

**ENVIRONMENTAL LITIGATION THREATENS THE RIGHTS OF  
FEDERAL OIL & GAS LEASEHOLDERS<sup>1</sup>**

In recent years, environmental activists have brought an increasing number of administrative and legal challenges seeking to delay or permanently halt oil and gas development. Perhaps nowhere have efforts to stem such development been more focused than on federal oil and gas leases, particularly leases that could be used for Coal Bed Methane (CBM) production, in Wyoming and Montana. More importantly, these challenges are starting to be met with some success in the federal courts. For example, in the recent decision Pennaco Energy, Inc. v. United States Dept. of Energy, 377 F.3d. 1147, *reh'g. denied* (10<sup>th</sup> Cir. 2004) the U.S. Court of Appeals for the 10<sup>th</sup> Circuit agreed with environmentalists' claims that CBM leases that had been issued by the Bureau of Land Management (BLM) in the Powder River Basin in Wyoming lacked sufficiently detailed environmental analyses and therefore violated the National Environmental Policy Act (NEPA), 42 U.S.C. §§ 4321 *et seq.* The court rejected the BLM's reliance on NEPA analysis it had prepared for its Resource Management Plan back in 1985 because the analysis had not specifically addressed the impact of CBM development, which was in its infancy at that time. The court also rejected the BLM's reliance on more recently prepared environmental documents because, even though the documents did specifically discuss impacts of CBM development, they had been issued after the leases had already been awarded. At

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present, the scope of this decision is limited to the leases at issue in the case, however, environmental activists have suggested that they will try to extend the reasoning of this decision to other BLM leases that also relied on the environmental analysis contained in these same two NEPA documents.

The ruling in Pennaco Energy comes on the heels of a decision last year by the U.S. Court of Appeals for the Ninth Circuit in Northern Plains Resource Council v. Fidelity Exploration and Dev. Co., 325 F.3d 1155 (9th Cir.), *cert. denied* 124 S.Ct. 434 (2003), which found that water brought to the surface during CBM production was a “pollutant” as defined in the federal Clean Water Act (CWA) and therefore that discharge of this water into another body of water was subject to regulation and permitting under the CWA. The federal court ruled that CBM water was a “pollutant” despite the fact that Montana state law on the issue was directly to the contrary.

The attempt to subject oil and gas leasing to judicial scrutiny under other federal environmental laws has also gained ground during this past year. For example, the U.S. District Court for Montana held that three BLM oil and gas leases as well as a pipeline right-of-way had all been issued in violation of a variety of federal environmental laws, including NEPA, the Endangered Species Act, 16 U.S.C. §§ 1531, *et seq.* and the National Historic Preservation Act, 16 U.S.C. §§ 470 *et seq.* See Montana Wilderness Assoc. v. Fry, 310 F.Supp.2d 1127 (D. Mont. 2004). In so ruling, the court indicated that it was taking under advisement whether to invalidate

the three leases and order the permanent shut down of the pipeline. Id. at 1154-57.

The growing trend of environmental litigation aimed at preventing federal oil and gas development in the West is not likely to end soon. In fact, other litigation, with even greater potential to impact CBM development, has been recently filed by environmental activists and is currently pending in the U.S. District Court for Wyoming. See American Lands Alliance v. BLM, No. 04-19 ABJ (D. Wyo). At its core, this lawsuit challenges the adequacy of the BLM's NEPA analysis contained in a 2003 Environmental Impact Statement which provides the environmental support underlying recent CBM oil and gas leases offerings in the Powder River Basin in Wyoming. Similar litigation is also pending in the U.S. District Court in Montana where environmental activists challenge a separate environmental document analyzing the impacts of CBM development in that state. See Western Organization of Resource Councils v. Clarke, No. 03-70 RWA (D. Mont.).<sup>2</sup> If successful, there is the potential for these cases or other environmental issues to seriously disrupt timely development of CBM leases.<sup>3</sup> Indeed, such impacts are already being felt in the form of delays as permitting agencies attempt to

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<sup>2</sup>The environmental plaintiffs are frequently represented by large, well-funded environmentalist law firms. The often coordinated legal tactics of these firms, which have only begun to be applied to oil and gas leasing in Wyoming and Montana, are not new and have served to disrupt other multiple-use activities on federal lands, perhaps most notably federal timber harvest in the wake of the listing of the Northern spotted owl under the Endangered Species Act in the 1990s.

<sup>3</sup>This article does not address the impact that a listing of the greater sage-grouse under the Endangered Species Act would have on federal oil and gas leases across the Western United States. It is noteworthy, however, that last spring the United States Fish and Wildlife Service found that "there is substantial information indicating that listing the greater sage-grouse [under the ESA] may be warranted." 69 Fed.Reg. 21494 (Apr. 21, 2004). The agency is currently conducting a status review of the species which is to be completed by December 29, 2004. A consideration of the impacts of new listings under the ESA on federal oil and gas lease holders will be the subject of a future article.

“bulletproof” the process. In this regard, BLM officials recently estimated that suspensions imposed by the agency on over 1,000 leases in the Powder River Basin between 2002 and 2004 cost state and federal governments some \$4.5 million in revenue. See BLM Lease Suspensions Cost Millions, Associated Press Newswire, September 13, 2004, *available at* 9/13/04 APWIRES 15:48:15. Of course, the losses to federal leaseholders due to missing a strong market not to mention drainage from neighboring non-federal lands are likely to have been many times higher.

As these cases amply demonstrate, a government agency that offers oil and gas leases has two important but sometimes conflicting obligations: The agency must both meet its obligations to design and administer leases in accordance with various environmental requirements and, at the same time, comply with its contractual obligations to the leaseholder. When such conflicts arise between these obligations, a leaseholder may find approval of permits delayed, and its operations abruptly suspended or otherwise disrupted, at great expense. However, this does not mean, as some government agencies suggest, that they can ignore their express and implied obligations under the lease or that a leaseholder is left without options if an agency takes this position. As the court observed in Pennaco Energy, federal oil and gas lessees acquire “certain rights subject only to stipulations contained in their leases.” *Id.* at 1160. Thus, where government delays in permitting or interference with ongoing operations in these circumstances are contrary to the terms of the lease, statutes and regulations, and/or agency directives they may well be compensable.

In fact, several recent legal precedents have established that the federal government is liable for damages caused to those holding contracts for natural resources located on federal land

when access to those resources is improperly delayed while government agencies attempt to comply with their environmental obligations. See, e.g. Scott Timber Co. v. United States, 333 F.3d 1358 (Fed. Cir. 2003)(holding that the government’s suspension of contract operations to comply with its environmental obligations without express contractual authority to do so is a breach of contract); Precision Pine and Timber, Inc. v. United States, 35 Fed. Cl. 50 (2001)(holding that, despite having suspension authority in the contract, the government’s unreasonable and protracted suspension of operations to comply with its environmental obligations is a breach of contract).<sup>4</sup>

Of course, each instance of government caused delay of operations on a federal oil and gas lease, will involve unique considerations and a lease holder should seek legal advice at the earliest possible time. However, every leaseholder can almost certainly benefit by following these simple guidelines relating to government delays:

1. Document all communications with government personnel regarding environmental issues or government actions that adversely affect your lease. If government personnel attempt to interfere with your operations in any way, ask them to put their directions in writing. If they do not do so promptly, you should immediately document any oral directions you receive in a letter to the contracting officer.
2. Do not agree to extended delays in permitting, interruptions to operations or cancellation of leases without a written reservation of your rights. Written notice to the contracting officer that you are following his directions under protest and with a full reservation of rights establishes that you did not agree to the actions taken by the government.
3. Most federal oil and gas leases today contain provisions that claim to allow the government to disrupt operations to minimize adverse impacts to other resources in certain circumstances. Nevertheless, there continues to be a real question as to the enforceability of

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<sup>4</sup>This case was decided by the current Chief Judge of the Court of Federal Claims. Located in Washington, D.C., the Court of Federal Claims traces its roots back to 1863 and has long had jurisdiction over claims against the federal government which are based on the constitution, a federal statute or a contract (including oil and gas leases) for money damages in excess of \$10,000.

these provisions. Irrespective of the inclusion in your lease of any such stipulation, do not assume that you are entitled only to minimal or no compensation for a significant delay in operations or permit approval. Depending on the circumstances, the government may be liable for significant damages. Get advice from an attorney knowledgeable in this area before agreeing to accept the government's version of what these clauses mean.

4. Generally speaking, the government can require only that operations be conducted in accordance with sound drilling practices and the specific requirements in the lease. You should not agree to changes in the timing or sequence of your operations unless there is a contract provision which allows the government to control your operations in this way. If the government directs you to change or delay your planned operations, insist that the contracting officer identify in writing the specific lease stipulation that the government claims justifies its interference with your operations.

5. Unilateral cancellation of a lease is an extraordinary action. If your lease is cancelled at any stage of your operations, seek legal advice immediately. You cannot afford to rely on government personnel for advice about your legal rights.

By following these guidelines, federal oil and gas leaseholders can protect their rights even in the face of increasing environmental litigation and also insure that the government continues to take seriously its contractual commitments in the lease. On the other hand, failing to hold the government accountable for impacts to lease operations will simply cause the government to believe that it can do so with impunity and can easily result in leaseholders being left to bear the often considerable costs of protracted delays.