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**IN THE DISTRICT UNITED STATES DISTRICT COURT**
**FOR THE DISTRICT OF IDAHO**

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| CITIZENS ALLIED FOR INTEGRITY AND ACCOUNTABILITY, INC., CHARLENE QUADE and RACHEL HOLTRY<br><br>Plaintiffs,<br><br>v.<br><br>THOMAS M. SCHULTZ, in his official capacity as Director of the Idaho Department of Lands; CHRIS BECK, MARGARET CHIPMAN, SID CELLAN, JIM CLASSEN and KEN SMITH, all in their official capacities as members of the Idaho Oil and Gas Conservation Commission<br><br>Defendants. | CASE NO. 1:17-cv-264-BLW<br><br>**PLAINTIFFS' RESPONSE TO DEFENDANT'S MOTION TO ALTER OR AMEND THE JUDGMENT** |

Having lost partial summary judgment, Defendants seek another bite at the apple, re-asserting their arguments that there is absolutely no property interest in mineral rights held by the owners of those rights and the land to which those rights attach. Further, Defendants seek to sever the invalid portion of their final orders (that portion dealing with integration of the rights of unconsenting landowners) from what they allege to be valid portions of those orders. While the

property interest in mineral and gas rights is a limited interest (not, for instance as strong as would be the property interest in the surface estate), the Court correctly looked to the Oil and Gas Conservation Act to help establish that such a right exists. The request to find otherwise should therefore be denied, though the Court may consider clarifying its reasoning. Because the issues involved in the integration of mineral rights are necessarily intertwined with the issues surrounding the spacing order in this particular case, the attempt to sever should likewise be denied.

**I. The Court Correctly Found a Property Interest in Mineral Rights Based, in Part, on the Oil and Gas Conservation Act.**

Plaintiffs have argued and still argue that the ability to sell or withhold from sale the minerals below their land, including oil and gas, constitutes a property interest protected by the Constitutional requirement for due process. The Court added an insight that had previously escaped Plaintiffs: that the Oil and Gas Conservation Act itself further strengthens and defines that property right. This may not have occurred in precisely the manner that the Court's Opinion defined the property interest (as an interest in "just and reasonable" terms), however, the insight is an important one that makes clear the property interest that has been created by state law.

At common law, as the Court has pointed out, there may not have been any property right in oil and gas underlying the surface estate.[1] Plaintiffs previously pointed out that Idaho's constitution and statutes clearly recognize all mineral interests as property rights, even to the point of taxing those rights as personal property. (Plaintiffs' Response to Defendants' Motion for Summary Judgment, pp. 2-4, Dkt. 30). The Court identified the final step of that argument,

[1] Plaintiffs here are noting this position, though they assert it would be directly contrary to the statement of the Supreme Court in *Ohio Oil Co. v. Indiana*, 117 U.S. 190 (1900), which expressly held that while the property interest in migratory oil and gas may be limited, **t**he owners of such rights "could not be absolutely deprived of this right which belongs to them without a taking of private property." 117 U.S. at 209.

which Plaintiffs had previously missed. The Oil and Gas Conservation Act itself solidified the property interest of mineral rights owners removing any doubt. (Memorandum Decision and Order, pp. 13-14, Dkt. 36). The Memorandum Decision and Order cast that right in terms of a right to "just and reasonable" terms, which correctly quotes the Oil and Gas Conservation Law, but may have strayed just off target in understanding the property interest at stake.

At common law, a mineral rights holder could have drilled their own well and extracted both their own and the Plaintiffs' oil and gas under the rule of capture. (Memorandum Decision and Order, p 13, Dkt. 36). Plaintiffs also had an independent right to drill for oil and gas. It was this unique nature of oil and gas that led to this Court and others expressing doubts about the nature of the property at stake.

While Idaho law has routinely treated the right to drill as an interest appurtenant to property, the Oil and Gas Conservation Act ("OGCA") made quite clear a property interest in the right to either drill or refuse to allow drilling. With the passage of the OGCA, the "right of capture" was largely legislated away, and instead landowners were able to retain their minerals rights unless and until their interests were integrated in compliance with the OGCA. Property owners, under the OGCA, have a protected interest in the oil and gas underlying their property, an interest that they can buy or sell where market conditions warrant, and one that the State may transfer to an oil and gas operator, if the processes of the law are satisfied.

The OGCA strengthened, enhanced or created a property interest by requiring that before operating any well, a well operator must provide notice to all "uncommitted owners" such as the plaintiffs herein, must attempt to lease their mineral rights, and only if a specified majority of the owners in a pool agree to lease, can the others be compelled to lease. Idaho Code §47-317(3). The Oil and Gas Conservation Commission and the Director of the Department of Lands are

required to establish spacing units, and then to "integrate" the mineral interests within those spacing units, and in doing so, ensure that mineral interest owners receive a royalty. Idaho Code §47-320. The OGCA itself has thus displaced the "rule of capture" and ensured that each of the Plaintiffs has a property interest, limited as it is, in their oil and gas.

The practical and empirical effect of the OGCA on property rights is easy to see. Prior to integrating the tracts that the Plaintiffs own, they and other nearby property owners were able to sell their oil and gas rights by leasing them to Alta Mesa. (Holtry Deposition, 28:13-16; Quade Deposition, 34:15-22;Dkt. 23-3, 23-4). They were also able to decline to do so. (Holtry Deposition, 28:19-30:6, Dkt. 23-3). Some of the property owners negotiated better royalty rates, while others simply accepted what was offered. (Hearing, 189:10-16, Dkt. 23-7). The record in this case clearly shows that prior to integration, Alta Mesa and the property owners were actively engaged in the buying and selling, for consideration, of the right to explore for and extract oil and gas in these tracts. Had Alta Mesa never reached a 55% threshold of property leased in the relevant unit, Plaintiffs would have retained that right to withhold their consent and to prevent the extraction of their oil and gas.

Defendants have also provided an important insight in their motion to alter or amend the judgment. A property interest at least should, and perhaps must, have a monetary value. *Town of Castle Rock*, 545 U.S. 748 (2005). And the OGCA ensures that the right to exploit oil and gas lying below one's land does have monetary value, as was clearly demonstrated by the record before the Oil and Gas Commission. Prior to the passage and updating of the OGCA there was essentially no market for gas and oil rights in Idaho. But the Idaho legislature created the conditions which spurred a market and in doing so ensured that a property right in oil and gas both existed and had at least some protection. While the Defendants here focus on "just and

reasonable" terms and ask the Court to reconsider whether there is a "right to just and reasonable terms" as the Court found, the property interest is actually the mineral rights themselves. The State may be right to complain that the right to "just and reasonable" terms cannot itself be a property interest. The property interest is in minerals and the right to sell, not sell, or exploit for oneself. The requirement of just and reasonable terms is part of what due process requires before an owner can be deprived of that property interest. Indeed, the OGCA itself ensures that mineral rights to oil and gas have a baseline monetary value, which owners like Quade and Holtry have the ability to try to improve upon by withholding their consent to drilling until either their price is met, or at least 55% of their neighbors see their prices met.

The fact that the OGCA created a property right does not necessarily mean that it defines the limits of that right, or the process that is due. Due process analysis requires several steps. Once a property interest is established, then any attempt to curtail that interest requires legal process. The extent of process required depends in large part on the nature of the property interest, the public interests at stake and the competing risks of committing error in the taking of property or in delaying or obstructing the public interest. Plaintiffs concede that a properly conducted evidentiary hearing which correctly utilizes a standard of "just and reasonable" terms for the taking would satisfy procedural due process in this case. See, *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S. Ct. 736, 86 L. Ed. 1037 (1942) ("the Congressional standard [of just and reasonable] prescribed by the statute coincides with that of the Constitution" in relation to the taking of natural gas). Just and reasonable terms are thus not the property interest itself, rather, the requirement of just and reasonable terms is the proper measure of process due if the state determines to allow Alta Mesa (or another operator) to take Plaintiffs' oil and gas.

Since "just and reasonable" terms are required both by statute and Constitution, that phrase must have meaning. Otherwise, it is arbitrary and meaningless and thus denies Plaintiffs the process that they are due. *Hornsby v. Allen*, 326 F.2d 605, 609 (5th Cir. 1964); *Holmes v. New York City Housing Authority*, 398 F.2d 262, 264 (2dCir. 1968); *Powers v. Canyon County*, 108 Idaho 967, 978-979 (1985). The failure to define "just and reasonable" imposes a completely arbitrary and meaningless standard between a property owner's interest in oil and gas rights, and the compelled transfer of those interests to an operator like Alta Mesa. While the royalty and bonus payment figures were fixed, "just and reasonable" terms potentially could address matters as diverse as the extent of surface estate interference allowed, to the terms of sale that the operator was required to obtain, to variations in reporting requirements, and more. Addressing these other matters is the point of "just and reasonable" terms and entirely necessary to satisfy due process.

Defendants argue that the wide range of discretion which the Director and the Commission claimed for themselves renders the property interest illusory and thus not worthy of protection, citing, among others, *Town of Castle Rock, Colo. v. Gonzales*, 545 U.S. 748, 748 (2005). The Court already addressed this argument, pointing out that while "just and reasonable" was not a defined term within the statute, it was also not entirely discretionary. (Memorandum Decision and Order, p. 15, Dkt. 36). In light of the extensive legal history behind the term "just and reasonable" as it is used in the oil and gas industry, the term is not a signifier of unfettered discretion. It is instead a statement of the minimum standard required when the state seeks to compel the sale of private property to a third party, in the public interest.

While the precise language of the Court's Memorandum Decision may have misstated the nature of the property interest, it was fundamentally accurate in that it found a limited property interest in either selling or withholding one's mineral rights at least up to the point that a majority of the landowners in a given tract gave the consent necessary to allow an integration

proceeding to occur. The Court should affirm that Idaho landowners who still hold mineral rights under their property have a limited property interest in their oil and gas rights, as confirmed by the OGCA's provisions specifically allowing such rights to be bought, sold and leased.

**II. The Court Should Decline the Invitation to Sever Portions of the Commission's Final Order.**

The State asks the Court to amend its Order to clarify:

1. That the spacing order remains enforceable
2. That the integration order is vacated only to Plaintiffs Holtry and Quade

(Dkt. 43-1, pp. 9 – 12). What the State seeks is severance of portions of an Administrative Board's Order. The Final Order of the Oil and Gas Conservation Commission adopted the findings of fact and legal conclusions of the Amended Order of the Department of Lands, approved the spacing unit, and integrated all mineral interests. The State seeks to sever approval of the spacing unit from the integration order, and further sever Plaintiffs Quade and Holtry from the integration order. The Court should decline.

**A. Invalid Portions of Administrative Orders Should be Severed From Valid Portions Only in Specified Circumstances Not Present Here.**

Though there is no Idaho case law and very little case law from other jurisdictions addressing the severability of portions of an administrative agency's order, a Texas Court addressed the severability of an administrative agency's order by analogizing to severability of an agency's promulgated rules :

> Courts addressing the severability of agency rules have adopted a two-pronged test. If only part of an agency rule is found invalid, the severance decision depends on the court's determination of two issues:
>
> > (1) will the function of the regulatory statute as a whole be impaired without the invalid part of the rule; and (2) is there any indication that the agency would not have adopted the rule but for

> the invalid part? If the answer to either query is "yes," in the court's view, then severance is not justified and the entire rule must fall.
>
> *Texas Dep't of Banking v. Restland Funeral Home, Inc.*, 847 S.W.2d 680, 683 (Tex. App.--Austin 1993) (citing *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 295, 100 L. Ed. 2d 313, 108 S. Ct. 1811 (1988)).

*Board of Pilot Comm'rs for the Ports of Brazoria County v. Gonzales*, 2000 Tex. App. LEXIS 3309, *5-9, 2000 WL 977408. The Texas Court found this test equally applicable to the orders of administrative agencies when a court finds only part of an administrative order invalid. *Board of Pilot Comm'rs for the Ports of Brazoria County v. Gonzales*, 2000 Tex. App. LEXIS 3309, *5-9, 2000 WL 977408.

A similar approach is justified in the present case where the Defendants ask that the invalid integration order be severed from the allegedly valid spacing order, and that the invalidity of the integration order as to two landowners be severed from the equally invalid integration order as to hundreds of others.

**B. The Order is Not Severable**

The answer to both of the queries used to determine whether an order is so intertwined that it cannot be severed is “yes,” at least in part. As to the first standard, whether the statutory scheme is impaired if only a part of the Commission’s final order is invalidated, the answer is yes for the simple reason that the statute envisions a linked set of decisions in which the spacing order and the integration order are co-extensive, are determined in a single proceeding, and the overall outcome of the proceeding is establishment of an order that incorporates just and reasonable terms for all parties. I.C. §47-320(1)(calling for a single proceeding and order to simultaneously establish spacing and integration). Where “just and reasonable” is not even defined, there is no way to say that the spacing order, standing alone and without integration, satisfies the statutory scheme.

The second query, whether the Commission would not have adopted the spacing order if it had known that the integration order was invalid, the obvious conclusion is a resounding yes. The order in question proceeded in part on the basis that the exact size and shape of the pool of hydrocarbons was unknown, but that integration of the entire "section" of land was appropriate while Alta Mesa drilled and explored to further determine the pool's limits, and the effected landowners. (Final Order of Oil and Gas Commission). In light of the difficulties merely in defining the pool, if the Commission had known that the terms of integration were invalid, they would not have approved spacing and drilling before those terms were established. Per the statute, the Commission is required to base its decision on the record made in the hearing before the Director, and there can be little doubt that a new hearing on integration will expand the record, thus requiring the Commission to consider that record in determining whether to approve a spacing order. Idaho Code §47-328(4). In short, a hearing at which the Plaintiffs had prior knowledge of the meaning of "just and reasonable" and in which they attempted to provide evidence relating to that meaning, would have an extremely high probability of also affecting the temporary spacing order that was entered in this case.

An analysis similar that used by the Tex Court was applied used by United States District Court for the District of Columbia:

> In analyzing whether an agency action is severable, courts consider whether the parts of the order are "intertwined" or whether "they operate entirely independently of one another." Id. In doing so, they examine the purpose of the agency's action and whether the action "sensibly serve[s] the goals for which it was designed" without the severed portion. *MD/DC/DE Broadcasters Ass'n v. FCC*, 253 F.3d 732, 734, 347 U.S. App. D.C. 19 (D.C. Cir. 2001); see also *Assoc. of Private Colleges & Universities v. Duncan*, 870 F. Supp. 2d 133, 155-57(D.D.C. 2012) (holding that when regulations are intended to have different purposes and are not dependent on each other, they are not intertwined). According to the D.C. Circuit, reviewing courts should ask "whether the [agency] would have adopted the same [result] . . . had the [agency] not erroneously interpreted [the statute]." *Davis Cnty. Solid Waste Mgmt*. at 1459. Severance and

> affirmance of a portion of an administrative regulation is improper if there is "substantial doubt" that the agency would have adopted the severed portion on its own. *Id.* And the agency's intent must be rational, meaning that "the remainder of the regulation [can] function sensibly without the stricken provision." *MD/DC/DE Broadcasters Ass'n*, 253 F.3d at 734.

*Wilmina Shipping AS v. United States Dep't of Homeland Sec.*, 75 F. Supp. 3d 163, 171-172, (Dist. of D.C. 2014). There can be no reasonable question but that the size and shape of the pool, and the appropriate spacing of wells (the matters addressed by spacing orders) are intertwined with the "just and reasonable" terms under which integration will be ordered, particularly in this case. The spacing order here was temporary and limited precisely because of the unique size and shape of the pool of hydrocarbons that Alta Mesa wished to extract. The pool was smaller than a section of land, the default size of a spacing order. The appropriate protections for landowners, the protections that would satisfy any possible definition of "just and reasonable" would necessarily take into account the unique spacing considerations at play. In this case, spacing and integration did not operate independently of each other, rather they were closely related.

The State asks the Court to sever Final Order of the Oil and Gas Conservation Commission regarding the integration order and limit it to the interests of Plaintiffs Quade and Holtry. The Court should decline as the interests of all property owners are intertwined with those of Holtry and Quade.

**C. Severance of Named Plaintiffs From Other Potential Parties is Unjustified.**

Plaintiffs Quade and Holtry, along with the members of Plaintiff Citizens Allied for Integrity and Accountability, were denied due process along with all property owners subject to the integration order. Plaintiffs Quade and Holtry were not the only property owners with objections to integration. The record reflects that:

1. Seven property owners were represented by Attorney Piotrowski at the hearing. Amended Order, p. 3;

2. Eight property owners submitted written comments but did not participate in the hearing. Amended Order, p. 3. Among those eight were the owner of a mobile home park and a representative of a home owners association;

3. Members of the public attended the hearing and testified. Amended Order p. 4;

4. Uncommitted mineral owners provided comments and expressed opposition to the proposed spacing unit. Amended Order, p. 19;

5. While the statutory threshold of 55% lease agreement of mineral interests had been met, Amended Order, p. 19, approximately one-third of the acres in the unit had not consented to drilling and extraction; Amended Order, p. 13.

It is clear that a significant number of property owners did not agree to the spacing unit, integration or the terms of the lease. Holtry and Quade were not the only property owners denied due process. Those submitting written objection were denied due process in the absence of any guidance regarding the definition of "just and reasonable" as it related to their property interests. They were unable to meaningfully direct their objections. Those who did not participate in writing or in person were denied due process in the absence of any guidance as to how they could meaningfully participate or even understand what would be relevant. Those who participated in person at the hearing were denied due process as standards were absent and evidence excluded. *Any* property owner denied due process is aggrieved by the Amended Order, not just Quade and Holtry.

The State further argues that providing all property owners due process, denied them by the State, would place onerous financial burdens on the Idaho Department of Lands and Alta Mesa. It is somewhat ironic that the value of the mineral interests at issue and the likely income they will generate were never adequately estimated and considered irrelevant at the hearing. Now, the State expresses concern at the rather insignificant economic cost to provide meaningful notice to owners of the mineral rights they seek to exploit.

Plaintiffs ask the Court to balance the burden of requiring Defendant to provide due process against the burdens the State seeks to place on property owners. The State would require every property owner objecting to spacing, integration or lease terms to file suit in Federal Court to protect their interests. The cost to individual property owners would be prohibitive. The State seeks to avoid the cost of cleaning up the mess they created by placing the financial burden on those whose rights they violated. This is unconscionable and the Court should decline.

Respectfully submitted this 15th day of October, 2018.

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/s/ James M. Piotrowski
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Attorneys for Plaintiff

**CERTIFICATE OF SERVICE**

I hereby certify that on the 15th day of October, 2018, I electronically filed the foregoing document with the Clerk of the Court using the CM/ECF system. The CM/ECF system will send notification of such filing to the following:

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|---|---|
| Steven Strack<br>Joy Vega<br>Kristina Fugate<br>Deputy Attorneys General<br>P.O. Box 83720<br>Boise, Idaho 83720-0010 | [ X ] electronic mail<br>[ ] U.S. Mail postage prepaid<br>[ ] Facsimile<br>[ ] Hand-Delivery |

/s/ James M. Piotrowski
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