Environmental Law

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## Samantha Blons April 18, 2014 5 Comments

Dallas Takings Case Could Affect Future

Mineral Development on Municipal Land

RESEARCH AND PROJECTS

Texas takings jurisprudence, as well as for the future of oil and gas development on governmentowned property in the state. The Trinity case

company, Trinity East Energy, LLC (a subsidiary of Keystone Exploration Ltd.), signed mineral leases for City-owned properties on the western edge of the City. At signing, Trinity paid Dallas a \$19 million bonus (plus a 25% royalty on gas to be produced). The leases granted to Trinity a property

ABOUT

Two days after Trinity filed its complaint in a Dallas state court, the leases expired according to their terms, and the mineral interest granted under them reverted to the City. From the complaint: "In the ultimate irony, the City's actions have allowed the City to receive over [\$19 million] for these mineral rights, while orchestrating the return of those same minerals to the City, leaving Trinity with nothing." Trinity seeks damages for the \$30 million that it allegedly spent on the failed project, plus \$100 million in lost profits. Trinity's inverse condemnation (i.e., takings) claim is based on the Texas Constitution, which prohibits the state and cities from taking private property for public use without adequately compensating the property owner. Tex. Const. art. I, § 17. Parties seeking to establish a takings claim against a Texas

could seek a judicial remedy, it needed to apply to drill in alternative locations (aside from the three sites identified in its rejected permit applications). The trial court ordered the parties to mediate before the January 2015 trial date. Below is an analysis of the arguments the parties may make at trial if a pre-trial settlement is not reached. Was there a taking? Despite Dallas's fair arguments to the contrary, the trial court should find that a compensable taking occurred here based on all the surrounding circumstances of this case—in particular, the reversion of

Trinity's mineral interest to Dallas after the City denied the drilling permits. See Sheffield Dev. Co.,

Inc. v. City of Glenn Heights, 140 S.W.3d 660, 672-73 (Tex. 2004).

(2) "Lucas"-type total takings, which are considered per se takings because they completely deprive an owner of "all economically beneficial use" of his or her property; and

the regulation interfered with the owner's reasonable investment-backed expectations, and (iii) the

Manhattan CATV Corp., 458 U.S. 419 (1982); Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992); Penn Central Transp. Co. v. New York City, 438 U.S. 104 (1978). Trinity's amended

First, the Lucas inquiry: was Dallas's denial of a drilling permit a per se "Lucas" taking because it

complaint seems to describe Dallas's regulatory actions as falling within either the second or third categories.

character of the governmental action.

sites were located in a floodplain.

that it was still a taking under the Penn Central factors.

Sheffield, 140 S.W.3d at 671. However, the Lucas standard is stringent and includes an important exception: no regulatory taking occured if the owner's desired use of the land was already prohibited or restricted in the owner's title or under state nuisance law or property principles. See Severance v.

permit severely limited (if not eliminated) Trinity's ability to benefit economically from its mineral interest. Both the City and Trinity apparently considered the leases to be worth at least \$19 million (plus royalties) in 2008, but absent a drilling permit, Trinity's mineral estate had little or no value. However, the City can respond that it did not deny Trinity ability to drill anywhere; it merely rejected the three requested drilling sites, and Trinity could have sought to drill in another location. The second factor—the extent to which the regulation interfered with Trinity's reasonable investmentbacked expectations—is more mixed, but it may favor Dallas. It may not have been reasonable for Trinity to expect that the City would grant all the approvals it needed to get before it could begin drilling. In addition to the drilling permit, Trinity also needed the City to approve the project at a public hearing (because the requested sites were in a City park), and approve an amendment to its

floodplain regulations (since the sites were in a floodplain). Moreover, an owner's reasonable

based on the City's alleged representations and assurances to that effect.

drilling. See Mayhew v. Town of Sunnyvale, 964 S.W.2d 922, 936 (Tex. 1998). On the other hand, Trinity may be able to show that it reasonably expected that it would be able to drill on these sites.

The third Penn Central factor focuses on the nature and character of the governmental action, and although somewhat mixed, it may favor Trinity. The Penn Central court explained that where a

more readily find a taking than it would if the regulation instead arose from "some public program adjusting the benefits and burdens of economic life to promote the common good." 438 U.S. at 124. Protecting a city's water supply is an example of a "public program" that weighs against finding a taking. See City of Houston v. Trail Enterprises, Inc., 377 S.W.3d 873, 879-80 (Tex. App.—Houston [14th Dist.] 2012, pet. denied). Here, Dallas can argue that denial of the permits was necessary to protect the floodplain or to prevent possible negative environmental effects of fracking. However, Trinity can counter that the denial should be "characterized as a 'physical invasion'" of its property by the City, because it triggered a reversion of Trinity's mineral interests to the City. The effect of

Dallas's regulatory action was that Trinity permanently lost its mineral interest to the City itself. Lastly, in addition to the Penn Central factors, Texas courts can consider other facts and circumstances surrounding the case, such as whether the City acted in "bad faith" in deciding a takings claim. See Hearts Bluff Game Ranch, Inc. v. State, 381 S.W.3d 468, 487 (Tex. 2012). If the court chooses to consider this factor, the plaintiff's fraud and breach of contract allegations will be relevant to determining whether Dallas acted in bad faith. But other facts might weigh against Trinity's recovery. For example, Dallas Mayor Mike Rawlings has indicated in the past that Trinity would not have drilled even if the permits had been granted, because of depressed natural gas prices and the fact that the Barnett Shale is unproven beneath Dallas. In sum, although the City has fair counterarguments, federal and state precedents support finding a taking in Trinity.

very low upfront lease bonuses, so that the companies won't lose too large an investment if they are later unable to drill. Or they may require that bonuses or other payments be contingent on the satisfaction of certain conditions, such as the project receiving all the necessary land use permits.

On the other hand, it is difficult to predict the potential impact of a single case in an area of the law as fact-dependent as takings law. It could be that Trinity knew there was a significant risk of the project's failure for lack of regulatory authorization, but it accepted that risk, and is now is trying to recoup its

its demonstrable damages.

5 comments

Donnie April 20, 2014 5:27 am

Superb analysis!. Well-reasoned and thoughtful.

Agree with Donnie, nice work Samanthal

Steve

private property.

REPLY

REPLY

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Email \*

POST COMMENT

May 20, 2014 6:44 pm

Good analysis. Some additional facts that you should know Two of the drill sites were on city property. One was on private property.

development on municipal lands.

those same mineral rights, all without compensating the co

compensable reversion of those mineral interests back to itself.

REPLY May 13, 2014 4:43 pm

Albie

July 16, 2014 10:34 pm

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Website Comment

city must prove that (1) the city intentionally performed certain acts, (2) which resulted in a "taking" of property, (3) for public use. See Gen. Services Com'n v. Little-Tex Insulation Co., Inc., 39 S.W.3d denying the drilling permits functioned to "take" its mineral interest, and therefore the City must compensate Trinity for its loss In its answer to Trinity's complaint, the City responded that it did not "take" any constitutionally

within one of the three categories of regulatory actions that constitute compensable takings under federal cases physical takings;

completely deprived Trinity of "all economically beneficial use" of its mineral interest? Perhaps, since a severed mineral interest is valueless without the ability to reach and extract the minerals, and Trinity lacked that ability unless the City granted it a permit. By denying the drilling permit, Dallas arguably left Trinity with a "token" mineral interest, of which it could make no productive or beneficial use. See

Why Trinity matters

In addition to the relevant caselaw, there are important policy reasons to find a taking here. Texas oil and gas attorneys should be considering the effect that this case could have on future mineral

Assume, for example, that this case goes to trial and the court decides that there was not a taking here. That means state and local governments can sell first mineral rights on government property to energy companies, then refuse to authorize drilling on those same properties, and finally win back

precedent could make energy companies wary of leasing on municipal and state properties in the first place. A company will have little incentive to pay a governmental entity a multimillion dollar lease bonus for its mineral interests today, if tomorrow that entity can prevent drilling and ensure a non-

Without a possible takings remedy, some companies may find it too risky to lease mineral rights on government property. Unless the potential project returns are high enough, it may not be worth the time and expense of negotiating leases with cities in the first place. Other companies will want to try to lease on city properties anyway, but to make the project economically feasible, they will need to shift the risk that the project fails back to the cities. For example, these companies might offer cities

Whether these municipal leasing projects are scrapped entirely or merely devalued to compensate for the increased regulatory risks, such results deprive cities and the state of future revenues from lease bonuses, taxes and royalties. Moreover, these results are inconsistent with Texas's longstanding policy in favor of efficient oil and gas production. See, e.g., Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.3d 1 (Tex. 2008) (J. Willett, concurring).

losses through litigation. It could also be true that that at the time of contracting, Trinity was willing to accept a riskier investment than other companies were; perhaps more conservative companies weren't interested in paying as much as Trinity was to accept that risk. The impact of a pro-Dallas outcome in this case could be muted based on any number of factors that would emerge at trial. Nevertheless, after balancing these qualifications and unknowns against the above-described policy implications—as well as supportive state and federal takings precedents—a trial court called upon to decide the Trinity case should find that a compensable taking occurred, and permit Trinity to recover

natural

oil and gas takings Texas Texas Texas Constitution

The denial of all three permits prevented mineral production from all leases held by Trinity, both on city property and

All 3 sites complied with the city drilling ordinance, and were approved, and recommended for approval, by city staff.

2 sites are in the flood plain, 1 is not. The Corp of Engineers approved the 2 sites in the flood plain. There are approximately 2500 wells in the floodplain in Dallas County and the 4 surrounding companies.

June 27, 2014 8:27 pm Hopefully the court can decide to permit Trinity to recover its damages

overcomes all other regulatory hurdles. The city manager had no permitting authority to promise and the company was well aware of this. It took the risk of leasing the property knowingly gambling on getting the necessary permits based on non-binding promises by a city official that that didn't have the jurisdiction to grant permits. It entered into this gamble with its eyes wide open. It made a bad bet.

to drill until time was running out on the leases, and, 2) the fact that the "promises" to be able to get those permits were made by a city staff member unauthorized to make those promises, without the regulatory power to issue those promises, and made in secret, without knowledge of Dallas residents or the majority of the Dallas city council Leases are not the same thing as permits. If they were, there would be no need for separate regulatory steps to apply for each. A lease does not guarantee the right to drill and a permit does not give one an automatic lease. A lease is merely temporarily purchasing the time to be the exclusive operator on that piece of property - if it

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Texas courts follow federal takings jurisprudence in deciding state takings claims. Edwards Aquifer Auth. v. Day, 369 S.W.3d 814, 838 (Tex. 2012). For Trinity to recover, it must prove that its claim falls (3) "Penn Central"-type takings, in which the court finds the government action to be a taking based on three major factors: (i) the economic impact of the regulation on the owner, (ii) the extent to which Day, 369 S.W.3d at 839; see also Lingle v. Chevron, 544 U.S. 528 (2005); Loretto v. Teleprompter Patterson, 370 S.W.3d 705, 742 (Tex. 2012). The City may be able to defeat Trinity's Lucas argument by, for example, showing that drilling on the requested sites would have caused a nuisance, since the But even if this case didn't involve a per se taking under Lucas, Trinity has a fairly strong argument The first factor, the regulation's economic impact, probably favors Trinity. Dallas's denial of a drilling expectations are shaped by existing uses of a property, which in this case did not include oil and gas regulation can be characterized as a "physical invasion" of the property by government, the court may

This blog post is a follow-up to two previous UT Energy Center posts, both of which discussed local conflicts over the use of hydraulic fracturing ("fracking") to produce oil or gas from shale formations. One such conflict is a case pending in Dallas, Trinity East Energy, LLC. v. City of Dallas (available here, Cause No. DC-14-01443). This blog post focuses exclusively on the Trinity plaintiff's inverse condemnation (takings) claim. international arbitration. Blog posts reflect the A \$130 million lawsuit filed in February against the City of Dallas could have serious ramifications for opinions of the authors and not of the University Global Energy. The suit, Trinity East Energy v. Dallas, involves allegations of takings, fraud, and breach of contract arising out of the City's refusal to authorize drilling by a natural gas company that had leased mineral rights on City property (available here, Cause No. DC-14-01443). In 2008, Dallas and the plaintiff Texas interest in the minerals under the City land, but that interest would expire and revert to the City in drought February 2014 unless Trinity began producing gas on the property. Trinity says it relied on, and was misled by, representations by City officials that the City would grant it a permit to drill. Over the next several years, Trinity applied for and was repeatedly denied the drilling permits it needed to begin production and retain its mineral interest. 591, 598 (Tex. 2001). Trinity's complaint alleges a regulatory taking-that Dallas's regulatory action in protected property right or interest of Trinity's, nor did it deprive Trinity of its "reasonable investmentbacked expectations." The City also objected to the court's jurisdiction on grounds that, before Trinity