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Gloria's Ranch, L.L.C.: Louisiana Appellate Court Holds Mineral Lessees and Lender Solidarily Liable for Damages Under the Louisiana Mineral Code for Failure to Release Mineral Lease and Pay Royalties

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The Louisiana Second Circuit Court of Appeal in Shreveport, Louisiana decided *Gloria's Ranch, L.L.C. v. Tauren Exploration, Inc.*[1] on June 2, 2017, holding mineral lessees and their lender solidarily liable for damages for failure to release a mineral lease and pay royalties. Although the Second Circuit concluded that the "case is highly fact-intensive and should not be construed as governing other cases that may follow unless the same facts exist,"[2] the potential negative impact of the decision cannot be overstated. As the two judges who were in favor of reversing the decision on rehearing noted in their aggressive dissent, "[t]he majority opinion has far-reaching implications on the banking industry as well as the oil and gas industry."[3]

The Second Circuit's solidary liability holding in *Gloria's Ranch* is important to the banking and oil and gas industries for at least two reasons. First, lenders, faced with the possibility of being held solidarily liable with oil and gas companies, will likely be hesitant to make loans to the oil and gas industry, which, as the dissent on rehearing noted, will have "a most chilling effect on their businesses."[4] Second, mineral lessees owning only a percentage interest in a lease can be, as solidary obligors, required to pay damages arising from the failure to release a lease in its entirety, including damages for lost leasing opportunities encompassing an entire lease. The only source of relief being the ability to pursue contribution from other solidary obligors or seeking a reduction of the damages amount in the virile portion of any solidary obligor who may have settled with the plaintiff.[5]

Factual Background and Ruling of the District Court

In 2004, Gloria's Ranch, L.L.C. ("Gloria's Ranch") granted a mineral lease (the "Lease") covering five sections in Caddo Parish, Louisiana, to Tauren Exploration, Inc. ("Tauren"). In 2006, Tauren assigned an undivided 49% interest in the Lease to Cubic Energy, Inc., now known as Cubic Louisiana, L.L.C. ("Cubic").[6]

Tauren and Cubic borrowed money from Wells Fargo Energy Capital, Inc. ("Wells Fargo") in 2007, each executing separate credit agreements.[7] Although Tauren's credit agreement was not included in the record,[8] the Second Circuit's decision states that Cubic received a revolving credit facility not to exceed $20 million outstanding at any time and a $5 million convertible term loan. As security, Cubic mortgaged

[1] 51,077 (La. App. 2 Cir. 6/2/17); 223 So.3d 1202.

[2] *Id.* at 1225.

[3] *Id.* at 1226 (Dissent, Bleich J. (Pro Tempore)).

[4] *Id.* at 1225 (Dissent, Bleich J. (Pro Tempore))

[5] This article focuses on the Second Circuit's decision to uphold the trial court's finding of solidary liability as to the mineral lessees and lender, but the Second Circuit's decision also addressed termination of a lease for failure to produce in paying quantities and failure to pay royalties under the Louisiana Mineral Code. To review the Second Circuit's analysis of these issues, *see id.* at 1210-1213 (failure to produce in paying quantifies) and 1215-1218 (failure to pay royalties).

[6] *Id.* at 1207. After the trial court entered its judgment, Cubic Energy, Inc. filed for bankruptcy. After the effective date of the bankruptcy judgment, March 1, 2016, Cubic Louisiana, L.L.C. was substituted as defendant. *Id.* at 1210 n.8.

[7] *Id.*

[8] *Id.* at 1208 n.4.

its interest in various mineral leases with landowners, including Gloria's Ranch, and collaterally assigned the profits therefrom (the "Cubic Mortgage").[9]

Under Cubic's credit agreement with Wells Fargo, the borrowed money had to be used for certain purposes (for example, drilling) and Wells Fargo retained the right, among other things, to approve (i) the location and depth of wells; (ii) Cubic's entry into new operating agreements or amendments of the original operating agreement, and (iii) Cubic's alienation of its oil and gas lease rights. Wells Fargo, however, did not obtain a working interest in the Lease.[10]

In November 2009, Tauren assigned its interest in the deep rights of the Lease to EXCO USA Asset, Inc. ("EXCO"), with Tauren maintaining a 51% interest in the shallow rights. At the same time, Cubic assigned to Tauren an overriding royalty interest in its 49% interest in the deep rights.[11]

As a result of the EXCO sale, Tauren made a cash payment to Wells Fargo; assigned Wells Fargo a 10% net profits interest in its shallow rights interest in the Lease; and assigned to Wells Fargo a portion of the overriding royalty interest in the deep rights in the Lease it had received from Cubic. In return, Wells Fargo cancelled the mortgage affecting Tauren's interest in the Lease.[12]

Later, in December 2009, Gloria's Ranch sent a letter to Tauren, Cubic, EXCO, and Wells Fargo requesting information regarding the Lease, and expressing its belief that the Lease had terminated, in whole or in part, for lack of production in paying quantities.[13] Unsatisfied with Tauren's reply, Gloria's Ranch sent a second later dated January 28, 2010 demanding that Tauren, Cubic, EXCO, and Wells Fargo present a recordable act evidencing termination of the Lease.[14]

When Gloria's Ranch did not receive a release of the Lease, it filed a lawsuit against all four entities – Tauren, Cubic, EXCO, and Wells Fargo ("Defendants'"). Gloria's Ranch argued that the Lease had terminated in 2009, in whole or in part, for failure to produce in paying quantities and that Defendants' failure to release the Lease prevented Gloria's Ranch from leasing the property to others, damaging it in the amount of bonus payments, rentals, and royalties it would have received. Gloria's Ranch later amended its Petition to include a claim for unpaid royalties on the grounds that if the trial court found the Lease was maintained in the fifth section by well production, the Defendants had failed to pay royalties.[15]

Before trial, Gloria's Ranch settled with EXCO, granted it a new lease, and dismissed it from the lawsuit (the "EXCO Settlement").[16]

After a four-day bench trial, the trial court issued a written judgment that the Lease had terminated in its entirety. But, in its oral reasons, the trial court concluded that in only four of the five sections the Lease had terminated for lack of production in paying quantities. As for the fifth section, the trial court concluded that Gloria's Ranch was entitled to payment for unpaid royalties and punitive damages for failure to pay upon written notice of nonpayment.[17] Although the trial court's oral reasons did not

9 *Id.* at 1207-08.

10 *Id.* at 1223.

11 *Id.* at 1208.

12 *Id.* at 1208.

13 *Id.* at 1208-09.

14 *Id.* at 1209.

15 *Id.* at 1209.

16 *Id.* at 1209.

17 *Id.* at 1209.

specifically cancel the fifth section, on appeal, the Second Circuit refused to revise the written judgment on the grounds that a sufficient basis existed for the trial court to find damages (royalty payments) alone were insufficient such that the fifth section should be cancelled as well.[18]

With respect to damages, the trial court held that *all* remaining defendants – Tauren, Cubic, and Wells Fargo – were solidarily liable for damages and attorneys' fees. The trial court held that the mineral lessees were solidarily liable without discussion, but it did address its decision to hold Wells Fargo solidarily liable with the mineral lessees.[19]

The trial court found Wells Fargo solidarily liable with the mineral lessees for four reasons: (i) the Cubic Mortgage contained an assignment of the Lease to Wells Fargo; (ii) the Cubic Mortgage provided that Cubic could not release the lease without prior consent from Wells Fargo; (iii) Tauren had assigned Wells Fargo an overriding royalty and net profits interest in the Lease; and (iv) Wells Fargo received cost information from Tauren and Cubic and regularly audited their records.[20]

The trial court originally granted damages against Tauren, Cubic, and Wells Fargo as follows: (i) $22,806,000 for lost leasing opportunities in three sections ($18,000 per acre for 1,267 acres);[21] (ii) $242,029.26 for unpaid royalties from the fifth section; (iii) $484,058.52 as a penalty for failure to pay royalties due from the fifth section; and (iv) attorneys' fees and expert costs.[22]

After damages were awarded, Tauren, Cubic, and Wells Fargo filed motions for new trial, and the trial court granted them in part to reduce the damage awards by 25% to account for the EXCO Settlement.[23]

The Second Circuit Affirms the Trial Court's Decision

Tauren, Cubic, and Wells Fargo, each asserting separate assignments of error, appealed but the Second Circuit affirmed the trial court's judgment.

With respect to the cancellation of the Lease, the Second Circuit affirmed the trial court's decision on the grounds that (i) in four of five sections, the Lease terminated for lack of production in paying quantities[24] and (ii) in the fifth section, the Lease terminated for failure pay royalties due.[25]

Only Tauren and Wells Fargo appealed the trial court's decision to hold them solidarily liable for damages, but the Second Circuit, as discussed below, was not persuaded by their independent arguments. Cubic did not appeal the trial court's decision regarding solidary liability.

18 *Id.* at 1217-18.

19 *Id.* at 1219.

20 *Id.* at 1219.

21 The trial court did not award lost leasing damages for the fourth section because Gloria's Ranch had granted a top lease to another entity. *Id.* at 1209 n.7. Additionally, it appears that because of the discrepancy between the trial court's oral reasons for judgment and the written judgment with respect to the cancellation of the fifth section, the fifth section was not included in the calculation of lost leasing opportunity damages. From a reading of the case, it does not appear that Gloria's Ranch appealed this discrepancy.

22 *Id.* at 1209.

23 *Id.* at 1209.

24 *Id.* at 1213.

25 *Id.* at 1217-18. Although the trial court's oral reasons did not specifically cancel Section 15, the Second Circuit rejected the argument to revise the written judgment (which held the entire Lease cancelled without excluding the fifth section) on the grounds that a sufficient basis existed for the trial court to find damages (royalty payments) alone were insufficient such that the fifth section should be cancelled as well. *Id.*

When reviewing the Second Circuit's opinion with respect to solidary liability, it is important to note that at the time Gloria's Ranch sent its January 28, 2010 demand letter requesting a release of the Lease, Tauren owned a 51% undivided interest in the shallow rights; EXCO owned a 51% undivided interest in the deep rights; and Cubic owned a 49% interest in the shallow and deep rights. And although Wells Fargo held a mortgage over Cubic's interest in the Lease, as well as an overriding royalty and net profits interest in the Lease, it was not a working interest owner.[26]

The Second Circuit's Holding that All Mineral Lessees Are Solidarily Liable, and Arguments in Response to the Holding

On appeal, Tauren argued that it should only be held responsible for damages related to its interest in the Lease.[27] In other words, Tauren argued that the trial court erred in finding it liable for damages related to interests it did not own.

The Second Circuit, in addressing Tauren's argument, conducted a review of basic principles of solidary liability under the Louisiana Civil Code and liability under the Louisiana Mineral Code, but failed to conduct a thorough application of those principles to the facts at hand.

Citing Article 1788 of the Civil Code, the Second Circuit noted that "[w]hen different obligors owe together just one performance to one obligee, but neither is bound for the whole, the obligation is joint for the obligors."[28] The Second Circuit further referenced Articles 1815 and 1789, stating that "[a]n obligation is indivisible when the object of the performance, because of its nature or because of the intent of the parties, is not susceptible of division,"[29] and "[w]hen a joint obligation is indivisible, joint obligors are subject to the rules governing solidary obligors."[30]
With respect to the Mineral Code, the Second Circuit, citing the comments to Article 168, concluded that a "lessee's interest in a mineral lease, like any other 'thing,' is susceptible of co-ownership."[31] The Second Circuit also cited Article 206 of the Mineral Code, noting that it "requires the former owner of the mineral right to furnish a recordable act evidencing the expiration of the right within 30 days of receiving a written demand from the person in whose favor the right has been extinguished,"[32] and stating that "[w]hether or not a defendant is a 'former owner' of the lease is a mixed question of law and fact . . . ."[33]

Noting that Tauren held a 51% working interest in the shallow rights of the lease, the Second Circuit held that Tauren was "clearly a former co-owner of the lease," and, as such, "was obligated to provide Gloria's Ranch with a recordable act evidencing the expiration of <u>its</u> interest in the lease."[34]

But, despite the Second Circuit's acknowledgment that Tauren could only release "<u>*its*</u> interest in the lease,"[35] the Second Circuit held that Tauren should be responsible for damages relating to the entire lease on the grounds that Gloria's Ranch had demanded "release from the *entire lease* for failure to

[26] *Id.* at 1218.

[27] *Id.* at 1219.

[28] *Id.* at 1218 (citing La. Civ. Code art. 1788).

[29] *Id.* at 1218 (citing La. Civ. Code art. 1815).

[30] *Id.* at 1218 (citing La. Civ. Code art. 1789).

[31] *Id.* at 1218 (citing La. R.S. 31:168, official comment).

[32] *Id.* at 1219 (citing La. R.S. 31:206).

[33] *Id.* at 1219 (citing *Armenia Coffee Corp. v. Am Nat. Fire Ins.*, 2006-0409 (La. App. 4 Cir. 11/21/06); 946 So.2d 249, 253, *writ denied*, 2006-2983 (La. 2/16/07); 949 So.2d 422.

[34] *Id.* at 1219 (emphasis added).

[35] *Id.* at 1219 (emphasis added).

produce in paying quantities, which included both the shallow and deep rights in the lease."[36] It appears that the Second Circuit was swayed in this respect by testimony from Gloria's Ranch's expert that "if any party who held an interest in the lease failed to release its interest, it would create a cloud on the title that would discourage potential lessees from executing a new lease with Gloria's Ranch."[37]

Against this backdrop, the Second Circuit appears to have interpreted Article 168 of the Mineral Code as absolutely providing that the "ownership of a mineral right, such as a mineral lease, is indivisible,"[38] holding that "the obligation of the owners of the lease to produce a recordable act evidencing the release of the lease was indivisible, and [that] the trial court correctly found Tauren solidarily liable with the remaining defendants."[39]

Several legal arguments, however, can be made in support of the argument that the Second Circuit's decision to affirm solidary liability with respect to Tauren and the other mineral lessees is simply wrong.

First, the Second Circuit's determination in *Gloria's Ranch* that a solidary obligation existed arguably hinged on the fact that ***all*** leasehold interest owners were sent a written demand to release the Lease, and, in order to effect a full release of the Lease absent any cloud on title, ***each*** had to act "to produce a recordable act evidencing the release of the lease," meaning that obligation was "indivisible . . . ."[40] Nevertheless, while the Second Circuit examined various Civil Code articles regarding solidary liability, it addressed them sporadically and failed to address key Civil Code articles that address when solidary liability exists. For example, the Second Circuit did not mention Article 1794, which provides that "[a]n obligation is solidary for the obligor when each obligor is liable for the whole performance. A performance rendered by one of the solidary obligors relieves the others of liability toward the obligee."[41] Nor did the Second Circuit address Article 1795, which provides that "[a]n obligee, at his choice, may demand the *whole performance from any of his solidary obligors*," and "[u]nless the obligation is extinguished, an obligee may institute action against any of his solidary obligors even after institution of action against another solidary obligor."[42] Thus, although each leasehold interest owner was issued written demand for release, the Second Circuit's decision in *Gloria's Ranch* does not comport with Louisiana law regarding the solidary obligations, specifically Articles 1794 and 1795. Contrary to the dictate of Article 1795, Gloria's Ranch could *not* have demanded the "whole performance [(release of the entire lease)] from any of [its] solidary obligors,"[43] a basic tenant of solidary liability. In other words, how could any of the defendant owners of a *partial* leasehold interest release the entire Lease? And if they could not do so, how could they be "liable for the whole performance"[44] as required for a finding of solidary liability under Article 1794?

Second, it can be argued that the Second Circuit incorrectly applied Article 168 of the Mineral Code to hold that mineral leases are indivisible, when the statutory language actually provides only that "[m]ineral rights are *susceptible* of ownership in indivision."[45] Under Louisiana law, the mere presence of a contract with multiple obligors does not automatically mean that the obligors are subject to

36 *Id.* at 1219 (emphasis added).

37 *Id.* at 1219.

38 *Id.* at 1219 (citing La. R.S. 31:168).

39 *Id.* at 1219.

40 *Gloria's Ranch*, 223 So.2d at 1219.

41 La. Civ. Code art. 1794.

42 La. Civ. Code art. 1795 (emphasis added).

43 La. Civ. Code art. 1795.

44 La. Civ. Code art. 1794.

45 La. R.S. 31:168 (emphasis added).

solidary liability;[46] a contractual obligation will not be considered a solidary obligation if the obligors "agree to render one inseparable performance."[47]

The Second Circuit, however, does not appear to have conducted an analysis of the Lease at issue to determine whether it contemplated the ability of divided ownership and divided obligations upon assignment. In its application to the Louisiana Supreme Court for supervisory writs, Tauren has argued that the Lease permits a partial assignment of obligations because it contains a "consent to assign provision," and further argues that, under the Lease, the parties "did not express a clear intent to be solidarily liable," but instead, "the Lease clearly expresses an expectation that their respective obligations would be several or joint and in either case divisible."[48]

Third, although not argued by Tauren or other mineral lessees, it can be argued that the trial court erred in calculating the virile portion owed by each. Article 1804 of the Louisiana Civil Code provides that "[i]f the obligation arises from a contract or quasi-contract, virile portions are equal in the absence of agreement or judgment to the contrary."[49] The trial court's decision to simply divide liability by the number of defendants, arguably runs afoul of Article 1804 since the percentage of liability for the mineral lessees arguably should reflect the percentage in the lease owned by the mineral lessees.

The Second Circuit's Decision to Hold Wells Fargo Solidarily Liable with the Mineral Lessees and Arguments in Response to the Holding

On appeal to the Second Circuit, Wells Fargo argued that the Second Circuit erred in holding that the Cubic Mortgage contained an assignment of the Lease and in holding it solidary liable with the mineral lessees. As previously noted, Wells Fargo held a mortgage over Cubic's interest in the lease, as well as having an overriding royalty and net profits interest in the Lease as assigned by Tauren.[50]

First, Wells Fargo argued that the Cubic Mortgage was not an assignment of the Lease because Wells only received a security interest in the Lease under its terms.[51] Gloria's Ranch argued that the use of the word "assign" in the Cubic Mortgage proved it included an assignment of the lease.[52] The Second Circuit disagreed, noting that use of the words "assign" and "assignment" in an instrument does not mandate a finding that the instrument included an assignment, and that, instead, a review of the entire instrument was in order.[53] Since it determined that the Cubic Mortgage did not include a transfer of Cubic's working interest in the Lease, the Second Circuit held that the Cubic Mortgage did not include an assignment of the Lease.[54]

Second, Wells Fargo argued that it should not have been held solidarily liable with the remaining defendants; however, the Second Circuit did not agree, holding that the trial court properly held all defendants solidarily liable for the damages awarded. The Second Circuit seems to have been persuaded by Wells Fargo's right to control elements of the Lease under the Cubic Mortgage, holding

46 *Notre Dame, LLC v. Kolbe & Kolbe Mill Work Co.*, 151 F.Supp.3d 715, 722 (E.D. La. 2015) (citing La. Civ. Code art. 1796). Solidary liability is not presumed, it must arise by law or by a clear expression of the parties' intent. *Id.*

47 *Notre Dame*, 151 F. Supp. at 722 (citing La. Civ. Code art. 1794).

48 Application for Writ of Certiorari and/or Review on Behalf of Tauren Exploration, Inc., *Gloria's Ranch, L.L.C. v. Tauren Exploration, Inc., et al.*, No. 17-C-1522, Supreme Court of Louisiana ("Tauren's Writ Application"), pp. 6-7.

49 La. Civ. Code art. 1804.

50 *Gloria's Ranch*, 223 So.2d at 1218.

51 *Id.* at 1219.

52 *Id.* at 1221.

53 *Id.* at 1221.

54 *Id.* at 1222.

that it should be held solidarily liable with the mineral lessees because it "owned or controlled the bundle of rights that make up ownership, *i.e.,* the rights to use, enjoy, and dispose of the lease."[55]

The Second Circuit found that the trial court had a legitimate factual basis for finding Wells Fargo solidarily liable with the remaining defendants, specifically referencing Article 1979, and noting that it provides that "'[a]n obligation may be solidary though it derives from a different source for each obligor.'"[56] The Second Circuit also relied on its contention that "'[i]t is the coextensiveness of the obligations for the same debt, and not the source of liability, which determines the solidarity of the obligation.'"[57]

The appellate court, in further support of its decision, relied on testimony from Gloria's Ranch's expert, who testified that "the Cubic mortgage was a 'very sophisticated financial instrument' which conveyed certain rights in the lease to Wells Fargo . . ." such that Wells Fargo "exercised control over Cubic's oil and gas operations on the lease, and controlled Cubic's ability to release the lease for failure to produce in paying quantities."[58] Citing the various aspects of control available to Wells Fargo, the Second Circuit held that "Wells Fargo shared coextensive liability with Cubic to provide a recordable act evidencing the release of its interest in the lease . . .," such that it should be held solidarily liable of damages arising from the failure to release the Lease.[59]

The Second Circuit's holding seems to have improperly expanded solidary liability to a mortgagor, particularly since, under Article 1796 of the Civil Code, "[s]olidarity of obligation shall not be presumed."[60] Moreover, for Wells Fargo to be solidarily liable with the mineral lessees, it also must, like the mineral lessees, be an obligor to an obligee. Under Article 1786, it is only when "an obligation binds more than one obligor to an obligee . . . [that] an obligation may be several, joint, or solidary."[61]

It can certainly be argued that Wells Fargo did not owe any obligations to Gloria's Ranch via contract <u>or</u> law. As such, it was not an obligor of Gloria's Ranch, and if it was not an obligor, how could it be held solidarily liable as with other obligors?

<u>Conclusion</u>

Although the Second Circuit noted that the case was "highly fact-intensive and should not be construed as governing other cases that may follow unless the same facts exist,"[62] this attempt to limit the scope of *Gloria's Ranch* is little comfort to lenders or mineral lessees now facing solidary liability for damages resulting from failure to release a lease or make royalty payments. As expected, Wells Fargo and the two remaining mineral lessees in the case, Tauren and Cubic, have applied for supervisory writs to the Louisiana Supreme Court, and it is anticipated that industry amicus briefs will be filed as well. This ruling represents an important case to lenders and others in the oil and gas industry, and a strong push will be expected for the Louisiana Supreme Court to review and to reverse the Second Circuit's decision to hold mineral lessees and their lender solidarily liable.

55 *Id.* at 1222.

56 *Id*. at 1223 (quoting La. Civ. Code art. 1797).

57 *Id.* at 1223 (quoting *Glasgow v. PAR Minerals Corp.*, 2010-2011 (La. 5/10/11); 70 So.3d 765).

58 *Id.* at 1223-24.

59 *Id.* at 1224.

60 La. Civ. Code art. 1796.

61 La. Civ. Code art. 1786.

62 *Gloria's Ranch*, 223 So.3d at 1225.

Appalachian Basin Royalty Litigation Update

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Royalty litigation involving the deduction of post-production costs (herein, "PPCs"), continues to proliferate in the Appalachian Basin. The netback method, which generally allows deduction of PPCs, has been adopted in Pennsylvania[1] as well as Kentucky.[2] West Virginia has followed the minority, marketable-product rule since 2006; however, the validity of the *Tawney* doctrine has been questioned and could soon be changed.[3] Recently, the U.S. District Court for the Northern District of Ohio determined that Ohio would follow the netback, or "at the well" rule.[4] This article focuses on the very latest cases in West Virginia and Ohio, and provides a brief summary of Pennsylvania and Kentucky decisions.

West Virginia: The Uncertain Future of *Wellman* and *Tawney* after *Leggett*

According to the Supreme Court of Appeals of West Virginia, "it is *Wellman* which forms the foundation of the current state of West Virginia's law on deduction of post-production costs."[5] The *Wellman* Court determined that "unless the lease provides otherwise, the lessee carries the burden of all costs incurred in exploring for, producing, marketing, and transporting the products to the point of sale."[6] Additionally, any costs that are to be incurred by the royalty owner must be "actually incurred" and "reasonable."[7] In *Tawney v. Columbia Natural Resources, L.L.C.*, the Court determined that the language "at the wellhead" was ambiguous, and delineated the requirements in a lease to allow for the deduction of PPCs:

> (1) it must 'expressly provide' the lessor will bear some part of the costs incurred between the wellhead and the point of sale; (2) it must 'identify with particularity' the specific deductions the lessee intends to take; and (3) it must indicate the method of calculating the amount to be deducted from the royalty for such post-production costs.[8]

Ten years after the burdensome *Tawney* rule was announced, the issue was raised in a statutory construction case on certified questions from the U.S. District Court for the Northern District of West Virginia.[9] The case of *Leggett v. EQT Production Co.* concerned the issue of whether a lessee can deduct PPCs under leases that provide for a flat-rate royalty, or a royalty not based on the production of minerals.[10] The West Virginia "flat-rate" statute, passed in 1982, directs that no well drilling or rework

1 *See Kilmer v. Elexco Land Services, Inc.*, 990 A.2d 1147 (Pa. 2010) (holding royalty clause permitting PPCs does not violate the Guaranteed Minimum Royalty Act).

2 *See Poplar Creek Dev. Co. v. Chesapeake Appalachia, L.L.C.*, 636 F.3d 235 (6th Cir. 2011); *Baker v. Magnum Hunter Production, Inc.*, 473 S.W.3d 588 (Ky. 2015) (confirming *Poplar* and holding that post-production deductions for gathering, compression, and treatment are allowed).

3 *See Estate of Tawney v. Columbia Natural Resources, Inc.*, 557 S.E.2d 254 (W. Va. 2006).

4 *See Lutz v. Chesapeake Appalachia, LLC*, No. 4:09-cv-2256, slip op. (N. D. Ohio Oct. 25, 2017).

5 *Leggett v. EQT Production Co.*,800 S.E.2d 850, 858 (W. Va. 2017), *petition for cert. filed,*No. 17-374, 2017 WL 4060168 (U.S. Sept. 8, 2017).

6 *Wellman v. Energy Resources, Inc.*, 557 S.E.2d 254, 265, Syl. Pt. 4 (W. Va. 2001).

7 *Id.* at Syl. Pt. 5.

8 *Kinney v. CNX Gas Company, LLC*, No. 5:15-CV-160, 2017 WL 3774376, slip op. at *4 (N.D. W. Va. Aug. 24, 2017) (quoting *Estate of Tawney v. Columbia Natural Resources, Inc.*, 557 S.E.2d 254, Syl. Pt. 10 (W. Va. 2006)).

9 *Patrick D. Leggett v. EQT Production Co.,* No. 16-0316, slip op. (W. Va. Nov. 17, 2016) *withdrawn*, 800 S.E.2d 850 (W. Va. 2017).

10 For example, a flat-rate lease may provide that the lessee is to pay to the lessor the sum of $75.00 per quarter for each gas well drilled on the leased premises irrespective of volumes.

permits shall be issued under leases with flat-rate royalty provisions unless the lessee files an affidavit with the permit application averring that it will pay the lessor a royalty of not less than one-eighth of the amount realized by the holder of the working interest "at the wellhead."[11] In these cases, the lessee implicitly agrees to pay a one-eighth royalty to the lessor without any express modification of the royalty language.

Initially, the West Virginia high court determined that the "at the wellhead" language in the statute was ambiguous, and construed the legislative intent to mean that "the royalty payment is not to be diluted by costs and losses incurred downstream from the wellhead before a marketable product is rendered."[12] The Court reformulated the certified question, and in a 3-2 decision concluded that under the flat-rate statute, the lessee may not take any PPC deductions from the royalties.[13]

However, the lessee filed a petition for rehearing which was, in a rare move, granted by the Court.[14] With a new justice replacing the justice who penned the initial *Leggett* opinion, and a reversal by one justice who initially voted with the majority, the Court ruled that PPCs may be deducted from flat-rate royalties.[15] This time, in a 4-1 decision, the Court held that applying *Wellman* and *Tawney* to "interpret a statute . . . is not legally sound."[16] Instead, the Court applied the rules of statutory construction and determined that the use of the language "at the wellhead" in the flat-rate royalty statute is not ambiguous.[17] Rather, the Court found it indicative of "a legislative intention to value the royalties on the unprocessed wellhead price," thereby approving the netback method for paying royalties.[18]

In its analysis, the *Leggett* Court noted that the *Wellman* and *Tawney* decisions stand on "faulty legs," and cited extensive academic authority criticizing those decisions.[19] The Court sent a request "implor[ing]" the Legislature to resolve the issues.[20] Finally, the *Leggett* Court, in a suggestive manner, concluded that "[w]e therefore leave for another day the continued vitality and scope of *Wellman* and *Tawney*."[21] It is expected that this invitation will be accepted in the future.

Ohio: Based on *Lutz,* Ohio Follows "At the Well" Rule

The *Lutz* saga, involving the question of PPC deductions, was recently resolved by the U.S. District Court for the Northern District of Ohio in its Memorandum Opinion and Order granting the defendant's motion for partial summary judgment.[22] Initially filed in 2009, the putative class action alleging, *inter alia*, breach of contract was dismissed as time-barred.[23] The Sixth Circuit Court, however, held that each alleged underpayment constituted a separate breach which triggered new accrual periods for

11 W. Va. Code § 22-6-8(e).

12 *Leggett*, slip op. at Syl. Pt. 2

13 *Id.* at 5.

14 The action was criticized by some as a political and improper move, as the decision to rehear came after the November 2016 election of Justice Beth Walker, who was alleged to be supportive of the oil and gas industry. Hoppy Kercheval, *Justice Walker's spotlight moment*, WV Metro News (May 3, 2017) http://wvmetronews.com/2017/05/03/justice-walkers-spotlight-moment/. This is also the basis for the current petition for Writ of Cert. to the U.S. Supreme Court. *See supra* note 5.

15 *Leggett*, 800 S.E.2d at Syl. Pt. 8.

16 *Id.* at 860.

17 *Id.* at 864.

18 *Id.* at 864-65.

19 *Id.* at 862.

20 *Id.* at 869.

21 *Id.* at 863.

22 *Lutz v. Chesapeake Appalachia, LLC*, No. 4:09-cv-2256, slip op. at 1 (N. D. Ohio Oct. 25, 2017).

23 *Id.* at 2.

purposes of the statute of limitations, and remanded the case to the District Court for further proceedings.[24] The parties again filed cross-motions for summary judgment, which led the Court to stay all proceedings and certify the following question to the Supreme Court of Ohio:

> Does Ohio follow the 'at the well' rule (which permits the deduction of post-production costs) or does it follow some version of the 'marketable product' rule (which limits the deduction of post-production costs under certain circumstances)?[25]

The Supreme Court took a pass on the question, declaring only that:

> Under Ohio law, an oil and gas lease is a contract that is subject to the traditional rules of contract construction. Because the rights and remedies of the parties are controlled by the specific language of their lease agreement, we decline to answer the certified question and dismiss this cause.[26]

Accordingly, the District Court was forced to apply the rules of contract interpretation to determine whether PPCs could be deducted under leases that provided for royalties to be paid based on the market value "at the well."[27] The Court followed the "four corners" rule, whereby language in a contract is not ambiguous unless the "meaning cannot be determined from the four corners of the agreement, or the language is susceptible of two or more reasonable interpretations."[28] The Court concluded that "the parties' intent was that the ***location*** for valuing the gas for purposes of computing the royalty was 'at the well.'"[29] But because the gas is not actually sold at the wellhead, the Court found that "at the well" logically referred to the location where the gas is valued for calculating royalties.[30] Therefore, the netback method was proper.

The Court clarified that construction of the lease under the "'marketable product' rule would ignore the clear language that royalties are to be paid based on 'market value ***at the well***.'"[31] Interestingly, the District Court noted the opinion of Justice O'Neill (who dissented from the Supreme Court's refusal to rule on the question) that he would follow the "at the well" rule, which would be "the gross proceeds of a sale minus post-production costs."[32] For now, the question has been resolved, and though not precedential, the *Lutz* opinion provides some guidance for operators in Ohio.

Pennsylvania: Despite Various Attempts to Modify, Netback Method and *Kilmer* Rule

In *Kilmer v. Elexco Land Services, Inc.*, the Supreme Court of Pennsylvania adopted the industry definition of "royalty" and held that the Pennsylvania Guaranteed Minimum Royalty Act ("the GMRA") "should be read to permit the calculation of royalties at the wellhead, as provided by the net-back method in the Lease."[33] The Court noted that the royalty is not charged for the costs of production,

[24] *Lutz v. Chesapeake Appalachia, L.L.C.*, 717 F.3d 459, 470 (6th Cir. 2013).

[25] *Lutz*, slip op. at 3.

[26] *Lutz v. Chesapeake Appalachia, L.L.C.*, 71 N.E.2d 1010, 1013 (Ohio 2016).

[27] *Lutz*, slip op. at 11-12.

[28] *Id.* at 12.

[29] *Id.* at 14.

[30] *Id.* at 14.

[31] *Id.* at 14 (emphasis in original).

[32] *Id.* at 13, n.8.

[33] *Kilmer v. Elexco Land Services, Inc.*, 990 A.2d 1147, 1157 (Pa. 2010).

but "usually it is subject to costs incurred after production, e.g., production or gathering taxes, costs of treatment of the product to render it marketable, costs of transportation to market."[34] In *Pollock v. Energy Corp. of America*, the plaintiffs argued that *Kilmer* did not apply to leases that were silent on the method of allocation of PPCs.[35] The U.S. District Court for the Western District of Pennsylvania granted summary judgment to the defendants and held that the "allocation of sold gas volumes less post-production costs is in conformity with the industry standard;" however, the Court noted that the entity deducting the costs must actually incur the costs while it has title to the gas.[36]

The case of *Hall v. CNX Gas Co., LLC* considered whether a producer must pay royalties based on the volume of gas measured at each wellhead or if it may proportionately allocate lost and used gas based on downstream commingled gas volumes where the lease is silent on allocation.[37] The Court upheld the dismissal of plaintiffs' claims, stating "[g]as lost or used on the way to the point of sale is simply not part of the royalty computation."[38] Various attacks on Kilmer have been deflected, as courts have determined that it's "holding cannot be strictly applied only to leases that are on all fours."[39]

This September, one case worth watching survived a motion to dismiss. The class action suit deals with a royalty provision that is to be "free of all costs, whether pre-production or post-production," but further delineates that "when gas production is sold in an arms-length transaction with an unaffiliated third party, the value of such gas production shall be the price paid to Lessee."[40] Plaintiffs allege breach of contract, *inter alia*, because the actual price paid to the lessee was below market value and "had [a third party buyer's] production costs and fees built into it."[41] The Court preliminarily found that "the provision at issue is susceptible to multiple reasonable interpretations," and noted "[N]othing in *Kilmer* compels the conclusion that the term 'post-production costs' as used in the contract at issue here has a fixed meaning under Pennsylvania law."[42] For now, the litigation will continue.

Kentucky: "At the Well" Method Allows Deduction of PPCs, but not Severance Taxes

The Kentucky Supreme Court ruled on the deduction of PPCs in *Baker v. Magnum Hunter Production, Inc.*[43] The *Baker* Court held that under Kentucky precedent, "royalty, absent an express contrary provision," is understood as "the lessor's cost-free share of production, with 'production' understood,

[34] *Id.* (citing Howard R. Williams & Charles J. Meyers, *Manual of Oil and Gas Terms* § R (Patrick R. Martin & Bruce M. Kramer eds., 2009)).

[35] *Pollock v. Energy Corp. of Am.*, 2012 WL 6929174, Rep. & Rec. at *4 (W.D. Pa. Oct 24, 2012), *reaffirmed Pollock v. Energy Corp. of Am.*, No. CIV.A. 10-1553, 2015 WL 3795659, Mem. Op. at *4 (W.D. Pa. June 18, 2015), *aff'd*, 665 F. App'x 212 (3d Cir. 2016). The *Kilmer* lease provided that "Lessor shall receive as its royalty one eighth (1/8) of the sales proceeds actually received by Lessee from the sale of such production, less the same percentage share of all Post Production Costs;" the *Pollock* leases generally provided that the lessors would receive 1/8 royalty on "net proceeds."

[36] *Id.* at *6.

[37] *Hall v. CNX Gas Co., LLC*, 137 A.3d 597 (Pa. Super. Ct. 2016), *appeal denied*, 160 A.3d 787 (Pa. 2016) ("A producer may not deduct the post production costs it incurs after it has sold the gas to a third party.").

[38] *Id.* at 604, *accord W.W. McDonald Land Co. v. EQT Production Co.*, 983 F.Supp.2d 790, 803 (S.D. W. Va. 2013) (holding that lost volumes of gas are not actually sold; thus the lessee is under no general duty to pay for them).

[39] *See Ulmer v. Chesapeake Appalachia, LLC*, No. 4:08-CV-2062, 2011 WL 1344596, at *2-3 (M.D. Pa. Apr. 8, 2011) ("It is our view that *Kilmer* is properly read broadly in light of the fact that the Pennsylvania Supreme Court granted extraordinary jurisdiction to resolve the purely legal question of whether post-production costs are proper under Pennsylvania oil and gas law.").

[40] *Slamon v. Carrizo (Marcellus) LLC*, 3:16-CV-2187, 2017 WL 3877856, at *1 and *2 (M.D. Pa. September 5, 2017).

[41] *Id.* at *2.

[42] *Id.* at *6.

[43] *Baker v. Magnum Hunter Production, Inc.*, 473 S.W.3d 588 (Ky. 2015), *reh'g denied* (Dec. 17, 2015).

in the case of gas, as the raw gas captured at the well."[44] "Value 'at the well' is thus the default measure of royalty in Kentucky where a lease is silent, and absent some clear indication to the contrary, leases . . . which expressly provide for that very measurement will be understood as intending Kentucky's long-established approach."[45] Once marketed, Kentucky courts allow a presumption that it was marketed "at the well," with the value at that point providing the basis for calculating royalty.[46] Reasonable well-side price may be determined by (1) actual well-side sale, (2) comparable sales in the vicinity, or (3) working back from a downstream sale by deducting downstream costs.[47]

On the same day the *Baker* decision was issued, the Kentucky Supreme Court answered a certified question from the Sixth Circuit regarding the apportionment of natural gas severance taxes in *Appalachian Land Co. v. EQT Production Co.*[48] The *Appalachian Land* Court held that "in the absence of a specific lease provision apportioning severance taxes, lessees may not deduct severance taxes or any portion thereof prior to calculating a royalty value."[49] The Kentucky Supreme Court certified to the Sixth Circuit that, "1) royalty owners are not statutorily liable for the severance tax assessed under KRS Chapter 143A; and 2) absent a specific contractual provision apportioning severance taxes, lessees may not deduct severance taxes or any portion thereof prior to calculating a royalty value. Accordingly, [the lessor] is not liable for any portion of the natural gas severance tax."[50]

44 *Id.* at 594 (confirming *Poplar Creek Dev. Co. v. Chesapeake Appalachia, L.L.C.*, 636 F.3d 235 (6th Cir. 2011)).

45 *Id.*

46 *Id.* at 594-95.

47 *Id.*

48 *Appalachian Land Co. v. EQT Production Co.*, 468 S.W.3d 841, 842 (Ky. 2015).

49 *Id.* at 842-43.

50 *Id.* at 848.

Northern Natural Gas Co., v. L.D. Drilling (U.S. Court of Appeals for the 10th Circuit)

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The United States Court of Appeals for the Tenth Circuit recently decided that after an underground storage facility has been properly certified by a State or Federal commission, landowners and producers will not be compensated in a condemnation proceeding for the value of any gas they produced which migrated from a certified underground storage facility.[1] The court reasoned that landowners and producers have no right under the "rule of capture" to produce such gas after the date of certification.[2]

The plaintiff, Northern Natural Gas Company (Northern), initiated condemnation proceedings against several parties under the Natural Gas Act of 1938.[3] Northern owned and operated an underground natural gas storage facility known as the Cunningham Field.[4] In 1978, the Federal Energy Regulatory Commission (FERC) and the Kansas Corporation Commission (KCC) first certified the Cunningham Field, approximately 25,000 acres of land, for gas storage.[5] Over time, Northern's certified boundaries expanded with the addition of a 1,760-acre tract north or the original boundary on October 30, 2008 (2008 Extension Area) and a 12,320-acre area located approximately five to six miles north of the original boundaries on June 2, 2010 (2010 Extension Area).[6]

In February 2009, before Northern obtained certificate authority over the entire 2010 Extension Area, Northern negotiated and obtained storage leases on approximately 3,040 acres in the southern part of the 2010 Extension Area.[7] Over the course of its operations, Northern discovered that volumes of storage gas injected into the Cunningham Field did not always match volumes withdrawn from the field. [8] Northern subsequently discovered that gas was leaking out of the Cunningham Field across a lengthy fault across the field's northern boundaries where non-affiliated landowners and producers were allegedly producing large amounts of gas.[9]

To establish the valuation of the migrated gas in a condemnation proceeding, Northern needed to establish a date of taking.[10] Northern perfected the date of taking and its right to take physical possession of the property on March 30, 2012.[11] After the District Court entered its judgment, both parties appealed, asserting various arguments in support of their positions that the award either over or under-compensated the landowners and producers.[12]

1 *Northern Natural Gas Co. v. L.D. Drilling*, 862 F.3d 1221, 1227-28 (10th Cir. 2017).

2 *Id.*

3 *Id.* at 1224.

4 *Id.* at 1225. Natural gas from the Cunningham Field was produced from the Viola Formation.

5 Under both the federal Natural Gas Act of 1938 and the Kansas Underground Storage of Natural Gas Act, a natural gas public utility seeking to convert property for underground storage may obtain a "certificate" from the appropriate commission (i.e., the FERC or KCC, respectively). *Id.* at 1224.

6 *Id.*

7 *Northern*, 862 F.3d at 1224.

8 *Id.* at 1225-26.

9 *Id.* at 1226.

10 *Id.* at 1225; *United States v. Miller*, 317 U.S. 369, 374, 63 S. Ct. 276, 280, 87 L. Ed. 336 (1943) (value is to be ascertained as of the date of taking).

11 *Northern*, 862 F.3d at 1225.

12 *Id.* at 1224.

To determine whether Northern owned the gas on the date of taking, the court analyzed the relevant statutory authority provided by the Kansas Underground Storage of Natural Gas Act (Kansas Storage Act).[13] The Kanas Storage Act governs the ownership of gas that has migrated outside of certified boundaries.[14] While the court found that the Act applied to gas that had migrated to "adjoining property," the court did not find the Act addressed gas that had migrated beyond adjoining property or within a field's certified boundaries (i.e. the 2010 Extension Area).[15] To determine how the Kansas Storage Act should treat migrated gas in an extension area, the court decided it was best to analyze the meaning of the Kansas Storage Act through the guidance of a series of Kansas Supreme Court cases decided between 1985 and 2013 that had interpreted the Act.[16]

The court first addressed the interplay between injectors of storage gas and the common-law rule of capture, under which the first person to "capture" a certain resource has rightful ownership to it.[17] The court first considered *Anderson v. Beech Aircraft.*[18] In *Anderson*, the Kansas Supreme Court court held that because Beech Aircraft's activities as an injector were unauthorized, the injected gas became subject to the common law "rule of capture."[19]

The court then examined the Kansas Supreme Court decision in *Union Gas System, Inc., v. Carnahan.*[20] *Union Gas System* distinguished *Anderson* by further analyzing the effect of certificate authority under the Kansas Storage Act.[21] The *Union Gas* court held that a natural gas public utility, which injected gas into an underground storage field for many years without certificate authority and subsequently sought to recover the value of such gas produced by others was "not entitled to recover for any of its gas produced… prior to… the date of the Commission's certificate."[22] The court explained that before the date of certification, Union had "placed itself under the rule of *Anderson*" by failing to seek a certificate. [23]As for the gas produced *after* the date of certification, Union was entitled to recover its value, because when it acquired the certificate, its status changed; "[i]ts operation was given official sanction and its gas was identified."[24]

The final case in *Northern's* analysis of the Kansas Storage Act was the Kansas Supreme Court decision in *Northern Natural Gas Co. v. ONEOK Field Services.*[25] The *ONEOK* court held that the Kansas Storage Act abolished the rule of capture as to natural gas which migrated horizontally within a stratum to an adjoining property or vertically to a different stratum but preserved the rule of capture as to natural gas which migrated beyond the certified boundaries.[26] To the extent that an injector's storage gas migrated beyond property adjoining the certificated boundaries of its storage field … the injector would lose title to such gas.[27] While producers would have title to any such migrating gas produced by

[13] *Id.* at 1228.

[14] Kan. Stat. Ann § 55-1210(c).

[15] *Northern,* 862 F.3d at 1231.

[16] *Id.* at 1231.

[17] *Id.* at 1229.

[18] *Anderson v. Beech Aircraft,* 237 Kan. 336, 699 P.2d 1023 (1985).

[19] *Id.* Beech Aircraft's activities were unauthorized because it was not a natural gas public utility and therefore did not have the right to obtain a certificate authorizing an underground storage facility.

[20] *Union Gas System, Inc., v. Carnahan*, 245 Kan. 80, 774 P.2d 962 (1989).

[21] *Id.*

[22] *Id.* at 967

[23] *Id.*

[24] *Id.* at 968.

[25] *Northern Natural Gas Co. v. ONEOK Field Servs. Co.*, 296 Kan. 906, 296 P.3d 1106 (2013).

[26] *Id.* at 1111

[27] *Id.* at 1125.

their wells, title would revert back to the injector once FERC either extended the certificated boundaries on the field to include the producer's wells or brought those wells onto property adjoining the expansion area.[28] Therefore, contemporaneous with certification, an injector would acquire storage rights to the property and would thus gain title to gas injected into its legally recognized storage area.[29]

Taken together, it was clear to the court in *Northern* that *Anderson, Union Gas, ONEOK* and the statuary scheme set forth in the Kansas Storage Act all emphasized the importance of timing and certification.[30] Thus, while the landowners and producers who took from the Cunningham Field may have held certain property rights over the natural gas in and under their land at some point in time *before* Northern obtained the authority to include the property within the Cunningham Field's legal boundaries, these rights had been eliminated by the date of taking.[31] On this date, the gas "in place" in and under the Extension Area land was within the Cunningham Field's certified boundaries as required by Kansas law and, accordingly, was wholly Northern's property.[32] Ultimately, the result of *Northern* is that once the boundaries of a field are certified, any gas that migrates from those boundaries is no longer subject to the rule of capture so long as the gas can be identified as storage gas.[33]

Due to the application of Kansas law, *Northern* does not facially apply to other states within the Tenth Circuit. Nevertheless, this holding may create conflicting persuasive authority for federal cases arising out of states like Oklahoma who consider reinjected gas "free game" under the rule of capture's "exclusive right to take" theory. While courts in Oklahoma could lean on the Tenth Circuit's "wild animal" analogy[34] and treatment of reinjected gas in *Bezzi v. Hocker,* it is important to note that this case did not involve an analysis of Oklahoma's Storage Act[35] and should therefore not be read as Oklahoma sanctioning the rule of capture for migrated storage gas. It should be noted, however, that the holding in *Northern* came down to the court thoroughly analyzing the Kansas case law that directly addressed the Kansas Storage Act. Future disputes under the Oklahoma act therefore will have to carefully parse the differences between the Oklahoma and Kansas Storage Acts to ascertain how persuasive Northern may be in other jurisdictions.[36] This exercise might greatly be aided by further Oklahoma precedent addressing the meaning of its state storage act under similar circumstances.

28 *Id.*

29 *Id.* at 1120.

30 *Northern,* 862 F.3d at 1231.

31 *Id.*

32 *Id.* at 1231-32.

33 *Id.* at 1232. Fortunately for Northern, the storage gas was easy to identify. Native gas from the Viola Formation was extremely high in helium. The storage gas and gas from the Extension Area sampled had little to no helium. Comparisons of isotopic characteristics and methane levels also yielded similar results, further proving how dissimilar the samples of gas from the Extension Area were from the Native Viola gas.

34 *Bezzi v. Hocker*, 370 F.2d 533, 535 (10th Cir. 1966) (when gas was reinjected in to a reservoir it became mobile and fugacious and was returned to its wild state. Unit Operator had no control or possession over the reinjected gas after it re-entered the reservoir than it had over the virgin gas originally in the reservoir.).

35 *See Bezzi v. Hocker*, 370 F.2d 533 (10th Cir. 1966)

36 *See* Okla. Stat. Ann. Tit. 52, § 36.6. (omits the term "adjoining property" as seen in K.S.A. 55-1210)

North Dakota Legislature Adopts Senate Bill 2134 in Effort to Define the Ordinary High Water Mark of the Missouri River to Resolve Oil and Gas Mineral Ownership Rights

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In North Dakota, the navigable Missouri River meanders directly through the center of the entire Bakken field, a distance of over 120 miles. The uncertainties of ownership of mineral interests underlying rivers and defining river boundaries, and the effects of river movements through accretion, erosion and avulsion are certainly not new challenges for oil and gas operators in many states. However, in addition to the more common problems associated with rivers and due to the federal government's construction of the Garrison Dam in the 1950s, many complex, diverse and competing ownership issues between the State of North Dakota, fee owners, the United States, and the Three Affiliated Tribes have resulted over the past decade. In 2017, the North Dakota Legislature adopted Senate Bill No. 2134 in an effort to resolve many of these complex ownership issues. This article will briefly set forth the background and events leading to the legislative efforts, the key provisions of the legislation, and the current status of the legislation and pertinent litigation.

A. Background of Equal Footing Doctrine.

At common law, the original thirteen states owned title to the land underlying navigable tidal waters in their sovereign capacity. In 1845 the United States Supreme Court recognized the "equal footing doctrine."[1] Under the equal footing doctrine, the United States held in trust for the new states' navigable waters and the lands beneath and, upon statehood, the new states would acquire title to the beds of the navigable waters and be admitted "upon equal footing, in all respects whatever…." with the original States.[2] In 1877, the Supreme Court reaffirmed that the equal footing doctrine applies to all navigable waters.[3] The Court held the rights of riparian owners in the soil below the high water mark are governed by state law, not federal law, and the states could determine the extent of riparian title below the high water mark as a matter of State property law.[4] Thus, upon entering the Union in 1889, North Dakota acquired title to the bed of the navigable Missouri River up to the ordinary high water mark under the Equal Footing Doctrine.

The State's inaugural legislature, however, enacted a statute suggesting the upland owner acquires title to the low water mark.[5] The statute provides "Except when the grant under which the land is held indicates a different intent, the owner of the upland, when it borders on a navigable lake or stream, takes to the edge of the lake or stream at *low* water mark." [6] Thus, with the development of the Bakken field and horizontal drilling along the Missouri River, the first significant ownership issue was simply whether the State owned fee title to the bed of the Missouri River up to the low water mark or the high water mark.

In *Reep v.North Dakota Board of University & School Lands*, 841 N.W.2d 664 (ND 2013), the Supreme Court held the State owned fee title to the bed of navigable rivers and lakes up to the ordinary high water mark (hereinafter "OHWM"). The Supreme Court reasoned that because the State acquired title

1 *Pollard v. Hagan*, 44 U.S. 212, 228-29 (1845). Codified by Congress in the Submerged Lands Act, ch. 65, 67 Stat. 29 (1953) (codified as amended at 43 U.S.C. §§ 1301-1302, 1311-1314).

2 *Id.* at 224 (citing *Martin v. Waddell*, 41 U.S. 367 (1842)).

3 *Barney v. Keokuk*, 94 U.S. 324, 338 (1877).

4 *Id.*

5 N.D. Cent. Code Sec. 47-01-15

6 *Id.* (Emphasis added).

to the bed of the Missouri River up to the OHWM under the Equal Footing Doctrine, N.D.C.C. Section 47-01-15 could not be interpreted as granting the upland owner fee title to the low water mark, as such an interpretation would result in a "gift" to the upland owner of the shore zone area between the low and high water mark and would, therefore, violate the anti-gift clause in the North Dakota Constitution.[7]

While *Reep* resolved the low versus high water mark issue, the delineation of the OHWM of the Missouri River has been the subject of major contention, controversy and litigation post-*Reep* with no near-term resolution on the horizon.

B. The Garrison Project and Competing Ordinary High Water Mark Surveys.

The 493,000-acre Garrison Project creating Garrison Dam and Lake Sakakawea was authorized by Congress in the Flood Control Act of 1944. The Corps of Engineers ("Corps") acquired by purchase or condemnation 463,000 acres necessary for the construction of the dam and the formation of Lake Sakakawea; the remaining 30,000 acres consisted of the Missouri River channel as it existed prior to the dam construction and was not acquired from the State by the Corps and remains "sovereign" lands owned by the State.

To determine compensation for acquisitions upland from the OHWM, the Corps conducted surveys and prepared "Segment Maps" from the Garrison Dam construction site to near the Montana-North Dakota state line. The Segment Maps depicted the Missouri River OHWM prior to inundation by Lake Sakakawea and show the Corps acquired fee simple title, but *reserved* to the upland owners "all oil and gas rights therein" in most areas of the Bakken region.

As the Bakken play developed, for oil and gas leasing purposes, the State did not rely upon the Corps survey to determine the OHWM, rather, the Board of University and School Lands authorized and implemented its own two surveys.[8] The first survey (Phase 1) determined the OHWM boundary based on "current conditions" of the Missouri River from an area west of the City of Williston to near the Montana-North Dakota state line. This segment of the Garrison Project is sometimes referred to as the "headwaters" area of the Missouri River and Lake Sakakawea. The second survey (Phase 2) extended from all areas east of Williston to Garrison Dam but was based on the OHWM of the historical Missouri River channel as it existed prior to Garrison Dam and the formation of Lake Sakakawea. Both State surveys in many segments differ significantly from the Corps survey, and depict the Missouri River channel much wider than the Corps survey, resulting in the State claiming larger mineral ownership acreages adverse to the riparian upland owners—at least as compared to the Corps survey.[9] The competing surveys required oil and gas companies to double lease both the State and the upland owners (including the United States) where the surveys overlapped. Operators subsequently were forced to suspend production proceeds pending resolution of the OHWM boundary conflicts.

C. *Wilkinson v. State of North Dakota*

In 2012 the Wilkinson family sued the Board of University and School Lands seeking a determination of mineral ownership and, among other claims, asserted a takings claim against the State.[10] Central to the case is whether the current or historic OHWM controls ownership. Prior to 1958, J.T. and Evelyn Wilkinson owned the surface and minerals for lands located just west of the City of Williston. In 1958,

7 841 N.W.2d at 674.

8 The State surveys are available online at https://land.nd.gov/Minerals/OilAndGasLeasing

9 The acreage discrepancies between the State and Corps surveys depicting the Missouri River channel in some Bakken well spacing units are very significant, consisting of several hundred acres or more.

10 *Wilkinson v. Board of University and School Lands,* 2017 ND 231.

they sold the surface to the United States for construction of Garrison Dam and Lake Sakakawea, but reserved the oil and gas.[11] After construction of Garrison Dam, the flooding of Lake Sakakawea altered the historic Missouri River channel.

The State moved for summary judgment, requesting the court determine the State holds title to the bed of the Missouri River up to the current ordinary high watermark as determined by the State's Phase 1 survey.[12] And, at oral argument, the attorneys for the State suggested for the first time that the State owned title to the bed of Lake Sakakawea, not merely the historic river channel. The Wilkinsons argued that summary judgment should be denied because there was no navigable body of water on the property at statehood and the property was later flooded as part of the Garrison project, not by river movement.

The district court granted the State's motion and ruled the State holds title to the current OHWM, and therefore owns both the surface and minerals of the disputed property. The court explained that the State's title to ownership up to the OHWM shifts with changing conditions regardless of whether those changes are naturally or artificially caused and further stated "the Missouri River is not distinguishable from Lake Sakakawea"[13] implying that the State may own all minerals underlying Lake Sakakawea, not merely the historic river channel. This holding, as well as other actions by the State[14], created significant alarm among mineral owners and the oil and gas industry that the State may now be claiming several hundred thousand mineral acres above the historic OHWM, mineral tracts that were reserved by private owners in the lands acquired by the federal government for the creation of Lake Sakakawea.

Following the district court decision and, while the *Wilkinson* appeal was pending, the North Dakota legislature introduced Senate Bill No. 2134 to clarify and limit the State's sovereign ownership claims "to the ordinary high water mark" of the "historical Missouri riverbed channel." The Supreme Court, in a rare occurrence, granted a stay of oral arguments and issuance of its decision in *Wilkinson* pending resolution of the legislative process.[15]

D. Senate Bill No. 2134

The 2017 North Dakota Legislature enacted Chapter 61-33.1 of the North Dakota Century Code relating to mineral rights of land inundated by Pick-Sloan Missouri basin project dams (Garrison Dam). Foremost, this comprehensive legislation limits the State's mineral ownership to the bed of the Missouri River channel up to the OHWM as the river existed prior to the closure of Garrison Dam in April 1953.[16] Chapter 61-33.1 also establishes various parameters, guidelines, and due process procedures for determining the actual OHWM boundary of the historic Missouri River channel. The key provisions may be summarized as follows:

[11] Id. at ¶ 2.

[12] If the historical Missouri River channel surveys were applied, the Wilkinsons would prevail as their mineral tracts lie above the OHWM of the historical channel.

[13] *Wilkinson v. Board of University and* School *Lands,* Amended Order on Summary Judgment Motion ¶ 21, Civ. No. 53-2012-CV-00038, Williams County District Court, (May 18, 2016).

[14] In 2016, the State filed a counterclaim in *Starin v. Schmidt,* Civ. No. 53-2015-CV-00986, Williams County District Court, suggesting the State owned minerals up to the current OHWM of Lake Sakakawea, far above the historic OHWM riverbed channel.

[15] *Wilkinson v. Board of University and School Lands*, Supreme Court Docket No. 20160100, Entry 91, February 1, 2017.

[16] Chapter 61-33.1 expressly excludes from the Act a determination of the ordinary high water mark or the actual ownership of the bed of the Missouri River insofar as the river is located on the Fort Berthold Indian Reservation. Ownership of the bed of the Missouri River within the exterior boundaries of the Reservation is currently a matter of dispute between the State of North Dakota and The Three Affiliated Tribes.

- The state sovereign land mineral ownership of the riverbed segments inundated by Pick-Sloan Missouri basin project dams (Garrison Dam) extends only to the historical Missouri riverbed channel up to the ordinary high water mark. N.D.C.C. Section 61-33.1-02.
- Adopts the Corps survey as the "presumptive determination of the ordinary high water mark of the historical Missouri riverbed channel, subject only to the review process under this section …" N.D.C.C. Section 61-33.1-03(1).
- Requires the Department of Mineral Resources to select a qualified engineering and surveying firm ("Firm") to conduct a review of the Corps survey to confirm its accuracy. N.D.C.C. Section 61-33.1-03(2).
- The selected Firm shall conduct a review of the Corps survey, using historical aerial photography and other technical information available at the time of closure of Garrison Dam and apply specific guidelines in determining the OHWM. N.D.C.C. Section 61-33.1-03(3).
- The Firm shall complete the review of the Corps survey within six months. The Firm may recommend the Corps survey be adjusted, modified, or corrected only where "clear and convincing evidence establishes the corps survey … does not reasonably reflect the ordinary high water mark…." N.D.C.C. Section 61-33.1-05.
- Upon completion of the review, the findings shall be published and the public shall have sixty days to submit comments, followed by a public hearing. After the public hearing, the Department of Mineral Resources, in consultation with the Firm, shall consider all public comments and develop a final recommendation to be provided to and approved by the Industrial Commission. N.D.C.C. Sections 61-33.1-06 and 07.
- After the final survey is adopted by the Industrial Commission, the Department of Trust Lands and oil and gas operators shall have two years to implement the necessary oil and gas lease acreage adjustments, lease bonus, and distribution of all royalty payments or refunds in accordance with the boundaries and acreage determinations established by the final approved survey. N.D.C.C. Section 61-33.1-04.
- Finally, the Chapter provides that any interested party who seeks to challenge the final review must file an action in district court within two years of its adoption by the Industrial Commission. A party who claims any portion of the final review is incorrect bears the burden of establishing a variance by clear and convincing evidence.

Chapter 61-33.1 was signed into law on April 21, 2017, and was made retroactive to the date of closure of the Pick-Sloan Missouri basin project dams.

E. Post-enactment of Chapter 61-33.1, the North Dakota Supreme Court Reverses and Remands *Wilkinson v. Board of University and School Lands.*

On September 28, 2017, the North Dakota Supreme Court reversed and remanded the district court's decision in *Wilkinson v. Board of University and School Lands.* The Court ruled the district court must "determine whether N.D.C.C. ch. 61-33.1 applies and governs ownership of the minerals at issue in this case."[17] Further, because the Chapter is retroactive to the closure of the Pick-Sloan project dams, the Court concluded that the district court must have an opportunity to consider the new statutory provisions when deciding ownership of the disputed minerals. Finally, the Court held that the district court "erred in determining there was no taking."[18] The federal government compensated the plaintiffs for the surface property, but the plaintiffs have not been compensated for the mineral

17 *Wilkinson,* 2017 ND 231 ¶ 20.

18 *Id.* ¶ 25.

interests. If the district court determines the State owns the minerals, the plaintiffs will be deprived of the mineral interests. The Court concluded that the landowners are entitled to compensation if the government's actions result in a "taking" of the mineral interests, citing other cases that suggest government-induced flooding can constitute a taking.[19] Thus, the district court "must reconsider this issue on remand if it decides the State owns the disputed minerals."[20]

Summary And Status

As required by Chapter 61-33.1, the Department of Mineral Resources has selected an engineering and surveying firm and the firm has commenced the review process to confirm the OHWM of the historic Missouri River channel. Subsequent to the Supreme Court's reversal in *Wilkinson*, there have been no further judicial filings by any party with the district court after remand. However, of note, the Board of University and School Lands has yet to publicly state whether the Board, on remand, intends to accept or to potentially challenge the validity of any or all of the provisions set forth in Chapter 61-33.1.

[19] *Id.* ¶ 24.

[20] *Id.*

North Dakota Court Addresses Rights of Surface Owners In Subsurface Disposal of Produced Water

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In *Mosser v. Denbury Resources, Inc.*, 2017 ND 169, 898 N.W.2d 406, the North Dakota Supreme Court, in answering seven questions certified to it by the United States District Court for North Dakota, held that "mineral developers may be liable to a surface owner for saltwater disposal into pore space."

North Dakota's Oil and Gas Production Damage Compensation Act (the "Act"), codified as Chapter 38-11.1 of the North Dakota Century Code, requires a mineral developer, in the absence of an agreement to the contrary, to provide 20 days' notice and an offer of damages to the surface owner prior to engaging in "drilling operations." "Drilling operations" are broadly defined to include all production and completion operations which require entry upon the surface estate. In the underlying case in *Mosser*, which was removed from state court to the Federal court on the basis of diversity jurisdiction in 2013, the plaintiffs claimed that they were entitled to damages under theories of trespass, nuisance and the Act as a result of Denbury's conversion of an existing oil and gas well to a salt water disposal well in 2011. *Mosser v. Denbury Resources,* 112 F.Supp.3d 906 (D.N.D.2015). Denbury was the operator of a secondary recovery unit known as the T.R. Madison Unit and utilized the disposal well to dispose of produced water in a subsurface stratum known as the Dakota Group. *Id.* at 910. Denbury's predecessor had obtained the necessary approvals from the North Dakota Industrial Commission to utilize the well as an injection well. *Id.* In denying competing motions for summary judgment, the United States Magistrate held that Denbury, as the oil and gas lessee, had the right to use the property covered by the lease for subsurface disposal of water produced from the lease or the secondary recovery unit which included the lease in question, thus barring claims for trespass and nuisance. *Id.* at 916.

Concerning the plaintiffs' claim for statutory damages in accordance with the Act, the Magistrate first determined that in North Dakota, the surface owner owns the subsurface pore space. *Id.* at 919. A statute existing since the time of statehood provides that the owner of the land "has the right to the surface and to everything permanently situated beneath or above it" (N.D.C.C. §47-01-12) and a separate statute enacted in 2009 provides that "title to the pore space in all strata underlying the surface of lands and waters is vested in the owner of the overlying surface estate (N.D.C.C. §47-31-03). Next, the Magistrate predicted that the North Dakota Supreme Court would determine that the terms "land" and "surface estate" as used in the Act include the subsurface pore space. 112 F.Supp.3d at 922-923.

The Magistrate then certified seven questions to the North Dakota Supreme Court, including as the first two questions whether the owner of the surface owns the pore space and whether compensation for "lost land value" and "lost use of and access to" land under the Act extends to the use of the pore space for saltwater disposal. In its decision, the North Dakota Supreme Court first determined that it would answer the first two questions even though the Magistrate had ruled on those questions because the Federal decision was not a "final decision" and because the questions may be determinative of the Federal action. 2017 ND 169 at ¶12.

Relying on the two statutes set forth above, the North Dakota Court agreed with the Magistrate that the owner of the surface estate owns the underlying pore space absent a conveyance of the pore space to a third party. *Id.* at ¶17. On the second question, the North Dakota Court agreed with the Magistrate that the surface owner's interest in the pore space "is part of the surface owner's interest in the land for purposes of" the section of the Act entitling the surface owner to damages for "lost land value" and "lost use of and access to land." *Id.* at ¶24.

In answering the third through sixth questions, the North Dakota Court went on to hold that the surface owner is not required to demonstrate that it is currently using or is likely to use the pore space in the reasonably near future to recover damages, that damages are not limited to a diminution in market value, that the surface owner is not required to prove damage other than "mere occupancy or loss of access," and that a surface owner can recover damages based only on evidence of what is being paid to other owners for the disposal of saltwater on a per barrel basis and the number of barrels likely occupying the pore space. *Id.* at ¶30. The North Dakota Court declined to answer the final question on whether additional damages could be based on lost opportunity costs if the plaintiff can establish that the use has foreclosed the ability of the surface owner to use the remaining capacity on the basis that it required speculation as to potential evidence. *Id.* at ¶31.

The two decisions in *Mosser* have left the oil and gas industry and surface owners in North Dakota many more questions than they have answered. The conclusions that the surface owner owns the pore space and that a mineral owner/lessee is entitled, subject to the restrictions of the Act and the accommodation doctrine as adopted by the North Dakota Supreme Court in *Hunt Oil Co. v. Kerbaugh, 283 N.W.2d 131 (N.D.1979),* to utilize the pore space to the extent reasonably necessary to develop the mineral estate are hardly surprising. In 2009 the Legislature, in addition to enacting Section 47-31-03 which provides that title to the pore space is vested in the owner of the overlying surface, enacted a fairly comprehensive statute relating to the underground storage of carbon dioxide which provides for the "amalgamation" of pore space interests in a process by which non-consenting owners can be included in a storage project. See, Chapter 38-22, N.D.C.C. and Section 38-22-10, N.D.C.C.

Nor can it be seriously argued that a surface owner is not entitled to compensation for the use of the pore space by a mineral developer to the extent damages could be proven. The Act entitles a surface owner to damages for "lost land value, lost use of and access to the surface owner's land, … lost value of improvements" and "loss of agricultural production and income." N.D.C.C. §§38-11.1-04 and 38-11.1-08.1. Both the Magistrate and the North Dakota Court recognized that only the lost land value and lost use of and access to land components can be applicable to pore space. While the Magistrate concluded that the North Dakota Court would likely conclude that plaintiffs could recover damages for lost land value even though they were not actually using the pore space when Denbury commenced its use, the Magistrate did cite somewhat favorably the Montana Supreme Court case of *Burlington Resources Oil & Gas Co. LP v. Lang and Sons, Incorporated,* 2011 MT 199, 461 Mont. 497, 259 P.3d 766, in which the Montana Supreme Court held that testimony from a number of witnesses that other landowners had received a per barrel fee for the disposal of salt water alone was not sufficient to justify an award of damages when there was no evidence of the separate compensable damages under the Montana equivalent of the Act. 112 F. Supp. 3d at 932. The North Dakota Supreme Court, in answering certified questions 3 through 6 held that a surface owner need not establish that the surface owner is currently using the pore space or is likely to make use of it in the near future, the surface owner need not prove "a diminution in the market value of the property affected by the saltwater disposal," a surface owner need not establish any damage other than the "mere occupancy of loss of access to the pore space," and a surface owner could recover damages when the only evidence is proof of what is being paid to other surface owners on a per barrel basis in arm's length, fairly comparable transactions and the number of barrels injected. 2017 ND 169 at ¶30. The analysis leading to these answers to certified questions 3 through 6 is somewhat cursory – the "plain language" of N.D.C.C. §38-11.1-04 is not limited to whether the surface owner is currently using or planning to use the pore space, is not limited to a diminution in market value, and does not prohibit evidence of what others may be paying to dispose of saltwater in pore space. *Id.* at ¶¶29-30. Taken literally, these answers suggest that all a surface owner needs to do to prove damages is to establish the amount per barrel paid in nearby voluntary transactions and apply that amount to the number of barrels disposed of, and to be disposed of, in the well. But the North Dakota Court did caution that the "probative effect and admissibility" of evidence is a matter for the trial court's discretion under Federal Rules of Evidence 401 through 403 and their state equivalents. And it seems likely that oil and gas operators through their attorneys and experts will be able to reduce the probative effect of that evidence by noting the inherent economic differences between a purely voluntary transaction in which an operator is obtaining a right it does not otherwise have and the damages to which a surface owner is entitled for the exercise of a right the operator has as a consequence of the dominant mineral estate.

How all of this will actually be implemented remains to be determined. *Mosser* was set for trial on October 3, 2017, but was settled in a confidential settlement prior to trial. In *Fisher v. Continental Resources,* 2015 WL 11400124 (D.N.D. October 8, 2015), the United States District Court for North Dakota held that pore space was encompassed within the meaning of "land" in the Act but also held that where a salt water disposal well had been drilled and a pipeline constructed but injection had not yet commenced the claim for damages was speculative and premature. *Id.* at 5. In *Rauum v. Murex Petroleum Corporation,* 2017 WL 2870070 (D.N.D. July 5, 2017), the United States District Court found that the use of a salt water disposal well for the disposal of "off-lease" produced water constituted a trespass. It awarded "damages" based on what it determined to be the "avoided cost" of $.07 per barrel under a theory of either restitution/unjust enrichment or damages "at law" based on the "value of the use of the property." *Id.* at 47.

In addition to the relatively straight-forward question of how "damages" under the Act are to be determined for use of the pore space, the North Dakota Court decision in *Mosser* raises other questions. In *Mosser, Fisher* and *Burlington Resources*, the "drilling operations" in question all involved entry upon the surface estate of the lands in question and the drilling or recompletion of a disposal well on the surface. But if the "pore space" is "land" and if the Act requires advance notice of any activity which requires entry on the "surface estate" and an offer to pay damages, is a subsurface intrusion resulting from injection in an adjoining tract an entry which requires notice and an offer of damages? Or is it permissible as an incident of the "negative" or "inverse" rule of capture? *See, Railroad Commission of Texas v. Manziel*, 361 S.W.2d 560 (Tex. 1962); *Chance v. BP Chemicals et al*, 77 Ohio St. 3d 7, 670 N.E.2d 985 (Ohio 1996).

Perhaps recognizing the possibility of unintended consequences, the Magistrate recognized that while "it does not appear the world will end" by construing the statutory language to include pore space, the end result might be legislative action to exclude the use of pore space from compensation under the Act or for the enactment of a unitization procedure for pore space similar to what has been provided for carbon dioxide storage in Chapter 38-22, N.D.C.C. 112 F. Supp 3d 906 at fn. 18.

Supreme Court Holds Drilling Across Tracts Not Trespass

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On May 19, 2017, the Texas Supreme Court held in a unanimous decision in *Lightning Oil Co. v. Anadarko E&P Onshore, LLC* that an oil and gas operator does not commit trespass when, after obtaining consent from the surface estate owner of a neighboring tract, it drills into the neighboring tract's surface and through the tract's subsurface in order to access minerals in which the operator has an interest. In so holding, the Court affirmed the concept in Texas law that absent an express grant in a lease, the surface estate owner, and not the mineral estate owner, controls the subsurface earth beneath a tract.

Background

Anadarko E&P Onshore, LLC ("Anadarko") was lessee to an oil and gas lease covering the Chaparral Wildlife Management Area (the "Chaparral")—a wildlife conservation area controlled by the Texas Parks and Wildlife Department—which lease granted Anadarko the right to explore, produce, and develop the mineral estate under the Chaparral. Because the Chaparral was a public area, the lease restricted the scope of drilling activities Anadarko could undertake on the Chaparral surface. To that end, the lease required that drilling sites be established at an offsite location when "prudent and feasible."

To access the minerals under the Chaparral while also complying with the Chaparral lease's restrictions, Anadarko entered into an agreement with the surface estate owners of a tract adjacent to the Chaparral ("Briscoe Ranch"), which permitted Anadarko to drill vertically into the ground beneath Briscoe Ranch, and then horizontally into the Chaparral subsurface. Lightning Oil Co. ("Lightning"), lessee of the Briscoe Ranch mineral estate, objected to Anadarko placing its drilling sites on the Ranch and drilling through Lightning's mineral estate.

Lightning sued Anadarko, alleging that Anadarko's drilling through Lightning's mineral estate was a trespass, and amounted to a tortious interference with Lightning's lease for the Briscoe Ranch mineral estate. Lightning sought a temporary restraining order and injunction to prohibit Anadarko from drilling through Lightning's mineral estate.

The lower courts hold in favor of Anadarko

The trial court in Dimmit County granted Anadarko's motion for summary judgment, disposing of Lightning's claims, and denied Lightning's motions for summary judgment.

The Fourth Court of Appeals affirmed, holding that the Briscoe Ranch surface estate owner, and not Lightning, controlled the subsurface earth beneath the Ranch, and could grant permission to Anadarko to site a well on the tract, drill into the subsurface, and directionally alter the well bore into the Chaparral subsurface. The court held that absent an express right to control the subsurface, Lightning was only entitled to "a fair chance to recover the oil and gas" in the Briscoe Ranch mineral estate. Therefore, the court held that because the Briscoe Ranch surface estate owner authorized Anadarko to drill through the subsurface earth, Anadarko was justified in undertaking that drilling, and such drilling was not a trespass.

The Texas Supreme Court affirms the lower courts

The Texas Supreme Court granted Lightning's petition for review, and affirmed the court of appeals' ruling in a unanimous decision. The Court identified the key issue as: whether Lightning's rights in the

Briscoe Ranch mineral estate included the right to prohibit Anadarko's drilling activities if those activities were not intended to capture Lightning's minerals but rather to traverse the subsurface formations in which Lightning's minerals were located, in order to access Anadarko's minerals beneath the Chaparral. The Court held that neither Lightning's lease for the Briscoe Ranch mineral estate, nor Texas law, granted Lightning the right to control the subsurface beneath the Ranch.

The Court did, however, note that although it generally agreed with the court of appeals' position that a surface owner controls much of the mass that undergirds the surface estate, there is a distinction between earth surrounding hydrocarbons and earth embedded with hydrocarbons (the latter of which by definition includes some of the minerals owned by the mineral estate owner). To that end, Anadarko's drilling could constitute a trespass if that drilling "infringe[d] on [Lightning's] ability to exercise its rights" to access the minerals beneath the Ranch. The Court found that Lightning provided no evidence to show that Anadarko's drilling would interfere with its own rights. And even if Lightning had presented evidence, that evidence would have had to overcome Anadarko's evidence that the Railroad Commission of Texas's rules and oversight regarding drilling activities were sufficient to protect Lightning's rights.

The Court also recognized that by drilling through the Briscoe Ranch subsurface, Anadarko would unavoidably extract a portion of that subsurface roughly equal to the volume of the wellbore—that is, the cuttings pushed to the surface during drilling—and that extracted material would contain a small portion of Lightning's minerals. Balancing the interests of Lightning and Anadarko, and the interest of the individual operator against the interests of society and the oil and gas industry as a whole, the Court held that since off-lease drilling arrangements often provide the most efficient means of exploiting minerals, Lightning's interest in the small quantity of minerals extracted by Anadarko must cede to society's goals (embodied by Anadarko's drilling) of maximum oil and gas recovery and minimum waste.

Key takeaways

Absent an express grant in a lease with the surface estate owner, a lessee who holds the right to recover hydrocarbons in a mineral estate has no right to control the subsurface surrounding those hydrocarbons. Thus, in some instances, an operator can obtain consent from the surface estate owner of an adjacent tract and horizontally drill through that tract's subsurface to access minerals in which the operator has rights. However, such an operator could be susceptible to a trespass claim if a mineral interest owner presents evidence showing that such drilling interferes with the owner's ability to exercise its rights to access its own minerals.

Hurricane Harvey, Force Majeure and the Energy Industry

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At this point, it is still difficult to assess the full impact of the devastation caused by Hurricane Harvey. More data is available now. On September 29, the Houston Chronicle reported on a recent survey of energy executives taken by the Federal Reserve Bank of Dallas. Of executives surveyed, 62% told the Dallas Fed that they believed any problems for the upstream production and services companies will have been fixed within six months. Fewer than a third opined there would still be a slight impact in six months.

The evidence indicates refineries and pipelines took the brunt of the storm. Harvey knocked out 25% of U.S. oil refining capacity. According to a September 11 Forbes report, refining in Corpus Christi is in the best shape post-Harvey, and conditions deteriorate progressively along the Gulf Coast, with Beaumont/Port Arthur refineries in the worst shape and likely to have the longest recovery. In its coverage of the Dallas Fed survey, the Chronicle reported that nearly 80% of executives expected Harvey still to have a slight or moderate impact on the refining industry in six months.

Less knowable are the commercial and contractual domino effects of Harvey. Many ongoing contracts are likely to have been unperformed for some period as a result of Harvey. Force majeure concerns are likely to arise from, among other situations, production shutdowns as a result of the hurricane and subsequent flooding; flooding or other damage to the premises of goods and services providers, resulting in delayed or non-delivery of goods; and potential government actions. Of course, every instance of delayed, partial or non-performance by one party is likely to have a detrimental effect on others in the energy value chain. As a result, we can anticipate that the energy industry is likely to experience a rise in contract disputes across a range of Hurricane Harvey-related situations that will trigger force majeure or similar concerns, as occurred in the aftermath of Hurricane Katrina and Hurricane Ike.

Force majeure, and the related doctrines of impossibility and/or commercial impracticability, may be viable defenses to failure to perform a contract where the failure to perform is caused by a natural disaster. It is typical for a commercial contract to contain a force majeure clause. Where a contract contains a force majeure clause, under Texas law, the terms of the contractual force majeure clause, as opposed to any common-law definition, generally control the breadth of the defense. *See, e.g., Virginia Power En. Mktg., Inc. v. Apache Corp.*, 297 S.W.3d 397, 402 (Tex. App.—Houston [14th Dist.] 2009, pet. denied) ("The scope and effect of a 'force majeure' clause depends on the specific contract language, and not on any traditional definition of the term.").

Most contractual force majeure clauses cover "acts of god," such as hurricane, flood, other severe weather events, war, terrorist attacks or similar occurrences. Every force majeure clause is different, and the precise language of the clause should be the first consideration when assessing what to do if a company finds itself potentially unable to perform a contract in the wake of a weather event like Hurricane Harvey. Some force majeure clauses will add a specific requirement that the event be "unforeseeable," while others are drawn more broadly (although a court interpreting the provision may still read an unforseeability requirement into the contract). *See, e.g., Valero Transmission Co. v. Mitchell Energy Corp.*, 743 S.W.2d 658, 663 (Tex. App.—Houston [1st Dist.] 1987, no writ); *Hydrocarbon Mgmt., Inc. v. Tracker Expl., Inc.*, 861 S.W.2d 427 (Tex. App.—Amarillo 1993, no writ). Force majeure clauses frequently require the non-performing party to take reasonable steps to minimize delay or damages caused by the force majeure event. The force majeure clause may also require the party claiming force majeure to provide notice to the other contracting party, often by a certain method (for instance, in writing), and possibly within a certain period of time. Close attention should be paid to any such requirements.

Even if there is no force majeure clause in the contract, depending on the jurisdiction, common-law doctrines that are the functional equivalent of a force majeure clause may provide a defense to performance. For example, in Texas, impossibility is recognized as a defense to contract performance. Pertinent to the post-Harvey situation, this defense may be applied where the thing necessary for performance has been destroyed or deteriorated and where the action is prevented by government regulation. *See, e.g., Key Energy Servs., Inc. v. Eustace*, 290 S.W.3d 332, 340 (Tex. App.—Eastland 2009, no pet.). The impossibility defense may also be referred to as a force majeure defense or a "commercial impracticability" defense. Regardless of the nomenclature used by the parties and the court, at common law, a situation approaching true impossibility—as opposed to mere impracticability or inconvenience (such as financial inconvenience)—will typically be required for this defense to be successful.

Similar defenses are recognized across much of the world, which (depending on choice of law issues) may be pertinent when inability to perform is implicated in a transnational contractual relationship. For example, the United Nations Convention on Contracts for the International Sale of Goods (CISG), which applies to certain commercial transactions between parties who are citizens of signatory states, provides that a "party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences." CISG Art. 79(1). Like a typical force majeure provision, the CISG also includes requirements for proper remedial actions and notice to the other party.

Ultimately, whether a force majeure or a similar doctrine will excuse performance is likely to turn on whether the party claiming force majeure could reasonably have avoided either the causal situation or non-performance. Whether the event was foreseeable is one element of this inquiry, but it is not necessarily determinative. For instance, if an unforeseeable event were to cause a contract to become more expensive to perform (but not impossible), a force majeure defense is likely to be challenging to prove. *See, e.g., Valero Transmission Co. v. Mitchell Energy Corp.*, 743 S.W.2d 658, 663 (Tex. App.—Houston [1st Dist.] 1987, no writ) ("[A] contractual obligation cannot be avoided simply because performance has become more economically burdensome than a party anticipated.").

It is best practice for a party considering asserting force majeure to analyze and evaluate whether there are alternatives that would make partial performance possible. Good faith and honest communications with the other party(ies) to the contract are key. It is generally advisable for the non-performing party to retain any written communications detailing the efforts taken to perform; this evidence may become important in defending any resulting breach of contract action. A non-performing party should also be careful about industry perception: performing one's most lucrative contracts, while not performing the less lucrative ones on the basis of a force majeure event, may result in negative visibility if such "most favored nation" status is not part of the underlying contractual relationship(s). While none of these issues alone may be dispositive, they may have a practical effect on the outcome of any resulting disputes.

In sum, if Hurricane Harvey and its aftermath appear to have made performance of a contract impossible, consulting the relevant contract(s) for any governing force majeure language should be the first step. Alternative means of performance, even if difficult, should also be thoroughly considered. Communication with the other contracting party(ies) is key and should be done in as timely a manner as possible. And finally, if the ultimate determination is that performance is not possible due to a force majeure event, notice should be provided to the other party(ies) in the time and manner required by the contract and/or governing law.

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