June 15, 2007

MEMORANDUM

FROM: Beveridge & Diamond, P.C.
Peter J. Schaumberg

RE: Review of "CRS Report for Congress" Regarding H.R. 6

Summary

The CRS Report ("Report") is premised upon a fundamental misunderstanding of H.R. 6. The Report repeatedly refers to the bill's provisions as only an "incentive" for 98/99 lessees to amend their contracts to include price thresholds, the effect of which would be to require the lessees to pay royalty on their production since market prices are well above the thresholds. "Nothing in section 204 legally compels the leaseholder to give up his freedom from having to pay royalties at any market price for oil and gas -- though of course, the bill presents him with a strong economic incentive to do so." Report at 2. The Report, however, completely overlooks Section 204(b), which imposes a mandatory $9 conservation of resources fee on oil production (and a $1.25 per mmBtu fee on gas -- but for brevity, we will refer only to the $9 fee on oil) from 98/99 leases (which have not been amended to include price thresholds) when market prices are above the thresholds.[1] This significant misunderstanding of the bill undermines several of the CRS legal arguments in support of H.R. 6.

The Report also reflects a lack of understanding of the current factual situation surrounding the 98/99 leases. Many of these leases are held by parties who were not the original lessees. The assignees very likely paid a premium to acquire leases with royalty relief and no price threshold. Many of the acquisitions occurred after MMS learned (which was no later than 2000) that the 98/99 leases had no price thresholds. Failure to acknowledge this key point undermines many of the CRS legal arguments in support of H.R. 6.

While the Report generally establishes the correct constitutional and legal framework for its selected issues, it omits several important aspects of these doctrines and applies the relevant standards incorrectly. Additionally, the Report does not discuss all legal problems with H.R. 6, omitting some constitutional bases upon which H.R. 6 may fail scrutiny (*e.g.,* as an unconstitutional bill of attainder). See generally the Beveridge & Diamond March 9, 2007

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[1] Section 204(b) provides that "the Secretary of the Interior by regulation shall establish a conservation of resources fee for producing Federal oil and gas leases in the Gulf of Mexico [which] shall apply to covered leases [*i.e.*, 98/99 leases without price thresholds] that are producing leases [,and the fee] shall be set at $9 per barrel for oil and $1.25 per million Btu for gas, respectively, in 2005 dollars."

Memorandum that analyzes the legal issues associated with H.R. 6 (“March 9 Memorandum”). A copy of the March 9 Memorandum is attached.

Takings -- Section I of the CRS Report

CRS’s failure to acknowledge the mandatory $9 conservation of resources fee undermines the entire takings analysis.

CRS

- CRS states that “nothing in section 204 directly or indirectly alters terms in existing DWRRA leases. Section 204 does not mandate renegotiation of lease terms, but only creates an *incentive* to renegotiate.” Report at 3. CRS goes on to state that “[o]ur research has not revealed any takings decisions in which the statutory or regulatory approach alleged to have caused the taking is identical to the approach of section 204. Often contractual takings claims involve outright abrogation of express contract terms by the United States. This differs from the incentive approach of section 204.” Report at 4. CRS concludes that “[t]his situation gives the United States an argument that there is no taking: from this perspective the decision of the leaseholder to renegotiate is voluntary, and a loss resulting from a voluntary action cannot be the basis of a takings claim.” Report at 3.

RESPONSE

- The mandatory $9 conservation of resources fee directly alters lease terms and constitutes an abrogation of the express contract term providing unqualified royalty relief on production.

- The mandatory $9 conservation of resources fee constitutes a taking because it entirely revokes the royalty interest granted to the 98/99 lessees once those leases start producing, up to the applicable royalty suspension volume. CRS concedes this point: “this memorandum will assume, that Congress could not directly eliminate the leaseholders’ royalty-free status without triggering a compensable taking.” Report at 7.

The “choice” between accepting price thresholds or becoming ineligible for new leases is illusory.

CRS

- CRS argues that a lessee’s decision to accept price thresholds and avoid the leasing bar is “voluntary” and cannot provide grounds for a taking. Report at 3-4.

RESPONSE

- CRS acknowledges that "ineligibility to receive new leases in the Gulf of Mexico imposes such a hardship as to prompt a court to reject a voluntariness defense." Report at 4.

- The March 9 Memorandum analyzes in detail why the "choice" H.R. 6 offers to "renegotiate" or to be barred from leasing is illusory.

98/99 lessees are being treated unequally.

CRS

- CRS asserts that courts have been less likely to find a taking where property owners have been treated equally.

RESPONSE

- Barring only 98/99 lessees from new lease sales is, in fact, unequal treatment.

- Moreover, CRS acknowledges that lessees may have paid higher bonuses to obtain leases with royalty relief and no price thresholds. "If so, leaseholders could argue, error or not, they paid for the economic advantage of having no price threshold." Report at 5.

The Monsanto case is distinguishable.

CRS

- CRS relies on a 1984 case, Ruckleshaus v. Monsanto, 467 U.S. 986 (1984) ("Monsanto"), for the proposition that a voluntary compromise of a property right in exchange for an economic benefit is not a taking and suggests that a court may reach the same conclusion with regard to H.R. 6. "The Court reasoned that during this period, Monsanto had voluntarily submitted its trade secret data with full knowledge of the legal possibility that EPA would use the data in ways that diminished their trade secret value, and thus could not complain when the agency actually did so." Report at 4.

RESPONSE

- The critical difference is that Monsanto had a choice before it ever submitted its trade secrets to the government. In contrast, the 98/99 lessees are being forced to accept a condition imposed after they acquired their lease interests.

- CRS acknowledges but relegates to a footnote a more recent decision contrary to Monsanto. See Philip Morris case in Report at 5, note 12.

Error does not preclude the Government from having to pay just compensation.

CRS

- CRS asserts that "if it is somehow confirmed that the omission [of the price thresholds] was in fact a mistake, it may lessen the probability that a court would find a taking in section 204, because the section could be viewed as a congressional effort to correct a governmental error that plaintiffs were exploiting." Report at 5.

RESPONSE

- CRS acknowledges that in contrast to section 302 of the DWRRA, section 304 "states no explicit thresholds. Thus the matter [of whether or not to include price thresholds] was left in 1995 to the Department's discretion." Report at 2. Therefore, the absence of price thresholds never can qualify as an obvious mistake because the lessees had no way of knowing whether the MMS in its discretion chose not to include the thresholds or merely neglected to do so. This is particularly true when it involved four lease sales over a two-year period and over 1000 leases. It is not the same type of "mistake" as the government writing a $1000 price into a contract for an item with a well-recognized market value of $100. CRS concedes that "[c]ertainly the fact that MMS arguably was acting within its DWRRA section 304 authority in not imposing price thresholds adds a complicating element to the analysis." Report at 15.

- The Interior Department Inspector General's Report found no conclusive explanation for the omission.

- Even if proof of a mistake existed, there is no authority for the proposition that governmental error allows the taking of a property right without paying just compensation.

98/99 lessees possessed reasonable investment-backed expectations.

CRS

- CRS states that a "regulatory taking claim may be parried by the government's argument that government contracting is a 'heavily regulated field,' so that affected leaseholders cannot claim to be surprised -- especially given the level of current oil prices --- that Congress sought to impose section 204. With regard to the bid ineligibility section 204 imposes, the United States has broad discretion in setting the qualifications of those with whom it contracts. Thus it may be argued that section 204 does not defeat any *reasonable* investment-backed expectations of affected leaseholders." Report at 6.

RESPONSE

- While OCS leasing is a regulated field, the only existing regulatory requirement to be a "qualified bidder" is that the person be a U.S. citizen or domestic corporation. 30 C.F.R. § 256.35. MMS also may disqualify from leasing operators who don't perform in accordance with MMS regulations. Id. Therefore, a bar from future OCS lease sales merely because one holds a 98/99 lease certainly would rise to the level of a "surprise." Such a limitation is blatantly discriminatory, particularly for those holders of 98/99 leases who acquired their lease interests by assignment, many of whom acquired their leases after MMS unquestionably knew of the lack of price thresholds and took no action. No 98/99 lessee could reasonably expect at the time it acquired its lease interest that its acquisition would result in a bar from future leasing.

Unconstitutional Conditions -- Section II of the CRS Report

H.R. 6 indirectly achieves a result, *i.e.*, elimination of royalty relief contained in 98/99 lessees, that Congress could not obtain directly.

CRS

- CRS states that "[i]t does not appear likely that Section 204 would violate the doctrine of unconstitutional conditions," but immediately concedes that "given the limited and inconsistent case law on the doctrine, it is difficult to reach a conclusion with any certainty." Report at 7.

RESPONSE

- While the "doctrine of unconstitutional conditions" is primarily employed in the free speech and land exactions takings context, the spirit of the doctrine is still applicable here: "The doctrine is intended to prevent the government from indirectly achieving a result that it could not command directly." Report at 7. Further, courts have employed this doctrine outside of the free speech and takings context, and therefore, might apply it here as well. See Burgess v. Lowery, 201 F.3d 942 (7th Cir. 2000) (conditioning of prison visitation on subjection to a strip search found manifestly unreasonable). "What the law of 'unconstitutional conditions' boils down to, so far as it might be thought to help governments seeking to curtail the usual freedoms ... is simply that conditions can lawfully be imposed on the receipt of a benefit ... provided the conditions are reasonable." Id.

- CRS fails to recognize that while Congress does not have to offer lease sales at all, once extended, participation cannot be unreasonably conditioned on giving up a right, particularly a constitutional right. H.R. 6's leasing bar is manifestly unreasonable compared to other legitimate conditions on participation, such as suspension and debarment regulations in analogous government contract settings. March 9 Memorandum at 36-38.

- Applying the doctrine of unconstitutional conditions, H.R. 6 has the same result as, and is no less objectionable than, a direct exaction on the 98/99 lessees, as the "choice" afforded by H.R. 6 is in fact no choice at all. March 9 Memorandum at 13-15, 20; see also Phillip Morris, Inc. v. Reilly, 312 F.3d 24, 70 (1st Cir. 2002) (Selya, J. concurring) ("In the end, the tobacco companies are left with a Hobson's choice: either comply with the Disclosure Act and forfeit your valuable trade secrets or withdraw from the lucrative Massachusetts market. This constitutes an unconstitutional condition on the tobacco companies' right to sell their products in the Commonwealth.").

- Monsanto, where the government conditioned pesticide registrations on surrender of trade secrets privilege, is inapposite. Congress has the general power to lease federally-owned offshore oil and gas interests (pursuant to the Property Clause of the Constitution), just as it has the general power to regulate pesticides. However, in Monsanto, the required exactions for receiving the benefit were not contractually vested and were generally applicable. Here, H.R. 6 conditions the opportunity to bid on new leases upon surrender of already-executed contracts, and singles out 98/99 lessees to bear this burden.

- Similarly, H.R. 6 does not pass the "land exaction" standard, if applied, since a lessee's fitness for new leases is completely unrelated to its past contract terms.

Equal Protection -- Section III of the CRS Report

H.R. 6 singles out 98/99 lessees for unique burdens and discrimination.

CRS

- CRS correctly notes that the Equal Protection Clause "seeks to assure that similar entities will be treated similarly by the government." Report at 9.

RESPONSE

- CRS does not contest that H.R. 6 in fact singles out 98/99 lessees as subject to the requirement to "renegotiate" a price threshold into existing leases or be barred from future lease sales, or to pay a mandatory $9 conservation of resources fee on production. Thus, these lessees are treated differently relative to the broader class of all OCS Gulf of Mexico lessees. This distinction is unusual, and invites closer Equal Protection scrutiny. Romer v. Evans, 517 U.S. 620, 631 (1996).

Rational basis review is not toothless, and fails if the law is punitive.

CRS

- CRS correctly sets out the general framework for Equal Protection analysis, finding that H.R. 6 implicates no "suspect class" or "fundamental rights" and requires "a rational basis for achieving a legitimate government objective." Report at 9-10.

RESPONSE

- CRS omits that deference here is still limited, and courts pay close attention where invidious discrimination or punitive intent is at issue. Congress cannot legitimately target a disfavored group; a classification of persons done for its own sake is impermissible.

H.R. 6 is not rationally related to any legitimate government interest.

CRS

- CRS claims: "It would seem that such a rational basis for achieving a legitimate government objective can be imagined." CRS then lists three allegedly rational bases in support of H.R. 6. Report at 10.

RESPONSE

- Each of these justifications is untenable. H.R. 6 itself lists purposes such as raising funds for alternative energy. CRS suggests that it "might also provide funds for protection of resources." While legitimate goals, they do not rationally justify singling out the 98/99 lessees to bear unique burdens (and a leasing bar would produce no revenue to the government at all!). March 9 Memorandum at 30.

- CRS adds that section 204 could be premised on Congress' judgment that the 98/99 lessees, benefiting from higher oil and gas prices today, "should be ineligible to bid on new OCS leases, under which they would earn further (though not to say unreasonable) profits from public property." Report at 10. This is not rationally related to a legitimate government purpose. First, given that Congress has decided to hold sales for OCS leases in the first place, and seeks bonuses and royalties from production, Congress has conceded that it will attract profit-seeking entities. Such opportunities, once offered, must be equally available to all potential lessees. It is unconstitutional to subject certain lessees to special obligations from which others practicing the same business or calling are exempt. March 9 Memorandum at 30. Second, if Congress believes that lessees without price thresholds earn "greater than reasonable profits," Congress' only remedy is to provide expressly for price thresholds in future royalty relief. Third, such a justification would permit Congress to readjust the leasing landscape and alter its voluntarily-made contracts whenever oil and gas prices change, clearly an impermissible scenario.

- Alternatively, CRS suggests that 98/99 lessees, exempt from royalties under those leases, may be in "a better financial position to bear the burden of a fee aimed at conservation of resources." Report at 10. This assertion also does not pass muster. As noted above, H.R. 6 (particularly its leasing bar) is not rationally related to any goal to conserve resources. Furthermore, 98/99 lessees may have paid *higher* bonus bids to the government, or higher payments to an assignor, to obtain leases with the additional royalty relief, and many of these leases are still speculative and non-producing.

Accordingly, some 98/99 leaseholders may be in a *worse* financial position than their counterparts to bear the mandatory fee.

H.R. 6 is likely punitive.

CRS

- CRS recognizes at footnote 32: "In continuing to establish a legislative history for section 204 or similar measures, Congress might wish to avoid any suggestion that its motives are punitive."

RESPONSE

- Based on the above analysis, H.R. 6 lacks any other credible purpose and its terms are "so far removed" from its stated justifications that it "raise[s] the inevitable inference that it is born of animosity toward the class that it affects." Romer, 517 U.S. at 634.

- A court may find H.R. 6 unjustifiably punitive on the present record. The only distinction between 98/99 lessees and unaffected lessees is the former's lack of price thresholds. This royalty relief is wholly unrelated to lessees' respective fitness to produce offshore oil and gas. Yet H.R. 6 imposes heavy selective economic burdens based on this status alone, and in the absence of any wrongdoing or harm by 98/99 lessees.

- The available legislative record already demonstrates a congressional intent to punish. March 9 Memorandum at 14-15.

Substantive Due Process -- Section III of the CRS Report

H.R. 6 does not rationally further a legitimate government purpose.

CRS

- CRS recognizes that H.R. 6 is subject to rational basis scrutiny under due process, yet states: "it would seem that section 204's effect on contractual 'property' rights is well on the constitutional side of the [rational basis] threshold. In section 204, Congress may be expressing a judgment that royalty-free DWRRA leases are not in the public interest and would be creating a means to discourage their continuance. That the means (ineligibility for new leases) is rationally related to this legitimate government objective seems difficult to question." Report at 8.

RESPONSE

- CRS omits that the rational basis inquiry is the same as for equal protection. March 9 Memorandum at 35. Thus, H.R. 6 may fail here for the same reasons discussed above. While Congress could *prospectively* stop all lease sales or offer only leases with price

thresholds to *everyone*, it cannot do so retroactively and selectively, rewriting past contracts and punishing 98/99 lessees awarded royalty relief therein.

H.R. 6 is impermissibly retroactive, in violation of due process.

CRS

- CRS admits that H.R. 6 is "retroactive" and will "upset[] settled expectations," but argues that this "retroactivity aspect of section 204 does not appreciably alter the substantive due process analysis." Report at 8-9.

RESPONSE

- Retroactivity is not favored in the law. March 9 Memorandum at 34. Courts are aware of the "temptation to use retroactive legislation as a means of retribution against unpopular groups or individuals." Landgraf v. Usi Film Prods., 511 U.S. 244, 264 (1994). Because H.R. 6's entire effect is to reach back and modify the terms of existing leases by imposing new economic burdens, it raises retroactivity concerns.

- A law's retroactive application must independently meet the due process rational basis test. CRS attempts to summarily dispose of this requirement: "Given that the DWRRA leases that Congress wishes to have renegotiated are already in existence, it had little choice but to apply section 204's new-lease eligibility restriction to existing leases." Report at 9. CRS begs the question whether Congress' desire to amend the 98/99 leases was a legitimate government purpose in the first place. Rather, *the very fact* that H.R. 6's intent is to rewrite past leases makes the statute retroactive, and independently requires a rational basis. As discussed above, there is no such justification, other than punishment, which cannot survive rational basis review.

H.R. 6 imposes severe, unanticipated, and undeserved economic burdens.

CRS

- CRS cites two cases, Concrete Pipe and Pension Ben., for the proposition that legislation imposing a "new duty or liability based on past acts" is lawful. Report at 8.

RESPONSE

- H.R. 6 differs significantly from legislation in these and other cases that merely "draws upon antecedent facts for its operations" in order to impose a burden on an industry or individuals that is either agreed upon in response to their wrongful actions or designed to cure harms for which they are responsible. March 9 Memorandum at 35-36. Such laws typically satisfy due process because the burdened party should have anticipated the liability, and such liability is not imposed disproportionately. For instance, both Concrete Pipe and Pension Ben. deal with insurance pooling schemes where employers must pay their share of unfunded vested employee benefits, which must necessarily be calculated

looking backwards in time. Similarly, in Usery v. Turner Elkhorn Mining, 428 U.S. 1, 17 (1976), see the March 9 Memorandum at 33-34, employee disability costs were allocated to those employers profiting from the fruits of their labor in prior years. In the environmental context, in United States v. Monsanto, 858 F.2d 160, 175 (4th Cir. 1988), see the March 9 Memorandum at 34, the court upheld restitution of responsible site cleanup costs under CERCLA.

- In contrast, H.R. 6 imposes severe retroactive obligations "automatically on a legislatively defined class of persons," who neither could have foreseen nor deserved such burdens. H.R. 6 has no forward-looking purpose or effect; it merely restructures executed contracts. The 98/99 lessees, when bidding on and executing their leases, could not have foreseen that Congress would come back several years later and attempt to revoke the deal. Nor could they anticipate facing future regulations changing the terms of such leases, especially if not generally applicable to all OCS lessees. The 98/99 lessees are also not guilty of any wrongdoing or harm. Thus, the law is likely punitive, not remedial, and violates due process.

Breach of Contract -- Section IV of the CRS Report

Failure to acknowledge the mandatory $9 conservation of resources fee undermines the breach of contract analysis.

CRS

- CRS states that "our research reveals no case where a voluntary surrender of a contract right was held to constitute a breach. Though the United States has indeed been held liable for breach, the court decisions involve government abrogation by fiat, not by offers of a choice." Report at 11.

RESPONSE

- Like the takings analysis, the breach of contract analysis fails to account for the fact that the mandatory $9 conservation of resources fee does directly alter lease terms and constitutes an abrogation of the express contract term providing unqualified royalty relief on production. So does the $3.75 conservation of resources fee.

- Under Mobil Oil, Winstar, and Amber Resources, the Government cannot impose new requirements not contemplated in the original contract, which is exactly what the Government is trying to do with H.R. 6 -- impose new requirements on the 98/99 lessees.

The choice between renegotiating and becoming ineligible for new leases is illusory.

CRS

- CRS argues that a lessee's decision to accept price thresholds and avoid the leasing bar is "voluntary" and cannot provide grounds for breach of contract. Report at 11.

RESPONSE

- o CRS acknowledges that "there may be a factual issue regarding whether in a handful of cases, renegotiation has been effectively compelled because the loss of eligibility for new leases for certain entities is so damaging that no real 'option' exists." Report at 11.

- o See analysis above regarding takings.

The Report does not perform a thorough analysis of the breach of contract issue regarding H.R. 6. See the March 9 Memorandum at 15-21 for a complete analysis of this issue.

Unilateral and Mutual Mistake -- Section V of the CRS Report

This entire section is based on a premise that lack of price thresholds in the 98/99 leases was a mistake. That premise, however, is uncertain.

CRS

- o The introduction to this section states that an argument that the 98/99 leases can be avoided or reformed "would be premised on the possibility that either the Minerals Management Service … or both the MMS and the lessees, made a mistake as to the effect of the 1998-1999 lease language." Report at 12.

RESPONSE

- o It is clear from their analysis that the CRS authors recognize that this premise is uncertain.

    * "[W]e will assume for purposes of our analysis that MMS, or MMS and the lessees, mistakenly thought the references to 30 C.F.R. Part 260 in the 1998/1999 leases had the effect of imposing price thresholds." Report at 12.

    * "In this section we assume that only the MMS … believed at the time the 1998/1999 leases were signed that price thresholds had been incorporated." Report at 12.

    * "In this section, we assume that *both* the MMS and the lessees believed at the time the 1998/1999 leases were signed that price thresholds had been incorporated by the leases' reference to 30 C.F.R. Part 260." Report at 13.

    * "Indulging in speculation, it seems likely that the 1998/1999 leases involved at most a unilateral mistake (by MMS), rather than mutual mistake…. " Report at 14.

- Further, in a detailed investigation report addressing the lack of price thresholds in the 1998/1999 leases, the Interior Department's Inspector General was unable to conclude why the price thresholds were omitted.

- On January 18, 2007, Assistant Secretary Allred testified before the U.S. Senate Committee on Energy and Natural Resources that the Interior Department "has looked at the mistakes theory" and that, based on information provided by the Interior Department's Inspector General, "it appears these were conscious decisions to remove [the price thresholds] in 98/99." Assistant Secretary Allred added that "as I understand it from [the Interior Solicitor], this would make it very difficult to argue a mistakes theory."[2]

<u>Unilateral Mistake</u>

Failure to include the price thresholds is not unconscionable.

<u>CRS</u>

- Failure to include the price thresholds may qualify as an unconscionable act, thus allowing the Government to avoid leases that lack the price thresholds.

<u>RESPONSE</u>

- As CRS acknowledges, "the matter [of whether to impose price thresholds] was left in 1995 to the [Interior] Department's discretion." Report at 2. Accordingly, as a matter of policy, MMS could offer leases without price thresholds. Therefore, the fact that MMS did so is not unconscionable.

- Further, it is difficult to argue that the failure to include price thresholds is unconscionable where 30 C.F.R. Part 256 dictates that MMS controls the entire lease process through a detailed procedure, including issuing the proposed notice of sale and final notice of sale with all the prescribed lease terms and preparing the lease language.

An action for relief from the 98/99 leases based on a unilateral mistake would be precluded because relief is unavailable for unilateral mistakes of law and the Government ratified the leases and/or unduly delayed in bringing the action for relief.

<u>CRS</u>

- A party may seek relief from a contract on the basis of a unilateral mistake.

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[2] Assistant Secretary Allred's testimony can be found at http://energy.senate.gov/public/index.cfm?FuseAction=Hearings.ByMonth&DisplayDate=01/18/07.

<u>RESPONSE</u>

- o A party is precluded from doing so, however, if it made a mistake of law or if it ratifies the contract or unduly delays manifesting an intent to avoid the contract.

- o A unilateral mistake of law is not grounds for relief from a contract. <u>See</u>, <u>e.g.</u>, <u>Jaglowicz v. Texas Life Ins. Co.</u>, 2006 U.S. Dist. LEXIS 92133 at * 7 (W.D. Ky Dec. 15, 2006) (applying Kentucky law). Here, MMS had the responsibility to know the law.

- o "The power of a party to avoid a contract for mistake ... is lost if after he knows or has reason to know of the mistake ... he manifests to the other party his intention to affirm it or acts with respect to anything that he has received in a manner inconsistent with disaffirmance." RESTATEMENT (SECOND) OF CONTRACTS § 380(2) (1981). "Ratification may be manifested in one or more of several ways: a party may ratify, first, by intentionally accepting benefits under the contract; second, by remaining silent or acquiescing in the contract for a period of time after he has the opportunity to avoid it; and third, by recognizing its validity of the contract by acting upon it, performing under it, or affirmatively acknowledging it." <u>United States v. McBride</u>, 571 F.Supp. 596, 613 (S.D. Tex. 1983) (finding that the United States ratified its contract with the defendant, and therefore, could not avoid it).

  - * MMS learned of the "mistake" no later than 2000.

  - * Since 2000, MMS has accepted rental and royalty payments, approved exploration plans and development and production plans submitted by 98/99 lessees, and approved assignments of 98/99 leases.

  - * It is now 2007 and MMS has taken no action with regard to the "mistake."

  - * In short, the Government has acted in a manner inconsistent with disaffirmance, and has ratified the leases by remaining silent for seven years after the Government arguably might have had the opportunity to avoid the leases.

- o Even if a court found the Government had not ratified the leases, the court would likely find that the Government cannot avoid the leases because of its undue delay. "The power of a party to avoid a contract for ... mistake is lost if after he knows of a ... mistake he does not within a reasonable time manifest to the other party his intention to avoid it." RESTATEMENT (SECOND) OF CONTRACTS § 381(2) (1981). The "reasonable time" period begins to run when the party learns of the mistake. <u>Id.</u> at comment b.

  - * MMS learned of the "mistake" no later than 2000.

  - * It is now 2007 and MMS has taken no action.

Mutual Mistake

The Government cannot reform the 98/99 leases based on mutual mistake.

CRS

- A party to a contract may seek to reform the contract on the basis of a mutual mistake.

RESPONSE

- "[R]eformation fixes a mistaken writing; it is not meant to fix a mistaken agreement." OneBeacon America Ins. Co. v. Travelers Indemnity Co. of Illinois, 465 F.3d 38, 42 (1st Cir. 2006). Therefore, to the extent a lessee understood or believed that no price thresholds were applicable, the concept of mutual mistake does not provide a basis to reform the contract, regardless of what MMS thought.

- A party cannot reform a contract if doing so would affect the rights of a bona fide purchaser, if the party seeking to reform the contract has ratified the contract or if, after learning of the mistake, the party has taken too long to bring the reformation action.

  * Where a writing that evidences or embodies an agreement in whole or in part fails to express the agreement because of a mistake of both parties as to the contents or effect of a writing, the court may at the request of a party reform the writing to express the agreement, except to the extent that rights of third parties such as good faith purchasers for value will be unfairly affected." RESTATEMENT (SECOND) OF CONTRACTS § 155 (1981). Since the time the 98/99 leases were executed, several of these leases have been assigned to third parties. The current lessees paid value for the assignment, and very likely paid a premium to acquire leases with royalty relief and no price threshold. These current lessees are bona fide purchasers for value of the 98/99 leases.

  * Taking away royalty relief would significantly curtail the rights of the current lessees, depriving them of an important economic benefit (royalty relief without price thresholds) that was the likely reason why, in good faith, they purchased the leases. Therefore, MMS could not reform the 98/99 leases.

- In addition, for the reasons discussed above, MMS's ratification of the 98/99 leases, and its inaction for at least seven years after learning of the "mistake," would preclude the Government from reforming these leases.

- Finally, because reformation is an equitable remedy, the equitable defense of laches is applicable. Courts have held that the doctrine of laches is appropriate against the Government in contract cases. S.E.R., Jobs for Progress, Inc. v. United States, 759 F.2d 1, 6-7 (Fed. Cir. 1985).

- Generally, to succeed on a laches defense, a party must show unreasonable delay in asserting a right; absence of an excuse for such a delay; knowledge, actual or constructive, of the injury or wrong; and prejudice. State ex rel. Meyers v. City of Columbus, 646 N.E.2d 173, 174 (OH 1995). The Government would be barred from seeking to reform the 98/99 leases by the doctrine of laches because:

  - MMS knew that the 98/99 leases lacked price thresholds in 2000 at the latest.

  - MMS has taken no action between 2000 and the present with regard to the lack of price thresholds in the 98/99 leases.

  - No excuse exists for the MMS's failure to take action.

  - The 98/99 lessees would be prejudiced by reformation of their leases.