, Bakersfield, Cal. (June 11, 1999). See Cal. Pub. Res. Code § 3237 (West 1984).

⁸¹ See *Texas v. Lowe*, 151 F. 3d 434, 439 (5th Cir. 1998).

well plugging costs from the officer of a corporation that had operated a well and whose corporate charter had been forfeited for failure to pay taxes.⁸² Again, a state was able to find the deep pocket and successfully impose the costs of well plugging on that deep pocket.

[3] **Replugging Previously Plugged Wells**

Wells that previously have been plugged may leak and require replugging. This is more likely where the wells were plugged long ago. Leaks, however, have developed in wells plugged to current standards, and there may be some wells that never can be securely plugged at a reasonable cost even with today's technology.⁸³ When a well leaks, or even when a well does not leak but the regulatory agency is concerned about the integrity of the plugging, it may order the operator who originally plugged the well to replug it.⁸⁴ The agency may be restricted, however, by a statute freeing the operator of plugging responsibility after the passage of a certain number of years.⁸⁵ Another major restriction is the absence of the operator that originally plugged the well. Because the wells most likely in need of replugging are old wells, including wells that were plugged before there was any state well regulation, replugging may be difficult and expensive. These wells may have been plugged simply by shoving some timber or junk down the hole, putting in a few sacks of cement, or placing some debris and dirt over the top of

⁸² *See* State v. Leutwyler, 979 S.W.2d 81 (Tex. App. 1998).

⁸³ Interview with Richard K. Baker, Deputy State Oil and Gas Supervisor, California Division of Oil, Gas and Geothermal Resources, Cypress, Cal. (June 11, 1999) [hereinafter Baker Interview].

⁸⁴ *See, e.g.,* Currey v. Corporation Comm'n, 617 P.2d 177, 179 (Okla. 1979).

⁸⁵ *See, e.g.,* Cal. Pub. Res. Code § 3251.5 (West Supp. 1999).

the well. The well bore may have broken down and the debris that is in the well will have to be removed before proper plugging can begin.⁸⁶

Many states have enacted statutes to provide funding to their regulatory agencies for plugging or replugging old wells for which there is no responsible party.⁸⁷ Also, the current landowner may have an economic incentive to replug the well. A farmer may decide to replug a leaking well himself to protect his crops and livestock. A commercial or industrial company may do the same to prevent injury to its employees and customers. A developer may replug old wells on the site of its proposed development so that it can proceed quickly with its development. It will pass the cost of the replugging to its buyers.⁸⁸

In California, and particularly in the Los Angeles Basin, many old oil fields have become residential and commercial developments. Long ago, houses and commercial structures were built over old oil wells. The wells developed leaks, and the structures had to be torn down, at least partially, to stop the leaks and properly plug the wells. Sometimes wells that were plugged to state standards developed leaks and had to be replugged. There have even been cases where current oil field technology has been insufficient to insure that a properly plugged well would not leak in the future. Landowners and developers built on old oil fields without taking adequate precautions to insure that their buildings would be safe.

⁸⁶ See Baker Interview, *supra* note 78. See also Interstate Oil and Gas Compact Commission, *supra* note 1, at 61-62.

⁸⁷ See, e.g., Cal. Pub. Res. Code §§ 3250-59 (West 1984); Tex. Nat. Res. Code Ann. § 89.043 (West 1993).

⁸⁸ See Baker Interview, *supra* note 78.

Recognizing that the DOGGR was not a zoning and building-permit agency, but that these tasks were the province of the local government, the California Legislature adopted a statute that shifted the burden of insuring the safety of building over old oil wells to the developers and the local permitting agencies.⁸⁹ Normally, replugging responsibility would rest with the last operator or, if the operator were out of business or insolvent, the money for replugging would come from the state's abandonment fund. However, if a developer or landowner built over the well without obtaining the DOGGR's advice regarding whether the well needed to be replugged, then the developer or landowner would be responsible.

This California law, enacted to deal with the urbanization of old oil fields, is a good illustration of the need to expand the responsibility for abandoned or deserted and even previously plugged wells beyond the last operator and the state well plugging fund. The regulatory agency should pursue those who operated the wells and, when they are no longer available, the oil industry itself. But when the land becomes so much more valuable for other uses, those who propose and create those new uses should also be responsible. The price a developer pays for land in an old oil field likely is discounted to reflect the presence of old wells. The developer obtains an undeserved windfall when it pays a lower price for the property and then the state steps in to plug or replug the wells before the developer begins its project.

§XX.05. Plugging Idle and Deserted Wells from the Perspective of the Landowner

[1] Adequacy of the Lease Covenants and other Terms

Landowners have two primary concerns in this area: making sure that they do not become liable for plugging and abandonment costs, and making sure that idle wells are plugged and abandoned at the "right" time. Most of the time, oil and gas wells are drilled under the terms of

⁸⁹ See Cal. Pub. Res. Code § 3208.1(b) (West 1984).

oil and gas leases from the owners of the mineral estate. Usually it is a lessee who makes the initial decisions about where and when to drill, how to operate, and when to plug and abandon the well.⁹⁰ Common sense and business realities dictate this arrangement since the oil and gas lessee generally has superior knowledge and experience in exploring for and developing oil and gas reserves, and in many cases, has specific knowledge not available to the mineral owner about the oil and gas reserves underlying the particular leased land. Further, since the lessee is responsible for the costs and expenses incurred in drilling, equipping and operating the wells that the lessee drills, the lessee will naturally require as much control as possible over those decisions.⁹¹

The purpose of an oil and gas lease is to find and produce oil and/or gas and develop the lands for the mutual benefit of the lessor and the lessee.⁹² This is consistent with public policy

⁹⁰ Typically, the lessee has

the sole and exclusive right to explore for, drill for, produce, extract and take oil, gas and other hydrocarbons . . . and the right to construct, erect, maintain, operate, use, repair, replace and remove pipe lines, telephone, telegraph and power lines, tanks, machinery, appliances, buildings and other structures useful, necessary or proper for carrying on its operations on the leased land . . .

7 Williams & Meyers, Oil & Gas Law § 699.1 at 699-2 (1998).

⁹¹ This is illustrated in a typical lease provision which provides: “Lessee, at its own cost and expense, shall pay for all labor performed and materials furnished in the operations of Lessee hereunder and Lessors shall not be chargeable with, or liable for, any part thereof.” *Id.* at 699-8.

⁹² See Earl A. Brown, *The Law of Oil and Gas Leases* §3.01 (2d ed. 1998).

which favors and encourages the development of mineral resources.⁹³ Accordingly, many of the provisions of a typical oil and gas lease and much of the jurisprudence over the years concern the full and proper development of the leased property, and the sharing of the benefits of that development. Examples of lease provisions that focus on the benefits of oil and gas development are the royalty clause, express drilling covenants, implied covenants of reasonable development, protection and marketing, and pooling and unitization clauses. By comparison, relatively little has been written about the relationship of the parties after some or all of the property has been fully developed and now is to be returned to the lessor.

⁹³ To further the elimination of waste by increasing the recovery of underground hydrocarbons, it is hereby declared as a policy of this state that the grant in an oil and gas lease or contract to a lessee or operator of the right or power, in substance, to explore for and remove all hydrocarbons from any lands in the state, in the absence of an express provision to the contrary contained in the lease or contract, is deemed to allow the lessee or contractor, or the lessee's or contractor's successors or assigns, to do what a prudent operator using reasonable diligence would do, having in mind the best interests of the lessor, lessee, and the state in producing and removing hydrocarbons. . . .

Cal. Pub. Res. Code § 3106(b) (West 1984). "To best meet oil and gas needs in this state, the supervisor shall administer this division so as to encourage the wise development of oil and gas resources." Cal. Pub. Res. Code § 3106(b) (West 1984).

[a] Respective Rights of the Lessor and the Lessee to the Use of the Surface

As between the surface and the minerals, the mineral estate, and therefore the lessee of the mineral interest owner, is the dominant estate.⁹⁴ The lessee is entitled to use so much of the surface as is reasonably necessary for the enjoyment of its leasehold rights.⁹⁵ Express lease provisions and the case law developed over many years have supported the premise that the lessee will have control over where and when to drill wells, where to locate surface facilities, and when to remove them.

Several typical lease terms and legal doctrines act as a check on these otherwise superior rights of the lessee. In addition to the express rights of the lessor set forth in the lease, the accommodation doctrine provides that the lessee must consider the rights of the lessor and accommodate the lessor's surface uses if they do not unreasonably interfere with the lessee's operations.⁹⁶ Typically, oil and gas production operations co-exist with many other surface uses,

⁹⁴ See 1 Williams & Meyers, *Oil & Gas Law* § 218 at 198.6 (1998). Despite erosion of the principal in recent years, this is still the general rule. See John F. Welborn, *New Rights of Surface Owners: Changes in the Dominant/Servient Relationship between the Mineral and Surface Estates*, 40 *Rocky Mt. Min. L. Inst.* ch. 22 (1994).

⁹⁵ California courts, for example, have adopted the general rule that oil and gas lessees are "entitled to use any and all parts of the entire [lease] tract reasonably necessary to give them the full benefit of the rights and estate conveyed." *Wall v. Shell Oil Co.*, 209 Cal. App. 2d 504, 511 (1962).

⁹⁶ See *Getty Oil Co. v. Jones*, 470 S.W. 2d 618 (Tex. 1971).

from ordinary farms and ranches, to the delicate habitat of sensitive plant and animal species, to highly urbanized areas.

Although not embodied in any express right of the lessor in the lease, sensible lessees try to accommodate the lessor's reasonable surface uses in most cases, since good working relations with the landowner will make the lessee's long-term operations easier. These range from simple things, such as paying for repairs to fences and upgrading roads, to more complicated matters, such as coordinating the timing of drilling operations to accommodate seasonal events involving crops or livestock.

Leases typically contain express rights reserved to the lessor. First, virtually all leases contain a primary term consisting of a fixed term of years, and a secondary term measured by production from the lease. If the lessee does not drill, complete and produce wells, and maintain that production of hydrocarbons in paying or commercial quantities, then the lease will terminate.⁹⁷ Second, leases often reserve an express right to use the surface in ways which do not interfere with the lessee's operations.⁹⁸ Third, most leases provide that certain portions of the leased lands cannot be used by the lessee. For example, leases typically provide that no well may be located within a certain distance from a dwelling. Fourth, most leases provide that the lessee must pay damages for the actual loss suffered by the lessor in connection with the lessee's operations.⁹⁹

⁹⁷ See, e.g., *Clifton v. Koontz*, 325 S.W.2d 684 (Tex. 1959).

⁹⁸ This is illustrated in a typical provision which provides: "Lessors reserve the right to occupy and to lease the same for agricultural and horticultural purposes, subject to the rights of Lessee hereunder." Williams & Meyers, *supra* note 90.

⁹⁹ As can be seen by a typical provision: "If Lessors are the owners of the surface of the leased

Certainly lessors who are concerned about idle well issues should cover them expressly in the oil and gas lease.¹⁰⁰ In the absence of express lease covenants, the lessor will have a more difficult time compelling the lessee to deal with idle wells in any particular way during the lease term.

**[b] Express Lease Covenants Concerning Plugging and
Abandoning**

Prior to the termination of the lease, the lessee is given a great deal of latitude concerning when to plug and abandon a well. Typically, the lessee is in the best position to know whether a particular well is no longer economic to operate, whether it can be reworked or recompleted in a different zone, or whether a new technology can be applied to extend or enhance the productive life of the well. In addition, even if the well is no longer economic to produce at the price and cost variables at any given point in time, either the price for which the commodity may be sold could rise or operating costs could fall, and a marginally uneconomic well could become economic. Finally, the lessee might find it useful to convert the inactive production well to a salt water disposal well or an injection well used in a pressure maintenance project, or otherwise utilize the wellbore for appropriate purposes.

Accordingly, leases seldom require that the lessee plug and abandon a well at any particular time prior to lease termination. As long as the locations of surface improvements are

land, Lessee shall pay the amount of all damages to livestock, crops, fruit or nut trees, timber, fences, ditches, buildings and other improvements caused by Lessee's operations on the leased land” *Id.* at 699-8.

¹⁰⁰ See Thomas W. Lynch, “The Perfect Oil and Gas Lease,” *40 Rocky Mt. Min. L. Inst.* § 3.12 (1994).

not objectionable to the lessor, no danger to health or safety is present, and the lessor still receives royalty or other revenue from the operations, then the fact that some of the wells on the lease are idle or temporarily abandoned is not likely to cause the lessor to demand that something be done. (Indeed, a typical lessor demand concerning a lease or portion of the lease which contains idle wells is for *more or further* development of the oil and gas reserves, not the plugging and abandoning of existing wells.) An exception to this usual situation, however, is when the lessor believes that the lands can be put to a more productive or valuable use than oil and gas production, or when the surface estate is severed from the mineral estate, and thus, the surface owner bears all of the inconvenience, but receives none or relatively little of the benefits from the lessee's operations.

Some leases have a "Pugh clause" that will operate to reduce the area covered by the lease if no production is obtained from a particular portion of the leased lands within a certain time, typically by the end of the primary term.¹⁰¹ A Pugh clause would require, as to the terminated parcels, that the lessee plug and abandon all idle or inactive wells, most likely at the time of termination of the lease as to the affected tracts.

Virtually all leases contain a covenant by the lessee that it will comply with all laws applicable to the lessee or its operations.¹⁰² This would apply both as to the length of time that a

¹⁰¹ See 4 Williams & Meyers, *Oil & Gas Law* § 670.4 at 101 (1998).

¹⁰² This is illustrated by a typical provision providing: "Lessee shall comply with all state, federal and local laws and with the rules, regulations and orders of any federal, state or other governmental agency having jurisdiction in the premises with respect to the spacing of, drilling for or producing of wells, or other operations for oil or gas" Williams & Meyers, *supra* note 90, at 699-11 to 699-12.

well may remain inactive, as well as the obligation to plug and abandon wells under applicable laws. To the extent that a law required plugging and abandoning a well, or as discussed above, the furnishing of a bond or idle well plugging program to the state agency, and such obligation was not performed, the lessor would have a claim based on the lease provision. In addition, the lessee is often expressly obligated to indemnify and hold harmless the lessor against losses arising out of the lessee's operations on the leased land.

Some leases expressly require the lessee, at termination, to plug and abandon all wells and restore the surface of the lands.¹⁰³ The lessee is generally given the right to remove its personal property and fixtures, including casing, tubing and surface equipment, from the leased lands within a certain period of time. Sometimes, the lessor has the right to require that wells *not* be plugged and abandoned, but that the lessor be given an opportunity to convert the well or equipment to another use. In any event, lessees generally acknowledge that, either under the express or implied terms of the lease or under applicable governmental regulation, the lessee has an obligation to plug and abandon wells at its own expense at lease termination.¹⁰⁴

¹⁰³ See Williams & Meyers, *supra* note 94, § 218.12 at 247 & n.1. An example of a lease provision regarding surface restoration is as follows:

Lessee, after termination of this lease, shall fill all sump holes and other excavations made by it on the leased land and in other respects restore the leased land as nearly to its original condition as is reasonably practicable, but Lessee shall not be obliged to restore anything for which it may theretofore have made payment by way of damages.

Williams & Meyers, supra note 90, at 699-9.

¹⁰⁴ See Douglas Hale Gross, Annotation, *Duty and Liability as to Plugging Oil or Gas Well Abandoned or Taken Out of Production*, 50 A.L.R. 3d 240 (1973). Disputes can arise, of course,

In addition to the express provisions of the oil and gas lease, courts have found in oil and gas leases various implied covenants.¹⁰⁵ The objective of the implied covenants is to assure the lessor that it receives the benefit of its bargain — that the lessee conduct its operations as a reasonable and prudent operator and that the leased lands be developed and operated for the benefit of both lessor and lessee.¹⁰⁶ The “prudent operator” rule requires that the lessee act as would a “reasonable and prudent operator” in the same circumstances. Under this standard, a lessee is obliged to plug and abandon wells and clean-up inactive areas of the lease only if a reasonable and prudent operator would do so. A lessor seeking to compel a lessee to plug and abandon idle wells prior to lease termination might assert a breach of the “prudent operator” covenant, in addition to other claims.

[2] Enforcement of the Lease and other Remedies of Landowner

A lessor who believes that idle wells on its lease should be plugged and abandoned sooner rather than later could bring an action under the express or implied covenants of the lease briefly described above. The suit would allege breaches of specific provisions, as well as the failure to meet the prudent operator standard. In addition, lessors often make alternative claims

if the final operator has “inherited” idle wells from a prior operator, or if a top lessee wants to use the idle wells left by a prior lessee. *See Railroad Comm’n v. American Petrofina Co.*, 576 S.W. 2d 658 (Tex. App. 1978).

¹⁰⁵ *See generally* 5 Williams & Meyers, *Oil & Gas Law* (1998).

¹⁰⁶ Various authorities have classified implied covenants differently. One of the six implied covenants described by Williams & Meyers is the “covenant to conduct with reasonable care and due diligence all operations on the leasehold that affect the lessor’s royalty interest.” *Id.* § 804 at 28.2.

under common law theories such as trespass, nuisance, waste, negligence, negligence per se, strict liability, fraud and malice.¹⁰⁷

In addition to pursuing a private action against the lessee for breach of the lease, depending on the particular state, the lessor may request that the state regulatory agency with jurisdiction over such matters initiate proceedings against the lessee to investigate and, eventually, order the plugging and abandoning of idle wells. For such actions to be successful, the particular facts presented would need to fall within the area where the agency believes it is entitled to take such actions.¹⁰⁸ Of course, in a state such as California, which has a regulatory scheme expressly permitting idle wells to remain idle, this course of action may not be fruitful except in extreme cases.

A lessor would usually have a claim against the current owner of the leasehold working interest under the lessor's lease. This would appear to be the case even where the working interest owner is not the operator. Since the lessor is usually not a party to the operating agreement and is not bound by the delegation of duties to the operator under the operating agreement, the fact that his lessee is not the operator does not immunize the non-operator from a

¹⁰⁷ See, e.g., Williams & Meyers, *supra* note 94, § 218.10 at 246-46.5; James N. Castleberry, Jr., *Tort Liability in Oil and Gas Operations*, 4 *Rocky Mt. Min. L. Inst.* 281 (1958); Susan G. Zachos, *Liabilities Arising from Ownership or Operation of Dead and Dying Oil Fields*, 42 *Rocky Mt. Min. L. Inst.* ch. 17 (1996); Robert N. Barnes, Patranell Britten Lewis & Roy B. Short, *Tort Liability for Past Mineral Development Activities*, 44 *Rocky Mt. Min. L. Inst.* ch. 17 (1998).

¹⁰⁸ See, e.g., Cal. Pub. Res. Code §3206.5 (West 1984) (specifying the procedure in which the state of California can order an operator to plug an abandoned well). See generally Zachos, *supra* note 107.

claim for performance of the lease covenants. The lessor can enforce the lease against the non-operating working interest owners under the lessor's lease even though they do not directly control operations.

Where the working interest owner under a particular lease is not the operator of the lease, but has entered into an operating agreement with other working interest owners, the lessor may wish to pursue a claim against the operator and the other working interest owners.¹⁰⁹

In most cases, the interest of both the lessor and the lessee are freely assignable. Typically, the lease provides that in the case of transfers by the lessee, upon transfer the transferee becomes liable for performance of the lease and the transferor is relieved of liability for all events occurring after the transfer.¹¹⁰ Thus, in the case where a lessee has sold its

¹⁰⁹ If the operator is the assignee of the original lessee, no privity of contract is required because the covenants run with the land at law, as long as the three requirements are met: intent, privity of estate, and touch and concern the land. Oil and gas covenants generally meet these requirements. See 2 Williams & Meyers, *Oil & Gas Law* § 403.3 at 268-69 & n.2 (1998). See also A. Ben Mitchell, "A Duty to Plug - The Deep Pocket Theory," 9 *E. Min. L. Found.* ch. 20 (1988).

¹¹⁰ See Williams & Meyers, *supra* note 109, § 403.1 at 265-66. A typical lease provision states:

If this lease shall be assigned as to a particular part or parts of the leased land, such division of the leasehold estate shall constitute and create separate and distinct holdings under the lease of and according to the several portions of the leased land as thus divided, and the holder or owner of each such portion of the leased land shall be required to comply with and perform the Lessee's obligations under this lease for, and only to the extent of, his portion of the leased land"

leasehold working interest, the lessor must look to the transferee. An exception would be if the events giving rise to the claim occurred during the time that the transferor owned the lease, such that a duty then owed was breached. The fact that many older leases do not place any restriction upon transfers of the working interest means that less creditworthy parties may eventually own the lease.

In any case, under the traditional rules, in order to maintain a contract action against a working interest owner or operator, the landowner will have to show either privity of contract or privity of estate.¹¹¹

[3] Successive Users of the Surface Estate

[a] When is the Right Time?

In many cases involving older leases, the lessor will not have a clear contract right to compel the lessee to plug and abandon idle wells prior to lease termination. Causes of action sounding in tort may be successful in extreme cases. A regulatory agency action is often limited to those wells which present a public health and safety issue. Thus, a lessor may simply have to wait until the lease reaches the end of its natural life or until the lessor can somehow induce the lessee to agree to an earlier termination.

Moreover, a successful claim for breach of the lease would not typically result in automatic termination of the lease.¹¹² More likely, damages, or perhaps injunctive relief would

Williams & Meyers, supra note 90, at 699-11.

¹¹¹ “[I]n most states the assignee is not liable for a breach of covenant occurring after his interest in the premises has been extinguished by further assignment of the interest, but possibly this may not be true in all jurisdictions.” *Williams and Meyers, supra note 109* (footnotes omitted). *See Sowell v. Northwest Cent. Pipeline Corp.*, 703 F. Supp. 575 (N.D. Tex. 1988).

be the remedy available to the lessor. In some cases, a court might order conditional cancellation, which would result in the lease being terminated if the lessee does not comply with the court's order.¹¹³

If the lease has a number of idle wells, and the lessor succeeded in a claim that they should be plugged and abandoned, the lease would nevertheless remain in effect if the traditional "paying quantities" test was satisfied.¹¹⁴ In theory, one producing well could continue to hold substantial acreage, even if the lessee plugged and abandoned all of the idle wells. Eventually, the working interest owner or operator will be required to plug and abandon the idle wells, but of course there may not be a financially responsible party to be found at that time.

[b] How Clean is Clean Enough?

Typically, the state regulatory agency is concerned with the plugging and abandoning of the well itself. If the lessee's operations have caused soil or water contamination, other agencies might become involved. However, once a well has been plugged and abandoned in accordance with the laws and regulations then in effect, a lessee has discharged its duty and may conclude that nothing further would be required.

¹¹² See Williams & Meyers, *supra* note 101, § 681.1 at 323, 325.

¹¹³ The remedy of conditional cancellation is available, for example, when there is a breach of the covenant of further exploration, in which the court orders the lessee to drill additional wells within the specified time in order to avoid outright cancellation. See Williams & Meyers, *supra* note 105, § 834 at 246. Similarly, a court might order the idle wells to be plugged and abandoned, and the lease would terminate only if the lessee failed to comply with the order.

¹¹⁴ See Williams & Meyers, *supra* note 109, § 334.6 at 156.

In the case of a well that has been properly plugged in the past, but proves to be inadequate today, or while adequate in some sense, does not meet current technical standards, is the lessee liable for the additional cost to bring it up to current standards? Is the lessee liable for any contamination that might result from an old plugging job? Arguably not, although this would seem to leave the landowner liable for any further work that might be needed.¹¹⁵

After lease termination, and once all wells have been plugged and abandoned, and the surface equipment removed, the lessee's duties may be largely over for leases located in rural or semi-rural areas because the land may be suitable for use in that condition. If the land is in an urbanized area, however, the lessor may have plans to redevelop the property and may intend to occupy the same lands where lease facilities were formerly located. Even if a well has been properly plugged and abandoned in accordance with applicable law and even if the regulatory agency has approved the lessee's work, the lessor may still come up somewhat short in that the lessor may not have all that is needed before it can proceed with the redevelopment of the property. Depending on the proposed use of the tract, the governmental agencies responsible for approving the development may require different or additional measures to be taken with respect to the plugged and abandoned well.

[4] Control of the Situation

The lessor is usually not in a position to control the pace of development of the lease, nor is it able easily to control the pace at which wells are plugged and abandoned, or surface facilities removed and the premises cleaned up for the next use of the lands. This is particularly true while the lease is in effect. Lessors usually have the benefit of covenants from their lessees to comply with all laws and to indemnify them against claims arising from the lessees'

¹¹⁵ See, e.g., Cal. Pub. Res. Code § 3251.5 (West 1984).

operations. Accordingly, lessors historically believed that since they had no right to control the details of the lessee's operations and could rely on the lessee to control and be responsible for its operations, they would not be liable for any damages or claims by regulatory agencies arising out of the lessees' operations. This conclusion was supported by the political realities in most states which have caused the state regulatory agencies to conclude that, as a general matter, they will not pursue the landowner who has not actually exercised control over the operation of the wells.¹¹⁶ However, the *Wells Fargo* case, plus the advent of CERCLA and other strict liability laws, have raised the possibility that they could be liable for claims arising out of the lessees' operations over which they have no control.¹¹⁷ The landowner, who has less control over operational matters such as plugging and abandoning idle wells than either the lessee or the state, believes that as between the state and the landowner, the state should pay to plug and abandon any wells left by the last operator.

¹¹⁶ See, e.g., *Zachos*, *supra* note 107, at 17-39 (describing Texas' written policy statement).

¹¹⁷ 42 U.S.C. § 9601-75 (1995). The "petroleum exclusion" often limits the application of CERCLA itself, but the notion of liability based on status as an owner of the property is troubling to the lessor. See, *Long Beach Unified Sch. Dist. v. Dorothy B. Godwin Cal. Living Trust*, 32 F.3d 1364, 1368-69 (9th Cir. 1994) (finding no basis for holding that easement holders are "owners" for purposes of CERCLA liability); *Quaker State Corp. v. United States Coast Guard*, 681 F. Supp. 280 (W.D. Pa. 1988) (finding surface owner to be the "owner" of oil and gas lessee's abandoned surface impoundment); Thomas F. Cope, *Environmental Liabilities of Non-Operating Parties*, 37 *Rocky Mtn. Min. L. Inst.* ch. 1 (1991) (arguing that the owner of a non-participating royalty interest ought not be liable, but that a royalty owner who also owned fee title or the mineral interest could be liable).

§XX.06. Plugging Idle and Deserted Wells from the Perspective of the Producer

[1] Control of Operations

As noted above, the lessee or operator is in the best position to know how to conduct operations on the lease. Specifically, with respect to idle wells, the lessor is typically not in a position to know whether a well could be restored to production or what additional work would make the well economic to reactivate. Similarly, the lessee is in the best position to know how a particular idle well might be used in connection with other operations on the lease which the lessee will attempt to optimize on a lease-wide or unit-wide basis. In short, neither the state regulatory agency nor the lessor is in a better position than the lessee to determine whether an idle well should be left idle or whether it should be plugged and abandoned. In such a case, absent compelling evidence to the contrary, the lessee's judgment ought to carry the day.

In order to prevent a lessee from holding a lease beyond the point where it is fulfilling its original goal of benefiting both the lessor and the lessee, the policy against "speculation" prohibits holding a lease solely for the purpose of speculating that the property may someday become valuable once again for oil or gas production, even though it cannot now be profitably operated.¹¹⁸ Even if the state regulatory agency would not or could not intervene to force a lessee to plug and abandon non-hazardous idle wells, the lessor will have rights in cases where "speculation" is present.

Thus, the lessee's judgment about when to plug and abandon wells, plus the relatively clear liability that the operator and working interest owners have for plugging and abandonment at the time of lease termination, cause lessees to believe that they ought to be able to leave wells idle so long as they do not endanger public health or safety. There are two risks associated with

¹¹⁸ See generally 3 Williams & Meyers, *Oil & Gas Law* § 604.6(c) at 88.2-88.6 (1998).

plugging and abandoning wells: technical competency and financial responsibility. It is ultimately the responsibility of the state regulatory agency to assure that both of these risks are appropriately managed.

[2] Technical Competence in Plugging

While some wells may present unusual challenges, a proper plugging and abandonment job is not a difficult task. To the extent that an operator or its contractor undertakes the work, the state will supervise and confirm compliance with applicable technical standards. This is the proper role for the state as regulator and neither lessees nor lessors believe otherwise.

[3] Adequacy of Bonds and other Financial Assurances

Historically, many producers did not set aside funds to pay for plugging and abandonment costs. This practice arose because the costs of plugging and abandoning a well were approximately equal to (or even less than) the salvage value of the personal property and fixtures that the lessee was entitled (and obligated) to remove from the land.

This premise may still be true in various geographic areas, but is not in others. Depending on the extent of cleanup and remediation required on and around the wellsite, there can be a substantial net cost to plugging and abandoning each well and restoring the site. The costs of simply plugging and abandoning the well, however, are often only a portion of the total clean-up costs of the surface and subsurface soil and water.

Traditionally, state regulators have made sure that the public would not bear the cost of plugging wells in the event that the operator failed to do so, by requiring individual well or statewide bonds. As discussed above, this remains the most common way to deal with the potential problem. If the bonding scheme is appropriately crafted and is properly administered, then neither the landowner nor the public should be at risk for any exposure to the costs of any

unplugged wells at lease termination. The fact that the size of the bond may not be appropriate to deal with high cost clean-up projects on some sites is not a sufficient reason to alter the traditional allocation of liabilities among lessor, lessee and regulator; rather, the bonding requirements simply need to keep up with evolving legal and technical requirements for plugging.

Moreover, even if specific operator or owner-supplied bonds prove to be inadequate, the orphan well funds being enacted or updated in various states (typically funded by a production tax) are an appropriate way to deal with deserted wells, previously plugged wells that require further work because of changing technical standards and insolvent operators. Assessing the magnitude of the problem and designing an orphan well fund that generates the right amount of revenue are the best ways of dealing with those problems. These are solutions that state regulatory agencies are better equipped to administer, rather than conducting inquiries into and adjudications of “ownership” or trying to determine who had the requisite amount of control or the appropriate level of financial benefit from the well so as to be held responsible under some vague principle of fairness and equity.

[4] Concerns of Seller

As noted above, typically the seller of a lease with idle wells located on it is relieved of liability *vis a vis* the lessor as to events arising after the transfer. In addition, under most states’ laws, the transferee-operator will substitute its bond for the bond of the transferor-operator and thus, the credit of the transferee will be substituted for the seller’s credit.

The allocation between buyer and seller of plugging and abandonment liability is the same as any other term of a sale — totally negotiable, depending on the facts of the particular transaction. Larger and stronger sellers may attempt to impose upon the buyer of the property

liability for all matters relating to the plugging and abandoning of wells on the property. The allocation of this responsibility between the parties ought to be left to the negotiated terms of their transaction. If the technical competency risk and the financial responsibility risk are managed properly by the state, then the fact that the transferor has — or has not — retained any obligations of contribution or indemnity from the transferee for these expenses should not matter.

[5] Concerns of Buyer

Most buyers of property will conduct some form of due diligence inspection of the properties, for traditional engineering and operating reasons, as well as for purposes of determining whether there are significant environmental compliance issues or costs associated with the property. Plugging and abandonment costs, in the absence of special circumstances, are usually not a major concern of buyers, but are simply a component of their valuation of the property.

Typically, a seller of producing properties would be asked by the buyer to represent and warrant that it has complied with all applicable laws in its operations on the properties being sold. This would include the proper plugging and abandoning, and any required remediation, of wells already plugged. On the other hand, the buyer of such properties would be asked to covenant that it will comply with all applicable laws and the terms and conditions of the lease, which would include plugging and abandoning at the appropriate time. Cross-indemnities against losses arising from the breach of such representations, warranties, and covenants are common and are typical of how such risks are allocated generally.¹¹⁹ Unique facts are handled with special contract provisions.

¹¹⁹ See generally David E. Pierce, “Structuring Routine Oil and Gas Transactions to Minimize Environmental Liability,” 33 *Washburn L. J.* 76 (1993).

Although virtually any arrangement could be negotiated, the typical purchase and sale terms would establish an effective time for the transfer of the properties and then allocate responsibility for various matters by reference to whether the liability arose before or after that time. In most cases, responsibility for plugging *vis a vis* the state and the landowner is understood to fall upon the buyer, with the seller contributing either directly or by way of being factored into the purchase price paid for the assets.¹²⁰ To the extent that a seller will or could be exposed to liability for the failure of the buyer to properly plug and abandon, as is the case with California's current statute, rational sellers will account for this risk in the price accepted for the property.¹²¹

Conclusion

The general obligation of the last operator to plug and abandon wells when the lease terminates is accepted by all participants. Landowners properly expect that they will not be held liable for these costs if they do not control the operation of the wells. Sellers of working interests properly expect that if they comply with all applicable laws while they own the property they will not be asked to retain indefinite, unlimited liabilities. State agencies properly expect to be given the bonding and orphan well fund mechanisms that will allow them to manage technical competency risks and financial responsibility risks. The public properly expects that landowners, lessees, and regulators will not impose burdens on public funds out of proportion to the tax contributions made from the business of producing oil and gas. Applying traditional rules

¹²⁰ See generally Frank Douglass, "The Obligations of Lessees and Others to Plug and Abandon Oil and Gas Wells," *25th Oil & Gas Inst.* 123 (Sw. L. Fdn. 1974).

¹²¹ See Cal. Pub. Res. Code § 3237 (West 1984).

and mechanisms for assessing and allocating those risks offers the best solution for the ongoing vitality of the industry.