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Imputing Regulatory Failures in Oil and Gas Licensing: A Discussion and Proposal

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I. Introduction

Abandoned unplugged wells are a growing problem in Kansas, as elsewhere. Unplugged wells are known to pose pollution risks to useable surface water and groundwater. While the state has a fulsome statutory and regulatory scheme requiring inactive wells to be plugged upon abandonment, large numbers of wells have been orphaned by their responsible operators. In recent years the Kansas Corporation Commission ("Commission"), which regulates oil and gas activity in the state, discovered a useful tool in ensuring plugging of abandoned wells: the authority to license oil and gas operators under Kan. Stat. Ann. § 55-155. Under this statute, the Commission's staff has denied new and renewed operator licenses on the basis of applicants' association, through common owners, officers, directors, and familial connections, with other licensed and formerly licensed operators that are noncompliant with Commission regulations. In many, and perhaps most cases, the underlying regulatory noncompliance pertains to the failure to plug abandoned oil, gas, or injection wells. It appears this practice is intended to address the significant and growing problem of unplugged wells that are no longer within the responsibility of any active licensed operator.

Kan. Stat. Ann. § 55-155(c)(4) requires license applicants to demonstrate compliance with all requirements of Chapter 55 of the Kansas Statutes Annotated (pertaining to oil and gas development) and Commission regulations. The provision requires compliance not only by the applicant, but also by "(B) any officer, director, partner or member of the applicant; (C) any stockholder owning in the aggregate more than 5%

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of the stock of the applicant; and (D) any spouse, parent, brother, sister, child, parent-in-law, brother-in-law or sister-in-law of the foregoing."[1] Thus, if the Commission determines that the applicant or any of these identified individuals is out of compliance with the Commission's authorizing statutes or its rules, regulators, or orders, it may deny the application for a new or renewal license.

In determining the regulatory compliance of an associated individual identified in subsection (c)(4), the Commission, acting through its legal and technical staff, considers not only the record of the individual personally, but also the records of any other licensed operators with whom the individual has been associated. As an illustration, the Commission would deny an application for renewal of Acme Oil Co.'s operator license if it were to find that its president, James Acme, was formerly a director of Ibid Petroleum, LLC, which operates an inactive well that is subject to the Commission's order to plug. In this example, the Commission first determined that James Acme was responsible for Ibid Petroleum, LLC's unplugged well. Then, pursuant to Kan. Stat. Ann. § 55-155(c)(4), it imputed James Acme's derivative responsibility for the well to Acme Oil Co. The Commission's action disregarded the two entities' legal separateness and limited liability. There was no showing that James Acme was personally responsible for the inactive unplugged well, yet the Commission held Acme Oil Co. responsible for the well via James Acme's connection with Ibid Petroleum, LLC. The Commission would then give Acme Oil Co. a choice: either take responsibility for Ibid Petroleum, LLC's unplugged well or lose its license. Cases like this hypothetical are increasingly common. The Commission has denied license renewal applications based on applicant's associations with separate noncompliant operators through common directors, owners, and family members.[2]

1. KAN. STAT. ANN. § 55-155(c)(4) (2015).

2. *See, e.g.*, Summer Sun Gas, Inc., Docket No. 18-CONS-3062-CMSC, 2017 Kan. PUC LEXIS 1659, at *1–2 (Kan. Corp. Comm'n Aug. 1. 2017) (denying application for renewal of operator license, stating, "Upon review of the application, Staff determined the application does not meet the requirements of K.S.A. 55-155 and K.A.R. 82-3-120. Specifically, the application does not satisfy K.S.A. 55-155(c)(4) as available records demonstrate Operator is associated with Kelly Oil Company, License No. 5632 ('Associated Entity') which is an operator out of compliance with K.S.A. Chapter 55. Specifically, Conservation Division records identify [John Doe] as a partner of Operator and as a partner of Associated Entity. Associated Entity is not in compliance with all requirements of K.S.A. Chapter 55 as Associated Entity is suspended per the Commission's Order in 16-CONS-3816-CSHO. Under K.S.A. 55-155(c)(4), no application or renewal shall be approved until the applicant has demonstrated to the Commission's satisfaction that the applicant complies with all requirements of K.S.A. Chapter 55."); Matador, Inc., Docket No. 18-CONS-3060-CMSC, 2017 Kan. PUC LEXIS 1650, at *1–2 (Kan. Corp. Comm'n Aug. 1, 2017) (denying application for renewal of operator license on substantially similar grounds, stating that an individual who was a partner in the applicant was also a partner in another "Associated Entity" that had a suspended operator license); Dolphin Energy LLC,

A recent case, however, has caused the Commission to reconsider its authority to issue summary denials in this fashion. The Commission's decision in *Agricultural Energy Services*[3] repudiated the Commission staff's interpretation of Kan. Stat. Ann. § 55-155(c)(4) as providing authority to deny an operator license application on the basis of regulatory violations for which the applicant or its constituents are not personally directly liable.[4]

The Commission's interpretation of Kan. Stat. Ann. § 55-155(c)(4) following *Agricultural Energy Services* raises the question: What does it mean for an applicant's constituent to be "personally liable" for the regulatory violations of other operators in relationships that may appear in the statute? There is no guidance for whether, or under what substantive and procedural standards, the Commission may impute personal liability on an applicant's constituent for the wrongs of its past associates. As Commission staff argued in *Agricultural Energy Services*, the state has a strong and increasingly urgent interest in ensuring the plugging of abandoned wells.[5] This interest, however, is at odds with the concept of limited corporate liability, which is "deeply ingrained in our economic and

Docket No. 17-CONS-3503-CEXC, 2017 Kan. PUC LEXIS 1036, at *1–2 (Kan. Corp. Comm'n Apr. 13, 2017) (granting an application for renewal of an operator license after initially denying the same "due to the affiliation of a principal of Applicant with Ramco Energy Corporation, which was found responsible for an unplugged well . . . in Docket 16-CONS-383-CSHO"); Black Gold Oil, LLC, Docket No. 18-CONS-3119-CMSC, 2017 Kan. PUC LEXIS 1852, at *1–2 (Kan. Corp. Comm'n Aug. 29, 2017) (denying application for operator license renewal because a principal of the applicant was the son of an individual affiliated with an operator that had an unplugged well remaining on its license); Application of Wayne E. Bright, Docket No. 18-CONS-3059-CMSC, 2017 Kan. PUC LEXIS 1666, at *1–2 (Kan. Corp. Comm'n Aug. 1, 2017) (denying application for operator license renewal because a partner of the applicant was "an authorized signatory" of another operator that was suspended under Commission regulations); Heckert Constr. Co., Docket No. 18-CONS-3214-CMSC, 2017 Kan. PUC LEXIS 2265, at *4–5 (Kan. Corp. Comm'n Nov. 16, 2017) (denying application for renewal of operator license because "available records identify an association with JRC Production, LLC, License # 34255 ('Associated Entity'), which is not in compliance with all requirements of K.S.A. Chapter 55, as Associated Entity has an unplugged well remaining on its expired license and is suspended"); Application of John Douglas Pitman Rev. Tr., Docket No. 18-CONS-3212-CMSC, 2017 Kan. PUC LEXIS 2267, at *4–5 (Kan. Corp. Comm'n Nov. 16, 2017) (denying application for renewal of operator license because trustee of applicant was associated with an entity with an unplugged well remaining on its license); Application of Ensminger Energy, LLC, Docket No. 18-CONS-3121-CMSC, 2017 Kan. PUC LEXIS 1838, at *1–2 (Kan. Corp. Comm'n Aug. 29, 2017) (denying application for renewal of operator license because of an association with an entity with a suspended license); *see also, e.g.*, Nadel & Gussman, LLC, Docket No. 17-CONS-3655-CMSC, 2017 Kan. PUC LEXIS 1332 (Kan. Corp. Comm'n May 18, 2017) (Setting a prehearing conference on the Commission's notice of denial of a license renewal application. The authors know anecdotally that the grounds for denial was that the applicant's officer was a former director of a licensed operator that was responsible for an unplugged well in violation of the regulation.).

3. Docket No. 17-CONS-3529-CMSC, 2018 Kan. PUC LEXIS 125 (Kan. Corp. Comm'n Jan. 23, 2018) (granting in part and denying in part Agricultural Energy Services' motion for summary judgment).

4. *Id.* at *17–18.

5. *Id.* at *14–16.

legal systems."[6] Courts disregard the separateness of business organizations, by imputing corporate liabilities to shareholders or agents, only in extraordinary circumstances. Administrative agencies' authority to pierce the corporate veil in adjudicative proceedings is murky at best.

This Article argues that the Commission's legitimate interest in enforcing its oil and gas regulations, especially including well-plugging regulations, does not justify absolute imputation of regulatory liability to third-party operators under Kan. Stat. Ann. § 55-155(c)(4). But, under certain circumstances, the state's interest may justify imputing personal liability on the individual constituents of a license applicant where the individual is culpable for the underlying regulatory violation or the applicant has a business connection with the operator primarily responsible for the violation, and the competing public policies of groundwater protection and limited liability justify the imputation. This Article proposes a procedural and substantive standard for the Commission to follow in adjudicating operator licenses under Kan. Stat. Ann. § 55-155(c)(4) that balances the need for enforcement with the individual rights of license applicants and their corporate constituents.

Section II of this Article surveys the state's interest in ensuring the responsible plugging of oil, gas, and water injection (or disposal) wells, and outlines the existing statutory and regulatory well-plugging scheme. Section II concludes with a discussion of *Agricultural Energy Services*. Section III discusses the legal constraints on the state's power to enforce these statutes and regulations by imputing liability for abandoned wells on third-party applicants for new and renewal operator licenses. This Section first outlines the constraints imposed by corporate law and the principle of limited liability for owners, directors, officers, and other agents of business organizations. Section III next analyzes the restrictions on the Commission's power imposed by the Fourteenth Amendment's procedural and substantive due process guarantees. Section III concludes with a relatively brief survey of the administrative law principles governing the Commission's actions in denying license applications under the statute.

Section IV synthesizes the state's legitimate interest and the constraints on its power set forth in the preceding Sections, and proposes an eight factor test for the Commission to apply in future licensing proceedings. This test would permit the Commission to deny a license under Kan. Stat. Ann. § 55-155(c)(4) due to an applicant's constituents' association with other operators if it finds either some culpability on the

6. United States v. Bestfoods, 524 U.S. 51, 61 (1998) (quoting Douglas & Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193, 193 (1929)) (internal quotation marks omitted).

part of an individual constituent or a business association between the applicant and the operator primarily responsible for the underlying violation. It further calls on the Commission to balance the competing public policies at stake in these license proceedings by considering the severity of the underlying violation and its proportionality to the effects on the applicant of ignoring its corporate form and denying the license. A balancing test (or a similar factors test) best protects the state's strong interest in preserving the public and environment from the negative externalities of oil and gas activities, including the pollution hazard posed by unplugged wells, without sacrificing the deeply ingrained principles of limited liability and due process.

II. UNPLUGGED WELLS IN KANSAS: THE PROBLEM, PUBLIC POLICY, AND STATUTORY ENFORCEMENT

A. A Brief History of the Problem

The first oil well in Kansas was drilled in 1860 by a newspaper man named George W. Brown from Lawrence, Kansas, and his partners.[7] The well did not produce oil or gas in commercial quantities.[8] Activity was slow during the Civil War until, three decades later the Norman #1 well was drilled near Neodesha, in the eastern part of the state, and produced commercial quantities of oil from a depth of 832 feet.[9] The Norman #1 well is considered by many to be America's first significant oil well west of the Mississippi River.[10] By 1904, Kansas was producing 4,000,000 barrels of crude oil per year. In 1915, the El Dorado Field east of Wichita was launched with the discovery of the Stapleton #1 well drilled by Cities Services Company in Butler County, Kansas.[11] Since that time, more than 430,000 oil and gas wells have been drilled in Kansas.[12] Those wells currently include 69,023 producing oil wells, 24,294 producing gas wells, 6127 producing coalbed methane wells, 5832 saltwater injection wells, and 7784 enhanced oil recovery wells.[13] Through October 2017, the state

7. Lawrence H. Skelton, *A Brief History of the Kansas Oil and Gas Industry*, 7 OIL-INDUSTRY HISTORY, no. 1, 2006, at 1.
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Oil and Gas Well Statistics for Kansas*, KANSAS GEOLOGICAL SURVEY (Jan. 16, 2018), http://www.kgs.ku.edu/PRS/wellStats.html [https://perma.cc/RP3Q-9UPN].
13. *Id.*

of Kansas had produced 6,648,889,680 barrels of oil and 40,966,467,801 thousand cubic feet of natural gas.[14]

Many of the wells drilled in Kansas since 1860 have been plugged poorly or not at all. As of January 2018, the Commission reported a statewide inventory of 21,734 abandoned and unplugged wells.[15] This was a net increase of 86 wells over the total for 2017. Since the state began its Abandoned Well Plugging and Site Remediation Program in 1996,[16] the Commission has plugged 10,104 abandoned oil and gas wells, averaging 505 each year.[17] At this pace, it will require approximately 43 more years to plug the known abandoned wells. In 2017 alone, however, the known unplugged abandoned wells increased by 3001 from the Commission's count at the beginning of 2016.[18] Based on the statistics above, it is likely that far more abandoned, unplugged wells will be discovered in the state over the next several years. At present, the number is increasing faster than the wells can be plugged.

B. The State's Policy Against Unplugged Wells and Scheme of Enforcement

Kansas law recognizes that unplugged wells can pose a risk to usable groundwater and surface water, either through pollution or the loss of usable water from downward drainage into an unplugged well.[19] Accordingly, the failure to plug a well at the end of its life is punishable as a felony.[20] Recognizing that plugging techniques have evolved substantially over time, the Kansas Legislature authorized the Commission to investigate abandoned wells previously plugged.[21] The Commission may drill out plugged wells to test the integrity of the plugs.[22] For wells drilled after July 1, 1996, the Legislature established a plugging assurance fund to pay the costs of these investigations.[23] The Legislature established a separate fund to investigate and plug wells drilled before July 1, 1996.[24]

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14. *State Production and Historical Information*, KANSAS GEOLOGICAL SURVEY (Jan. 24, 2016), http://www.kgs.ku.edu/PRS/petro/state.html [https://perma.cc/EWR2-H7QW].

15. *Abandoned Oil & Gas Well Status Report 2018*, KAN. CORP. COMM'N 3 (Jan. 2018), http://www.kcc.state.ks.us/images/PDFs/legislative-reports/2018_Abandoned_Wells_Report.pdf [https://perma.cc/CSG5-658S].

16. *See infra* text accompanying note 21.

17. *Abandoned Oil & Gas Well Status Report 2018*, *supra* note 15, at 3.

18. *Abandoned Oil & Gas Well Status Report 2017*, KAN. CORP. COMM'N (Jan. 2018) http://www.kcc.state.ks.us/images/PDFs/legislativereports/2017_abandoned_oil_gas_well_status_report.pdf [https://perma.cc/L299-ZSFD].

19. *See* KAN. STAT. ANN. § 55-156 (1993).

20. *Id.*

21. KAN. STAT. ANN. § 55-161 (2001).

22. *Id.*

23. KAN. STAT. ANN. § 55-167 (2001).

24. KAN. STAT. ANN. § 55-192 (1998); KAN. STAT. ANN § 55-193 (2017).

Together, these funds provide money to plug abandoned wells for which no responsible operator can be found.

Under Kansas law, inactive, unplugged wells are deemed likely to cause pollution of usable water strata or supply.[25] The legislature also declared that abandoned oil and gas surface structures are a public nuisance. Under Kan. Stat. Ann. § 55-177, following termination of an oil and gas lease, the lease operator must remove all surface structures and equipment and re-grade the surface of the soil in a "manner as to leave the land, as nearly as practicable, in the same condition . . . as it was before such structures and abutments were placed thereon."[26] Leaving oil and gas production structures on the land is punishable as a misdemeanor offense.[27]

Ensuring that wells are properly plugged after they cease producing or become inactive is one of the Commission's most important functions. Accordingly, the statutory act authorizing the Commission contains a licensing procedure for oil and gas operators that requires, among other things, the licensee to post significant financial assurance to ensure the licensee's ability to plug wells that it operates.[28] The Commission adopted detailed regulations governing plugging methods and procedures.[29] To ensure wells are plugged properly, the Commission requires operators to provide a written plugging application to the Commission when they intend to plug a well.[30] When it receives a plugging application, the Commission provides the operator with specific instructions for the proper plugging of the well.[31] The operator must notify the appropriate district office of the operator's proposed plugging plan before plugging.[32] The actual plugging operations are often observed on-site by a member of the Commission's staff.

The Commission recently made the issue of unplugged wells a high regulatory priority.[33] Indeed, enforcement of Commission regulations has

25. KAN. STAT. ANN. § 55-179(d) (2001).
26. KAN. STAT. ANN. § 55-177(a) (1986).
27. KAN. STAT. ANN. § 55-177(b) (1986).
28. KAN. STAT. ANN. § 55-155 (2015).
29. KAN. ADMIN. REGS. § 82-3-114.
30. KAN. STAT. ANN. § 55-173 (2009).
31. KAN. ADMIN. REGS. § 82-3-113.
32. *Id.*
33. *See infra* text accompanying note 34. There are a number of ways an inactive, unplugged well may come to the Commission's attention. Oil and gas wells must generally be either producing or plugged. When a well becomes inactive, but the well's operator is not prepared to plug it permanently, the operator may apply for "temporary abandonment authority." This authority permits the operator to leave the well inactive and unplugged for one year at a time. KAN. ADMIN. REGS. § 82-3-111(a). An operator may receive temporary abandonment authority for a particular well for a maximum of ten years, at which time the operator must place the well back into service or have it plugged. *Id.* Injection wells, such as saltwater disposal wells, are also subject to the state's plugging

generally increased in recent years. From 2001 to 2012, the Commission's administrative docket included an average of approximately eight show-cause enforcement orders per year.[34] Since 2013, however, the average number of show-cause orders has increased to 450 per year.[35] Penalty proceedings, which averaged eighty-eight dockets per year from 2001 to 2012, have also increased to an average of 450 per year since 2013.[36] Much of the increase in enforcement is attributable to unplugged wells that have been abandoned by operators whose licenses have expired. Many of these dockets result in no action by the responsible operator, and the operator's unplugged wells are placed on the state's list for plugging. While it is difficult, if not impossible, to determine exactly how many of the Commission's dockets relate to abandoned and unplugged wells, there is clearly a substantial increase in the dockets related to this issue.[37] In sum, the prevalence of abandoned, unplugged wells in the state appears to be driving Commission policy in recent years.

C. The Role of Kan. Stat. Ann. § 55-155(c)(4)

Another mechanism by which the Commission enforces its plugging rules involves Kan. Stat. Ann. § 55-155, the state's oil and gas operator licensing statute. Subsection (c)(4) of the statute states that an applicant for a new or renewal operator license must:

> [D]emonstrate[] to the commission's satisfaction that the following comply with all requirements of chapter 55 of the Kansas Statutes Annotated, and amendments thereto, all rules and regulations adopted thereunder and all commission orders and enforcement agreements, if the applicant is not registered with the federal securities and exchange commission: (A) The applicant; (B) any officer, director, partner or member of the applicant; (C) any stockholder owning in the aggregate more than 5% of the stock of the applicant; and (D) any spouse, parent, brother, sister, child, parent-in-law, brother-in-law or sister-in-law of the foregoing.[38]

When an operator responsible for a noncompliant well applies each year to renew its operator license, under (c)(4), the Commission reviews the regulatory history of the applicant operator itself and each of the

requirements and must pass a mechanical integrity test periodically or otherwise be plugged. KAN. ADMIN. REGS. § 82-3-407.

34. Jon Myers et al., Remarks at the Kansas Corporation Commission Regulations of the Oil & Gas Industry in Eastern Kansas: Enforcement Policy and Practices (Aug. 4, 2017) (unpublished CLE materials on file with the authors).

35. *Id.*

36. *Id.*

37. *See supra* note 2.

38. KAN. STAT. ANN. § 55-155(c)(4) (2015); *see also* KAN. ADMIN. REGS. § 82-3-120(g).

individuals identified in (c)(4). If the applicant or any of these individuals is deemed responsible for a regulatory violation, such as maintaining an inactive, unplugged well, the Commission will deny the application unless the applicant agrees to take control of the well and plug it. Until the Commission's recent decision in *Agricultural Energy Services*,[39] in determining the regulatory compliance of each of the identified individuals in (c)(4), the Commission reviewed the regulatory histories of all the licensed and formally licensed operators with which each individual was associated. If the Commission deemed one of the identified individuals to be "associated" with a licensee maintaining an inactive, unplugged well on its license, it imputed the responsibility for the well to the individual and therefore the applicant.

A hypothetical illustration of the typical case will aid the discussion. Consider the following set of facts:

- 1999: Alpha Oil, Inc., a licensed operator, sells and transfers its wells to other operators and ceases business. Alpha Oil fails, however, to transfer the Ida #1 well, which is inactive.
- 2015: Finally discovering the Ida #1 well is inactive and unplugged, the Commission serves Alpha Oil with a notice of violation at its former resident agent's registered office, for failure to plug the Ida #1. The Commission eventually obtains a penalty order against Alpha Oil by default. The order requires Alpha Oil to plug the Ida #1 well or place it back into service.
- 2017: Beta Oil, LLC applies to renew its operator license. The Commission denies the renewal, citing Beta Oil's association with Peter Oleum, who is a 5% non-managing member of Beta Oil. The Commission cites the fact that Peter was a director of Alpha Oil, which has the unplugged Ida #1 well on its operator license. The Commission offers Beta Oil the option of adding the Ida #1 to its operator license and having it plugged in order to receive a renewed license.

Cases like this hypothetical are not uncommon.[40] But as discussed in the following Section, the Commission largely rejected such an application of Kan. Stat. Ann. § 55-155(c)(4) in *Agricultural Energy Services*. It is unclear under *Agricultural Energy Services* whether, and under what circumstances or standards, the Commission may impute the regulatory liability of associated operators to applicants for new and renewed operator licenses under the licensing statute.

39. *See infra* Part II.D.
40. *See supra* note 2.

D. Agricultural Energy Services

On January 23, 2018, in *Agricultural Energy Services*, a divided Commission overruled its previous practice of conditioning the renewal of operator licenses on the acceptance of responsibility for the regulatory violations of operators with which the applicant's corporate constituents were formerly associated.[41] The case arose in the typical fashion. In March 2017, the Commission's staff issued a Notice of Denial of License Renewal Application to Agricultural Energy Services ("AES"), stating that the application was denied under Kan. Stat. Ann. § 55-155(c)(4) because AES "appears to be associated with entities not in compliance with Commission statutes, regulations, and orders," namely First National Oil, Inc., which had an unplugged well on its expired license.[42]

AES filed a motion for summary judgment, arguing that the plain language of Kan. Stat. Ann. § 55-155(c)(4) did not permit the Commission's actions and that, as applied to AES, the statute violated due process.[43] The Commission staff responded and the Commission found the following pertinent uncontroverted facts: (a) the application was denied solely under subsection (c)(4); (b) the denial was based on the staff's belief that AES was associated with First National Oil; (c) one of AES's officers was also a director, along with his brother, of First National Oil, and his father was an officer of First National Oil; (d) First National Oil's operator license was suspended for regulatory noncompliance related to an unplugged well.[44]

The Commission's staff defended its practice of imputing regulatory liability on individuals "associated" with noncompliant operators under Kan. Stat. Ann. § 55-155(c)(4). It argued that the statute is in place to ensure that an individual "cannot incorporate or otherwise shift licensure to avoid Commission regulations regarding abandoned wells, that the statute only has meaning if the Commission's ability to deny licenses extends beyond theories of corporate veil-piercing and alter ego, or that [a]n artificial entity acts only through its officers, employees, and agents."[45] The staff further urged that its interpretation is "a state and legislative interest" related to the Commission's "ability to get wells plugged."[46]

41. Agricultural Energy Services, Docket No. 17-CONS-3529-CMSC, 2018 Kan. PUC LEXIS 125, at *22 (Kan. Corp. Comm'n Jan. 23, 2018).
42. *Id.* at *1.
43. *Id.* at *3.
44. *Id.* at *7–9.
45. *Id.* at *14 (internal quotation marks omitted).
46. *Id.* at *16.

The Commission found that the staff's interpretation of Kan. Stat. Ann. § 55-155(c)(4) was erroneous, stating, "the plain reading of K.S.A. 55-155(c)(4) requires the relevant officer, director, partner, member, stockholder or family member of the applicant to be *personally* non-compliant with Kansas law or Commission orders and enforcement agreements before the license application can be denied on the basis of this subsection."[47] One of the three Commissioners dissented, suggesting that when read as a whole, the provisions of Kan. Stat. Ann. § 55-155 may provide a legal basis for the staff's interpretation.[48] Commissioner Albrecht further stated: "[T]his matter raises a number of complex issues of first impression, one of which is whether the plain meaning of K.S.A. 55-155 can or should be discerned on the flimsy record before the Commission. I draw different conclusions from the evidence, therefore summary judgment must be denied."[49]

Agricultural Energy Services raises a number of issues. What does it mean for an individual constituent of a license applicant to be "personally" noncompliant with statute or agency regulations or orders? Does it leave room for the Commission to disregard the corporate entity of other operators with which the individual has been associated? If so what standards, procedural and substantive, should govern such an action? In the Sections that follow, this article will examine the propriety of the Commission staff's interpretation and application of Kan. Stat. Ann. § 55-155(c)(4) under principles of corporate, constitutional, and administrative law, and propose a substantive test under which the Commission may deny a license under (c)(4) based on the vicarious liability of the applicant's constituents.

III. CONSTRAINTS ON STATES' POWER TO DISREGARD CORPORATE FORMALITIES

The Commission expressed concern in its majority decision in *Agricultural Energy Services* that the licensing statute should not be interpreted to permit the Commission to disregard corporate formalities.[50] Oil and gas exploration and production is a capital- and risk-intensive endeavor.[51] Individual actors in the industry frequently organize

47. *Agricultural Energy Services*, 2018 Kan. PUC LEXIS 125, at *17 (emphasis in original).
48. *See id.* at *23–24 (Albrecht, Comm'r, dissenting).
49. *Id.* at *30.
50. As used in this article, "corporate" refers to limited liability business organizations generally, rather than corporations exclusively, and includes reference to corporations, limited liability companies, limited partnerships, limited liability partnerships, and any other entity that is presumed separate from its owners and managers.
51. Appalachian Land Co. v. EQT Prod. Co., 468 S.W.3d 841, 843 (Ky. 2015) ("The extraction of natural gas is a capital intensive process involving various technologies and extraction methods.").

themselves into some kind of limited liability corporate form, such as a corporation, limited liability company, or limited partnership. Consequently, applicants for operator licenses tend to be corporate entities rather than individuals.[52] The Commission's recent licensing cases, particularly *Agricultural Energy Services*, thus present the question whether the state, acting through a specialized regulatory body, may exercise its power to disregard an applicant's corporate form (and sometimes multiple corporate forms) to deny an oil and gas operator license or impose plugging liability. As this Section will elucidate, the question is less whether the state may exercise this power than what procedures are necessary to do so. Possible constraints on the exercise of this power arise under corporate, constitutional, and administrative law.

A. Corporate Law Constraints

1. The Bedrock Principle of Limited Liability

Kansas law empowers any person, singly or jointly with others, to organize as a corporation,[53] limited liability company,[54] limited partnership,[55] or limited liability partnership.[56] Each of these types of business organization is a separate legal person from its owners.[57] The corporate person "is an artificial being, invisible, intangible, and existing only in contemplation of law."[58] The corporate being and its owners are "presumed separate and distinct, whether the corporation has many stockholders or only one."[59] It follows that the debts and liabilities of a corporate person are not the individual debts or liabilities of its owners.[60] The officers, directors, or managers of a corporate person are likewise separate and not individually responsible for corporate debts or

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52. *See* sources cited *supra* note 2.
53. KAN. STAT. ANN. § 17-6001(a) (2016).
54. KAN. STAT. ANN. § 17-7673(a)–(b) (2015).
55. KAN. STAT. ANN. § 56-1a151 (1999).
56. KAN. STAT. ANN. § 56a-1001(a) (2010).
57. *E.g.*, § 17-7673(b) ("A limited liability company formed under this act shall be a separate legal entity, the existence of which as a separate legal entity shall continue until cancellation of the limited liability company's articles of organization.").
58. Dean Ops. v. One Seventy Assocs., 896 P.2d 1012, 1016 (Kan. 1995) (citing Land Grant Ry. & Tr. v. Bd. of Cty. Comm'rs, 6 Kan. 245, 253 (1870)); *see also* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985) ("[The corporation] is no more than a name for a complex set of contracts among managers, workers, and contributors of capital. It has no existence independent of these relations.").
59. Amoco Chems. Corp. v. Bach, 567 P.2d 1337, 1341 (Kan. 1977).
60. Speer v. Dighton Grain, Inc., 624 P.2d 952, 958 (Kan. 1981) (citing *Amoco Chems. Corp.*, 567 P.2d at 1341).

liabilities.[61] The law thus limits the liability of owners to the amount of their investments in the corporate being, and relatedly, the liability of officers and directors to the liabilities arising from their own wrongful acts. [62] The concept of limited liability is a fundamental general principle of corporate law.[63]

As an initial matter, let us recall what limited liability is by way of an illustration. Judge Frank Easterbrook and his coauthor Daniel Fischel provide this simple one: "A person who pays $100 for stock risks that $100, but no more. A person [who] buys a bond for $100 or sells goods to the firm for $100 on credit risks $100, but no more."[64] But why is limitation beneficial? One court has explained that the concept "has long served useful business purposes, encouraging risktaking [sic] by individual investors as well as overall convenience of financial administration."[65] One theory holds that limited liability is essential to the modern publicly held corporation with many small shareholders because, without limited liability, every share of stock would place the owner's entire personal assets at risk, causing investors to eliminate or reduce their investments to a few, closely monitored firms.[66] Other commentators advance that limited liability makes organized securities markets possible by allowing investors to uniformly value shares of stock.[67] This rationale maintains that, without limited liability, different investors would attach different values to the same shares of stock based on the investor's own wealth and probability it could be reached in the event of corporate default. Easterbrook and Fischel conclude that limited liability is

61. Galvan v. McCollister, 580 P.2d 1324, 1325 (Kan. 1978) (quoting McFeeters v. Renollet, 500 P.2d 47, 50 (Kan. 1972)); Lincoln Farm Supply, Inc. v. CT Implement Co., No. 106,162, 2012 WL 924860, at *5 (Kan. Ct. App. Mar. 6, 2012) (citing *Speer*, 624 P.2d at 958).

62. Easterbrook & Fischel, *supra* note 58, at 89–90 ("The rule of limited liability means that the investors in the corporation are not liable for more than the amount they invest."); *Speer*, 624 P.2d at 958–59 (citing Kirk v. H.G.P. Corp., 494 P.2d 1087, 1090 (Kan. 1972)) (noting that "a corporate officer or director acting on behalf of a corporation is personally liable for damages caused by his willful participation in acts of fraud or deceit to one directly injured"); *McFeeters*, 500 P.2d 47 at Syl. ¶ 2; Meehan v. Adams Enters., Inc., 507 P.2d 849, 851 (Kan. 1973); State *ex rel.* Sanborn v. Koscot Interplanetary, Inc., 512 P.2d 416 at Syl. ¶ 7 (Kan. 1973).

63. Easterbrook & Fischel, *supra* note 58, at 89; *see also* United States v. Bestfoods, 524 U.S. 51, 61 (1998) (noting that the concept is "deeply 'ingrained in our economic and legal systems'") (quoting Douglas & Shanks, *supra* note 6, at 193).

64. Easterbrook & Fischel, *supra* note 58, at 90.

65. Valley Fin., Inc. v. United States, 629 F.2d 162, 171 (D.C. Cir. 1980); *see also* Jonathan A. Marcantel, *Because Judges Are Not Angels Either: Limiting Judicial Discretion by Introducing Objectivity into Piercing Doctrine*, 59 U. KAN. L. REV. 191, 193–94 (2011) ("Limited liability is a bedrock feature of corporate law for it encourages diversification and liquidity, promotes market efficiency, and decreases the need for monitoring agents and officers.").

66. Easterbrook & Fischel, *supra* note 58, at 90 (citing Henry Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 262 (1976)).

67. *Id.* at 92 (citing Paul Halpern et al., *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117, 129 (1980)).

necessary to reduce the costs of separation and specialization of function among a diverse group of agents who manage a firm and the owners who invest in it, thus making large and publicly traded corporations possible.[68] Easterbrook and Fischel also argue that limited liability benefits voluntary creditors of firms as well as shareholders, because "if limited liability were not provided by law, firms would attempt to create it by contract," and the default rule "enables firms to obtain the benefits of limited liability at lower cost."[69]

2. Piercing the Corporate Veil: An Exception to Limited Liability

Another function of limited liability is to allow corporate persons to externalize the costs of engaging in risky activities.[70] Although it is unlikely that limited liability meaningfully contributes to excessive risk-taking,[71] courts and administrative agencies,[72] in some circumstances, seek to reduce the social costs of limited liability.[73] The primary way courts and administrative agencies have of reallocating risk from creditors (voluntary and involuntary, such as tort victims) to corporate owners and managers is by piercing the corporate veil.

The doctrine of veil piercing is an exception to the general rule of limited corporate liability by which "courts disregard the separateness of the corporation and hold a shareholder responsible for the corporation's action as if it were the shareholder's own."[74] What constitutes an appropriate case in which to pierce the corporate veil is among the most confusing questions in corporate law.[75] No uniform standard exists for determining whether a corporate form should be disregarded.[76] Perhaps

68. *See id.* at 93–94.

69. *Id.* at 93.

70. *Id.* at 117.

71. *Id.* at 106 ("Our point is not that limited liability will never result in a socially excessive amount of risk taking in situations involving voluntary creditors. Rather, we argue that it is unlikely that any rule will lead to systematically excessive risk taking; indeed, it is unlikely that the legal rule will matter much.").

72. *See generally* Lindsey Simon, *Chapter 11 Shapeshifters*, 68 ADMIN. L. REV. 233 (2016) (discussing veil piercing by administrative agencies in the context of bankruptcy proceedings).

73. Easterbrook & Fischel, *supra* note 58, at 117; *see, e.g.*, Valley Fin., Inc. v. United States, 629 F.2d 162, 171 (D.C. Cir. 1980) ("On occasion, however, this concept [of limited liability] is abused, and yields results contrary to the interests of equity or justice. Courts have not hesitated to ignore the fiction of separateness and approve a piercing of the corporate veil when the corporate device frustrates clear intendment of the law.").

74. Simon, *supra* note 72, at 245 (quoting Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1036 (1991)) (internal quotation marks omitted); *see also* Amoco Chems. Corp. v. Bach, 567 P.2d 1337, 1341 (Kan. 1977) ("However, in an appropriate case the corporate form will be disregarded and the corporation and its stockholders may be treated as identical.").

75. Easterbrook & Fischel, *supra* note 58, at 89.

76. *Valley Fin., Inc.*, 629 F.2d at 172.

the most prominent test is a three-pronged analysis formulated by Frederick Powell in which the court evaluates: (1) whether the corporate person is the "alter ego" or "mere instrumentality" of the owners; (2) whether the corporate form has been used to perpetuate a fraud, wrong, or injustice on the plaintiff; and (3) whether the plaintiff would suffer some unjust loss or injury as a result of the corporate person's actions but for piercing the veil.[77] Except for a few general principles—such as the proposition that veil piercing is an extraordinary action that should be undertaken reluctantly and cautiously[78]—the development of the doctrine across, and even within, jurisdictions has been somewhat haphazard. Innumerable variations on Powell's classic formulation have been adopted, leading to "a legal quagmire" of veil-piercing standards.[79] According to Easterbrook and Fischel, "[p]iercing seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled."[80]

Kansas case law only slightly reflects the imprecision so often criticized in the veil-piercing area. Like courts in most jurisdictions,[81] in Kansas the veil-piercing test has coalesced around a factors analysis. Yet Kansas cases exist where a corporate veil is pierced without application of any particular test.[82] Kansas courts nevertheless assiduously follow certain fundamental principles. Namely, Kansas courts hold that (1) the power to pierce the corporate veil "is to be exercised reluctantly and cautiously," (2) "the corporate entity can be disregarded if it is used to

77. Simon, *supra* note 72, at 246 (citing FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS 1–10 (1931); Cathy S. Krendl & James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DENV. L.J. 1, 13 (1978).

78. *See* Simon, *supra* note 72, at 245; *see, e.g.*, *Amoco Chems. Corp.*, 567 P.2d at 1341 ("Power to pierce the corporate veil is to be exercised reluctantly and cautiously.").

79. Simon, *supra* note 72, at 246 (quoting Henry W. Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CAL. L. REV. 12, 15 (1925)).

80. Easterbrook & Fischel, *supra* note 58, at 89 (internal quotation marks omitted).

> One commentator described the legal analysis as jurisprudence by metaphor or epithet. It does not contribute to legal understanding because it is an intellectual construct, divorced from business realities. The metaphors are no more than conclusory terms, affording little understanding of the considerations and policies underlying the court's actions and little help in predicting results in future cases . . . . As a result, we are faced with hundreds of decisions that are irreconcilable and not entirely comprehensible. Few areas of the law have been so sharply criticized by commentators.

Id. at 89 n.1 (citing PHILLIP BLUMBERG, THE LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS 8 (1983)). Jonathan Marcantel notes that:

> [B]ecause these decisions are necessarily factually charged, they are largely more reflective of the judge's personal opinion on the instant case as opposed to the judge's interpretation of the general law. Thus, in terms of predictability and consistency, the tests have become only slightly more sophisticated than the smell test.

Marcantel, *supra* note 65, at 197–98.

81. Marcantel, *supra* note 65, at 192.

82. *See, e.g.*, Kirk v. H.G.P. Corp., 494 P.2d 1087 1090–91 (Kan. 1972) (piercing the veil of a corporate defendant to impose liability for unplugged wells without reference to a detailed legal standard).

cloak or cover fraud or illegality or to work injustice, or if necessary to achieve equity," and (3) the doctrine "fastens liability on an individual or corporation which uses a corporate entity merely as an instrumentality to conduct its own business."[83] These basic rules clearly reflect at least two of the elements of Powell's tripartite standard—whether the corporate form is merely the owner's alter ego and whether it was used to perpetuate fraud or injustice.[84] The provision that a corporate form will be disregarded if necessary to achieve equity also appears to embrace Powell's third element—necessity of piercing the veil to prevent the victim from suffering an unjust loss.[85]

The predominant test for piercing the veil applied by Kansas courts is articulated in *Amoco Chemicals Corp. v. Bach*.[86] There, the Kansas Supreme Court set forth the following eight factors:

> (1) [u]ndercapitalization of a one-[person] corporation,[87] (2) failure to observe corporate formalities, (3) nonpayment of dividends, (4) siphoning of corporate funds by the dominant stockholder, (5) nonfunctioning of other officers or directors, (6) absence of corporate records, (7) the use of the corporation as a façade for operations of the dominant stockholder or stockholders, and (8) the use of the corporate entity in promoting injustice or fraud.[88]

This test has been widely followed.[89] Although the Kansas test speaks in terms of corporations, there is virtually no doubt that the alter

83. Serv. Iron Foundry, Inc. v. M.A. Bell Co., 588 P.2d 463, 473 (Kan. Ct. App. 1978) (citing *Amoco Chems. Corp.*, 567 P.2d 1337, 1341 (Kan. 1977); Kilpatrick Bros., Inc. v. Poynter, 473 P.2d 33, 41 (Kan. 1970)).

84. *See supra* text accompanying note 77.

85. *See supra* text accompanying note 77.

86. 567 P.2d 1337 (Kan. 1977).

87. While the test specifically focuses on undercapitalization of single-shareholder corporations, the fact of "single ownership alone will not support the alter ego theory and justify a disregard of the corporate entity." *Amoco Chems. Corp.*, 567 P.2d at 1341. Further, although early Kansas cases decided before codification of the state's corporation code suggest otherwise, the code specifically authorizes corporations incorporated, owned, and controlled by a single person. *Id.* (citing Adams v. Morgan, 52 P.2d 643 (Kan. 1934) (*overruled by Amoco Chems. Corp.*, 567 P.2d at 1337).

88. *Id.* at 1341–42.

89. *See, e.g.*, Sampson v. Hunt, 665 P.2d 743, at Syl. ¶ 3 (Kan. 1983); Golconda Screw, Inc. v. West Bottoms, Ltd., 894 P.2d 260, 268 (Kan. Ct. App. 1995); Kvassay v. Murray, 808 P.2d 896, 904 (Kan. Ct. App. 1991). Kansas courts have adopted a separate multifactorial analysis for determining when to disregard the separateness of affiliated corporate entities (e.g., parent and subsidiary corporations). Affiliate entity cases follow the same general principles as typical veil-piercing cases, but consider these ten factors:

> (1) whether the parent corporation owns all or a majority of the capital stock of the subsidiary; (2) whether the corporations have common directors or officers; (3) whether the parent corporation finances the subsidiary; (4) whether the parent corporation subscribed to all of the capital stock of the subsidiary or otherwise causes its incorporation; (5) whether the subsidiary has grossly inadequate capital; (6) whether the parent corporation pays the salaries or expenses or losses of the subsidiary; (7) whether the subsidiary has substantially no business except with the parent corporation, or no assets except those conveyed to it by the parent corporation; (8) whether in the papers of the parent corporation, and in the

ego and veil-piercing doctrines apply equally to other limited liability business organizations, such as limited liability companies.[90]

In at least one case, Kansas courts have pierced the veil of limited liability to impose liability for plugging oil and gas and water injection wells on a corporate constituent. *Kirk v. H.G.P. Corp.*[91] was an action for judicial cancellation of an oil and gas lease brought by the owners of the lease premises against the owner of the lease, H.G.P. Corporation.[92] H.G.P.'s majority shareholder and principal officer, director, and manager was Claude Beets.[93] The oil and gas leases at issue were H.G.P.'s only assets.[94] The parties agreed to a partial settlement whereby H.G.P. agreed to acquiesce in cancellation of the lease if it could remove its equipment, plug the oil and injection wells, and restore the surface of the property before the plaintiffs' claim for damages would be decided by the court.[95] H.G.P. removed its equipment from the property, sold it to Beets, and applied the proceeds to the balance of the corporation's debts to Beets.[96] Although H.G.P. did plug some of the wells on the property, it did so negligently and spilled crude oil, "causing considerable damage."[97] The plaintiffs amended their petition to add Beets as a defendant, and Beets "moved for summary judgment, contending as a matter of law that he could not be held personally liable for the obligations of the defendant corporation."[98] The district court denied the motion and, following a trial on the merits, found Beets "personally liable for the plugging of the oil wells."[99]

In affirming the district court's ruling, the Kansas Supreme Court applied multiple exceptions to the rule of limited liability. First, the court held that Beets was directly liable for the tortious acts of H.G.P. in his capacity as a director and officer because he willfully prioritized his own

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> statements of its officers, the subsidiary is referred to as such or as a department or division; (9) whether the directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take direction from the parent corporation; and (10) whether the formal legal requirements of the subsidiary as a separate and independent corporation are not observed.

Dean Operations v. One Seventy Assocs., 896 P.2d 1012, 1017–18 (Kan. 1995).

90. Edwin W. Hecker, Jr. & Stanley N. Woodworth, *Limited Liability Companies*, *in* KANSAS CORPORATION LAW & PRACTICE § 13.3.1(e) (5th ed. 2011) (collecting cases from other jurisdictions where the limited liability of a limited liability company was pierced and discussing certain factors' applications in the context of limited liability companies).

91. 494 P.2d 1087 (Kan. 1972).

92. *Id*. at 1088–89.

93. *Id.* at 1089.

94. *Id.*

95. *Id.* at 1089–90.

96. *Id.* at 1090.

97. *Kirk*, 494 P.2d at 1090.

98. *Id.*

99. *Id.*

claims as creditor of the corporation ahead of the claims of the plaintiffs as creditors.[100] The court also held Beets personally liable in his capacity as a shareholder under the doctrine of alter ego, finding H.G.P. was "a mere cloak" by which Beets conducted his personal affairs.[101]

The court thus imposed responsibility for plugging the wells on the property, and for damages to the surface from failed plugging attempts, on Beets personally. While the court's discussion makes no mention of particular factors on which it rested its decision, the opinion does generally apply the broad policies of Powell's test—it found that H.G.P. was the mere alter ego of Beets, that Beets used H.G.P. to perpetuate an injustice on the plaintiffs, and that piercing the corporate veil was necessary to secure a just determination of rights and liabilities.[102]

3. Veil Piercing by Administrative Agencies

i. In General

Courts are not the only adjudicative bodies that disregard corporate forms; administrative agencies do it too. As one commentator on the subject noted, however, "[a]gency veil-piercing builds upon the doctrine's general uncertainty in two ways." [103] First, there is a dearth of authority granting administrative agencies veil-piercing power.[104] Additionally, even if agencies are empowered to pierce corporate formalities, it is unclear what veil-piercing standards should apply in administrative proceedings.[105]

Some agencies simply assume without analysis they have the authority to pierce the veil. At least one judge has announced that limited liability concepts "lose much of their sacrosanctity when urged in the

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100. *Id.* at 1090–91.

101. *Id.* The court noted the following:

> The record shows the defendant corporation was a tool by which the appellant conducted his own personal business. He was the principal stockholder, principal officer and manager of the affairs of H. G. P., principal creditor, principal receiver of the assets, principal salvage operator, and principal transferee of all funds secured by the corporation; in short, *Beets was the defendant corporation*.
>
> . . . .
>
> It is clear that H. G. P. was a mere cloak by which Beets conducted his personal affairs and when the corporate entity becomes a conduit of an individual, the corporate veil may be pierced by the court in the interest of securing a just determination of rights and liabilities. Such a conclusion follows from the facts and circumstances as disclosed by the record.

Id. (emphasis in original).

102. *Kirk*, 494 P.2d at 1090–91.

103. Simon, *supra* note 72, at 247.

104. *Id.*

105. *Id.* at 247–48.

context of regulated industries."[106] There seems to be little discussion among courts about the authority of regulatory agencies to exercise veil-piercing powers, though Kansas courts have addressed the practice at least once. In *Kansas Commission on Civil Rights v. Service Envelope Co.*,[107] the Kansas Supreme Court held that the Commission had the power in an administrative proceeding to enforce an employment discrimination award against individual constituents of the corporate respondent on a theory of direct liability or alter ego, but only if the individual officers, directors, or employees were joined in the original agency proceedings.[108] On the facts of the case, however, the original agency discrimination proceedings did not join the corporate shareholder and officer against whom the petitioner sought to enforce the award.[109] The court therefore denied the petitioner's attempt to assert liability for the administrative award against the shareholder and officer.[110]

Although not strictly a veil-piercing case, *State ex rel. Fatzer v. Zale Jewelry Co.*[111] illustrates courts' willingness to permit the state to disregard corporate formalities in the regulation of professions.[112] *Fatzer* was an action in quo warranto, in which the state of Kansas (through its then-attorney general, Fatzer) challenged Zale Jewelry Co.'s right to practice optometry.[113] Zale Jewelry operated a jewelry store on the first floor of its building.[114] It also rented space in the rear of the building to Marks, who was a Kansas licensed optometrist,[115] and to Douglas Optical Company, which manufactured prescription lenses.[116] Under the lease agreements, Marks and Douglas Optical promised not to compete with Zale Jewelry, and Zale Jewelry agreed to handle the tenants' accounts receivable and bookkeeping.[117] Zale Jewelry widely advertised its jewelry store's connection with the services of Marks and Douglas Optical.[118] The state alleged that Zale Jewelry's lease arrangements with Marks and Douglas Optical were a subterfuge and that Zale Jewelry was actually

106. *Id.* at 248 (citing Capital Tel. Co. v. FCC, 498 F.2d 734, 738 (D.C. Cir. 1974)).
107. 660 P.2d 549 (Kan. 1983).
108. *Id.* at 555.
109. *Id.*
110. *Id.*
111. 298 P.2d 283 (Kan. 1956).
112. *Id.* at 283.
113. *Id.* at 284.
114. *Id.*
115. *Id.*
116. *Id.* at 284–85.
117. State *ex rel.* Fatzer v. Zale Jewelry, 298 P.2d 283, 284 (Kan. 1956).
118. *Id.* at 288 (describing Zale Jewelry's signage and advertisements, such as: "A New service for you – Now – located right in our store you will find complete new optical dispensing offices;" "You can add your optical purchase to your regular Zale's account;" and "You save from $50 to $20 on eye care").

engaged in the practice of optometry without a license.[119] The Kansas Supreme Court examined the evidence and agreed, holding the state, through its attorney general, was empowered to look behind Zale Jewelry's contractual arrangements and impose liability for practicing optometry without a license.[120]

Service Envelope and *Fatzer* may provide some authority for agency veil piercing in Kansas. But they do not address the second major quandary in this area—what standard to apply. Cases from other jurisdictions suggest that, in the context of regulated industries, virtually no principled standards apply. The Federal Mine Safety and Health Review Commission may have encapsulated agencies' attitudes regarding administrative veil piercing when it said, "the fiction of a corporate entity *must* be disregarded whenever it has been adopted or used to defeat a paramount public policy," and "[n]or in cases involving the frustration of a regulatory statute is the single enterprise entity or alter ego doctrine subject to the strict standards that govern application of the doctrine in tort or contract cases."[121]

The United States Supreme Court has indicated that a state may impose derivative liability for corporate actions on corporate owners under two circumstances: either by a statute that clearly abrogates common law principles of limited liability or by making the necessary showings under the common law to pierce the corporate veil.[122] Where there is such a statute, it appears no showing of alter ego is necessary and thus no legal standard for veil piercing is relevant. In *United States v. Bestfoods*,[123] the Court considered whether, under the federal Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"), the United States could impose liability for environmental cleanup costs on a parent corporation based solely on the fact the parent exercised control over the operations of a subsidiary that generated the waste.[124] The Court answered "no, unless the corporate veil may be pierced."[125] CERCLA, the Court reasoned, gives no indication that it was intended to replace limited liability provisions of corporate law, and "the failure of the statute to speak to a matter as fundamental as the liability implications of corporate ownership demands application of the rule that

119. *See id.* at 287.

120. *Id.* at 289–90 (finding the lease arrangements to be "a subterfuge" and allowing the state to oust Zale Jewelry from engaging in the practice of optometry).

121. Sec'y of Labor v. NBC Energy, Inc., 4 FMSHRC 1860, 1872–73 (1982) (citing Capital Tel. Co. v. FCC, 498 F.2d 734, 738 (D.C. Cir. 1974)).

122. *See* United States v. Bestfoods, 524 U.S. 51, 63–64 (1998).

123. 524 U.S. 51 (1998).

124. *Id.* at 55.

125. *Id.*

'in order to abrogate a common-law principle, the statute must speak directly to the question addressed by the common law.'"[126] Accordingly, the government was not permitted under CERCLA to impose derivative liability on the parent corporation except by piercing the corporate veil of the subsidiary.[127] The Court did not address what law would govern the veil-piercing standard in any given case.

Anderson Petro-Equipment, Inc. v. State[128] is one recent case where a state was held to be empowered by statute to impose regulatory liability on an officer of the corporate operator of an oil well.[129] The Texas Railroad Commission brought an administrative action against Anderson Petro Equipment, Inc. to plug an abandoned well.[130] Meanwhile, before suit, Anderson Petro forfeited its corporate privileges with the state for failing to pay franchise taxes when due.[131] The state of Texas then sued Anderson Petro and its officer Curtis Ray Anderson to recover the costs of plugging the well. The trial court ordered that Anderson Petro and Anderson were jointly and severally liable for the plugging expenses, as well as attorneys' fees, costs, and interest.[132] Both defendants appealed arguing Anderson could not be held personally liable for Anderson Petro's debts.[133] Because Anderson Petro forfeited its corporate charter after the commission imposed liability on the company for plugging expenses, *Anderson Petro* did not squarely pose the question whether the Texas well-plugging statute could impose individual liability for plugging costs.[134] Rather, the issue was whether, if individual liability were so imposed, it was extinguished when the corporation forfeited its privileges.[135] The *Anderson Petro* court cited a statute contained in Texas's tax code making corporate officers liable for debts incurred by the corporation during the time period after the franchise tax came due, and before corporate privileges were revived.[136] The court thus held, without

126. *Id.* at 63 (quoting United States v. Texas, 507 U.S. 529, 534 (1993)) (internal brackets omitted).

127. *Id.* at 63–64 ("The Court of Appeals was accordingly correct in holding that when (but only when) the corporate veil may be pierced, may a parent corporation be charged with derivative CERCLA liability for its subsidiary's actions.").

128. No. 03-13-000176-CV, 2013 Tex. App. LEXIS 13075 (Tex. App. Oct. 22, 2013).

129. *Id.*

130. *Id.* at *3–4.

131. *Id.* at *2.

132. *Id.* at *1.

133. *Id.*

134. *Anderson Petro-Equipment, Inc.*, 2013 Tex. App. LEXIS 13075 *1 n.3.

135. *Id.* Texas case law contains a curious number of decisions (from 1994 alone) involving corporate oil and gas operators who were assessed plugging liability after forfeiting corporate privileges. *See, e.g.*, Cain v. State, 882 S.W.2d 515 (Tex. App. 1994); Jonnet v. State, 877 S.W.2d 520 (Tex. App. 1994); Serna v. State, 877 S.W.2d 516 (Tex. App. 1994).

136. *Anderson Petro*, 2013 Tex. App. LEXIS 13075, at *15 (citing TEX. TAX CODE ANN. § 171.255(a)).

analysis, that the state was empowered by the tax code provision to impose derivative liability for corporate obligations on Anderson.

Contrast *Anderson Petro* with a case from New York's highest court, *Morris v. State Department of Taxation & Finance*.[137] In *Morris*, the State Department of Taxation obtained an order against the president of a corporation for tax owed on the use of corporate assets in New York.[138] There was no statutory authorization for imposing derivative liability for corporate tax obligations on officers of the corporation. The New York Court of Appeals set aside the order on the basis that the State Department of Taxation could impose derivative liability only on a showing that the corporate veil should be pierced, and it failed to establish the necessary showing.[139] *Morris* applied New York's common law veil-piercing standard to the state's actions.[140]

McCall Stock Farms v. United States[141] is another case where the court required an administrative agency to apply a common law standard to pierce the veil of a corporation. In *McCall Stock Farms*, the Federal Circuit Court of Appeals upheld the Small Business Administration's ("SBA's") interpretation of the federal Debt Collection Act permitting the agency to invoke the alter ego doctrine to aid administrative offsets of loans made to corporate applicants.[142] However, "[s]ince the agency interpretation did not go so far as to articulate a specific test for determining alter ego status," the court reviewed the SBA's imposition of liability for an offset of a corporate loan on a constituent of the corporate borrower under a common law veil-piercing standard.[143]

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137. 623 N.E.2d 1157 (N.Y. 1993).

138. *Id.* at 1159–60.

139. *Id.* at 1163.

140. *See id.* at 1160–61 (setting forth the general rules for piercing the corporate veil under New York law). For a further discussion of sales tax liability of affiliate corporations, *see generally* Chris Reitz, Comment, *The Application of Kansas Sales Tax to Transactions Between Affiliated Companies*, 42 U. KAN. L. REV. 461 (1994).

141. 14 F.3d 1562 (Fed. Cir. 1993).

142. *Id.* at 1566–67.

143. *See id.* at 1567 (noting that the SBA did not articulate a specific test for determining alter ego status). The *McCall Stock Farms* court considered the imposition of derivative liability in that case to be "reverse" veil piercing, and devotes considerable attention to the propriety of reverse piercing. *See id*. at 1568–69. The court ultimately declined to hold reverse veil-piercing improper, which places *McCall Stock Farms* among the majority of courts on the issue. *See id.* at 1568. Kansas courts, on the other hand, appear not to allow reverse piercing. *See* Lemus v. Horizon Express, Inc., No. 99,034, 2008 Kan. App. Unpub. LEXIS 956, at *9 (Kan. Ct. App. Dec. 12, 2008). The Kansas Court of Appeals, in an unpublished and nonprecedential decision, stated its position as follows:

> Sometimes called "reverse veil-piercing" this concept would make a corporation liable on debts or actions of a shareholder except it was rejected by the United States Court of Appeals for the Tenth Circuit, which applied Kansas law in Floyd v. I.R.S., 151 F.3d 1295, 1298–1300 (10th Cir. 1998). We agree with the rationale and holding of the court in *Floyd.* As that court noted, to allow the collection of claims against individual shareholders from corporate assets would interfere with the legitimate expectations of corporate creditors, who naturally expect that the corporation's assets will be available to pay its obligations.

On first blush, *Anderson Petro*, *Morris*, and *McCall Stock Farms* might seem irreconcilable, but *Anderson Petro* and *Morris* are clearly distinguishable. In *Anderson Petro*, the state was empowered by express statutory authority to look beyond the corporate veil to impose regulatory liability on a corporate constituent.[144] In *Morris*, however, the state had no statutory authority to disregard the taxpayer's corporate form and therefore had to satisfy the common law veil-piercing standards that any private litigant would.[145] *McCall Stock Farms* complicates this clear dichotomy.[146] There, the administrative agency interpreted its statutory authority to permit it to disregard a debtor's corporate form but its interpretation did not go so far as to articulate a specific test for doing so.[147] Unlike the statute in *Anderson Petro*, which simply stated that the debts of a Texas corporation arising after franchise tax becomes due are imputed to the corporation's shareholders, the statute at issue in *McCall Stock Farms* did not expressly authorize summary veil piercing.[148] The agency thus had the authority to interpret the statute to allow piercing, but it also had the concomitant obligation of articulating a specific piercing standard.[149]

Applying these cases to Kan. Stat. Ann. § 55-155(c)(4), there is clear express authority for imputing the regulatory violations of the enumerated persons to a corporate applicant.[150] There is not express authority, however, for imputing to those enumerated individuals the regulatory violations of other corporate operators with whom the individuals are or were associated.[151] Under the theory of *Anderson Petro*, the Commission may arguably impute the violations of the corporate applicant's constituents to the applicant without satisfying any specific test. The

Id. at *9. The court further noted, "[i]f there is some limited circumstance in which reverse veil-piercing should be allowed, [the present] case certainly is not it." *Id.* at *9–10.

144. *See* Anderson Petro-Equip. Inc. v. State, No. 03-13-000176-CV, 2013 Tex. App. LEXIS 13075, at *9–10 (Tex. App. Oct. 22, 2013).

145. *See* Morris v. N.Y. State Dep't of Taxation & Fin., 623 N.E. 2d 1157, 1161–63 (N.Y. 1993).

146. *See McCall Stock Farms*, 14 F.3d at 1565–68.

147. *See id.* at 1566–67.

148. *See id.* at 1565.

149. *See id.* at 1565–67.

150. *See* KAN. STAT. ANN. § 55-155(c)(4) (2017). This provision states that to receive an operator license, an applicant must:

> [D]emonstrate[] to the commission's satisfaction that the following comply with all requirements of chapter 55 of the Kansas Statutes Annotated, and amendments thereto, all rules and regulations adopted thereunder and all commission orders and enforcement agreements, if the applicant is not registered with the federal securities and exchange commission: (A) The applicant; (B) any officer, director, partner or member of the applicant; (C) any stockholder owning in the aggregate more than 5% of the stock of the applicant; and (D) any spouse, parent, brother, sister, child, parent-in-law, brother-in-law or sister-in-law of the foregoing.

Id.

151. *See id.*

Commission lacks clear authority, however, to impute the violations of other operators to the applicant's constituents. Thus, under the theories of *Morris* and *McCall Stock Farms*, the Commission would have to articulate a specific standard to impute the liability of other operators to the applicant's constituents or apply the common law standard.

ii. Veil Piercing in Administrative Licensing Proceedings

In the business licensing context, even in the absence of express statutory authority for imposing derivative liability, courts have upheld license denials on the basis that agencies are not held to a strict standard in disregarding an applicant's corporate form.[152] In *Capital Telephone Co. v. FCC*,[153] for example, the circuit court affirmed the commission's denial of a "high-band paging" license to Capital Telephone Co.[154] Capital appealed, arguing the commission improperly pierced its corporate veil in reaching its decision without satisfying the prerequisites for veil piercing.[155] When Capital applied for an exclusive license of a certain frequency, its sole owner and president, Bakal, also separately applied in his personal capacity for an exclusive license of another frequency.[156] A third applicant, Air Page, applied for a license of the same frequency requested by Capital.[157] The commission granted Bakal's application but denied Capital's (granting the license instead to Air Page) on the basis that Capital was the alter ego of Bakal.[158]

According to the circuit court, "[t]he Commission recognized the injustice that would be done to Air Page if both the Bakal and Capital applications were granted. This would, in effect, grant to one individual the use of all the most desirable available high-band paging channels in the . . . area" and would leave Air Page left to compete with less desirable low-band channels.[159] "In this situation," the court continued, "to conform to what it considered to be a fair and equitable distribution of the available frequencies, the Commission took cognizance of the identity of interest between Bakal and Capital and pierced the corporate veil of Capital."[160] In affirming the commission's veil-piercing-by-fiat decision, the *Capital Telephone* court articulated the general principle that "courts

152. *See, e.g.*, Capital Tel. Co. v. FCC, 498 F.2d 734, 738 (D.C. Cir. 1974); S.O.U.P., Inc. v. FTC, 449 F.2d 1142, 1142 (D.C. Cir. 1971).
153. 498 F.2d 734 (D.C. Cir. 1974).
154. *Id.* at 735–36.
155. *Id.* at 738.
156. *Id.* at 736.
157. *Id.*
158. *Id.* at 736–37.
159. *Capital Tel.*, 498 F.2d at 736.
160. *Id.*

have consistently recognized that a corporate entity may be disregarded in the interests of public convenience, fairness and equity."[161] But it concluded:

> However, we need not pause to consider whether Capital would be Bakal's alter ego under the strict standards of the common law alter ego doctrine which would apply in a tort or contract action. The contest in this case is over a license in a regulated industry and the applicable standard appears in the statute, not in court decisions involving civil suits.[162]

The applicable licensing statute at issue in *Capital Telephone* stated in pertinent part that in considering applications for licenses, the commission "shall make such distribution of licenses . . . as to provide a fair, efficient, and equitable distribution of radio service to each of the same."[163] It appears that the statutory standard that supplanted the common law veil-piercing standard is simply that licenses are to be granted to foster a fair, efficient, and equitable distribution of radio service. Certainly, such a standard is less rigorous than any court's veil-piercing analysis would be. In other words, the commission was justified in disregarding Capital's corporate form to achieve an equitable distribution of radio service even though its actions would fail any common law standard.

The District of Columbia Circuit Court of Appeals has similarly upheld the Federal Trade Commission's denial of a nonprofit corporation's motion to proceed on appeal in forma pauperis because the corporation's members could personally afford the court costs.[164] In a very brief opinion affirming the Commission's ruling, the majority of the court stated only that it would not comply with the statute governing in forma pauperis appeals to grant the application.[165] Two of the court's panelists wrote in a concurring opinion[166] that "[t]he corporate form is a convenient, organizational vehicle, but its convenience does not justify

161. *Id.* at 738 (citing Taylor v. Standard Gas & Elec. Co., 306 U.S. 307, 322 (1939); Chi., Milwaukee & St. Paul Ry. Co. v. Minneapolis Civic & Commerce Ass'n, 247 U.S. 490, 500–01 (1918); Francis O. Day Co. v. Shapiro, 267 F.2d 669, 673–74 (D.C. Cir. 1959); United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, 255 (E.D. Wis. 1905)). The *Capital Telephone* court further clarified the rule in the following footnote: "Where the statutory purpose could be easily frustrated through the use of separate corporate entities a regulatory commission is entitled to look through corporate entities and treat the separate entities as one for purposes of regulation." *Id.* at 738 n.10 (citing Gen. Tel. Co. v. United States, 449 F.2d 846, 855 (5th Cir. 1971)).

162. *Id.* (citing *Gen. Tel. Co.*, 449 F.2d at 855; H.P. Lambert Co. v. Sec'y of Treasury, 354 F.2d 819, 822 (1st Cir. 1965); Mansfield Journal Co. (FM) v. FCC, 180 F.2d 28, 37 (1950); Cent. & S. Motor Freight Tariff Ass'n, 273 F. Supp. 823, 831–32 (D. Del. 1967)).

163. *Id.* at 737 (citing 47 U.S.C. § 307(b) (1970)).

164. S.O.U.P., Inc. v. FTC, 449 F.2d 1142, 1142 (D.C. Cir. 1971).

165. *Id.*

166. The opinion actually refers to this separate opinion as a "[s]tatement . . . in support of the order of the court." *Id.* (Fahy, J., concurring).

turning it into a vehicle also for avoiding the costs involved in a lawsuit as if it were a pauper."[167]

S.O.U.P., Inc. v. Federal Trade Commission[168] is notable, however, for Chief Judge Bazelon's dissent.[169] The dissent expressed concern that the majority's holding "may have the unfortunate effect of deterring the use of corporations as vehicles for raising issues of great public importance."[170] He further noted that "[n]othing in this record indicates that SOUP's effort to proceed in forma pauperis is in any way offensive to the public interest. Nor does anyone assert that its application is a sham or an abuse of this Court."[171]

The dissenting opinion in *S.O.U.P., Inc.* essentially weighed the public policy benefits of respecting the corporate entity and requiring formal veil piercing against the public policy costs of requiring the agency to undertake a full veil-piercing analysis. The *Capital Telephone* court appeared to engage in a similar, though less plainly articulated, analysis. Public policy is not, in contrast, one of the numerous considerations contained in Kansas's common law veil-piercing test. Indeed, the public policy consideration in agency piercing cases seems to take the place, to an extent, of the equitable consideration in common law cases. In the context of regulated industries, sound public policy will usually counsel in favor of disregarding corporate formalities without undertaking a formal veil-piercing analysis, even where to do so would undermine the accepted economic policies underpinning limited liability.

What may be most troubling about administrative veil-piercing in licensing cases is the lack of procedure. As illustrated above, regulatory agencies are often not required to follow a particular substantive test in determining whether to disregard a corporate licensee's formal entity in licensing proceedings. It must be noted that traditional licensing cases, like *Capital Telephone*, merely involve the granting or denial of a license rather than the affirmative imposition of liability on a corporate constituent. In this sense, they are not true veil-piercing cases although they do involve the disregard of a corporate form. They are also distinguishable from the Commission's application of Kan. Stat. Ann. § 55-155(c)(4) in that the Commission not only denies a license by ignoring corporate formalities but also effectively imposes affirmative regulatory liability. The fact that cases like *Capital Telephone* and *S.O.U.P., Inc.* do not involve liability imputation likely explains in part

167. *Id.*
168. 449 F.2d 1142 (D.C. Cir. 1971).
169. *Id.* at 1145 (Bazelon, C.J., dissenting).
170. *Id.*
171. *Id.*

why those courts did not require greater procedural or substantive protections of the applicant.

B. Constraints Imposed Under Constitutional Law

When an agency adjudicates an application for a business license, it is deciding whether to grant a government benefit.[172] In 1970, in *Goldberg v. Kelly*,[173] the United States Supreme Court recognized a duty under the Fourteenth Amendment to review the process by which agencies make decisions granting or revoking government benefits.[174] The Fourteenth Amendment provides that no state shall "deprive any person of life, liberty, or property, without due process of law."[175] Unless there has been an interference with one of the specified interests—life, liberty, or property—no due process requirement exists.[176] In other words, the existence of a protected interest is the trigger for due process protections. In analyzing agency adjudications of government benefits, courts ask if a decision requires due process review at all before asking what process is due.[177]

1. Determining Whether a Protected Interest Exists

The first step—determining whether any process is due—depends on whether a life, liberty, or property interest is at stake. In answering this question, courts have focused on the breadth of the decisionmaker's discretion and the extent, if any, to which it is limited by rules or standards.[178] Ironically, where agencies are granted broad discretion to provide or revoke an interest, courts do not impose due process requirements in addition to the statutory or regulatory requirements governing the action.[179] Yet the more limited the agency's discretion (or, stated another way, the more confining on the agency the applicable statutory or regulatory standards), the more likely courts are to impose due process requirements.[180] One explanation for this seeming paradox is that

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172. Tim Searchinger, Note, *The Procedural Due Process Approach to Administrative Discretion: The Courts' Inverted Analysis*, 95 YALE L.J. 1017, 1017 (1986).

173. 397 U.S. 254 (1970) (*superseded by statute as stated in* Hudson v. Bowling, 752 S.E.2d 313, 321–22 (W. Va. 2013)).

174. Goldberg v. Kelly, 397 U.S. 254, 262–63 (1970).

175. U.S. CONST. amend. XIV, § 1. The Kansas Constitution also provides certain due process rights. *See* KAN. CONST. § 18 ("All persons, for injuries suffered in person, reputation or property, shall have remedy by due course of law, and justice administered without delay.").

176. Linda L. Munden, Comment, *Retail Liquor Licenses and Due Process: The Creation of Property Through Regulation*, 32 EMORY L.J. 1199, 1202 (1983).

177. Searchinger, *supra* note 172, at 1017.

178. *Id.* at 1017–18.

179. *Id.*

180. *Id.* at 1020. Searchinger continues:

due process protects only those interests the government has induced people to rely on by creating a justifiable expectation that a benefit will be provided upon the satisfaction of specific criteria.[181] A "reasonable expectation[]" of a benefit is not enough to trigger due process unless there is a "mutual understanding" between the government and the applicant that the benefit will be provided.[182] In other words, to create a protectable life, liberty, or property interest, the expectation a benefit will be provided must be legitimized, or justified, by a government promise that it will be conferred upon satisfaction of definite criteria.[183]

Courts often refer to government benefits that do not rise to a protected property right as "privileges." [184] If a benefit is merely a privilege, it is terminable or revocable without process when it ceases to serve the public interest.[185] Differentiating between a privilege and a right

> If parole boards, business licensing commissions, or social security officials exercise standardless discretion, unencumbered by procedures, and without obligations to explain their decisions, they have no constitutional obligation to follow careful procedures. But if they already implement specific statutory, regulatory or internal standards and procedures, they must also follow the extra requirements of due process. In *Hewitt v. Helms*, Justice Rehnquist noted the paradox of inferring due process rights from procedural rules: "The creation of procedural guidelines to channel the decisionmaking of prison officials is, in the view of many experts in the field, a salutary development. It would be ironic to hold that when a State embarks on such desirable experimentation it thereby opens the door to scrutiny by the federal courts, while States that choose not to adopt such procedural provisions entirely avoid the strictures of the Due Process Clause."

Id. at 1021–22 (citing *Hewitt v. Helms*, 459 U.S. 460, 471 (1983)).

181. *Id.* at 1034–35. This so-called "reliance theory" has been criticized as a justification for courts' approaches to granting due process only where agency decisions are bound by standards or rules. *See id.* at 1034–36.

182. Leis v. Flynt, 439 U.S. 438, 442–43 (1979) (finding that respondents had a reasonable expectation that they would be permitted to represent their clients in Ohio courts, but that the rules of the Ohio Supreme Court did not create a mutual understanding that permission would be granted because authority to approve a *pro hac vice* application was consigned to the discretion of the trial court). As discussed in this Section, a mutual understanding may arise by statutory language requiring the state to grant a license where certain minimum criteria are met. *See, e.g.*, Rydd v. State Bd. of Health, 451 P.2d 239, 247–48 (1969) (holding a licensee for a day care center had a protectable property interest in the license because the license was one which the state must grant if the applicant meets certain minimum requirements).

183. *Leis*, 439 U.S. at 442–43. Another commentator has observed that courts are more likely to find an entitlement (e.g., a property interest) where the benefit possesses many characteristics traditionally associated with property, such as "the right to possess the thing, to use and manage it, to collect any income it generates, to sell it or give it away and keep the capital, to be secure from expropriation by others, and to transmit it to one's successors." Munden, *supra* note 176, at 1203. Per Munden, "[w]hen licenses carry a large number of the rights described in [this] model, they are more clearly property interests that will trigger the due process clause." *Id.* at 1204.

184. *See* Steve Oxenhandler, Comment, *Taxicab Licenses: In Search of a Fifth Amendment, Compensable Property Interest*, 27 TRANSP. L.J. 113, 117 (2000); *e.g.*, Rocky Mt. Rogues, Inc. v. Town of Alpine, 375 F. App'x 887, 894–95 (10th Cir. 2010) ("There is no vested right in a licensee to continue in the liquor business beyond the expiration of the date of the license under which he operates. A liquor license is a mere privilege, which is at all times in the control of the legislature.") (quoting Albertson's, Inc. v. City of Sheridan, 33 P.3d 161, 167–68 (Wyo. 2001)).

185. *See* Robert H. Nelson, *Private Rights to Government Actions: How Modern Property Rights Evolve*, 2 U. ILL. L. REV. 361, 362 (1986).

often turns on courts' interpretations of the statute creating the expectation of the government benefit. A statute that endows the licensing agency with unfettered discretion in granting applications does not create in the applicant a legitimate claim to a property interest in the license.[186] In contrast, where the license sought is one that the state must grant if the applicant meets certain minimum requirements, courts will find a legitimate claim of entitlement and thus a protectable property interest in the license.[187]

Two Kansas cases illuminate the dividing line between a licensing statute that creates a privilege and one that creates a property interest.[188] In *Kansas Racing Management, Inc. v. Kansas Racing Commission*,[189] applicants for a license under the Kansas Parimutuel Racing Act to operate a greyhound or horse racing business appealed the Kansas Racing Commission's denial of their application in favor of another applicant.[190] The relevant issue on appeal was whether the Commission violated the applicants' due process rights by refusing to disclose investigative reports conducted on the applicants' constituents and provide the applicants an opportunity to present evidence and witnesses regarding the reports.[191]

As in the typical case, the court began its due process analysis by questioning whether the applicants had a property or liberty interest in being awarded a license such that the procedural or substantive requirements of due process would attach.[192] The Act granted the Commission discretion in granting greyhound or horse racing licenses. The court excerpted the pertinent provision as follows:

186. *See* Kan. Racing Mgmt., Inc. v. Kan. Racing Comm'n, 770 P.2d 423, Syl. ¶ 5 (Kan. 1989).

187. Zimmerman v. Bd. of Cty. Comm'rs, 264 P.3d 989, 1002 (Kan. 2011) (citing *Kan. Racing Mgmt., Inc.*, 770 P.2d at 432).

188. *See id.*

189. 770 P.2d 423 (Kan. 1989).

190. *Id.* at 426–27.

191. *Id.* The Act permitted the Commission to receive criminal and background investigative information on applicants and their constituents for purposes of determining an applicant's qualifications for licensure. *Id.* at 428–30 (citing KAN. STAT. ANN. § 74-8804(n)–(o) (1988)).

192. *Id.* at 431–32. Although not directly relevant to the instant discussion, the applicants' argument that they had a liberty interest is worth noting. The argument focused on the effect of the investigative reports received by the Commission on the reputations of the applicants. *Id.* at 433. The court stated the general rule as follows:

> The concept of "liberty" is broad and includes the freedom to work and the protections of the person's good name. A person may [not] be deprived of a "liberty" interest without due process if that person's standing in the community is damaged; if his reputation, honor, or integrity are questioned; or if a stigma or other disability is imposed upon him which forecloses his freedom to obtain and hold another job.

Id. (internal citations omitted). The court found no evidence that the applicants were stigmatized by the investigative reports. *Id.* It found they were not prejudiced in similar applications in other states because the Commission's decision to deny their Kansas licenses was discretionary and not based on their unfitness. *Id.*

> If an application is found to be in compliance [with the provisions of the Act] and the commission finds that the issuance of a license would be within the best interests of horse and greyhound racing within this state from the standpoint of both the public interest and the horse or greyhound industry, *as determined solely within the discretion of the commission*, the commission *may* issue an organization license to the applicant.[193]

The court summarized the statute thusly, "[i]n other words, the Commission is not statutorily required to grant an organizational license even though the applicant is found to be in compliance with statutory requirements."[194] Because the Commission had no obligation to grant a license to any applicant, regardless of the sufficiency of the application, applicants could have only a unilateral expectation of receiving a license that could not give rise to a legitimate claim of entitlement to a license.[195]

While there was no legitimate claim to entitlement to a license, the court noted that the Act created a property interest in the *renewal* of a license that was previously granted.[196] The court construed a provision in the Act granting a licensee the right to judicial review of a decision to deny renewal of the license as creating a property interest in the licensee.[197] It concluded that "if the Commission refuses to renew that license, the holder has a protected right to notice and a due process hearing."[198]

In reaching its holding, the *Kansas Racing Management* court distinguished the earlier case *Rydd v. State Board of Health*,[199] where the court found a legitimate claim of entitlement to an award of a daycare license.[200] *Rydd* involved the Board of Health's denial of the applicant's application without notice or a hearing.[201] The reason given for the denial was that the applicant would "not be able to give the proper amount of time" to the children nor "be of the proper temperament for looking after

193. *Id.* at 427 (quoting KAN. STAT. ANN. § 74-8813(e) (1988)) (modification and emphasis in original).

194. *Id.*

195. *Kan. Racing Mgmt.*, 770 P.2d at 433. The court cited *Curtis Ambulance v. Shawnee Cty. Bd. of Comm'rs*, in which the Tenth Circuit Court of Appeals declined to recognize a property interest in a disappointed low bidder for a county contract because underlying state law permitted the county to exercise discretion in awarding or rejecting bids. 811 F.2d 1371, 1384–85 (10th Cir. 1987). Because the county's authority to reject bids was not "sufficiently circumscribe[d]," by statute or other law, the bidder could not establish a "mutually explicit understanding" giving rise to a legitimate claim of entitlement to the contract. *Id.*

196. *Kan. Racing Mgmt.,* 770 P.2d at 434.

197. *Id.* (quoting KAN. STAT. ANN. § 74-8815(l) (1988)).

198. *Id.*

199. 451 P.2d 231 (Kan. 1969).

200. *Id.*

201. *Id.* at 241.

children."[202] *Rydd* held the applicant was entitled to due process of law in adjudication of her license application, because she had a legitimate expectation of receiving the license, and that due process in this context required notice and an opportunity for a hearing *before* the board rendered its decision on the application.[203] According to the court in *Kansas Racing Management*, the result in *Rydd* was justified, because "the license for a day care center was within the category of licenses which the State *must* grant if the applicant meets certain minimum requirements."[204] Therefore, *Rydd* differs from *Kansas Racing Management*, because the applicant in *Rydd* had a justified claim of entitlement to a license.[205]

2. Procedural Due Process Requirements

Where courts find a property interest in a government benefit, like a business license, the analysis turns to what process is due under the Fourteenth Amendment. Due process has two components: procedural and substantive.[206] This Section will focus on the procedural component.

The essence of procedural due process is reasonable notice and an opportunity to be heard.[207] It has been posited that process's value is "that it minimizes the risk of 'error' in the 'truthfinding process.'"[208] Other commentators argue "process values" are broader and include protecting individual dignity, equality, and responsiveness to a "democratic morality's demand for participation in decisions affecting individual and group interests."[209] Maximum procedural due process would encompass all the elements of a criminal proceeding, including the rights to notice, a neutral tribunal, confront and cross-examine witnesses, present evidence, assistance of counsel, and a speedy and public jury trial.[210] But, the scope

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202. *Id.*

203. *Id.* at 246.

204. *Kan. Racing Mgmt*., 770 P.2d at 432 (emphasis added).

205. *See* Zimmerman v. Bd. of Cty. Comm'rs, 264 P.3d 989, 1002, Syl. ¶ 10 (Kan. 2011) (discussing *Rydd* and *Kansas Racing Management*, holding that "[a]n applicant has no vested rights in a conditional use permit when its issuance depends upon the discretionary approval of a governmental authority.").

206. Albright v. Oliver, 510 U.S. 266, 272 (1994).

207. Goldberg v. Kelly, 397 U.S. 254, 267–68 (1970).

208. *See* Searchinger, *supra* note 172, at 1036 (quoting Mathews v. Eldridge, 424 U.S. 319, 335 (1976)).

209. Toni M. Massaro & Thomas L. O'Brien, *Constitutional Limitations on State-Imposed Continuing Competency Requirements for Licensed Professionals*, 25 WM. & MARY L. REV. 253, 293 n.149 (1983) (quoting Jerry L. Mashaw, *The Supreme Court's Due Process Calculus for Administrative Adjudication in* Mathews v. Eldridge: *Three Factors in Search of a Theory of Value*, 44 U. CHI. L. REV. 28, 49–50 (1976)). This criticism is particularly directed toward the Supreme Court's procedural due process analysis under *Mathews v. Eldridge*. *Id; see infra* text accompanying notes 216–217.

210. *See* Munden, *supra* note 176, at 1204; Massaro & O'Brien, *supra*, note 209, at 292.

of the due process requirement depends on the particular facts of each case.[211]

The Supreme Court set forth the fundamental principles of procedural due process in *Goldberg v. Kelly*.[212] The Court explained that the extent to which procedural due process must be afforded is "influenced by the extent to which [the recipient] may be 'condemned to suffer grievous loss,'" and "whether the recipient's interest in avoiding that loss outweighs the governmental interest in summary adjudication."[213] Accordingly, consideration of what procedural due process may require under any given set of circumstances must begin with a determination of the precise nature of the government function involved as well as of the private interest that has been affected by governmental action.[214]

Goldberg clarified that "[i]n a wide variety of situations, it has long been recognized that where harm to the public is threatened, and the private interest infringed is reasonably deemed to be of less importance, an official body can take summary action pending a later hearing."[215] Later, in *Mathews v. Eldridge*,[216] the Court articulated a more specific framework for procedural process that is still followed today. *Eldridge* explained that determination of the procedural due process that must be afforded in a given case turns on three factors: (1) the private interest that will be affected, (2) "the risk of an erroneous deprivation of such interest through the process used," and (3) the probable value of additional or substitute procedural safeguards.[217]

211. Massaro & O'Brien, *supra*, note 209, at 292.

212. 397 U.S. 254 (1970).

213. *Id.* at 262–63 (1970) (quoting Joint Anti-Fascist Refugee Comm. v. McGrath, 341 U.S. 123, 168 (1951) (Frankfurter, J., concurring)).

214. *Id.*

215. *Id.* at 263 n.10 (quoting R.A. Holman & Co. v. SEC, 299 F.2d 127, 131 (D.C. Cir. 1962)). *Goldberg* held that an evidentiary hearing must precede the termination of welfare benefits. *Id.* at 266. The important factor was the impact on the welfare recipients after termination of their benefits because the recipients relied on the benefits for basic necessities like food and shelter. *Id.* at 265. Massaro and O'Brien synthesized the *Goldberg* Court's definition of an evidentiary hearing as involving:

> [T]imely and adequate notice detailing reasons for the proposed termination; an effective opportunity to defend by confronting adverse witnesses and presenting arguments and evidence; retained counsel, if desired; an impartial decisionmaker; a decision resting solely on the legal rules and evidence adduced at the hearing; and a statement of reasons for the decision and the evidence on which the decisionmaker relied.

Massaro & O'Brien, *supra* note 209, at 293 n.144 (citing *Goldberg*, 397 U.S. at 266–71).

216. 424 U.S. 319 (1976).

217. *Id.* at 335; *accord.* Darling v. Kan. Water Office, 774 P.2d 941, 945 (Kan. 1989) (citing Morrissey v. Brewer, 408 U.S. 471, 481 (1972); *Eldridge*, 424 U.S. at 335). *Eldridge* held that termination of disability benefits requires only a post-termination hearing. *Eldridge*, 424 U.S. at 323. The Court recognized that disability benefits recipients had other sources of income, making the disabled worker's need "less than that of a welfare recipient." *Id.* at 342; *cf. Goldberg*, 397 U.S. at 265.

A court evaluating the procedural aspects of the Kansas Corporation Commission's denials of license renewals would apply the *Eldridge* standard. The Kansas Supreme Court has noted, in dicta, that the appropriate procedure for adjudications of denial of license renewals is notice and a pre-denial hearing on the grounds for denial.[218] Before specifically discussing what procedural safeguards the Commission should follow in denying an operator license based on the regulatory history of the applicant's constituents in their personal and representative capacities with other licenses, it is necessary to review the requirements of substantive due process in general and in cases of government-imposed vicarious or indirect liability.

3. Substantive Due Process Requirements

Due process is not merely a procedural safeguard. Intertwined with the concept of procedural due process is substantive due process.[219] Roughly defined, substantive due process is "the constitutional guaranty that no person shall be deprived of his life, liberty, or property for arbitrary reasons, such a deprivation being constitutionally supportable only if the conduct from which the deprivation came is proscribed by reasonable legislation . . . reasonably applied."[220] Substantive due process thus protects a person from arbitrary action, "and the applicable standard is one of reasonableness."[221]

Early Kansas cases have applied this test of reasonableness to statutes intended for the regulation of oil and gas activities. In *State v. Lebow*,[222] the court articulated the general principle that "the test of validity [of a statute] within the police power is whether or not the regulations prescribed are reasonable."[223] The test of reasonableness "is whether the

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218. Kan. Racing Mgmt., Inc., v. Kan. Racing Comm'n, 770 P.2d 423, 434 (Kan. 1989).

219. *See* McDonald v. City of Chicago, 561 U.S. 742, 861–62 (2010) (Stevens, J., dissenting). Justice Stevens's conception of substantive due process is as "a forward-looking methodology" that considers "the sociopolitical landscape of a modern society." Lahny R. Silva, *In Search of a Second Chance: Channeling BMW v. Gore and Reconsidering Occupational Licensing Restrictions*, 61 U. KAN. L. REV. 495, 513 (2012) (citing *McDonald*, 561 U.S. at 876–77, 873).

220. Darling v. Kan. Water Office, 774 P.2d 941, 945–46 (Kan. 1989) (citing 16A AM. JUR. 2D *Constitutional Law* § 816 (1979)).

221. Vaughan v. Kan. State Bd. of Nursing, 2016 WL 758348, at *13 (Kan. Ct. App. 2016); *see also* Searchinger, *supra* note 172, at 1032–33 ("One argument might be that substantive due process protects only against discrimination and that a fundamental liberty right to be free from discrimination emanates from the due process clauses or from other constitutional guarantees. But the term 'discrimination' has little inherent meaning. The right to be free from discrimination is only the right not to be disadvantaged for invidious or arbitrary reasons. In *Department of Agriculture v. Moreno,* for example, the Supreme Court applied the due process clause to strike down a law governing the distribution of welfare benefits solely because it distinguished between potential recipients 'without any rational basis.' The only liberty right at stake was the right not to be disadvantaged arbitrarily.").

222. 280 P. 773 (Kan. 1929).

223. *Id.* at 775.

attempted regulation makes efficient constitutional guarantees and conserves rights, or is destructive of inherent rights."[224] It further requires there be "some clear, real, and substantial connection between the assumed purpose of the enactment and the actual provisions thereof."[225] *Lebow* upheld, under the Fourteenth Amendment, a statute making it unlawful to permit salt water or oil to escape onto the ground from a well against an attack under substantive due process, finding that the state had the police power to protect the purity of streams, wells, and lakes from pollution, and that the instant statute had a "clear, real, and substantial connection" with this purpose.[226]

In *Winkler v. Anderson*,[227] the Kansas Supreme Court similarly upheld the constitutionality of a statute imposing a minimum setback requirement for newly drilled oil and gas wells from railroad rights of way.[228] The court acknowledged that enforcement of the statute would render the plaintiff's oil and gas lease "entirely valueless," but found that the state had a legitimate interest in protection of railway rights of way from being impeded by oil and gas operations in furtherance of the common convenience, prosperity, and welfare.[229] The court held the statute's requirements were reasonable in light of the state's interest in regulating oil and gas development.[230]

To synthesize these principles, substantive due process analysis requires "a case-by-case balancing of the nature of the individual interest infringed, the importance of the government interest furthered, the degree of infringement and the sensitivity of the government entity responsible for the action to more carefully tailored alternative means of achieving its goal."[231] At its heart, substantive due process analysis is a balancing of the governmental interest at stake in a particular case with the individual interest at stake. If the government's interest is substantial enough to

224. *Id.*
225. *Id.* at 775.
226. *Id.* at 776.
227. 177 P. 521 (Kan. 1919).
228. *Id.* at 521.
229. *Id.* at 522 (citing State v. Wilson, 168 P.679, 682 (Kan. 1917)).
230. *Id.* Regarding the potential effects of oil and gas activity, the court noted,

> [W]hile oil and gas wells are not nuisances *per se,* and the business of drilling and operating them is ordinarily legitimate and harmless, it is conceivable that they may become detrimental in a high degree. The greed for mineral in a rich field becomes insatiate. Steam and electric railway rights of way may be exploited, and unless the works, structures, establishments, activities and products of mining operations be kept at a safe distance from railway tracks, life and property might be endangered, commerce impeded, and the general welfare seriously affected.

Id.

231. Darling v. Kan. Water Office, 774 P.2d 941, 946 (Kan. 1989) (citing Zablocki v. Redhail, 434 U.S. 374 (1978)).

justify infringing the individual's life, liberty, or property interest, the government may do so in a manner that is rationally related to the government's interest.[232]

i. Substantive Due Process and Administrative Licensing

Licenses granted to any applicant that meets the statutory criteria are the least protected.[233] Relatedly, the more traditional property characteristics a license has (e.g., exclusive possession and use; right to transfer), the stronger the protections it receives from due process.[234]

Professor Lahny Silva has explored another aspect of due process in the context of licensing adjudications: the effect of the licensee's past conduct.[235] Silva argues that state occupational licensing policies that disqualify applicants on the basis of their nonviolent criminal histories violate due process requirements articulated by the Supreme Court in *BMW of North America v. Gore.*[236] *Gore* established the constitutional standard for substantive due process review of punitive damages awards.[237] In *Gore*, the Court considered both the procedural due process limitations on punitive damages awards and the substantive limitations on the amount of awards. The procedural due process principle developed under *Gore* "established a fair notice test for reviewing civil penalties. Lower courts are to consider (1) whether the person received fair notice that her conduct will subject her to punishment, and (2) whether she received fair notice of the severity of the penalty that a state may impose for that conduct."[238] As for substantive due process limitations, the Court evaluated the reasonableness of the punitive damages judgment and set forth three "guideposts" for lower courts to follow in evaluating similar awards and awards of civil penalties:

> (1) the degree of reprehensibility of the defendant's conduct, (2) the ratio of punitive damages to the actual and potential harm that the plaintiff and other conceivable victims suffered, and (3) an inquiry into how punitive damage awards compare with the civil and criminal penalties that had been or could be imposed for comparable misconduct.[239]

232. *See* Washington v. Glucksberg, 521 U.S. 702, 728 (1997).
233. *Id.* at 1200–01, 1209–14.
234. *Id.* at 1202–05; *see also* Oxenhandler, *supra* note 184, at 116–17.
235. *See generally* Silva, *supra* note 219.
236. 517 U.S. 559 (1995); Silva, *supra* note 219, at 500–01.
237. Silva, *supra* note 219, at 522.
238. *Id.* at 523.
239. *Id.* (citing *Gore*, 517 U.S. at 578–86) (internal citations omitted).

Silva urges that these same procedural and substantive safeguards be applied in adjudications of occupational license applications.[240] Silva's analysis would recognize the fact that most criminal offenders are not given fair notice of the collateral consequences (such as future disqualification for an occupational license) that a criminal conviction entails.[241] She would also have agencies apply the *Gore* guideposts in determining whether to restrict licensing on the basis of a past criminal conviction by considering: (1) the reprehensibility of the underlying conduct, (2) the proportionality of the severity of the underlying criminal conduct to the harm to the applicant of license denial, and (3) the affect, if any, such a criminal history would have under other jurisdictions' licensure policies.[242] Although Silva's analysis is limited to the collateral consequences of criminal convictions in licensure proceedings, it is instructive to the present discussion. Like the class of license applicants Silva discussed, applicants for operator licenses or renewals of licenses before the Commission are often denied on the basis of their history of regulatory compliance (or the histories of persons deemed associated with the applicants).

ii. Due Process Where Statute Imposes Derivative Liability

Maine's highest court considered the circumstances under which the state may constitutionally impose vicarious liability on one legal person for the acts of another in *Portland Pipe Line Corp. v. Environmental Improvement Commission*.[243] In *Portland Pipe Line*, an oil pipeline corporation and ten major oil companies brought a declaratory judgment action seeking a determination that Maine's Coastal Conveyance Act violated substantive due process (facially and as applied) by imposing "absolute" vicarious liability on oil terminal facilities for spills caused by oil carriers "destined for" the facility.[244] Under the Act, the state "need only plead and prove the fact of the prohibited discharge or other polluting

240. *Id.* at 530.
241. *Id.* at 531.
242. *Id.* at 532–33.
243. 307 A.2d 1 (Me. 1973).
244. *Id.* at 10–11 (citing ME. STAT. tit. 38, § 552 (1970)). The plaintiffs also argued the Act's procedural provisions were inadequate under procedural due process. *Id.* at 14–16. The Act provided for an "informal" arbitration proceeding where rules of evidence were not binding to determine terminal operators' vicarious liability for acts of carriers. *Id.* at 14. *Portland Pipe Line* recited the familiar rules of procedural due process that a "judicial proceeding is not an element of due process[,] procedural due process requires no particular form of procedure[, and t]he rules of evidence are not binding on administrative bodies as they are empowered by statute to receive evidence not ordinarily admissible in judicial proceedings." *Id.* (citations omitted). The court declined to rule on the plaintiff's procedural due process claim, however, because the commission had not yet adopted arbitration procedures or conducted arbitrations. *Id.*

condition and that it . . . was attributable to carriers or others for whom the licensee [terminal] is responsible."[245]

Plaintiffs argued that vicarious liability may be imposed without violating due process guarantees only in cases where there is "a control relationship" between the acting party and the person held liable.[246] Because the plaintiff pipeline company and oil companies did not necessarily have a control relationship with oil carriers destined for their terminals,[247] they asserted that they were protected by due process from absolute vicarious liability for the acts or omissions of such carriers.[248] The court disagreed because "in our view the 'control relationship' cases cited by plaintiffs are not an exhaustive list of instances where vicarious liability may be constitutionally imposed."[249] The court cited *Atlantic Coast Line Railroad v. Riverside Mills*,[250] a Supreme Court case upholding the constitutionality of the Carmack Amendment, under which a railroad receiving goods to be shipped over multiple rail lines was made liable for damage to the goods while in the hands of subsequent carriers.[251] The amendment imposed vicarious liability on initial rail carriers, thereby abrogating both common law principles and typical contract provisions between carriers that would have limited an initial carrier's liability for goods once they passed beyond its line.[252] The *Atlantic Coast Line* Court upheld the amendment's imposition of vicarious liability as constitutional.[253]

The Supreme Court's reasoning in *Atlantic Coast Line* is critical to understanding *Portland Pipe Line* and the operation of substantive due process in regulation of industry. Per the *Portland Pipe Line* court:

245. *Id.* at 10 (citing ME. STAT. tit. 38, § 552).

246. *Id.* at 17.

247. By way of background, the court explained the relationship of the plaintiff pipeline company and oil companies in a footnote:

> Pipe Line does not own, charter, or have control of any of the vessels destined for its terminal. Since it is a common carrier it may not refuse to transport the oil tendered at its South Portland terminal. It has no possessory interest in the oil. The oil companies, in varying degrees, receive oil from vessels not owned, leased or controlled by them. Some of these terminals off-load oil owned by other companies. Thus Pipe Line, and to some extent the other plaintiffs, are held liable for acts of vessels in which they have no ownership interest and over which they exercise no control. Insofar as the Pipe Line is concerned, it engages in an involuntary relationship with the ships destined for its terminal because of its inability to refuse to off-load and transport the cargoes of these vessels.

Id. at 17 n.30.

248. *Id.* at 17.

249. *Portland Pipe Line*, 307 A.2d at 17.

250. 219 U.S. 186 (1911).

251. *Id.* at 205.

252. *Id.* at 196.

253. *Id.* at 207.

> The Court stressed the mutually advantageous relationship of the railroads. Although independently managed, they were cooperating in a profit-making enterprise. The Court saw no constitutional infirmity in imposing liability on one railroad for the acts of another in order to further a valid public policy. That policy was to facilitate recovery by a shipper who would be otherwise forced to determine on what line the damage to his goods occurred and maintain litigation in a distant forum.[254]

The government policy to facilitate shippers' recoveries was sufficient to justify imposition of vicarious liability.[255] For the *Portland Pipe Line* court, the "seeming inequity" of the *Atlantic Coast Line* holding is understandable in view of the "business association" among railroad carriers.[256] The railroads "had the facilities and were free to institute procedures where, among themselves, primary liability could be accurately located."[257] Thus, according to the Maine Supreme Court:

> *Atlantic Coast Line* stands for the proposition that government, in further a valid policy, may constitutionally impress vicarious liability on one party to a 'business association' for the acts of another party to that association, where the party held liable has the means, within the association, to ultimately place primary liability upon the party causing the loss.[258]

The *Portland Pipe Line* court synthesized the following rule: it is constitutional under substantive due process for the state to impose vicarious liability on a party engaged in business for the acts of a business associate when (1) both parties "are engaged in a mutually beneficial relationship," (2) within the relationship there is adequate opportunity to locate the primary liability among the business associates, and (3) the imposition of liability is in furtherance of a valid public policy.[259] Applying this framework to the vicarious liability provision of the Coastal Conveyance Act, the court found the Act's prime purposes were the speedy settlement of third-party claims and clean-up of oil spills, both of which were furthered by the imposition of vicarious liability.[260] Curiously, however, the court did not specifically find that carriers and terminals were engaged in a mutually beneficial business association in which the associates could locate primary liability. On the contrary, the court noted that because carrier vessels move in and out of Maine waters

254. *Portland Pipe Line*, 307 A.2d at 18.
255. *Id.*
256. *Id.*
257. *Id.*
258. *Id.*
259. *See id.* at 18–19.
260. *Portland Pipe Line*, 307 A.2d at 19.

they may not always be amenable to suit.[261] The *Portland Pipe Line* court nevertheless upheld the statutory imposition of vicarious liability under substantive due process because "the imposition of vicarious liability was a reasonable method of furthering" the objectives of the Act.[262]

C. Administrative Law Constraints

As an administrative agency, the Commission's actions are subject to constraints imposed by judicial review and principles of administrative law. The two seminal cases concerning review of agency actions by the judicial branch are *Abbott Laboratories v. Gardner*[263] and *Citizens to Preserve Overton Park, Inc. v. Volpe*.[264] In *Abbott Laboratories*, the Supreme Court held the law provides for judicial review of final agency actions to one "suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute," and the right to judicial review will not be cut off unless "there is persuasive reason to believe that such was the purpose of Congress."[265] *Overton Park* expanded the rule, holding there is a presumption of reviewability for agency actions even where the decision may have been discretionary with the agency.[266]

In Kansas, the review of agency actions is conducted exclusively under the Kansas Act for Judicial Review and Civil Enforcement of

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261. *Id.*

262. *Id.* State long-arm statutes represent another type of statutory imposition of derivative liability. The federal courts of Kansas generally hold that little or no showing of alter ego status or veil-piercing factors is necessary to assert personal jurisdiction over corporate affiliates under the state's longarm statute. *See* Grimandi v. Beech Aircraft Corp., 512 F. Supp. 764, 771 (D. Kan. 1981); Energy Reserves Grp. v. Superior Oil Co., 460 F. Supp. 483, 489–90 (D. Kan. 1978). Writing in 1978, the Federal District Court for the District of Kansas announced:

> This Court today concludes that alter ego principles no longer play any proper role in the analysis of the constitutional propriety of the exercise of jurisdiction properly invoked by service authorized by statute. This Court further concludes that because of the broad wording of the Kansas long-arm statute, and because of the liberal interpretation to be given its literal reach, alter ego principles play no viable role in the construction and applicability of that statute and consequently do not restrict those who might be reached for service thereunder.

Superior Oil Co., 460 F. Supp. at 490. The District of Kansas distinguished the propriety of piercing the corporate veil from the constitutional propriety of the exercise of jurisdiction. *Id.* at 506–07. Whereas piercing the veil rests on a number of corporate law factors necessitating analysis of the nature of the relationship, and degree of control or identity, between the corporate person and its owners, exercising jurisdiction merely requires the existence of the relationship itself. *Id.* As a consequence, while the mere existence of a relationship between corporate entities would not suffice to disregard their corporate forms, it is enough to constitutionally treat the entities as one under a state long-arm statute. *See id.*

263. 387 U.S. 136 (1967), *superseded by statute*, S. Rep. No. 91-1196, at 40, *as recognized in* Lubrizol Corp. v. Train, 547 F.2d 310, n.22 (6th Cir. 1976).

264. 401 U.S. 402 (1971).

265. *Abbott Labs.*, 387 U.S. at 140 (quoting 5 U.S.C. § 702) (internal quotation marks omitted).

266. *Overton Park*, 401 U.S. at 410.

Agency Actions.[267] Generally, the Act entitles a person to judicial review of any final agency action. Non-final agency action is generally not reviewable except where "[i]t appears likely that the person will qualify . . . for judicial review of the related final agency action," and "postponement of judicial review would result in an inadequate remedy or irreparable harm disproportionate to the public benefit derived from postponement."[268] The Act sets forth eight grounds for review of agency action.[269] The most frequently cited ground for review of agency action is subparagraph 8, "the agency action is otherwise unreasonable, arbitrary or capricious."[270] In Kansas, arbitrary or capricious conduct can be shown where an administrative order is not supported by "evidence that is substantial."[271] Substantial evidence is evidence that "possesses both relevance and substance, and which furnishes a substantial basis of fact from which the issues can be reasonably resolved."[272] In general, this standard has been held to mean the agency must express the basic facts on which it relies "with sufficient specificity to convey to the parties, as well as to the court, an adequate statement of the facts which persuaded the agency to arrive at its decision."[273] However, "[f]indings of ultimate fact expressed in the language of the applicable statute are not enough in the absence of basic findings to support them."[274]

Accordingly, the Commission must support its licensing decisions by substantial evidence and convey the factual basis for its decisions to the affected parties. In sum, given the corporate and constitutional limitations on the Commission's power in this context, it would not satisfy the standards of the Kansas Act for Judicial Review and Civil Enforcement of Agency Actions to simply state in an order denying a license application that the applicant was found to be "associated" with an entity that is in regulatory noncompliance.[275]

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267. KAN. STAT. ANN. §§ 77-601 to -630 (2009).
268. KAN. STAT. ANN. § 77-608 (1984).
269. KAN. STAT. ANN. § 77-621(c) (2009).
270. KAN. STAT. ANN. § 77-621(c)(8).
271. KAN. STAT. ANN. § 77-621(c)(7).
272. Kan. Racing Mgmt., Inc. v. Kan. Racing Comm'n, 770 P.2d 423, 438–39 (Kan. 1989) (quoting *In re* Petition of City of Shawnee for Annexation of Land, 687 P.2d 603, 619 (Kan. 1984)).
273. Blue Cross of Kan., Inc. v. Bell, 607 P.2d 498, 504–05 (Kan. 1980).
274. *Id.* at 505 (citing Cities Serv. Gas Co. v. State Corp. Comm'n, 440 P.2d 660, 668 (Kan. 1968)).
275. *See supra* note 2.

IV. PROPOSING A STANDARD FOR DISREGARDING CORPORATE FORMALITIES IN OPERATOR LICENSING IN KANSAS

This Section proposes a procedural and a substantive standard for the Commission to satisfy before denying a new or renewal operator license application under Kan. Stat. Ann. § 55-155(c)(4) based on the liability of an applicant's constituent for the regulatory noncompliance of another operator. These standards are synthesized from the competing public policies at stake in these licensing cases, and the principles of corporate, constitutional, and administrative law surveyed above. This Section argues for a factor test requiring the Commission to balance the competing policies and establish either the culpability of an individual with some degree of management control over the applicant, or a business association between the applicant and the operator primarily liable for the underlying regulatory violation within which the applicant can locate the primary liability for the violation with the operator.

A. Identifying the Competing Policies

The Commission's power to deny applications for new and renewal operator licenses pursuant to Kan. Stat. Ann. § 55-155(c)(4) is clearly not absolute. It is subject to constraints imposed under corporate, constitutional, and administrative law principles. The extent of each of these constraints is not perfectly clear in Kansas law. Under corporate law principles, the Commission cannot invade the limited liability of the applicant, and other corporate licensed operators with which the applicant is associated, absent a showing that the harm of disregarding the corporate form is outweighed by the public good of doing so.[276] Under due process considerations, the Commission cannot deprive an applicant of its constitutionally protected right to an operator license unless justified by a countervailing legitimate governmental interest in protecting the public welfare.[277] And under administrative principles, the Commission cannot impose liability on a license applicant for a regulatory violation committed by one licensed operator without showing that it may do so within the limits of its statutory authority and basing its decision on substantial evidence.[278]

Each of the three categories of constraints on the state requires the Commission to balance the public policy benefits of respecting applicants' corporate separateness against the public policies protected by the

276. *See supra* Part III.A.
277. *See supra* Part III.B.
278. *See supra* Part III.C.

Commission's authorizing statutes and regulations. There are a number of competing public policies at stake in any case where the Commission seeks to impose liability for a regulatory infraction of another licensee on an applicant for a new or renewed operator license. These primarily include:

> (1) the protection of usable groundwater and surface water from pollution by unplugged wells or drainage into unplugged wells;[279]
>
> (2) the economic benefits of limited liability, to which courts and commentators have attributed diversification, liquidity, market efficiency, and the very existence of publicly traded corporations;[280]
>
> (3) the protection of the public and environment from negative externalities of oil and gas development;[281] and
>
> (4) the administrative costs of requiring the Commission to satisfy the common law veil-piercing standard employed by Kansas courts.[282]

With these competing public policies in mind, the following subsections will turn to synthesizing a procedural and substantive standard for the Commission to apply in balancing these policies in licensing proceedings.

B. Whether Applicants Have a Property Interest in a License

To enjoy the protections of due process, an applicant must first establish it has a property interest in the license. Kansas authority is fairly clear that a legitimate claim of entitlement to a license exists if the licensing statute ensures any applicant will receive a license upon satisfying certain enumerated requirements.[283] Like the licensing statute in *Rydd*, the statute under which the Commission grants operator licenses, Kan. Stat. Ann. § 55-155, is "within the category of licenses which the State *must* grant if the applicant meets certain minimum requirements."[284] Kan. Stat. Ann. § 55-155 states in pertinent part:

279. *See supra* Part II.B.
280. *See supra* Part III.A.1.
281. *See* Winkler v. Anderson, 177 P. 521, 522 (Kan. 1919); State v. Lebow, 280 P. 773, 775 (Kan. 1929).
282. *See* S.O.U.P., Inc. v. F.T.C., 449 F.2d 1142, 1145 (D.C. Cir. 1971) (Bazelon, C.J., dissenting).
283. *See supra* Part III.B.1 (citing Zimmerman v. Bd. of Cty. Comm'rs, 264 P.3d 989, 1002 (Kan. 2011)).
284. Kan. Racing Mgmt., Inc. v. Kan. Racing Comm'n, 770 P.2d 423, 432 (Kan. 1989) (emphasis added).

> (b) Every operator and contractor shall file an application or a renewal application with the [C]ommission. Application and renewal application forms shall be prescribed, prepared and furnished by the [C]ommission.
>
> . . . .
>
> (e) Upon the approval of the application or renewal application, the [C]ommission shall issue to such applicant a license which shall be in full force and effect until one year from the date of issuance or until surrendered, suspended or revoked as provided in K.S.A. 55-162, and amendments thereto.[285]

The plain language of Kan. Stat. Ann. § 55-155 does not empower the Commission to exercise any discretion whatsoever in deciding to grant an application that satisfies the enumerated requirements. Rather, like the licensing statute at issue in *Rydd*, the statute conditions receipt of an operator license on satisfaction of the enumerated requirements. Kan. Stat. Ann. § 55-155 thus provides a "mutual understanding" that applicants who satisfy the enumerated requirements will receive a license. Applicants for original and renewal operator licenses clearly have a legitimate claim of entitlement to, and therefore a protectable property interest in, a license. This conclusion is burnished by the Commission's regulations. Under Kan. Admin. Regs. § 82-3-120(i), "A denial [of an application] pursuant to K.S.A. 55-155(c)(3) or (4), and amendments thereto, shall be considered a *license revocation*," which would clearly entail a present property interest.[286] Determining that applicants possess a protected property interest in a license does not, of course, end the analysis. It remains to be determined what procedural and substantive protections applicants enjoy in the license, as well as what limited liability protection applicants have in their corporate form.

C. Synthesizing a Procedural Rule for Applying Kan. Stat. Ann. § 55-155(c)(4)

In fashioning a procedural due process standard, courts consider the following factors: (1) the private interest that will be affected by the agency's action; (2) the risk of an erroneous deprivation of such interest through the procedures used and the probable value of additional or substitute procedural safeguards; and (3) the governmental interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.[287] The amount of weight given to the first factor depends on the nature of the

285. KAN. STAT. ANN. § 55-155(b), (e) (2015).
286. KAN. ADMIN. REGS. § 82-3-120(i) (2010) (emphasis added).
287. Mathews v. Eldridge, 424 U.S. 319, 335 (1976).

protected property right at stake.[288] In general, business licenses that are granted to any applicant who satisfies the enumerated application requirements enjoy a lower level of protection relative to licenses that are granted to a limited number of applicants.[289] Being a license granted to any qualified applicant, the Kansas operator license—though undoubtedly a protected property interest—likely deserves relatively low procedural protections.

Nevertheless, the Commission's regulations specify that when an application is denied on the basis of the liability imputation provision of Kan. Stat. Ann. § 55-155(c)(4), the denial is to be treated as a license revocation.[290] Under Kansas precedent, license revocations require at least notice of the grounds for the revocation and a pre-revocation hearing.[291] The precise procedures, such as evidentiary standards and burdens of proof, are less well defined. It appears a license revocation hearing at the Commission would be governed by the Kansas Administrative Procedure Act ("KAPA"),[292] which provides specific procedures.[293]

The procedural protections provided by a pre-revocation hearing held in accordance with KAPA would satisfy the constraints of procedural due process on the Commission's power to deny a license on the grounds of imputed liability for a regulatory violation. The fact that an operator license may be granted to any number of qualified applicants weighs against requiring any greater procedural protections.

D. Synthesizing a Substantive Standard for Applying Kan. Stat. Ann. § 55-155(c)(4)

Even if the Commission holds a pre-revocation hearing on the denial of a license under Kan. Stat. Ann. § 55-155(c)(4) and follows the procedures required by KAPA, it still may not arbitrarily deprive a license applicant of a license in violation of substantive due process. In this case, substantive due process requires, at a minimum, that the Commission find the existence of a connection between the applicant and the regulatory violation and that the severity of the regulatory noncompliance is significant enough to justify the effects on the applicant of denying the license application. The connection between the applicant and the responsible operator may be shown through the culpability of the

288. *See supra* text accompanying notes 224–226.
289. *See supra* text accompanying notes 224–226.
290. KAN. ADMIN. REG. § 82-3-102(i).
291. *See* Kan. Racing Mgmt., Inc. v. Kan. Racing Comm'n, 770 P.2d 423, 434 (Kan. 1989).
292. Kansas Administrative Procedure Act, KAN. STAT. ANN. §§ 77-501, to -566 (2018).
293. *See* KAN. STAT. ANN. § 55-162(a)(5) (2018).

applicant's constituent or through a business association with the operator primarily liable for the violation. The standard synthesized below ensures this minimum protection by requiring the Commission to consider multiple factors designed to achieve an equitable balancing of the competing public policies set forth above in Part IV.A.

When the state seeks to enforce a statute, substantive due process essentially requires the state establish: (1) that enforcement of the statute has for its object the preservation of "the public health, safety, morals, or general welfare" and is within the scope of legislative power; and (2) that enforcement is reasonable, based on balancing the rights of persons subject to the statute with the government's interest.[294] Further, the state must be sensitive to more carefully tailored alternative means of achieving its goal.[295]

When the Commission denies a license application under Kan. Stat. Ann. § 55-155(c)(4), the nature of the interest infringed is a protected property right in the license.[296] The "strength" of this property interest, however, may be diminished by the fact that licenses are granted to any applicant that satisfies the minimum statutory requirements.[297] The degree of the infringement is nevertheless serious. Denial of an operator license means the applicant is denied the right to pursue certain economic activities. The Commission has acknowledged the seriousness of denial of a license renewal under Kan. Stat. Ann. § 55-155(c)(4) by equating it with a license revocation.[298]

The state has a clear, legitimate interest in regulating the oil and gas industry. The Kansas Supreme Court has lamented that regulation is often necessary to preserve the public welfare from some negative externalities of oil and gas development.[299] The state has a specific public policy protecting useable groundwater from oil pollution from gas development, as well as a policy against abandoned and unplugged wells as a nuisance.[300] After establishing a legitimate government interest in the enforcement of Commission statutes and regulations—especially those

294. *See* State v. Lebow, 280 P. 773, 775 (Kan. 1929); *see generally supra* Part III.C.3 (surveying the requirements of substantive due process law in general and in the context of administrative licensing). Substantive due process analysis requires a "case-by-case balancing of the nature of the individual interest infringed, the importance of the government interest furthered, the degree of infringement and the sensitivity of the government entity responsible for the action to more carefully tailored alternative means of achieving its goal." Darling v. Kan. Water Office, 774 P.2d 941, 945–46 (Kan. 1989) (citing Zablocki v. Redhail, 434 U.S. 374 (1978)).

295. *Darling*, 774 P.2d at 946.

296. *See supra* Part IV.B.

297. *See supra* Part IV.B.

298. KAN. ADMIN. REGS. § 82-3-120(j) (2002).

299. *See* Winkler v. Anderson, 177 P. 521, 522 (Kan. 1919).

300. KAN. STAT. ANN. § 55-156 (2018).

pertaining to well plugging—the question turns to whether the Commission may reasonably impute the regulatory failures of "associated" operators to a license applicant.

One consideration in determining the reasonableness of imputing regulatory liability of other operators to applicants is whether the action is carefully tailored to achieve the government interest at stake.[301] This requires the Commission establish a connection between the applicant and the imputed regulatory violation that would either (a) make the applicant culpable for the violation or (b) allow the applicant a means of allocating the ultimate liability for the violation with the operator primarily responsible. The Commission may establish such a connection in a number of different ways. For instance, it would establish culpability with the applicant to show that the individual associated with the applicant under Kan. Stat. Ann. § 55-155(c)(4) is directly personally liable under a Commission order for a regulatory violation.[302]

Alternatively, the associated individual may be found to be indirectly liable for the regulatory violation. This could mean that the Commission determines after a hearing that the individual as an officer, director, manager, owner, or employee of the operator responsible for the violation is personally liable for the violation because she exercised control over the subject matter of the violation or otherwise acted wrongfully. It could also mean that the Commission determines after a hearing that the individual, as an owner of the operator responsible for the violation, is personally liable for the violation because the operator was merely her alter ego and she used the corporate form to perpetuate an injustice.

In lieu of showing that the applicant is culpable for the underlying violation, the Commission may satisfy the reasonableness requirement by establishing that the applicant is in a business association with the operator primarily liable for the violation and that it has the ability, within the relationship, to locate ultimate liability on the appropriate operator, as in *Portland Pipe Line*.[303]

A second consideration in determining the reasonableness of the Commission's application of the statute is whether there is alternative means of achieving the same government interest that entails a lesser degree of infringement on individual rights.[304] Kansas law provides a number of alternative means of enforcing well-plugging liability and

301. *See* Darling v. Kan. Water Office, 774 P.2d 941, 946 (Kan. 1989).

302. *See* Kan. Comm'n on Civil Rights v. Serv. Envelope Co., 660 P.2d 549, 555 (Kan. 1983) (requiring a corporate constituent to be individually named in a Commission order to justify enforcing the order against the constituent).

303. *See* Portland Pipe Line Corp. v. Envt'l Improv. Comm'n, 307 A.2d 1, 18 (Me. 1973).

304. *See Darling*, 774 P.2d at 946.

ensuring plugging of wells. One such alternative for ensuring plugging of a well would be the plugging fee funds.[305] This alternative may be particularly appropriate, instead of imposing derivative liability on an applicant for another operator's violations, where the operator primarily responsible for the well is defunct, dissolved, or bankrupt. In such a case, it is not possible for the applicant to ultimately place liability for the well on the person primarily responsible.

Finally, as articulated by Professor Silva, reasonableness requires application of substantive due process principles similar to those set forth in *Gore*.[306] Initially, these principles require that the Commission consider whether the applicant had fair notice that the past regulatory violations of its constituents (and those other persons identified in Kan. Stat. Ann. § 55-155(c)(4)) may be imputed to the applicant, and that the violations of corporate operators with which those constituents were associated may be imputed to the constituents individually. In all likelihood, neither the applicant nor any of its constituents would have such notice unless the constituent was culpable for the violation (either by her own wrongdoing or as a person who exercised control over the subject matter of the violation).

The *Gore* principles applied in this context would also require the Commission to consider (1) the severity of the underlying regulatory violation and (2) the proportionality of the severity of the violation to the harm a denial of the license would cause the applicant.[307] If, as the Supreme Court held, these considerations, or "guideposts," are appropriate in determining the reasonableness of a punitive damages award, they must also be appropriate in determining whether an applicant for an operator license should be punished for the regulatory noncompliance of another operator.[308]

From these various principles, we can distill the following eight factors to guide the Commission in imputing the regulatory failures of "associated" operators to license applicants. To impute the noncompliance of another operator to the applicant under Kan. Stat. Ann. § 55-155(c)(4), the Commission should consider:

> (1) the existence of a Commission order naming the individual associated with the applicant as primarily liable for the underlying regulatory violation;
>
> (2) whether the individual committed any wrongdoing relating to the regulatory violation or otherwise exercised such control over

305. *See supra* text accompanying notes 23–24.
306. *See supra* Part III.B.3.a.
307. *See generally supra* Part III.B.3.a.
308. BMW of N. Am. v. Gore, 517 U.S. 559, 574 (1995).

> the subject matter of the violation as to be considered personally liable as an operator;
>
> (3) whether the individual may be personally liable for the violation under the common law doctrine of alter ego or veil piercing;
>
> (4) the extent of the individual's managerial control of the applicant;
>
> (5) the existence of a business association between the applicant and the operator primarily responsible for the regulatory violation and the ability of the applicant to locate primary liability for the violation with that operator;
>
> (6) whether the applicant or the individual associated with the applicant had fair notice that the regulatory violation may cause the Commission to deny a subsequent license application;
>
> (7) the severity of the regulatory violation; and
>
> (8) the proportionality of the severity of the violation to the harm a denial of the license would cause the applicant.

It is not necessary the Commission establish each factor to deny a license application under subsection (c)(4). Certain factors deserve greater weight than others. In particular, factors (1)–(3), when present, should weigh strongly in favor of imputing the regulatory violation to the licensee. This analysis requires the Commission to show more than the mere association of a corporate applicant with one of individuals identified in Kan. Stat. Ann. § 55-155(c)(4) and the individual's association with a noncompliant operator. It requires showing either culpability of the associated individual for the underlying regulatory violation—through her own wrongdoing or her control of the subject matter of the violation or the noncompliant operator—or a business association between the applicant and the noncompliant operator that would enable the applicant to place ultimate liability for the violation where it justly belongs.

Where no such culpability or business association exists, the Commission's police powers to regulate the oil and gas industry do not justify piercing the corporate veil of the applicant and also of the operator originally responsible for the violation.[309] Further, where the Commission cannot establish a business association in which the applicant may locate primary liability for a well-plugging violation, we believe the Commission already has adequate alternative means of enforcing the government's interest in plugging the well in the form of the plugging fee fund.

Consider the following hypothetical scenario. ABC, Inc. applied for an operator license and was denied under Kan. Stat. Ann. § 55-155(c)(4)

309. It should be noted that the piercing in this scenario is actually a reverse piercing because it attributes the regulatory noncompliance of a corporate constituent to the corporate applicant.

on the basis that its treasurer was formerly a director of XYZ, LLC, which has an abandoned well on its operator license. XYZ was liquidated in Chapter Seven bankruptcy proceedings five years ago and its liability for plugging any wells was discharged.[310] The evidence showed that ABC's treasurer, while a director of XYZ, had no direct personal responsibility for the unplugged well. Under these facts, there is no evidence to support the individual culpability of ABC's treasurer. Nor is there evidence of a business association between ABC and XYZ by which ABC could locate primary liability for the well to XYZ because XYZ was liquidated. In this case, the unplugged well is truly orphaned and a good candidate for plugging under the state's plugging fee fund. It would be unnecessary and unreasonable to make ABC liable for the well.

The test also requires the Commission to weigh the severity of the underlying regulatory violation against the significance of denying an operator license to an applicant who otherwise satisfies the statutory requirements. Consider, for instance, a case where the underlying regulatory violation relates to responsibility for a shallow abandoned, unplugged oil well in eastern Kansas. If the evidence at the pre-revocation hearing showed that there is little to no useable groundwater in the vicinity of the well, such that the well does not seriously threaten groundwater pollution, the Commission should find that factors (7) and (8) weigh against denying the license. Consider also a case involving a large corporation that operates hundreds of wells across the state. In general, larger entities have more officers, directors, and owners, and thus have a greater risk of suffering imputed regulatory liability under subsection (c)(4). Denial of a large operator's license renewal may have far-reaching effects in terms of the number of leases, amounts of money, and number of employees and contractors potentially involved. Are the consequences of denying such an operator's license renewal on the basis of imputed liability justified by the severity of the underlying regulatory violation? It would seem not, at least where the violation is one or a few unplugged wells. Of course, the relative burden of plugging a few wells may be small for large corporations. Thus, when analyzing factors (7) and (8), the Commission should bear these considerations in mind. It should also consider the potential impact such imputation may have on other large operators' perceptions of the state's regulatory and business climate.

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310. *See* NCL Corp. v. Lone Star Bldg. Ctrs., Inc., 144 B.R. 170, 177 (S.D. Fla. 1992) (noting response costs related to prepetition releases are generally discharged in bankruptcy); *see, e.g.*, In re Sandridge Energy, Inc., No. 16-32488 (DRJ), 2016 Bankr. LEXIS 4622, at *105–07, *260–62 (Bankr. S.D. Tex. Sept. 20, 2016) (approving plan of reorganization in which prepetition plugging liability is discharged).

It could be argued that imposing a multifactorial standard on the denial of new and renewal license applications under Kan. Stat. Ann. § 55-155(c)(4) would add administrative burdens to the Commission. Undoubtedly it would require greater administrative costs to require the Commission to hold a pre-revocation evidentiary hearing to determine whether the state can satisfy any standard. But these costs are more than justified by the important public policies at stake in the applicant's rights in the license and the limited liability of its corporate form. Based on its decision in *Agricultural Energy Services*, the Commission appears willing to undertake greater administrative burdens to avoid arbitrarily denying an operator license on the basis of another operator's regulatory noncompliance.[311] On balance, the benefits to public policy of imposing a test such as is proposed above is justified by the administrative burden it entails.

V. CONCLUSION

The state of Kansas has an undeniable interest in the protection of fresh, usable groundwater and surface water from pollution by unplugged wells. It has a further interest in the licensing and regulation of oil and gas operators. But, as the Commission itself found in *Agricultural Energy Services*, its previous unprincipled application of the licensing statute to impose well-plugging liability on operators with no culpability for the well nor meaningful association with the responsible operator is not a reasonable exercise of its power. The principles of limited liability and due process are too important to allow the Commission to disregard the legal separateness of oil and gas operators without examination of the facts or policies at stake in any given case. The Commission should not altogether cease to impute well-plugging liability to operator applicants following *Agricultural Energy Services*. Instead, it should do so under a standard like the one proposed in this article that places liability for unplugged wells and other regulatory violations on a culpable person and balances the competing policies underpinning corporate, constitutional, and administrative law in Kansas.

311. Agriculture Energy Servs., Docket No.: 17-CONS-3529-CMSC, 2018 Kan. PUC LEXIS 125, *11 (Kan. Corp. Comm'n Jan. 23, 2018).