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ONE J

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Table of Contents

I. Legislative and Regulatory Developments	142
A. House Bill 199	142
1. "Kentucky Abandoned Storage Tank and Orphan Well Reclamation Fund"	142

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B. Senate Bill 100.....	143
1. “Net Metering Act”	143
C. Senate Bill 28.....	143
1. “Notice of Environmental Incidents Act”	143
D. House Bill 165	144
1. “An act relating to Fees for Air Quality”	144
II. Judicial Developments	144
A. Nami Resources Company, LLC. v. Asher Land and Mineral, Ltd.	144
B. K. Petroleum, Inc. v. Vanderpool	145
C. Pollitt v. Public Service Commission of Kentucky.....	147

Introduction of Oil and Gas Development

This article provides an update of oil and gas law developments in the Commonwealth of Kentucky from August 01, 2018 through July 31, 2019, and focuses on major legislative and regulatory enactments, as well as developments in Kentucky common law.

I. Legislative and Regulatory Developments

The Kentucky General Assembly’s regular session began on January 08, 2019 and ended March 28, 2019. The following is a discussion of the notable legislation relating to oil and gas law passed during the regular session.

A. House Bill 199

1. “Kentucky Abandoned Storage Tank and Orphan Well Reclamation Fund”

House Bill 199 (“*HB 199*”) amends Kentucky Revised Statutes Title 353, Chapter 510 to add definitions in state code for “control person,” “eligible well” and “orphan well.” Further, the bill amends Title 353, Chapter 564 to provide for forfeiture of equipment or product remaining at an orphan well or abandoned storage tank facility site. In addition, HB 199 makes several changes to the bonding and permitting provisions of KRS Chapter 353, including eligibility requirements for permit issuance or transfers.¹

HB 199 will amend the statutes to create a framework for plugging nearly 14,000 abandoned oil and gas wells across the state. Furthermore, this legislation provides the Kentucky Energy and Environment Cabinet (“*Cabinet*”) with enhanced enforcement authority, including broad authority

1. H.B. 199, 2019 Gen. Assemb., Reg. Sess. (Ky. 2019), Ky. Rev. Stat. Ann. § 353.510 (West 2019).

to promulgate administrative regulations to provide further detail as to the prioritization of wells and abandoned storage tank facilities to be reclaimed or remediated. The Cabinet is also given more enforcement flexibility to ensure that landowner rights are protected, which includes amending the existing statute to allow for the forfeiture of equipment or product remaining at either an orphan well or abandoned storage tank facility site. The Governor of Kentucky signed HB 199 into law on March 18, 2019.²

B. Senate Bill 100

1. "Net Metering Act"

Senate Bill 100 ("*SB 100*") amends Kentucky Revised Statutes Title 278, Chapter 465 to increase the net capacity for an eligible electric generating facility to 45 kilowatts and redefines the statutory definition of "net metering."³

Under SB 100, the ratemaking process to set the amount of compensation for electricity produced by "eligible customer-generators" must be initiated by a retail electric supplier or generation and transmission cooperative on behalf of one or more retail electric suppliers. Further, SB 100 prohibits eligible customer-generators who close their net metering accounts from receiving any cash refund for accumulated excess generation credits. In sum, this legislation gives Kentucky energy companies the ability to buy back households' excess electricity. The Governor of Kentucky signed SB 100 into law on March 26, 2019.⁴

C. Senate Bill 28

1. "Notice of Environmental Incidents Act"

Senate Bill 28 ("*SB 28*") creates a new section of Kentucky Revised Statutes Title 224.46-505 to 224.46-590. This bill requires the secretary of the Energy and Environment Cabinet to send notice of violation for a hazardous waste site or facility to designated officials. Accordingly, notice is sent to the county/judge executive of the county or the chief executive officer of the urban-county government where the site or facility is located.⁵

Regarding the potential impacts on the oil and gas industry, this bill amends Kentucky Revised Statutes 224.10-212 to specify that notices of violation for hazardous waste sites or facilities are not prohibited from

2. *Id.*

3. S.B. 100, 2019 Gen. Assemb., Reg. Sess. (Ky. 2019).

4. *Id.*

5. S.B. 28, 2019 Gen. Assemb., Reg. Sess. (Ky. 2019).

disclosure due to confidentiality. This means that confidentiality is no longer a valid reason to forgo disclosure of a hazardous waste site or facility. The Governor of Kentucky signed SB 28 into law on March 25, 2019.⁶

D. House Bill 165

1. “An act relating to Fees for Air Quality”

House Bill 165 (“*HB 165*”) amends Kentucky Revised Statutes Title 224, Chapters 20-050. Regarding the oil and gas industry, *HB 165* gives the Energy and Environment Cabinet, or an air pollution control district, the ability to establish an “air quality fee structure.” This fee structure may include a permit or registration fee. This fee would be in addition to the collection of a per-ton emissions-based assessment. Furthermore, this legislation removes the various assessment requirements relating to the determination of fee assessments for particulate matters. The Governor of Kentucky signed *HB 165* into law on March 15, 2019.⁷

II. Judicial Developments

A. Nami Resources Company, LLC. v. Asher Land and Mineral, Ltd.

Nami Resources Company, LLC v. Asher Land and Mineral, Ltd. (“*Nami*”) is a published decision rendered by the supreme court of Kentucky⁸ Accordingly, it is binding precedent in the Commonwealth of Kentucky. *Nami* reached the supreme court on appeal from an opinion of the Kentucky Court of Appeals, which affirmed the trial court’s jury verdict against Nami Resources Company, LLC. in the amount of \$1,308,403.60 in compensatory damages and \$2,686,000.00 in punitive damages.⁹

The supreme court held that Nami Resources Company (“*Nami Resources*”), an oil and gas lessee, which deducted post-production costs that were not incurred or were unreasonable, was in fact breaching the natural gas lease by underpaying royalties to Asher Land and Mineral (“*Asher*”) because the terms of the lease provided for payment schedules for royalties.¹⁰ Despite the breach of the lease, the supreme court reiterated that Asher could not recover punitive damages from Nami Resources because Asher asserted no compensable injury beyond the claim for unpaid royalties. Further, the

6. *Id.*

7. H.B. 165, 2019 Gen. Assemb., Reg. Sess. (Ky. 2019).

8. See *Nami Res. Co. v. Asher Land & Mineral, Ltd.*, 554 S.W.3d 323 (Ky. 2018)

9. *Id.* at 328.

10. *Id.* at 334.

supreme court found that Asher alleged no misconduct by Nami Resources other than the conduct of breaching the leases by underpaying the royalties due.¹¹

However, Asher cross-appealed on a claim “that the trial court erred by denying its motion to amend its complaint to assert the additional claim that Nami had committed trespass by improperly extracting natural gas from an area of Asher’s property that was not subject to the leases.”¹² The trial court found that the assertion of the “trespass claim came after five years of litigation,” thus Supreme Court affirmed the ruling of the trial court and found that the lower court was “well within the scope of its [] discretion in denying Asher’s motion to amend its complaint.”¹³

Therefore, in cases involving oil and gas leases, the supreme court applied the general proposition that “[t]he amount of damages is a dispute left to the sound discretion of the jury.”¹⁴ Because “[the jury’s] decision should be disturbed only in the most egregious circumstances,” here, the supreme court found that in this instance, the jury’s awarding of compensatory damages to Asher was not egregious. Accordingly, the opinion of the Court of Appeals was affirmed in part and reversed the awarding of punitive damages.¹⁵

B. K. Petroleum, Inc. v. Vanderpool

K. Petroleum, Inc. v. Vanderpool is an unpublished decision from the Court of Appeals of Kentucky, and accordingly, it is binding in the Commonwealth of Kentucky unless the Kentucky Supreme Court overrules the appellate court’s opinion.¹⁶ *K. Petroleum, Inc.* (“*KPI*”) was appealed from a judgment based upon a jury verdict awarding Simon and Sandra Vanderpool \$27,241.28 in compensatory damages on its finding that KPI produced natural gas from the Vanderpools’ property without written proof of a leasehold permit and \$190,688.96 in punitive damages based upon a finding that it did so maliciously.¹⁷ In response, the Vanderpools cross-

11. *Id.* at 335-36.

12. *Id.* at 342.

13. *Id.* at 343.

14. *Id.* at 337 (citing *Childers Oil Co. v. Adkins*, 256 S.W.3d 19, 28 (Ky. 2008) (quoting *Hazelwood v. Beauchamp*, 766 S.W.2d 439, 440 (Ky. App. 1989))).

15. *Id.* at 343.

16. *K. Petroleum, Inc. v. Vanderpool*, No. 2017-CA-0014160-MR, 2019 WL 2713078 (Ky. Ct. App. June 28, 2019).

17. *Id.* at *1.

appealed from the judgment alleging entitlement to the sum of \$217,930.24 in compensatory damages and pre-judgment interest.¹⁸

Here, this case involved “the leasehold rights of two natural gas production companies... to produce oil and gas on the Vanderpool’s property” after the land was executed to them from Charles and Flora Nantz.¹⁹ Following a dispute “between the Vanderpools and KPI regarding royalty payments for oil and gas produced on the property...KPI requested proof of the property’s change of ownership before transferring royalty payments to the Vanderpools.”²⁰ The original Land Contract conveyed the mineral rights to the Vanderpools.²¹ From 1995 to 2002, the Vanderpools received royalty payments from KPI.²² In 2002, Mike Vanderpool “shut in the wells without notice” and locked the property gates which prevented KPI from accessing the wells.²³

After a lengthy procedural history, including a trial and appeal in 2012 and 2014, respectively, the matter again went to trial in June 2017 after the Court of Appeals held that the trial court erred by not allowing KPI to “introduce a settlement agreement under which KPI agreed to pay the Nantzes, the Vanderpools’ predecessor in interest, an agreed-upon amount for release of their claims concerning underpaid royalty payments on the subject property.”²⁴ In this trial, the jury “[p]redicated liability upon the fact that KPI had no written lease on the property and awarded damages for the value of the gas taken.”²⁵ Accordingly, the appellate court’s decision addressed “two primary issues: ownership of the wells and damages.”²⁶

On the question of ownership, KPI argued “that the admission of the settlement agreement entitled them to a directed verdict.”²⁷ This court disagreed and found that a settlement agreement cannot be “expansively construed.”²⁸ Moreover, this court held that a settlement agreement does not “purport to be a lease.”²⁹ Per the statute of frauds, an oil and gas lease must

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.* at *2.

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

be in writing and signed by the party to be charged to be enforceable.³⁰ Here, KPI did not offer any evidence of such writing.³¹ Therefore, the Court held that because “[t]he sub-wells on the Vanderpools’ property were listed as abandoned by the Department of Mines and Minerals, Division of Oil and Gas,” there was no lease.³²

On the question of damages, the appellate court followed the Kentucky Supreme Court’s decision in *Harrod Concrete & Stone Co. v. Crutcher* that:

[T]he proper measure of damages in all innocent trespass cases is the value of the mineral after extraction, less the reasonable expenses incurred by the trespasser in extracting the mineral

Where the trespass has been determined to be willful, we continue to maintain that the measure of damages is the reasonable market value of the mineral at the mouth of the mine/well, without an allowance of the expense of removal. This approach has been consistently applied in Kentucky and serves as a sufficient financial penalty for the wrongdoing of the trespasser, thus obviating the need for additional punitive damages.³³

Therefore, the Court of Appeals held that the Vanderpools were not entitled to punitive damages.³⁴ In sum, the Court found that because the jury “was not instructed to make the correct findings as to the compensatory damages caused by [KPI’s] trespass.....[t]he errors in the instructions as to the proper measure of damages were not only palpable but resulted in manifest injustice entitling KPI to a new trial on the issue of damages.”³⁵

C. Pollitt v. Public Service Commission of Kentucky

In *Pollitt v. Public Service Commission*, the Supreme Court of Kentucky (“*Supreme Court*”) held that because Pollitt, the operator, “failed to show “extraordinary cause,” the motion for interlocutory relief from the order of the Court of Appeals” should be denied.³⁶ Accordingly, this decision is binding precedent in the Commonwealth of Kentucky.

In 1998, the Public Service Commission held Pollitt in contempt for failing to comply with a judgment that imposed a civil penalty of \$25,750 for

30. *Id.* (citing *Kash v. United Star Oil Co.*, 233 S.W. 898, 901 (Ky. 1921)).

31. *Id.*

32. *Id.*

33. *Harrod Concrete & Stone Co. v. Crutcher*, 458 S.W.3d 290, 296-97 (Ky. 2015).

34. *Id.*

35. *Id.*

36. *See Pollitt v. Pub. Serv. Comm’n*, 552 S.W.3d 70, 73 (Ky. 2018).

various regulatory violations.³⁷ The Commission subsequently filed an action in to enforce the civil penalty, and in 2004, the trial court entered judgment in favor of the Commission, which was affirmed on appeal.³⁸

In 2017, it was revealed that Pollitt was still operating its gas system in violation of the circuit court's injunction.³⁹ The trial court denied a motion to hold Pollitt in contempt because Pollitt argued that it was "[u]nsafe to terminate the operation of the system."⁴⁰ The Commission then "filed a judgment lien to collect upon the money judgment that was [previously] affirmed by the Court of Appeals."⁴¹ However, the circuit court was "concerned that enforcement of the judgment would effectively put Pollitt out of business, thus denying natural gas to the thirty-seven customers who relied on Pollitt's services."⁴² The Court of Appeals granted the Commission's motion and dissolved the stay of execution upon the judgment. Pollitt subsequently appealed.⁴³

Here, the Supreme Court articulated that although review of the issue was appropriate, the scope of review was "limited to those cases which demonstrate 'extraordinary cause[.]'"⁴⁴ With this in mind, the Supreme Court found that the trial court's "one-page order d[id] not specify the procedural grounds for its decision."⁴⁵ First, the Supreme Court held that because the judgment involved a previously-obtained money judgment that was affirmed by the Court of Appeals in 2005, it was valid.⁴⁶ Second, because of precedent established by the Supreme Court in *Norsworthy v. Kentucky Board of Medical Licensure*, although Pollitt expressed that it would suffer financial consequences because of the judgment, the Supreme Court articulated that "unsupported financial concerns" are not a valid basis for injunctive relief.⁴⁷

In conclusion, the Supreme Court found that the equities weighed in favor of the Commission.⁴⁸ Because Pollitt failed to show "extraordinary cause"

37. *Id.* at 71.

38. *Id.*

39. *Id.* at 72.

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.* (citing Nat'l Collegiate Athletic Ass'n v. Lasege, 53 S.W.3d 77, 84 (Ky. 2001)).

45. *Id.* at 73.

46. *Id.*

47. *Id.* (citing *Norsworthy v. Kentucky Bd. of Med. Licensure*, 330 S.W.3d 58, 62 (Ky. 2009) (quoting *Ghirad v. St. Claire Med. Center, Inc.*, 443 S.W.3d 609, 611 (Ky. 2014)).

48. *Id.*

for injunctive relief, the motion for interlocutory relief from the Court of Appeals was denied.⁴⁹

49. *Id.*