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Pennsylvania Supreme Court Reverses Approval of Gas Well Pad on Narrow Grounds, But Suggests that Municipalities May Permit Unconventional Natural Gas Drilling in any and all Zoning Districts

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***Robinson Township* Revisited**

The parameters of Pennsylvania local government regulation of the oil and gas industry continue to be refined and left uncertain by the ongoing judicial fallout from the Pennsylvania Supreme Court's 2013 decision in *Robinson Township v. Commonwealth.*[1] In *Robinson Township,* the Court invalidated two sections of Pennsylvania's updated Oil and Gas Act (Act 13) limiting the authority of local governments to regulate oil and gas operations. The three-Justice plurality decision was based on a reinvigorated interpretation and application of the Article I, Section 27 of the Pennsylvania Constitution, commonly known as the Environmental Rights Amendment (ERA), which states:

> The people have a right to clean air, pure water, and to the preservation of the natural, scenic, historic and esthetic values of the environment. Pennsylvania's public natural resources are the common property of all the people, including generations yet to come. As trustee of these resources, the Commonwealth shall conserve and maintain them for the benefit of all the people.

A fourth Justice found those sections of Act 13 to be invalid based on due process grounds. In reaching its conclusion, the plurality questioned the long-standing three-part balancing test applied to determine when Commonwealth actions violate the ERA. That test originally had been adopted by the Pennsylvania Commonwealth Court in its 1973 decision in *Payne v. Kassab.*[2] Under *Payne,* Commonwealth actions were measured under the following standard:

> (1) Was there compliance with all applicable statutes and regulations relevant to the protection of the Commonwealth's public natural resources?
>
> (2) Does the record demonstrate a reasonable effort to reduce the environmental incursion to a minimum?
>
> (3) Does the environmental harm which will result from the challenged decision or action so clearly outweigh the benefits to be derived therefrom that to proceed further would be an abuse of discretion?

***PEDF*: The ERA and State Leasing**

Because the part of the *Robinson Township* addressing *Payne* was only a plurality decision, it was not binding precedent. However, in 2017 the Pennsylvania Supreme Court rendered a decision in *Pennsylvania Environmental Defense Foundation v. Commonwealth,*[3] in which a majority of the

[1] 83 A.3d 901 (Pa. 2013).

[2] 312 A.2d 86 (Pa. Commw. Ct. 1973).

[3] 161 A.3d 911 (Pa. 2017).

Court definitively rejected the *Payne* balancing test. The *PEDF* case did not deal with local, or even state, regulatory authority, but instead involved a challenge to the disposition of revenues obtained by the Commonwealth in conjunction with its lease of oil and gas rights in Pennsylvania state parks and forests. The court found that the ERA grants citizens the right to "clean air and pure water, and to the preservation of natural, scenic, historic and esthetic values of the environment" and the right of "common ownership by the people, including future generations, of Pennsylvania's public natural resources." While it remains unclear how the appellate courts will analyze these rights, the Pennsylvania Environmental Hearing Board has analyzed this standard in several Department of Environmental Protection permitting actions, finding that the ERA does not permit unreasonable degradation, diminution, depletion or deterioration of the environment.[4]

Gorsline: Applicability of the ERA to Local Land Use Permitting?

The ramifications of *Robinson Township* again were considered by the Pennsylvania Commonwealth Court in *Gorsline v. Fairfield Township Zoning Hearing Board.*[5] There, the Commonwealth Court upheld a township's conditional use approval of an oil and gas well in a Residential Agriculture (R-A) zoning district. The township zoning ordinance did not expressly authorize oil and gas wells; however, the ordinance contained a "savings clause", which authorized similar and compatible uses in that district as conditional uses. The Commonwealth Court found that the proposed well was similar to and compatible with other uses permitted in that district and rejected *Robinson Township*-ERA based arguments to the contrary. Although there was no automatic appeal by right, the Supreme Court agreed to take the case and address four issues, including whether "the Commonwealth Court's decision below, that an industrial shale gas development is similar to and compatible with uses expressly permitted in an R-A District, conflicts with this Court's decision in *Robinson Township*."[6]

On June 1, 2018, the Supreme Court published its long-awaited *Gorsline* opinion.[7] In a 4-3 decision, the majority reversed the Commonwealth Court's ruling affirming the granting of a conditional use approval for the well pad, but it did so in a narrow holding, finding that the operator there did not present enough evidence before the township establishing that the well pad was "similar to" other uses allowed in the township's R-A District under the ordinance's savings clause.

In light of its determination that the operator did not meet its burden of proof on the similar use issue, the majority declined to address the closely-watched constitutional question – objectors' claimed violations of substantive due process rights and the ERA based on their interpretation of *Robinson Township.* However, the majority opinion concluded with language recognizing that zoning decisions are inherently local matters, and that municipalities are empowered to "permit oil and gas development in any or all of its zoning districts."[8] In addition, the majority cautioned that its holding "should not be misconstrued as an indication that oil and gas development is never permitted in residential/agricultural

[4] *Ctr. for Coalfield Justice and Sierra Club v. DEP,* EHB Dkt. No. 2014-072-B (August 15, 2017); *The Delaware Riverkeeper, et. al. v. DEP and R.E. Gas Development, LLC.*, EHB Dkt. No. 2014-142-B(Consolidated with 2015-157-B)(May 11, 2018).

[5] 123 A.3d 1142 (Pa. Commw. Ct. 2015).

[6] *Gorsline v. Fairfield Township Zoning Hearing Board*, 139 A.3d 178 (Pa. 2016)..

[7] 186 A.3d 375 (Pa. 2018).

[8] *Id.* at 389.

districts, or that it is fundamentally incompatible with residential or agricultural uses."[9] The three dissenting Justices would have addressed the *Robinson Township* constitutional question, and faulted the objectors for reading *Robinson Township* too broadly when they claimed that natural gas development is inherently incompatible with residential uses, and that its impacts never can be mitigated through imposition of conditions on approval. Thus, language in both the *Gorsline* majority and dissenting opinions appears to reject the post-*Robinson Township* assertion of many shale gas opponents that unconventional natural gas wells must be relegated to industrial zoning districts and are fundamentally incompatible with residential or agricultural zoning districts.

Ordinance Validity Challenges Based on *Robinson Township*

Although the Supreme Court's 2013 decision in *Robinson Township* was viewed as a victory for those advocating local regulatory control of oil and gas operations, industry opponents quickly sought to use that decision to attack local ordinances permitting industry activity. They argued that these local ordinances violate the ERA because they do not regulate oil and gas development stringently enough, that ordinances cannot permit oil and gas uses in agricultural or residential districts, and that municipalities must engage in extensive environmental assessments when enacting regulations or considering development applications.

The *Gorsline* decision already has directly impacted one lower court case addressing these types of ordinance validity challenges. In June 2017, the Commonwealth Court, in *Delaware Riverkeeper v. Middlesex Township Zoning Hearing Board*,[10] affirmed the validity of a township zoning ordinance authorizing oil and gas wells in a number of zoning districts, either as uses by right or as conditional uses. In late 2017, the Supreme Court ordered that its consideration of the objectors' petition for allowance of appeal be placed on hold pending its decision in *Gorsline*. Two months after its decision in *Gorsline*, the Supreme Court entered an order vacating the Commonwealth Court decision in *Delaware Riverkeeper* and remanding the case back to the Commonwealth Court for reconsideration in light of the Supreme Court's decisions in *Gorsline* and *PEDF*. In doing so, the Supreme Court expressly quoted its passage from *Gorsline* that "this decision should not be construed as an indication that oil and gas development is never permitted in residential/agricultural districts, or that it is fundamentally incompatible with residential or agricultural uses."[11]

There is one more appeal pending before the Commonwealth Court raising *Robinson Township*-ERA ordinance validity issues. In *Frederick v. Allegheny Twp. Zoning Hearing Board,*[12] the Westmoreland County Common Pleas Court affirmed a zoning hearing board decision rejecting a challenge to a township zoning ordinance authorizing oil and gas wells as a use by right in all zoning districts. The appeal in that case was argued in November 2016 before the same three-Judge Commonwealth Court panel hearing the *Delaware Riverkeeper* argument. After more than a year of inactivity, the Commonwealth Court in early 2018 ordered supplemental briefs addressing the implications of *PEDF*.[13] Oral argument was heard before the court *en banc* in February 2018, and a decision is pending.

[9] *Id.*

[10] 2017 WL 2458278 (Pa. Commw. Ct. 2017)(unpubished).

[11] *Delaware Riverkeeper v. Middlesex Twp. Zoning Hearing Bd.*, No. 270 WAL 2017 (Pa. Aug. 3, 2018).

[12] No. 1898 of 2015 (Washington Cnty. Ct. of Common Pleas October 21, 2015).

[13] No. 2295 CD 2015 (Pa. Commw. Ct. Jan. 3, 2018).

Conclusion

The Pennsylvania Supreme Court gradually is fleshing out the parameters of local government regulatory rights and responsibilities under the ERA in the post-*Robinson Township* world. Decisions by the Commonwealth Court, and perhaps the Supreme Court, in *Delaware Riverkeeper* and *Frederick* are likely to be the next judicial building blocks in this developing jurisprudence. It is critical to note that while virtually all the post *Robinson Township* cases have addressed oil and gas operations, the developing case law will be applicable to virtually all Pennsylvania land development activities, including other extractive industry, commercial and residential uses.

Yanny or Laurel? Black & Blue or White & Gold Dress? Fixed or Floating Royalty? The Texas Supreme Court Decides Another Fixed or Floating Royalty Case

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Audio and visual illusions aside, few issues cause as much frustration and confusion in the oil and gas industry as the fixed or floating debate. In *U.S. Shale Energy II, LLC v. Laborde Props., L.P.*, 17-0111, 2018 WL 3189552 (Tex. June 29, 2018), the Texas Supreme Court decided yet another fixed or floating royalty case, this time finding a floating royalty.

A royalty interest can be either "fixed" or "floating." A "fixed" or "fractional" royalty interest is an unchanging fraction of production that "remains constant" and "is untethered to the royalty amount in a particular oil and gas lease."[1] On the other hand, a "floating" or "fraction of" royalty interest is "a fractional share of the royalty that is provided for in a lease."[2] A floating royalty "varies depending on the royalty in the oil and gas lease in effect and is calculated by multiplying the fraction in the royalty reservation by the royalty in the lease."[3] In short, when the lease royalty increases (or decreases), so does the floating royalty, while the fixed royalty remains constant.

While the definitional distinction is clear, ascertaining which type of royalty interest was conveyed or reserved by a deed is a task that can be fraught with difficulty. Disputes are common when an instrument contains multiple fractions in the grant or reservation, whether as a double fraction (e.g., 1/2 of the 1/8 royalty) or a restated fraction (e.g., a 1/2 royalty, the same being equal to 1/16 of production), sometimes with an express reference to the "usual" 1/8 royalty (e.g., 1/2 of the usual 1/8 royalty). One of these fractions is almost always 1/8 or a multiple thereof. "Of course, as long as the landowner's royalty provided in a lease . . . is set at 1/8, the reservation has the exact same effect regardless of whether the reserved interest is classified as fixed or floating."[4] But since many of these deeds were executed, royalty rates have become more favorable for lessors, with leases now commonly providing for a 1/4 or 1/5 royalty. Because the classification of a royalty as fixed or floating can have a significant impact on the size of the interest and, consequently, the size of the royalty owner's checks, it is no surprise there is ample litigation on this issue.

The "legacy of the 1/8 royalty" (sometimes incorrectly referred to as the "estate misconception" theory) is often cited as the reason many older deeds contained seemingly conflicting fractions. At the time these deeds were executed, "[t]he ubiquity of the 1/8 landowner royalty led many landowners to presume that the landowner royalty would remain 1/8 in perpetuity."[5] The Texas Supreme Court has "thus recognized that, '[t]hough not inexorably so, the reality is that use of 1/8 (or a multiple of 1/8) in some instruments undoubtedly embodies the parties' expectation

1 *U.S. Shale Energy II, LLC v. Laborde Props., L.P.*, No. 17-0111, 2018 WL 3189552, at *2 (Tex. June 29, 2018) (quoting *Hysaw v. Dawkins*, 483 S.W.3d 1, 9 (Tex. 2016)).

2 *Butler v. Horton*, 447 S.W.3d 514, 517 (Tex. App.—Eastland 2014, no pet.) (citing *Moore v. Noble Energy, Inc.*, 374 S.W.3d 644, 647 (Tex. App.—Amarillo 2012, no pet.) (citing *Range Res. Corp. v. Bradshaw*, 266 S.W.3d 490, 493 (Tex. App.—Fort Worth 2008, pet. denied))).

3 *Laborde Props.*, 2018 WL 3189552, at *2 (quoting *Hysaw*, 483 S.W.3d at 9).

4 *Id.*

5 *Id.* (citing *Hysaw*, 483 S.W.3d at 10; *Luckel v. White*, 819 S.W.2d 459, 462 (Tex. 1991)).

that a future lease will provide the typical 1/8th landowners' royalty.'"[6] However, the Court has cautioned against giving the "legacy of the 1/8 royalty" dispositive weight.[7]

Few definite rules of construction have emerged.[8] Indeed, the Texas Supreme Court has recognized that "[b]ecause the parties' intent as expressed within the document must control . . . '[v]ariety of outcome should be expected,' even among documents that contain similar words and phrases."[9] Thus, Texas courts continue to grapple with interpretive challenges in construing these deeds, sometimes reaching inconsistent or even irreconcilable results, leading to these cases reaching the Texas Supreme Court with seemingly greater frequency than other mineral lease construction issues.

In *Laborde*, a 1951 deed reserved to the grantors "**an undivided one-half (1/2) interest in and to the Oil Royalty**, Gas Royalty and Royalty in other Minerals in and under or that may be produced or mined from the above described premises, **the same being equal to one-sixteenth (1/16) of the production**."[10] Over half a century later, the lessee under a lease providing for a 1/5 royalty issued a division order crediting the grantor's successors with 1/2 of the 1/5 royalty (for a total of 1/10 of production), based on its interpretation of the deed as reserving a floating 1/2 royalty interest.[11] The grantee's successor disputed this allocation and contended that the grantor's successors held a fixed 1/16 royalty interest and thus should be credited with only 1/16 of production.[12] Litigation ensued, and the trial court declared that the deed reserved a floating 1/2 royalty interest.[13] The San Antonio Court of Appeals reversed, finding the second clause of the reservation ("the same being equal to one-sixteenth of the production") modified the first (1/2 interest in and to royalty), evidencing an intent to reserve a fixed 1/16 interest.[14]

The Texas Supreme Court reversed, holding that "the deed unambiguously reserved a floating 1/2 interest in the royalty."[15] The Court began its analysis by noting that the first clause of the reservation, when read independently, "clearly" and "quite plainly" reserved a floating royalty interest, as it expressed the parties' intent "to link the reserved interest to the royalty in effect at any given time."[16] Because there was "no evidence that a lease was in effect when the deed was executed," the Court found it of no consequence that the standard royalty in 1951 was 1/8 as "[t]he parties could not have intended to tie the reservation to something that simply did not exist."[17]

6 *Id.* (citing *Hysaw*, 483 S.W.3d at 11).

7 *Hysaw*, 483 S.W.3d at 13.

8 In *Hysaw*, the Court rejected "mechanical rules of construction that offer certainty at the expense of effectuating intent" and "rote multiplication of double fractions." *Id.* at 4, 16.

9 *Laborde Props.*, 2018 WL 3189552, at *5 (Boyd, J., dissenting) (citing *Hysaw*, 483 S.W.3d at 13).

10 *Id.* at *1.

11 *Id.*

12 *Id.*

13 *Id.*

14 *Laborde Props., L.P. v. U.S. Shale Energy II, LLC*, No. 04-16-00168-CV, 2016 WL 5922404, at *1 (Tex. App.—San Antonio Oct. 12, 2016), *rev'd*, No. 17-0111, 2018 WL 3189552 (Tex. June 29, 2018).

15 *Laborde Props.*, 2018 WL 3189552, at *1.

16 *Id.* at *3, *5.

17 *Id.* at *3.

The issue, then, was whether the second clause ("the same being equal to one-sixteenth (1/16) of the production") "indicates an interest fixed at 1/16 of production despite the language in the first clause tying it to the royalty."[18] The Court answered in the negative, disagreeing with the court of appeals and the dissent that the second clause modified the first, finding such interpretation would render the first clause meaningless.[19] Specifically, if the deed was construed as reserving a fixed 1/16 royalty, "the statement in the deed purporting to reserve a 1/2 interest in and to the royalty is no longer true when the [lease] royalty deviates from 1/8."[20] "By contrast, construing the deed to reserve a floating royalty interest properly harmonizes the deed's pertinent language," as "it continues to be true that (1) the deed reserved a 1/2 interest in the royalty (which is now 1/5), and (2) that 1/2 interest amounted to 1/16 of production when the deed was executed in 1951 (though, under the current lease, it amounts to 1/10 of production)."[21] Under the latter interpretation, said the Court, "neither clause of the reservation is nugatory because both are given proper grammatical and practical effect" regardless of the lease royalty rate.[22]

To harmonize the two clauses, the Court found the second "simply describes the effect of the first" and merely clarified, "as an incidental factual matter," what a 1/2 interest in the royalty would amount to when a lease provided for a 1/8 royalty, the common royalty rate at that time.[23] The Court found further support for this interpretation in a single comma (though it took care to assure that the comma was not "the dispositive consideration").[24] Offset by a comma, the second clause was a nonrestrictive dependent clause, meaning it only "'gives additional description or information that is incidental to the central meaning of the sentence' and 'could be taken out of the sentence without changing its essential meaning.'"[25] As such, the incidental second clause could not modify or vary the first clause but instead simply provided clarification.[26]

The three-justice dissent, on the other hand, viewed the deed as reserving a fixed 1/16 royalty interest, finding it "obvious" the grantors "believed they were reserving a royalty interest equal to 1/2 of a 1/8 royalty" because "a 1/8 royalty was then the standard royalty" and "the first clause fits perfectly with the intent expressed in the second clause."[27] The dissent disagreed with the majority's foundational conclusion that the first clause, standing alone, clearly indicated intent to reserve a floating royalty interest, pointing to Texas Supreme Court and appellate cases that have found that clauses containing a single fraction with a reference to a "royalty" can describe either a fixed or a

18 *Id.*

19 *Id.* at *3-4.

20 *Id.* ("[I]f a lease agreement provides for any royalty rate other than 1/8 (such as the 1/5 royalty currently in effect), in order for the reserved royalty interest to remain consistent with 1/16 of production, that interest would necessarily deviate from 1/2, rendering the 1/2 interest clause meaningless.").

The dissent noted that the majority's assertion that construing the deed as reserving a fixed 1/16 royalty interest would render the first clause meaningless because the reserved interest would not equal 1/2 of the current lease's 1/5 royalty "depended wholly on [the majority's] improper foundational conclusion" that the first clause created a floating royalty and, in contrast with the majority's insistence, rendered the second clause meaningless. *Id.* at *8 (Boyd, J., dissenting).

21 *Id.* at *4-5.

22 *Id.*

23 *Id.* at *3-4.

24 *Id.* at *4.

25 *Id.* (quoting Bryan A. Garner, *The Redbook: A Manual on Legal Style* § 1.6(a), at 6 (3d ed. 2013)) (citing Bryan A. Garner, *The Elements of Legal Style* 140-41 (1991)).

26 *Id.*

27 *Id.* at *6 (Boyd, J., dissenting).

floating royalty interest.[28] The dissent also noted that cases finding floating royalty interests generally involve deeds that contain "other language," such as a minimum-royalty or future-lease clause.[29] Here, the dissent noted, there was no "other language" in the deed that would inform the meaning of the reservation.[30]

The dissent also criticized the majority for "constru[ing] the first clause in isolation, without considering" the second clause, which "provides insight into the first clause's meaning."[31] This divergence from the *Hysaw* Court's "commitment to a holistic approach aimed at ascertaining intent from all words and all parts of the conveying instrument," the dissent explained, led to the majority "constru[ing] the second clause in light of the meaning it attributed to the first clause" and "relegate[ing] the second clause to an afterthought."[32] Further, the dissent found the majority thereby ignored *Hysaw*'s mandate to consider all other language in the document "*before* ascribing any particular meaning to double-fraction language in a conveying instrument."[33] Relying on the "legacy of the 1/8 royalty," the dissent opined that reading the first clause in the context of the second evidenced intent to reserve a fixed 1/16 royalty and was the only interpretation that would not render either clause meaningless.[34]

Although the majority relied on the "legacy of the 1/8 royalty" to explain the purpose of the second clause, it found the dissent's reliance on the doctrine and resulting "construction ignore[d] the fact that the parties reserved 1/2 of the '[r]oyalty' with no language indicating that the parties intended to limit the rate to the 1/8 that was commonly used at the time."[35] Quoting *Hysaw*'s holding that "'the possibility that the parties were operating under the assumption that future royalties would remain 1/8 will not alter clear and unambiguous language that can otherwise be harmonized,'" the Court noted its interpretation harmonized both clauses "while the dissent's view would render the first clause meaningless when the applicable lease agreement provides for any royalty other than 1/8."[36]

The sharp contrast in the majority's and dissent's approach to interpreting a seemingly simple sentence and their divergent conclusions, both reached at least in part in reliance on "the legacy of the 1/8 royalty," is indicative of the frustration involved in construing these provisions. *Laborde*, in conjunction with the many cases that came before it, exemplifies that the ultimate conclusion depends on the precise language, punctuation, and sentence structure of not only the grant/reservation, but also on other provisions of the deed (*see Hysaw*), as well as the weight the court affords to the "legacy of the 1/8 royalty."

28 *Id.* at *7-8 (citations omitted).

29 *Id.* at *6 (Boyd, J., dissenting) (citations omitted).

30 *Id.*

31 *Id.* at *8.

32 *Id.*

33 *Id.* (citing *Hysaw*, 483 S.W.3d at 14) (emphasis by dissent).

34 *Id.*

35 *Id.* at *4.

36 *Id.* (quoting *Hysaw*, 483 S.W.3d at 10).

U.S. Third Circuit Affirms Dismissal of Pipeline Challenge for Lack of Subject Matter Jurisdiction Because Plaintiff Failed to Seek Rehearing Before FERC and then Filed in District Court, Rather than Appellate Court

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In *Adorers of the Blood of Christ v. Federal Energy Regulatory Commission*, 897 F.3d 187 (3rd Cir. 2018), the plaintiffs were a religious order and individuals who owned land along the path of a proposed natural gas pipeline that would run for nearly two hundred miles within Pennsylvania.[1] The owner of the proposed pipeline sought a certificate of public convenience and necessity, pursuant to 15 U.S.C. § 717f of the Natural Gas Act.[2] The granting of such a certificate authorizes the holder of the certificate to begin construction of the pipeline and grants the certificate holder the power of eminent domain to secure the necessary rights-of-way.[3]

The plaintiffs were given notice of the pipeline company's application for a certificate, but they did not participate in hearings regarding the application.[4] FERC issued an order granting the certificate.[5] The plaintiffs did not seek a rehearing, but a little over five months later, the plaintiffs filed suit in federal district court, asserting that FERC's approval of the pipeline and the company's construction of it would violate the plaintiffs' rights under the Religious Freedom Restoration Act (RFRA).[6]

The United States District Court dismissed, concluding that it lacked subject matter jurisdiction. The Third Circuit affirmed. The appellate court noted that the Natural Gas Act allows a person aggrieved by an order issued by FERC to seek rehearing at any time within 30 days of the order.[7] If a person fails to seek rehearing, that person is barred from seeking judicial review.[8] If the person seeks rehearing, but FERC denies the relief sought on rehearing, the aggrieved person may seek judicial review in the D.C. Circuit Court of Appeals or the appellate circuit in which the natural gas company is located or has its principal place of business.[9] The Natural Gas Act gives the chosen appellate court exclusive jurisdiction over the matter.[10]

In this case, the plaintiffs were barred from seeking judicial review because they had not sought rehearing at FERC. Further, even if the plaintiffs had not forfeited their right to judicial review, the district court would not have had subject matter jurisdiction, because jurisdiction is vested exclusively in the appellate court.

The plaintiffs asserted, however, that the federal district court had subject matter jurisdiction under 28 U.S.C. § 1331 (federal question jurisdiction). They noted that RFRA mandates that the "[g]overnment shall not substantially burden a person's exercise of religion even if the burden results from a rule of general applicability," unless the government demonstrates that its action and the

[1] Adorers of the Blood of Christ v. Federal Energy Regulatory Commission, 897 F.3d 187, 189-90 (3rd Cir. 2018)
[2] *Id.* at 189, 190.
[3] *Id.* at 194; *see also* 15 U.S.C. § 717f(h).
[4] 897 F.3d at 190-1.
[5] *Id.* at *3.
[6] *Id.*
[7] *Id.* at 189; *see also* 15 U.S.C. § 717r(a).
[8] 15 U.S.C. § 717r(a) (No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon."); *see also* 897 F.3d at 189.
[9] 15 U.S.C. § 717r(b); *see also* 2018 WL 3559225 at *4.
[10] 897 F.3d at 189-93; *see also* 15 U.S.C. § 717r(b).

resulting burden is the "least restrictive means" of advancing a "compelling government interest."[11] The plaintiffs alleged that their religious beliefs require them to preserve the land and that construction of the pipeline, as well as the pipeline's facilitation of oil and gas activities, was contrary to their religious beliefs, and that FERC's approval of the pipeline constituted a violation of RFRA, as would the pipeline company's construction of the pipeline.[12]

Further, noted the plaintiffs, RFRA provides that "[a] person whose religious exercise has been burdened in violation of [RFRA] may assert that violation as a claim or defense in a judicial proceeding and obtain appropriate relief against the government."[13] The plaintiffs argued that this gave them the right to file suit in federal district court. The Third Circuit disagreed. The court noted that RFRA never states that an aggrieved person has a right to bring a claim in federal district court.[14] Rather, RFRA states that a person may assert a RFRA claim or defense in a "judicial proceeding." The Third Circuit explained that an appellate court proceeding is a "judicial proceeding."[15] Because the Natural Gas Act's allows a party to seek judicial review in an appellate court, after seeking and failing to obtain relief in an application for rehearing at FERC, the Natural Gas Act's scheme for challenging a FERC order is consistent with RFRA's provision that an aggrieved person may seek redress in a "judicial proceeding."

Further, the Natural Gas Act clearly seeks to divest district courts of jurisdiction to hear challenges to FERC orders, while placing exclusive jurisdiction in the appellate courts.[16] Accordingly, the Third Circuit affirmed the district court's order dismissing the case for lack of subject matter jurisdiction.[17]

[11] 897 F.3d at 194 (citing 42 U.S.C. § 2000bb-1(a) through (b)).
[12] *Id.* at 192, 193.
[13] *Id.* at 194 (citing 42 U.S.C. § 2000bb-1(c).
[14] *Id.*
[15] *Id.* at 196
[16] 897 F.3d 195.
[17] *Id.* at 198.

U.S. Fourth Circuit Affirms Dismissal of Challenge to Pipeline that was Filed in the District Court, Holding that Appellate Courts are Granted Exclusive Jurisdiction to Consider Challenges to FERC Orders

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In *Berkley v Mountain Valley Pipeline, LLC*, 896 F.3d 624 (4th Cir. 2018), the plaintiffs were individuals who owned land along the path of a proposed natural gas pipeline that would run in a mostly southerly direction through West Virginia and into Virginia. The owner of the proposed pipeline secured a certificate of public convenience and necessity, pursuant to 15 U.S.C. § 717f of the Natural Gas Act.[1] The granting of such a certificate authorizes the holder of the certificate to begin construction of the pipeline and grants the certificate holder the power of eminent domain to secure the necessary rights-of-way.[2]

The plaintiffs, who oppose the pipeline, brought suit in the United States District Court for the Western District of Virginia even before the certificate was granted, seeking an order that portions of the Natural Gas Act are unconstitutional.[3] They did so in an effort to stop the pipeline. The district court dismissed the suit, concluding that it lacked subject matter jurisdiction, and the plaintiffs appealed to the United States Court of Appeals for the Fourth Circuit, which affirmed the dismissal.[4]

The Fourth Circuit noted that that the Natural Gas Act generally divests federal district courts of jurisdiction to hear challenges to actions that FERC takes pursuant to the Act (condemnation actions are an exception).[5] The Act does not deny an opportunity of judicial review, but it provides that a person aggrieved by an action of FERC must first seek rehearing of a FERC action.[6] If the FERC denies the relief requested by the applicant for rehearing, then the person may appeal that denial to the appropriate federal court of appeals, but the person does not have the right to judicial review until FERC reaches a final decision on the application for rehearing.[7]

The plaintiffs complained that FERC often takes so long to resolve an application for rehearing that meaningful review is unavailable.[8] The Natural Gas Act requires FERC to act on applications for rehearing within 30 days, but often FERC acts by issuing an order that grants the application for rehearing to give itself time to consider whether to alter its prior decision. Thus, the FERC acts on the application within 30 days, but does not make a final decision whether to alter its prior order. The Fourth Circuit acknowledged that such use of tolling orders may, "in effect, deny a plaintiff meaningful judicial review" if a plaintiff is seeking to block a pipeline project, but, in these circumstances, this is not sufficient to avoid the effect of the statute.[9] The court noted the plaintiffs had not shown that they would suffer irreparable harm from the construction of the pipeline.[10]

[1] 896 F.3d at 628.
[2] *Id.*
[3] *Id.*
[4] *Id.* at 627.
[5] *Id.* at 629-30 (citing 15 U.S.C. § 717r).
[6] 896 F.3d at 630.
[7] *Id.* at 630, 631.
[8] *Id.* at 630-1.
[9] *Id.* at 631.
[10] *Id.* at 632.

Therefore, the appellate court affirmed the district court's order dismissing the case for lack of subject matter jurisdiction.[11]

[11] *Id.* at 633.

Pennsylvania Supreme Court Rules on Injunctive Relief for the Marcellus Shale Coalition[1]

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On June 1, 2018, the Pennsylvania Supreme Court largely affirmed and partially vacated a November 8, 2016 temporary injunction granted to the Marcellus Shale Coalition (MSC) in its challenge to several new regulations that had been promulgated by the Pennsylvania Environmental Quality Board[2] on October 8, 2016.

MSC had filed a Petition for Review[3] of limited sections of the new Chapter 78a Regulations on October 13, 2016, seeking expedited relief in the form of a temporary injunction of the challenged regulations pending review and resolution on the merits.

<u>The Commonwealth Court Decision</u>

Following a two-day hearing before a single judge of the Commonwealth Court in October 2016, the Court held that MSC had satisfied the six-part test[4] for obtaining injunctive relief for four of its seven substantive counts. The Court enjoined Pennsylvania Department of Environmental Protection from implementing and enforcing:

> Count I – new obligations related to potential impacts of well sites on non-listed species, which are neither threatened nor endangered species, and common areas of school property and playgrounds, and the creation of new "public resource agencies" with whom applicants would be required to consult prior to submission of well permit applications (25 Pa. Code §§ 78a.1 and 78a.15(f) and (g) (Public Resources));
>
> Count II – new obligations related to monitoring or remediation wells owned or operated by others (25 Pa. Code §§ 78a.52a(c)(3) and 78a.73(c) and (d) (Area of Review));
>
> Count IV – requirements to upgrade, re-permit or close existing freshwater impoundments and centralized impoundments (holding produced water) (25 Pa. Code §§ 78a.59b(b) and 78a.59c (Impoundments)); and

[1] *Marcellus Shale Coalition v. Pennsylvania Department of Environmental Protection and Environmental Quality Board*, Docket No. 573 M.D. 2016 (Commonwealth Court of Pennsylvania); and *MSC v. PADEP and EQB*, Docket No. 115 MAP 2016 (Pennsylvania Supreme Court). Babst Calland represents the Marcellus Shale Coalition in this action.

[2] In Pennsylvania, the EQB promulgates regulations authorized by various environmental statutes as well as the Pennsylvania Oil and Gas Act, 58. Pa. C.S. 2301 *et seq.* (Act 13), which authorizes the EQB to regulate the unconventional oil and gas industry through 25 Pa. Code Chapter 78a. Chapter 78a is a new chapter in the Pennsylvania Code that applies solely to the unconventional oil and gas operations, as defined in Act 13. As a practical matter, PADEP develops and proposes the regulations that the EQB formally adopts, usually without any revision.

[3] MSC filed its challenge to the Chapter 78a Regulations as a declaratory judgment action under the Pennsylvania Declaratory Judgments Act, 42 Pa. C.S. §7531 *et seq.* There is no statutory right to judicial review of regulations in Pennsylvania, but there is a long line of case law affirming the right to pre-enforcement review under some circumstances. *See Arsenal Coal Co. v. Commonwealth*, 477 A.2d 1333 (Pa. 1984).

[4] *See* Slip Op. fn 4 for the six-part test, which is uncontested.

Count V – new obligations for post construction stormwater management at well sites post drilling (25 Pa. Code § 78a.65(d) (Site Restoration)).[5]

The PADEP and the EQB, collectively the Agencies, appealed the injunction to the Pennsylvania Supreme Court.[6] The parties briefed the matter, and the Supreme Court heard oral arguments in October 2017. On June 1, 2018, Chief Justice Saylor authored the majority opinion that was joined by Justices Baer, Todd, Dougherty, Wecht and Mundy. Justice Donohue filed a concurring and dissenting opinion.

The Supreme Court Decision

The Supreme Court upheld the injunctions for Counts I and II, upheld a portion of the injunction for Count IV, and vacated the injunction for Count V entirely. Justice Donohue, in dissent, would have reversed the preliminary injunction on all counts.

The Supreme Court vacated a portion of the injunction of Count IV, related to the registration and upgrade of existing freshwater impoundments, believing that the PADEP claimed undisputed authority under the Dam Safety and Encroachments Act[7] for the regulation. The freshwater impoundments in question, however, are those that fall below the threshold for permits under DSEA and have been regulated by means of earth disturbance permits issued pursuant to the Clean Streams Law.[8]

Proceeding count by count, the Supreme Court squarely addressed two key parts of the six-part standard for injunctive relief—raising a substantial legal question and showing irreparable harm.

Substantial Legal Question

As for the substantial legal question, the Agencies had offered a new three-part test, citing no authority for their proffered standard of review. Slip Op. at 18. The Supreme Court confirmed the standard of review of a trial court order granting a temporary injunction is an inquiry into the record to determine "if there were any apparently reasonable grounds for the action of the court below." Slip Op. at 20, quoting *Brayman Constr. Crop. V. PennDOT*, 13 A.3d 925, 935-36 (Pa. 2011) (emphasis omitted).

The Supreme Court noted that the regulations at issue are legislative rules, rules that establish controlling standards of conduct, which are only valid if they "fall within the scope of the rulemaking power granted by the General Assembly." Slip Op. at 19. The Agencies argued that

[5] *MSC v. DEP*, Memorandum Opinion and Order, Nov. 8, 2016, as amended Feb. 14, 2017, J. Brobson. Counts for which injunctive relief was not granted include challenges to: 25 Pa. Code §§ 78a.58(f) (onsite processing), 78a.66 (remediation of spills), and 78a.121(b) (waste reporting).

[6] Under Pennsylvania Rule of Appellate Procedure 1736, there is an automatic supersedeas afforded when the Commonwealth appeals an order, effectively staying the temporary injunction pending resolution of its appeal. Accordingly, MSC filed for and obtained expedited relief vacating the automatic supersedeas and allowing the temporary injunction to stay in place during review by the Supreme Court. *MSC v. DEP*, No. 573 M.D. 2016 Order, J. Brobson (Dec. 8, 2016).

[7] Act 325 of Nov. 26, 1978, P.L. 1375, as amended, 32 P.S. §§ 693.1-693.27.

[8] Act 394 of June 22, 1937, P.L. 1987, as amended, 35 P.S. §§ 691.1-1001. Upon a joint request by the parties, the Commonwealth Court subsequently issued an order providing new deadlines related to freshwater impoundments, resetting the original time frames to start from the Court's order.

the trial court had not afforded appropriate deference to their interpretation of their enabling statutes but cited no authority for such deference. Slip Op. at 17-18. The Supreme Court concluded that less deference is afforded to an agency in the context of a preliminary injunction than would be applicable to a final determination on the merits. Slip Op. at 20. And as appellants, the Agencies had the burden to demonstrate the error in the trial court. Slip Op. fn 13.

The substantial legal questions implicated by the counts for which injunction was granted and affirmed include:

- the doctrine of *ejusdem generis*, as related to the expansion of the list of public resources enumerated in Act 13, Section 3215(c);
- statutory construction of the term "other critical communities" in Act 13, Section 3215(c);
- the new requirement to enter and take action on other persons' property, related to the area of review obligations and offset wells;
- the application of retroactive permitting standards to impoundments that were built in accordance with PADEP approvals and permits, with no change in the governing law; and
- the scope of the exemptions from Pennsylvania's Solid Waste Management Act[9] for oil and gas operations.

Irreparable Harm

As for irreparable harm, the Agencies' rulemaking record included cost estimates required by the Regulatory Review Act,[10] which were submitted to the Independent Regulatory Review Commission with both the proposed and final rulemaking packages. PADEP estimated the initial costs of compliance with the challenged provisions to range from $40 to $70 million, and up to $16 million annually thereafter.[11] As acknowledged by the Commonwealth and Supreme Courts, the costs of compliance with a rule that is ultimately invalidated are not costs recoverable from the Commonwealth, making the harm irreparable. Slip Op. at 23.

<u>Current Status</u>

The Supreme Court's majority opinion authorized continuation of the status quo for MSC members regarding new regulations that are drastic departures from the previous law, as well as new regulations that would impose substantial costs that would be unrecoverable if and when the challenged regulations are invalidated. As for the merits, both parties have briefed and will argue their applications for summary relief this fall before the Commonwealth Court, potentially resolving all remaining counts on the current record without the need for an evidentiary hearing.

[9] Act 97 of July 7, 1980, P.L. 380, as amended, 35 P.S. §§ 6018.101-1003.

[10] Act 181 of June 25, 1982, P.L. 633, 71 P.S. §§ 745.1-745.15.

[11] MSC has challenged PADEP's cost estimates as being too low, but points to the rulemaking record as admissions by PADEP regarding the inevitability of substantial costs.

Liability of Mortgagee-Bank for Faults of its Mortgagor-Borrower

Patrick S. Ottinger
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Energy lenders to the upstream sector released a collective sigh of relief, thanks to the Louisiana Supreme Court. In a highly anticipated ruling, the Supreme Court, on June 27, 2018, reversed the controversial decision of the Second Circuit, Court of Appeal, in *Gloria's Ranch v. Tauren Exploration*.[1]

The underlying operative facts in the case are not particularly controversial or unusual for a case arising out of Haynesville Shale formation, but the ruling of the trial court, as modified and affirmed by the appellate court, was both extreme and unprecedented in Louisiana law. It certainly was problematic, and a cause for significant concern to the energy lending industry.

The basic facts are these. Three companies held the mineral lease granted by Gloria's Ranch: Cubic, Tauren and Exco. Cubic borrowed money from a Wells Fargo affiliate, which debt was secured by a mortgage containing, among other customary provisions, an assignment of production proceeds. The mortgage and the credit agreement were typical of most documentation in a reserve based loan transaction, commonly called an "RBL."[2]

The mineral lease participated in production from the Cotton Valley and Haynesville zones, but production diminished to the point that the lessor asserted that the lease had lapsed due to lack of production in "paying quantities."[3] Gloria's Ranch issued a demand to the defendants for a release of the expired lease.[4] The defendants resisted, contending that the mineral lease had not lapsed. Additionally, royalties from a certain well completed in the Haynesville zone were not paid to Gloria's Ranch by the lessees.

Suit was filed by Gloria's Ranch against the three companies,[5] and Wells Fargo, mortgagee of Cubic, to declare the mineral lease to have expired by its own terms; for damages for failure to release the expired lease,[6] and for unpaid royalties from a well in Section 15. The trial court found

[1] 2017-C-1518 (La. 6/27/18); _ So. 3d _, *reversing* 223 So. 3d 1202 (La. App. Ct. 2d Cir. 2017). In the interest of full disclosure, the author of this article represented American Bankers Association and Texas Bankers Association as *Amici Curiae* in support of Wells Fargo's position.

[2] "At its core, the traditional reserve-based loan is little more than an asset-backed loan, a mortgage secured by oilfield reserves rather than a home." Michael P. Marek & Robert A. Wilson, *A Future For Reserve-Based Lending in Emerging Markets? Limitations on the Traditional Model*, 10 TEX. OIL & GAS L.J. 150 (2014).

[3] *See* Patrick S. Ottinger, *Production in "Paying Quantities"–A Fresh Look*, 51 ANN. INST. ON MIN. LAW 24 (2004). Also published at 65 LA. L. REV. 635 (Winter 2005). *See also* PATRICK S. OTTINGER, *Louisiana Mineral Leases: A Treatise* (Claitor's Law Books & Publishing Division, Inc., 2016), § 3-15 (hereinafter cited as "Ottinger, *Mineral Lease Treatise*").

[4] LA. REV. STAT. ANN. § 31:206. Under article 206 of the Louisiana Mineral Code, "when a mineral [lease] is extinguished by . . . expiration of its term, . . ., the former owner shall, within thirty days after written demand by the person in whose favor the right has been . . . terminated, furnish him with a recordable act evidencing the extinction or expiration of the [mineral lease]."

[5] Exco settled with the plaintiff prior to trial, leaving only Tauren, Cubic, and its mortgagee, Wells Fargo, as defendants.

[6] *Id.* at § 31:207. Under article 207 of the Louisiana Mineral Code, if the "former owner of the . . . expired mineral [lease] fails to furnish the required act [evidencing the termination of the mineral lease] within thirty days of receipt of the

that the mineral lease had lapsed due to the failure to produce in "paying quantities," and awarded damages for lost-leasing opportunities at $18,000 per acre ($22,806,000) due to the unreleased lease. It further awarded $726,087 for unpaid royalties for the well in Section 15 pursuant to article 140 of the Louisiana Mineral Code ($242,029.26 in royalties due plus $484,058.52 in "double royalties" as damages). Attorney's fees in the amount of $936,803 were also awarded. This judgment was rendered against all three remaining defendants (including Wells Fargo), *in solido*.[7]

Whatever can be said about the other parts of the court's decision, the most radical aspect of the decision is that the mortgagee-lender of one of the lessees (Cubic) was held co-extensively liable along with the defaulting lessees. Of particular relevance to this topic, with regard to Wells Fargo, the trial court held that the mortgage granted to it by Cubic contained an "assignment," sufficient to make Wells Fargo some sort of lessee and, thus, liable for the failure to release the expired mineral lease, and for unpaid royalties and codal damages. On appeal, the appellate court disagreed with that specific ruling, finding that the language of the mortgage on which the trial court relied was not an assignment of an interest in the Gloria's Ranch lease, but, rather, an assignment or pledge of production, in the nature of a security interest.[8]

Nevertheless, the appellate court found that the various covenants and provisions in the recorded mortgage (as well as the unrecorded credit agreement) constituted some indicia of "control," sufficient to justify a finding that Wells Fargo "owned" an interest in the lease that supported its liability along with Cubic. Most important to the court seemed to be a mortgage provision that required the bank's consent to the release by the lessee of an item of collateral, in this case, a mineral lease. As to this common mortgage clause, the court noted, as follows:

> 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. As such, Wells Fargo shared coextensive liability with Cubic to provide a recordable act evidencing the release of its interest in the lease, and we discern no manifest error in the trial court finding Wells Fargo solidarily liable with the remaining defendants.[9]

In its analysis leading to the determination 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," the appellate court evaluated this novel theory under the definition of

demand . . ., he is liable to the person in whose favor the . . . lease has been . . . expired for *all damages resulting therefrom* and for a reasonable attorney's fee incurred in bringing suit."

[7] Louisiana's liability *in solido* is the rough equivalent to "joint and several liability."

[8] This typical mortgage provision read, thusly:

2.03 Assignment. To further secure the full and punctual payment and performance of all present and future Indebtedness, up to the maximum amount outstanding at any time. . . . Mortgagor does hereby absolutely, irrevocably and unconditionally pledge, pawn, assign, transfer and assign to Mortgagee all monies which accrue after 7:00 a.m. Central Time . . . to Mortgagor's interest in the Mineral Properties and all present and future rents therefrom . . . and all proceeds of the Hydrocarbons . . . and of the products obtained, produced or processed from or attributable to the Mineral Properties now or hereafter (which monies, rents and proceeds are referred herein as the "Proceeds of Runs"). Mortgagor hereby authorizes and directs all obligors of any Proceeds of Runs to pay and deliver to Mortgagee, upon request therefor by Mortgagee, all of the Proceeds of Runs . . . accruing to Mortgagor's interest[.]

[9] 223 So.3d at 1224.

"ownership" under civil law as being composed of the rights of *usus, fructus* and *abusus*.[10] That the appellate panel seemed to recognize that it was entering uncharted legal territory, with significant implications to the sanctity and utility of a mortgage, it attempted to limit its ruling with the following admonition, to-wit: "We note this case is highly fact-intensive and should not be construed as governing other cases that may follow unless the same facts exist."

After affirming the trial court's award of damages, and awarding the additional award of attorney's fee of $125,000, the defendants applied to the court for rehearing, which was denied. However, two of the five judges[11] dissented vigorously from the denial of rehearing, stating that the decision might have "[d]evastating economic repercussions."[12]

The defendants next sought writs from the Louisiana Supreme Court, supported by significant *amici curiae* briefing. Writs were granted,[13] the case was briefed, and argued on March 13, 2018. The court issued its opinion on June 27, 2018, and unanimously reversed the Second Circuit's decision as it relates to the liability of a mortgagee for the faults or inactions of its borrower-lessee.

Justice Marcus Clark, writing for the court, noted that the mortgagee was not an "owner" for purposes of article 207 of the Mineral Code and, therefore, was not liable for damages "resulting" from the lessee's failure to release the expired mineral lease. Additionally, it found the mortgagee was not a "lessee" for purposes of article 140 of the Louisiana Mineral Code and, was not liable for failure to pay royalties that were due. Finding that a mortgage was expressly authorized by articles 203 and 204 of the Louisiana Mineral Code, the court concluded, as follows:

> Based on the foregoing, we find no authority for the court of appeal's holding that a mortgage and a credit agreement, which are both legally provided for in the La. Mineral Code, can be methods by which ownership of a mineral lease are conveyed simply because they assert some control over the collateral described therein. We find the "bundle of rights" controlled by Wells Fargo are not traits of ownership, but of security rights. The mortgage and credit agreement contain provisions typical of security contracts, all designed to protect the collateral.[14]

The decision of the Supreme Court was both authoritative and comprehensive in rejecting the novel theory embraced by the appellate court. Had the court not reversed the decision of the Second Circuit, the implications to lending practices in the upstream sector of the E&P industry would be far reaching and potentially problematic. If there were merit to the theory embraced by the

10 "Ownership is the right that confers on a person direct, immediate, and exclusive authority over a thing. The owner of a thing may use, enjoy, and dispose of it within the limits and under the conditions established by law." LA. CIV. CODE ANN. art. 477A.

11 A panel of an appellate court is composed of three judges, but in order to consider an application for rehearing, two additional judges are randomly assigned. LA. CONST. art. V, § 8(B).

12 Dissent in Denial of Rehearing, p. 1.

13 17-1518, 17-1519, 17-1522 (La. 12/15/17), 231 So.3d 639; 231 So.3d 640; 231 So.3d 642.

14 Opinion, page 10. Among other authority, the court cited Ottinger, *Mineral Lease Treatise*, § 12-10, for the proposition that it is "customary in the oil and gas industry" to include covenants and provisions of the type as found in the Wells Fargo mortgage.

appellate court (and the Supreme Court correctly held there was not), there would be no reason what a bank could not be held co-responsible with its borrower for other faults or inactions of the latter, including personal injury or death on the rig floor, unpaid vendors, "legacy lawsuits," and other claims encountered by the mineral lessee. Additionally, notwithstanding the Second Circuit's attempt to limit its decision, the ruling, while arising in the oil and gas context, would certainly be argued as applicable in other commercial contexts in which the loan documentation imposed covenants that could be assimilated to "control."

The Supreme Court's decision in *Gloria's Ranch* was cogent and precise in rejecting the rationale of the courts below, restoring the mortgage to its historic role of being merely a security device with great commercial efficacy. The various covenants and provisions contained in the mortgage granted by the mineral lessee to its lender are matters between the parties to the mortgage only, and are designed to allow the lender to be informed as to the operations and activities of its borrower in order to be fully informed as to the borrower's ability to repay the loan.[15] There is no basis in the law to allow a third party, such as a mineral lessor, to avail the various provisions contained in the mortgage.

The decision in Gloria's Ranch also addressed an issue concerning the damages authorized for non-payment of royalties. Several articles of the Louisiana Mineral Code provide authority for the award, in a suit for nonpayment of royalties, of "damages double the amount of royalties due . . .." In article 138.1, the award of "double damages" is mandatory ("the court shall award"), while, in all other articles, it is permissive ("the court may award").[16] With respect to those articles stating that the court "may award" damages, the courts have recognized that the award of damages is discretionary, and not mandatory.[17] One court has stated that, "generally, such a maximum penalty should be reserved for the most blameworthy conduct."[18]

Prior to the decision of the Supreme Court in *Gloria's Ranch*, however, an unsettled issue was whether the Mineral Code envisions a maximum award of "double," or actually "treble," the amount of unpaid royalties as damages. One school of thought was that the lessor is always entitled to its unpaid royalties, and the award of "double the amount of royalties due" is in addition to the royalties which are due, such that, in essence, the lessor might recover three times the royalties due.

While many courts have interpreted the codal provisions as authorizing, in essence, "treble" damages, Justice Knoll, in a dissenting opinion, expressed a contrary view in *Cimarex Energy Co. v. Mauboules*.[19] The decision in *Gloria's Ranch* resolves the conflicting views on the topic. The court has now clarified this issue, holding, as follows:

15 Covenants of this type are typically contained in a mortgage in an RBL transaction, and are encouraged by Federal regulators. *See* Comptroller's Handbook on Safety and Soundness, Oil and Gas Exploration and Production Lending, issued by the Office of the Comptroller of the Currency (March 2016), pp. 1-2, available for review: https://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/pub-ch-og.pdf.

16 "The word 'shall' is mandatory and the word 'may' is permissive." LA. REV. STAT. ANN. § 1:3.

17 *See*, *e.g.*, *Wegman v. Central Transmission, Inc.*, 499 So. 2d 436, 451 (La. App. Ct. 2d 1986), *writ den'd* 503 So. 2d 478 (La. 1987) ("Under R.S. 31:140 if the lessee fails to pay royalties due or fails to inform the lessor of a reasonable cause for failure to pay in response to the required notice, the court *may* award as damages double the amount of royalty due. Hence the award is discretionary."), and *Matthews v. Sun Exploration & Production Co.*, 521 So. 2d 1192, 1196 (La. App. Ct. 2d 1988) ("LSA-R.S. 31:140 provides the trial court with great discretion in awarding damages. It does not mandate that any award be given in excess of the royalties due.").

18 *Samson Contour Energy E & P, L.L.C. v. Smith,* 175 So. 3d 967, 981 (La. App. Ct. 2d 2015) (on rehearing).

19 40 So. 3d 931 (La. 2010).

Based on this generally accepted definition of damages as compensation for the loss sustained, we interpret La. Mineral Code art. 140 as authority to award up to double the amount of royalties due. Clearly, an award of the amount of royalties due is the compensation for the failure to perform that obligation. The use of the permissive word "may" gives the court the authority to double that amount if the court, in its discretion, finds the defendant's conduct so warrants. A contrary reading that assumes the unpaid royalties are something separate from "damages" ignores the plain meaning of the word "damages." We do not believe the law, as written, leads to any absurd results, and, thus, we conduct no further investigation as to the legislative intent. Accordingly, we amend the judgment to reflect that the damages due under La. Mineral Code art. 140 are equivalent to two times the amount of royalties due ($242,029.26 x 2 = $484,058.52).

Court Holds that Flat Rate Royalty Modifies Habendum Clause and that an Implied Covenant of Further Exploration Does Not Exist Under West Virginia Law

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In *Bounty Minerals, LLC v. EQT Production Co.*, 2018 WL 2749598 (N.D. W. Va. 2018), Bounty Minerals filed two suits in state court, asserting that oil and gas leases covering two tracts had terminated because of a lack of production in paying quantities. Bounty sought a declaratory judgment that the leases had terminated, and it also sought damages based on slander of title, with the alleged harm being lost leasing opportunities.[1] Alternatively, Bounty asserted that the lessee, EQT Production, had breached an implied covenant of further exploration and an implied covenant of reasonable development.[2]

Each of the oil and gas leases provided that it would last for a primary term and as long thereafter as the lessee (1) produced oil or gas, (2) operated the lease in search for oil or gas, or (3) used the leased premises for gas storage. Each lease also provided for a flat-rate royalty of either $100 or $87.50 every three months (depending on the tract where a well was located)—for each natural gas well drilled, "the product of which is marketed and sold off the premises, while the gas from said well is so marketed and used."[3] Bounty's petitions indicated that EQT had drilled at least one gas well on each tract, but that neither well was producing gas, and that EQT had continually tendered a purported flat-rate royalty or shut-in royalty on each well. Bounty contended that the wells were not producing, and further that the wells were not capable of producing in paying quantities. After removing the cases to federal court, where the cases were consolidated, EQT moved to dismiss all claims under Federal Rule of Civil Procedure 12(b)(6), arguing that the allegations in Bounty's petitions failed to state any cause of action.[4]

The court rejected Bounty's argument that the leases had terminated for a lack of production in paying quantities.[5] The court explained that the controlling West Virginia precedent was *Bruen v. Columbia Gas Transmission Corp.*, 426 S.E.2d 522 (W. Va. 1992). In *Bruen*, West Virginia's high court stated that if a lease contains a "'flat-rate' rent payments, then quantity of production is not relevant to the expiration of the lease if such 'flat-rate' rental payments have been made by the lessee."[6] The court rejected various arguments made by Bounty. For example, Bounty asserted that *Bruen* and a U.S. Fourth Circuit case applying *Bruen*[7] were distinguishable because those cases involved wells

[1] This claim appears in paragraph 14 of the plaintiffs' complaint in *Bounty Minerals, LLC v. EQT Production Co.*, No. 17-C-422 (N.D. W. Va. 2018), filed 12/18/2017.

[2] *Bounty Minerals, LLC v. EQT Production Co.*, 2018 WL 2749598 *1(N.D. W. Va. 2018)

[3] *Id.* at *3-4.

[4] *Id.* at *1.

[5] Id. at *2.

[6] Id. at *2 (citing *Bruen*).

[7] Wellman v. Bobcat Oil & Gas, Inc., 524 F. App' 26 (4th Cir. 2013).

that either were producing or merely shut-in, whereas EQT's wells were (Bounty alleged) incapable of production.[8] The court found that purported basis of distinguishing the earlier cases unconvincing.

Bounty also argued that, if the leases did not terminate under the facts alleged, EQT could continue the leases as long as it was willing to make rental payments.[9] The court disagreed, noting that the implied covenant of reasonable development can prevent a lessee from holding a lease indefinitely without developing the leased premises. Bounty further argued that if such payments were sufficient to maintain the lease in the absence of a well capable of producing paying quantities, then EQT would have been able to maintain the lease even if it had not drilled a well before the end of the primary term. The court disagreed again, stating that payment of a flat-rate royalty will not maintain a lease unless there is a well to which a flat-rate royalty clause applies. Thus, absent the application of some other savings clause, EQT's lease would have ended at the end of the primary term if EQT had not drilled any wells. Accordingly, the court dismissed Bounty's claim for a declaratory judgment that the leases had terminated. This also required dismissal of Bounty's slander of title claim, which depended on Bounty's contention that the leases had terminated.[10]

The federal district court then considered Bounty's claim for a breach of an implied covenant of further exploration. The court concluded that no such implied covenant exists under West Virginia law.[11] The court noted that the West Virginia Supreme Court of Appeals has never recognized such a covenant. Further, stated the court, such a covenant is not necessary to protect lessors because the implied covenant of reasonable development protects them. The court cited with approval a recent decision in which the Ohio Supreme Court rejected the existence of an implied covenant of further exploration under Ohio law, reasoning that a lessor's interests are adequately protected by an implied covenant of reasonable development.[12] The federal district court therefore dismissed Bounty's claim that EQT had breached an implied covenant of further exploration.

Finally, the court considered Bounty's claim that EQT had breached an implied covenant of reasonable development.[13] Bounty asserted that operators of "ordinary prudence and experience in the same general vicinity, or neighborhood, under similar conditions have been proceeding successfully with further development."[14] The court held that this and other facts alleged in Bounty's petitions were sufficient to state a cause of action for breach of the implied covenant of reasonable development. Accordingly, the court denied EQT's Rule 12(b)(6) motion to dismiss those claims.[15]

Notably, the court did not expressly discuss whether a lessee's duties under an implied covenant of reasonable development can encompass both a duty to drill additional wells to a proven formation and also a duty to drill wells to unproven formations whenever a reasonably prudent operator would do so. In some other jurisdictions in which courts have rejected the existence of an implied covenant of further exploration, the courts have suggested that the implied covenant of

[8] 2018 WL 2749598 at *4.

[9] *Id.*

[10] *Id.* at *5.

[11] *Id.* at *6.

[12] Alford v. Collings-McGregor Operating Co., 95 N.E.3d 382 (Ohio 2018).

[13] 2018 WL 2749598 at *6-7.

[14] *Id.* at *7.

[15] *Id.*

reasonable development can include a duty to drill wells both to proven and unproven formations, assuming a reasonably prudent operator would drill such wells.[16]

[16] *See, e.g.*, Sun Exploration & Prod. Co. v. Jackson, 783 S.W.2d 202, 204 (Tex. 1990) (citing Clifton v. Koontz, 325 S.W.2d 684, 696 (Tex. 1959)).

D.C. Circuit Holds that Neither FERC's Collection of Fees from Companies that it Regulates nor FERC's use of Tolling Orders in Pipeline Disputes Violates Environmental NGO's Due Process Rights

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In *Delaware Riverkeeper Network v. Federal Energy Regulatory Commission*, 895 F.3d 102 (D.C. Cir. 2018), an organization called the Delaware Riverkeeper Network brought suit against the Federal Energy Regulatory Commission (FERC), asserting that FERC's actions had violated the plaintiff's due process rights.[1] The plaintiff's main claim related to financing. FERC receives an annual appropriation from Congress.[2] A federal statute requires FERC to assess fees against the companies that it regulates in amounts sufficient to cover the annual appropriation from Congress. The amount of the annual appropriation goes into the United States Treasury, not directly to FERC, and the size of FERC's annual appropriation is not determined by the fees it collects.[3] Rather, the fees that FERC must collect are determined by the amount appropriated by Congress. Nevertheless, the plaintiff argued that the requirement that FERC collect fees from the companies that it regulates, including pipelines, creates a structural bias at FERC in favor of approving pipeline applications.[4]

The court rejected this claim. The court concluded that the requirement that FERC charge fees to the companies that it regulates does not create a structural bias because the size of FERC's budget is not controlled by the amount of fees it collects.[5] Further, the constitutional right to due process protects life, property, and liberty interests, and the court concluded that the plaintiff did not show any such interest at stake in FERC's pipeline deliberations.[6]

The plaintiff asserted a separate due process claim related to FERC's use of tolling orders to meet deadlines for acting on rehearing applications.[7] Under the Natural Gas Act, unless FERC "acts upon [an] application for rehearing within thirty days after it is filed, such applications may be deemed to be denied."[8] Riverkeeper asserted that FERC regularly fails to resolve rehearing applications within thirty days, and to meet its deadline to act on a rehearing application before the application is deemed to be denied, FERC "act upon the application" by issuing a tolling order that extends the pendency of the application indefinitely. If the application is seeking rehearing on an order that allowed construction of a pipeline to proceed, the result of the tolling order is that construction of the pipeline may proceed. Riverkeeper asserted that this can prevent judicial review until it is too late to stop construction of a pipeline because a party may not seek judicial review unless that party has sought rehearing of the order that the party seeks to challenge,[9] and because a party cannot seek review until after the application for rehearing is decided.[10] The D.C. Circuit

[1] 895 F.3d at 106.
[2] *Id.* at 111.
[3] *Id.* at 112.
[4] *Id.*
[5] *Id.*
[6] 895 F.3d at 110.
[7] *Id.* at 112-3.
[8] 15 U.S.C. § 717r(a).
[9] 895 F.3d at 113.
[10] 15 U.S.C. § 717r(b).

rejected this due process claim, noting that the Circuit has "long held that FERC's use of tolling orders is permissible under the Natural Gas Act."[11]

[11] *Id.* at 113.

West Virginia Passes Legislation Impacting Oil & Gas Leasing

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During the 2018 Regular Session, the West Virginia Legislature passed two bills that directly impact oil and gas leasing: the Cotenancy Modernization and Majority Protection Act (HB 4268) (the "Cotenancy Act") and the Act commonly referred to as the Check Stub Bill (HB 4270) (the "Check Stub Bill"). The following is a non-exhaustive overview of each.

1. The Cotenancy Act

The Cotenancy Act, codified in the Code of West Virginia, 1931, as amended ("W. Va. Code") at Chapter 37B, Article 1, Section 1, et seq.,[1] was enacted by the West Virginia Legislature on March 5, 2018, and was effective on June 3, 2018. The Cotenancy Act provides a limited means by which the interest of non-consenting cotenants ("NCCs") or unknown or unlocatable interest owners ("UUIs") in oil, natural gas, and their constituents may be leased on a tract-by-tract basis.[2] In addition to providing a mechanism for developing such interests not previously available without 100% owner participation, the Cotenancy Act modifies the existing law of waste, creating a statutory defense to a claim of waste or trespass when the interests are developed in accordance with the Cotenancy Act.[3]

For an owner or operator to utilize the Cotenancy Act, including the statutory defense to waste and trespass claims, several criteria must be satisfied: (1) there must be 7 or more royalty owners in the tract; (2) royalty owners with at least 75% of the right to develop the mineral interest must consent to the lawful use or development of the mineral property; (3) the owner or operator must make a "reasonable effort to negotiate with all royalty owners in [the] oil or natural gas mineral property"; and (4) the operator must provide its "best and final lease offer" to all NCCs.[4]

If the foregoing measures are met, a NCC has 45 days following operator's written delivery of its "best and final lease offer" during which the NCC may elect to receive either a prorata share of production royalty or a revenue share (i.e., a working interest). If the NCC does not deliver its written election during this 45-day period, the NCC will be deemed to have elected to receive the production royalty. During the 30-day period following the NCC's election (or deemed election) of the production royalty option, the NCC may appeal to the Oil and Gas Conservation Commission to verify that the correct royalty is being paid, but operations may proceed during this appeal process.[5]

UUIs are deemed to have elected a production royalty, and the Cotenancy Act provides certain reporting requirements for the remittance of such royalties to the West Virginia State

[1] The references to Chapter 37B, Article 1 of the W. Va. Code in the Cotenancy Act may change as a result of the Check Stub Bill, which was also drafted with references to W. Va. Code §37B-1-1, et seq. References herein to particular sections of the Cotenancy Act are therefore references to the sections of the Cotenancy Act appearing in the corresponding sections, as set forth in the Enrolled Version of House Bill 4268.

[2] W. Va. Code §37B-1-4(a).

[3] *Id.*; W. Va. Code § 37-7-2.

[4] W. Va. Code §37B-1-4(a), (c).

[5] W. Va. Code §37B-1-4(b), (c).

Treasurer.[6] After 7 years of the first such report to the Treasurer, a bona fide surface owner may file a quiet title action in order to acquire the interest of any or all UUIs in the oil and gas estate underlying its surface tract.[7]

Finally, it is worth noting that surface rights are not provided by the Cotenancy Act. When the Act is used to develop mineral interests, the operator may not drill or otherwise disturb the surface without the surface owner's consent, whether or not the surface owner also owns the associated mineral interest. Surface owner consent is not required, however, for tracts where there is no surface disturbance or for tracts otherwise "subject to an existing surface use agreement, oil and gas lease which includes surface use rights, or other valid contractual arrangement in which the owner has granted rights to the operator to use the surface for horizontal drilling or any other use for which this article is used."[8] The provision is expressly not intended to otherwise alter West Virginia common law regarding a mineral owner's rights to use the surface for mineral extraction.[9]

2. The Check Stub Bill

The Check Stub Bill, codified in the W. Va. Code at Chapter 37B, Article 1, Section 1, et seq.,[10] was enacted by the West Virginia Legislature on March 10, 2018, and was effective on June 8, 2018. The Check Stub Bill deals with timing and reporting requirements associated with payments being made to interest owners due to development and production of oil, natural gas, or their constituents by horizontal wells.[11] The following information is required to be enclosed with each such payment:

(a) Well name and/or number, and state API number, identifying each lease, property, unit, pad, and well for which the payment is being made, and county where the lease, property, and well are located;
(b) Production month and year;
(c) Total barrels of oil; MCF, MMBTU, or DTH of natural gas; and volume of natural gas liquids produced from each well and sold;
(d) Price received per unit of oil, natural gas, and natural gas liquids produced;
(e) Gross value of total proceeds, less taxes and deductions;
(f) Aggregate amounts of each category of deductions for each well that affects payments;
(g) Royalty owner's interest in production from each well, shown as decimal or fraction;
(h) Royalty owner's ratable share of the total value of proceeds of the sale of oil, natural gas, or natural gas liquids, prior to all deductions (including deduction of taxes);
(i) Royalty owner's ratable share of the proceeds from the sale of oil, natural gas, and natural gas liquids, less its ratable share of taxes and other deductions; and

[6] W. Va. Code §37B-1-4(d).

[7] W. Va. Code §37B-1-4(g).

[8] W. Va. Code §37B-1-6(a).

[9] W. Va. Code §37B-1-6(b).

[10] *See* fn.1. References herein to particular sections of the Check Stub Bill are references to the sections of the Check Stub Bill appearing in the corresponding sections, as set forth in the Enrolled Version of House Bill 4270.

[11] W. Va. Code §37B-1-1(a).

(j) Contact information for the producer, including mailing address and telephone number.[12]

The Check Stub Bill does not provide clear guidance on what specific deductions should be itemized, other than taxes and "each category of deductions for each well which affect payment and are allowed by law, including without limitation those deductions provided for under the terms of the governing lease."[13] If the interest owner does not receive the required information in a timely manner, such owner may send a written request for such information to the operator or producer by certified mail. If the operator or producer does not provide the information within 60 days following receipt of the request, the owner may bring a civil action against the operator or producer, and may recover attorneys' fees and court costs if successful.[14]

With respect to timing, all such payments shall be made within 120 days from the first date of sale, and within 60 days thereafter for each additional sale, unless the failure to comply with this timing requirement is due to a lack of record title, legal dispute concerning the interest, or other specified condition.[15] The Check Stub Bill provides an exception to this timing requirement, such that payments can be accumulated until the proceeds attributable to any interest owner exceeds $100. Notwithstanding this exception, payments must be made at least once annually and as soon as practicable upon cessation of production or upon transfer of the payment responsibility to another party.[16] Failure to make timely payments will result in a mandatory additional interest payment, with interest to be set at the prime rate, plus 2%, until payment is made, to be compounded quarterly.[17]

[12] W. Va. Code §37B-1-1(a).

[13] W. Va. Code §37B-1-1(a)(6).

[14] W. Va. Code §37B-1-1(a)(6).

[15] W. Va. Code §37B-1-3.

[16] W. Va. Code §37B-1-2.

[17] W. Va. Code §37B-1-3.

Federal Fifth Circuit Holds Debtor-in-Possession Lessee Is Bona Fide Purchaser

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The U.S. Court of Appeals for the Fifth Circuit held in June 2018 that a debtor-in-possession is a bona fide purchaser under Louisiana law and benefits from the accompanying protections, despite a failure to make agreed-upon settlement payments for the ratification of a mineral lease. In so doing, the court affirmed the holdings of the U.S. district and bankruptcy courts in the *Matter of Goodrich Petroleum Corporation*[1] that the lessor could not dissolve a ratified mineral lease for non-payment of amounts due under a settlement agreement with the lessee because the lessee, having filed for bankruptcy, represented a debtor-in-possession, standing in the shoes of the trustee, who was a third party bona fide purchaser. A bona fide purchaser could rely on the recorded lease ratification stating that consideration had been received, even though the lessee had failed to make the payments due under the settlement agreement between the parties.

The appellant, Fallon Family, L.P., filed a petition in 2012 against Goodrich Petroleum Corporation and Goodrich Petroleum Company, L.L.C. (collectively, "Goodrich") to terminate a mineral lease on the basis that Goodrich, the lessee, had ceased continuous operations. The parties settled in 2014, entering into an agreement whereby Fallon Family, L.P. would ratify the lease and Goodrich would make an initial $650,000 payment followed by $1 million in subsequent payments, the first installment of which was due in October 2015. The lease ratification was recorded in the conveyance records and stated in relevant part:

> NOW, THEREFORE, for the promises and covenants exchanged below, and other good and valuable consideration exchanged by the Parties on or near this date, the receipt and sufficiency of which is hereby acknowledged, the Parties agree . . .

Goodrich made the initial payment and the first installment payment. Goodrich, however, failed to make the next installment payment, leaving an outstanding balance of $900,000 owed to Fallon Family, L.P. Goodrich filed for bankruptcy on the same day that the second installment payment came due.

Fallon Family, L.P. filed an emergency motion in the bankruptcy proceeding, arguing in the alternative that the settlement agreement should be dissolved, stripping Goodrich of its interest in the lease.[2] In refusing to do so, the Fifth Circuit discussed the interplay between Section 544(a) of Title 11, U.S. Code, known as the "strong arm" provision of the Bankruptcy Code, and the Louisiana Public Records Doctrine, codified in Article 3338 of the Louisiana Civil Code.

The "strong arm" provision grants to the bankruptcy trustee the right to "avoid any transfer of property of the debtor . . . that is voidable by . . . (3) a bona fide purchaser of real property, other than fixtures, from the debtor, . . . whether or not such a purchaser exists." The court pointed out that, under the Bankruptcy Code, because the debtor-in-possession stands in the shoes of the trustee, the code creates a legal fiction whereby the debtor enjoys the abilities and rights of a bona fide purchaser.

[1] *Matter of Goodrich Petroleum Corp.*, 894 F.3d 192, 197 (5th Cir. 2018), *as revised* (June 29, 2018).
[2] The principal goal of the motion was to compel assumption or rejection of the settlement agreement as an executory contract under Section 365 of Title 11, U.S. Code, which the bankruptcy court declined to do. That issue is not discussed by the Fifth Circuit.

Having established that Goodrich held the position of a bona fide purchaser, the court then looked to Louisiana law. The Louisiana Public Records Doctrine states:

> The rights and obligations established or created by the following written instruments are without effect as to a third person unless the instrument is registered by recording it in the appropriate mortgage or conveyance records pursuant to the provisions of this Title:
>
> [. . .]
>
> (2) The lease of an immovable.[3]

Article 3343 of the Louisiana Civil Code defines a third person as one "who is not a party to or personally bound by an instrument." Citing to its holding in *In re Zedda*,[4] the court disagreed with Fallon Family, L.P.'s argument that debtors-in-possession and bona fide purchasers are not third persons under the law. The court also rejected Fallon Family, L.P.'s argument that Article 128 of the Mineral Code applied to force Goodrich to fulfill its pre-bankruptcy obligations to Fallon Family, L.P.

The court then cited the longstanding principle in Louisiana law that "where the conveyance record indicates that consideration has been paid in full, a third party is not susceptible to the remedy of dissolution, which would be available between original contractual parties."[5] Because the lease ratification indicated that consideration had been paid, Fallon Family, L.P. could not argue otherwise. The court recognized that while Goodrich the debtor failed to fulfill its obligations under the settlement agreement, Goodrich the debtor-in-possession nevertheless could avoid dissolution.

This holding highlights the business risk inherent in recording a document indicating that consideration has been paid in full when, by the actual agreement between the parties, consideration remains to be paid.

[3] LA. CIV. CODE art. 3338.
[4] *In re Zedda*, 103 F.3d 1195 (5th Cir. 1997).
[5] *Matter of Goodrich Petroleum Corp.*, 894 F.3d at 201.

Federal District Court Dismisses City of New York's Climate Change Lawsuits Against Major Oil and Gas Companies

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In *City of New York v. BP, P.L.C.*, 2018 WL 3475470 (S.D. N.Y. 2018), the City of New York filed suit against Chevron Corp., Exxon Mobil, BP p.l.c., Royal Dutch Shell plc, and ConocoPhillips—seeking compensatory damages for costs that the City alleges it has incurred, as well as future costs that it will incur, because of sea-level rise caused by climate change that is caused in large part by the burning of fossil fuels.[1] The City also sought certain injunctive relief.[2] The City characterized its claim as arising under New York law, based on theories of public nuisance, private nuisance, and trespass.[3] The defendants moved to dismiss, arguing that the City's complaint failed to state a claim and that the court lacked jurisdiction.[4]

The court granted the motion to dismiss. Central to the court's reason was its conclusion that the City's claim was, in large part, governed by federal common law, not state law. In explaining its conclusion that federal common law applied, the court noted that the City's complaint alleged that, "Greenhouse gas molecules cannot be traced to their source, and greenhouse gases quickly diffuse and comingle in the atmosphere. However, because of their rapid and widespread global dispersal, greenhouse gas emissions from each of Defendants' fossil fuel products are present in the atmosphere in New York State."[5] Citing the decision of the United States Ninth Circuit Court of Appeals, the court stated that "Widespread global dispersal is exactly the type of 'transboundary pollution suit[]' to which federal common law should apply."[6] The court's conclusion that federal common law governs the City's claims is further supported by the fact that much of the combustion of fossil fuels that occurs in the United States takes place outside New York.

The court then analyzed the viability of the City's claims under federal common law, noting that, in *American Electric Power Co, Inc. v. Connecticut*, 564 U.S. 410 (2011), the United States Supreme Court held that the Clean Air Act displaces any federal common law nuisance claims to enjoin a defendant's emissions of greenhouse gas emissions.[7] Further, in *Native Village of Kivalina v. ExxonMobil Corp.*, 696 F.3d 849 (9th Cir. 2012), the United States Ninth Circuit held that the Clean Air Act displaces any federal common law claims for damages arising from past emissions.[8] Relying on *American Electric Power* and *Kivalina*, and also citing Judge Alsup's decision in *City of Oakland v. BP, P.L.C.*, 2018 WL 3109726 (N.D. Cal. 2018), the court held that the City's claims were displaced by the Clean Air Act, to the extent that the City based its claims on combustion of fossil fuels in the United States, and that the Clean Air Act did not support a cause of action for the City's claims.[9]

[1] 2018 WL 3475470 at *1-2.
[2] *Id.* at *2.
[3] *Id.*
[4] *Id.* at *3.
[5] *Id.* at *4.
[6] *Id.* (quoting and citing Native Village of Kivalina v. ExxonMobil Corp., 696 F.3d 849 (9th Cir. 2012)).

[7] 2018 WL 3475470 at *4.
[8] *Id.* at *5.

[9] *Id.* at *6

The City also argued that its claims should not be displaced by the Clean Air Act because the City was complaining about the defendants' sale and marketing of fossil fuels, but the court rejected that argument, noting that the harms alleged by the City arise from combustion of fossil fuels, not the production or sale of them.[10]

Finally, the City noted that its complaint also alleged harm arising from activities that occur outside the United States, and that the Clean Air Act does not apply to emissions that occur outside the U.S.[11] Accordingly, argued the City, the Clean Air Act should not displace claims based on activities outside the U.S. The court held, however, that the general presumption against the extraterritorial effect of U.S. law led to the conclusion that the City's claim was not viable, even as it relates to foreign sales and emissions.[12] Therefore, the City's entire claim should be dismissed.

[10] *Id.* at *5

[11] *Id.* at *6.

[12] *Id.* at *7.

U.S. District Court Dismisses Oakland and San Francisco's Climate Change Lawsuits Against Major Oil and Gas Companies

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In September 2017, in *City of Oakland v. BP, P.L.C.*, 2018 WL 3109726 (N.D. Cal. 2018), the Cities of Oakland and San Francisco brought separate actions in state court against five of the largest investor-owned oil and gas companies in the world—Chevron Corp., Exxon Mobil, BP p.l.c., Royal Dutch Shell plc, and ConocoPhillips—seeking billions of dollars for costs that the cities allege they will incur because of sea-level rise caused by climate change that is caused in large part by the burning of fossil fuels, including the products produced by the defendants.[1] The cities characterized the claims as public nuisance claims under California law.[2] The defendants removed the case to federal court arguing that the plaintiffs' claims should be governed by federal common law, and the cases were consolidated before Judge Alsup of the United States District Court for the Northern District of California.[3] The court agreed that the case should be governed by federal common law, and therefore denied the plaintiffs' motion to remand in an order issued in February 2018. The plaintiffs then amended their complaints to include public nuisance claims based on federal common law, while retaining their public nuisance claims based on California law.

In March 2018, at the request of Judge Alsup, the parties' counsel and experts conducted a day-long tutorial on climate change science for the court. All parties agreed that climate change is occurring and that the combustion of fossil fuels plays a substantial role in causing climate change, as does deforestation.[4] The court accepted that conclusion.

The defendants moved to dismiss the plaintiffs' action for failure to state a claim, and the court's analysis focused on that motion. The court noted that, early in the litigation, the plaintiffs had seemed to "limit liability to those who had promoted allegedly phony science to deny climate change," in an effort to influence public policy. But in an apparent effort to avoid running afoul of the *Noerr-Pennington* doctrine, the plaintiffs adjusted their arguments to avoid assertions that efforts to affect public policy form a basis for liability.[5] Instead, the plaintiffs argued that the sale of fossil fuels, "combined with an awareness that greenhouse gas emission led to increased global temperatures, constitute a public nuisance," even if the sales are otherwise lawful. The court noted that this claim was "breathtaking" in scope, and would affect many sellers of fossil fuels throughout the world.[6]

The court and the parties looked to the Restatement (Second) of Torts § 821B to determine what constitutes a public nuisance.[7] The court stated that the existence of a public nuisance claim "requires proof that a defendant's activity unreasonably interferes with the use or enjoyment of a public right and thereby causes the public-at-large substantial and widespread harm." In determining

[1] *City of Oakland v. BP, P.L.C.*, 2018 WL 3109726 *3, 7 (N.D. Cal. 2018).

[2] *Id.* at *3.

[3] *Id.*

[4] *Id.* at *3, 4.

[5] Id. at *4 n.6.

[6] 2018 WL 3109726 at *4.

[7] *Id.* at *4, 5.

whether harm is unreasonable, a court should weigh the utility of conduct against the harm caused by such conduct. The court explained that, for this reason, although climate change has caused harm and will continue to cause harm, such harm must be weighed against the benefits of fossil fuel use. The court stated that "our industrial revolution and the development of our modern world has literally been fueled by oil and coal. Without those fuels, virtually all of our monumental progress would have been impossible. All of us have benefitted. Having reaped the benefit of that historic progress, would it really be fair to now ignore our own responsibility in the use of fossil fuels and place the blame for global warming on those who supplied what we demanded? Is it really fair, in light of those benefits, to say that the sale of fossil fuels was unreasonable?"[8]

Ultimately, however, the court stated that it did not need to decide that question in order to resolve the cases before it. The court noted that, in *American Electric Power Co, Inc. v. Connecticut*, 564 U.S. 410 (2011), the United States Supreme Court held that the Clean Air Act displaces any common law nuisance claims to enjoin a defendant's emissions of greenhouse gas emissions.[9] Further, in *Kivalina v. ExxonMobil Corp.*, 696 F.3d 849 (9th Cir. 2012), the United States Ninth Circuit (whose decision was binding on the U.S. District Court for the Northern District of California) has held that the Clean Air Act displaces any federal common law claims for damages arising from past emissions.[10] The plaintiffs attempted to distinguish *American Electric Power* and *Kivalina* by arguing that those cases dealt with claims based on emissions, whereas the Cities of Oakland and San Francisco were complaining about the defendants' sale of fossil fuels.[11] The court rejected that purported distinction, noting that the harms alleged by the two cities are caused by emissions from the combustion of fossil fuels, not from the mere act of selling those products.[12]

The court noted that the plaintiffs' complaints also allege that harm has caused by sales and emissions outside the U.S.[13] Such emissions would not be covered by the Clean Air Act and therefore claims based on those emissions should not be displaced by the Act.[14] The court held, however, that the general presumption against the extraterritorial effect of U.S. law led to the conclusion that the plaintiffs' claim was not viable, even as it relates to foreign sales and emissions.[15] Therefore, the entire claim should be dismissed. Otherwise, the decision of a "single judge or jury in California" could "effectively allow plaintiffs to govern conduct and control energy policy on foreign soil."[16]

[8] *Id.* at *5.

[9] *Id.* at *6.

[10] *Id.* at *6.

[11] 2018 WL 3109726 at *6.

[12] *Id.*

[13] *Id.* at *7.

[14] *Id.* at *6.

[15] *Id.* at *7.

[16] 2018 WL 3109726 at *7.

Ohio Federal Court Finds Statutory Unitization Is *Not* A Taking

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In R.C. 1509.28, Ohio has adopted a statutory unitization process that enables producers to optimize development of a common source of supply while utilizing the most economically-efficient and effective drilling techniques available. It serves to prevent waste, protect correlative rights and conserve the state's scarce natural resources, and is one way by which owners of a common source of supply get to share in the benefits of production that could otherwise be lost. It is an essential device in the state's conservation tool-box to prevent minority interest owners from blocking development through strategic behavior.

Naturally, there are challenges. In *Kerns v. Chesapeake Exploration, L.L.C.*, plaintiffs filed suit in the U.S. District Court for the Northern District of Ohio claiming that a unit order issued to Chesapeake Exploration, L.L.C., by the Division of Oil and Gas Resources Management under R.C. 1509.28 was an *unconstitutional taking of plaintiffs' mineral estate*. In rejecting that claim, the court issued a number of interesting holdings:

First, the court held that Chesapeake was not a state actor for purposes of asserting a constitutional violation under 42 U.S.C. § 1983. Private entities, according to the court, may be "considered state actors for the purposes of § 1983 only if the conduct that allegedly gave rise to the deprivation of plaintiffs' constitutional rights may be 'fairly attributable to the state.'" That depends on whether "the State has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State." Here, the court found that neither Chesapeake's application for the unit order and permit, nor its drilling of and production from a well, with plans to drill two more, were sufficient to qualify as state action, noting that "[p]rivate use of state-sanctioned private remedies or procedures does not rise to the level of state action." (Citation omitted.)

Second, the court held that R.C. 1509.28 was a legitimate exercise of the state's police power and therefore the use of its procedures do not constitute impermissible takings of property. In doing so, the court recognized that the Supreme Court of the United States has consistently held that a state may adopt reasonable regulations to prevent economic and physical waste of natural resources even if those regulations impact the property rights of individual owners. It rejected the argument that these prior Supreme Court decisions were inapplicable because they were rooted in considerations of correlative rights that do not apply in the context of the horizontal development of shale formations containing minerals that would otherwise be non-migratory. "The state's interest in protecting the rights of landowners and avoiding waste and negligence exist regardless of the type of drilling at issue. Indeed, if Plaintiffs' arguments were accepted, landowners would be left with no mechanism for retrieving oil in a way that avoids waste and contemplates the rights of their neighbors."

Notably, the court also rejected the argument that a per se taking had occurred because the drilling fractured the shale underlying plaintiffs' property, resulting in a physical trespass of water, sand, and hydraulic fracturing chemicals. It reasoned that private property rights are created by state law, and that in Ohio, subsurface ownership rights are not absolute but subject to the general police power of the state.

The court's decision falls squarely within the holdings of every other court to have considered the issue of whether a statutory unitization or pooling process amounts to an unconstitutional taking of private property. It has been appealed to the United States Court of Appeals for the Sixth Circuit, and we will update you on any future developments.

[Disclosure: The Vorys law firm represented Chespeake in this matter.]

Offset-Well Clauses: Attempting to Apply Classic Oil and Gas Concepts in the Horizontal Well Context

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A common theme in recent oil and gas jurisprudence, the Texas Supreme Court recently evaluated how yet another principle established in the world of the vertical well applied modernly to horizontal drilling in *Murphy Exploration & Production Company v. Adams*.[1]

Lessors sued for breach of contract against lessee to determine whether a well drilled on the lessors' tract satisfied the relevant lease's offset well provision.[2] The provision required that, within 120 days following completion of a producing well on an adjacent tract located within 467 feet of the leased premises, the lessee must either (1) commence operations on the leased premises "to a depth adequate to test the same formation" from which the adjacent tract was producing, (2) pay the lessors royalties as provided for in the leases as if an equivalent amount of production was being obtained on the leased premises as from the adjacent tract, or (3) release acreage sufficient to constitute a spacing unit allocated under the leases to the well on the adjacent tract as to the producing zones.[3]

Upon completion of a producing well on the adjacent tract at a location 350 feet from the leased premises, the lessee chose to exercise the first option and commenced drilling operations.[4] The parties agreed that the well was drilled within the appropriate time frame and to the appropriate depth pursuant to the offset well provision.[5] The sole discrepancy between lessors and lessee was whether the well was, in fact, an "offset" well.[6] The lessors contended the well was not an offset well in light of the common meaning of "offset" and industry understanding of the term—essentially, it was too far from the producing well on the adjacent tract to offset any drainage.[7] The lessee, however, argued that, under contract interpretation principles, the leases imposed no location or spacing requirement on the offset well, despite a clear depth requirement, time requirement, and even a proximity requirement for the *triggering* well.[8]

The trial court rendered summary judgment against the lessors, but the appellate court reversed and remanded.[9] The appellate court found that the lessee did not meet its burden of proof: *conclusive evidence that the well "offset" the triggering well and prevented draining*.[10] The lessee's expert did testify that traditional notions of drainage across lease lines have limited application in the Eagle Ford where the triggering and alleged offset wells were located, but he did not "conclusively

1 *Murphy Expl. & Prod. Co.-USA v. Adams*, 16-0505, 2018 WL 2449313 (Tex. June 1, 2018).

2 *Id.* at *2.

3 *Id.* at *1.

4 *Id.*

5 *Id.*

6 *Id.*

7 *Id.* at *2.

8 *Id.*

9 *Id.*

10 *Id.*

answer the specific question" of whether the well the lessor drilled protected the lessors' tract from drainage by the triggering well.[11]

By a five-vote majority, the Texas Supreme Court reinstated the trial court's judgment as modified, finding that the appellate court "read a requirement into the lease that its unambiguous language does not support."[12] The majority opinion found that the leases, executed in 2009, "were drafted with horizontal shale drilling in mind,"[13] and the "realities of this type of drilling are thus part of the 'facts and circumstances surrounding the contract's execution' that may 'inform' [the] construction of the lease language."[14] Original understanding of the implied covenant to protect against drainage[15] and the express offset well lease provisions "arose in the context of vertical wells, which are designed to 'drain an entire reservoir' of minerals that have 'seeped out' and sit 'on top of shale.'"[16] In contrast, the court recognized that little drainage can occur in horizontal wells because they specifically perforate the less permeable shale to produce.[17]

The lessors' argument (and the appellate court holding) that courts should *imply* a proximity requirement at risk of "writing the word 'offset' out of the provision entirely" was rejected.[18] The Supreme Court instead found that, had the parties negotiating the leases intended "offset" only to protect against "drainage," they would have referenced the direction and placement of perforations along the horizontal wellbore; since they had contemplated horizontal drilling, they certainly had also contemplated that the surface location of a horizontal well is entirely irrelevant to draining as opposed to the direction of the drilling and the location of the perforations.[19] As such, the parties must have intended "to require accelerated drilling when production from a well on an adjacent tract evidenced that the leased tract was also capable of production."[20]

Focusing on those aforementioned realities of horizontal drilling, which provided the context for this logic, the court expressly limited its holding to leases involving shale plays and hydraulic fracturing of horizontal wells, noting that outside of that particular context, similar language may not reflect the same intention.[21]

Despite the narrow holding, a lengthy dissent indicates that this issue is far from resolved. Justice Johnson's dissent, joined by three other justices, argues that the majority oversimplified the case by deciding the lease was unambiguous, allowing it to construe the offset wells provision as a matter of law and grant summary judgment, thereby avoiding consideration of any outside evidence

11 *Adams v. Murphy Expl. & Prod. Co.-USA*, 497 S.W.3d 510, 516-17 (Tex. App.—San Antonio 2016), rev'd, 16-0505, 2018 WL 2449313 (Tex. June 1, 2018).

12 *Murphy*, 2018 WL 2449313 at *1, *7.

13 *Id.* at *4.

14 *Id.* (citing *URI, Inc. v. Kleberg County*, 543 S.W.3d 755, 765 (Tex. 2018)).

15 *Id.* at *3 (citing *Kerr-McGee Corp. v. Helton*, 133 S.W.3d 245, 253 (Tex. 2004) (breach of implied covenant to protect against draining requires lessor to meet difficult burden to show "substantial drainage" and "that a reasonably prudent operator would have acted to prevent the drainage")).

16 *Id.* at *4 (citing Jason Newman & Louis E. Layrisson, III, *Offset Clauses in a World Without Drainage*, 9 TEX. J. OIL GAS & ENERGY L. 1, 11 (2013-2014) (citing *Elliff v. Texon Drilling Co.*, 210 S.W.2d 558, 561 (1948))).

17 *Id.*

18 *Id.* at *5.

19 *Id.*

20 *Id.* at *6.

21 *Id.* at 7.

by which the lessors could present their true intent—to protect against drainage, as the provision has meant to do "for decades before" without consideration of the "finer points of oil and gas production." The dissent finds this particularly true where the leases are "not limited to the Eagle Ford Shale, but instead encompass all the minerals under the lease acreage, and . . . specifically contemplate . . . vertical wells."

Turning to the plain language of the contract, the dissent asks, if not to protect from drainage, then what does the word "offset" contribute to the lease, further noting that contracts should be interpreted to give meaning to each provision therein and terms should be given their plain and generally accepted meanings. The dissent notes that neither current industry sources nor oil and gas jurisprudence originating in the same timeframe as these leases were executed "reflect a change in the traditional definition and understanding of offset in light of new trends in oil and gas production."[22] By including an offset wells provision, the lessors believed they were opting out of relying on the implied covenant to protect against drainage and meeting the extremely high burden that implied covenant requires. Instead, an offset well clause generally saves the time and expense of proving drainage. The lessee's summary judgment burden, therefore, was to *conclusively prove its well was protecting against drainage from the triggering well.*

Before the Texas Supreme Court decision, the appellate court's holding created uncertainty for both the lessor *and* the lessee. For the lessee, the question became, if not this well, then what well *would* meet the court's practically impossible summary judgment burden? The lessees in shale formations would have to prove an offset well protects against drainage *without any showing that drainage ever occurred* (which would have been required under the implied covenant to protect against drainage). And the court of appeals created a mandatory definition for "offset well" regardless of the contractual or geological context (which, again, would have been considered under the implied covenant to protect against drainage as part of proving drainage was occurring). For the lessor, although the appellate court decision essentially *presumed* drainage when a triggering well reaches a certain proximity to the lease lines, the reverse could have been argued: the same proximity could have benefited the lessee to establish a presumption of protecting against drainage.

Yet a 5-4 holding does not solidify the worries of either party. Even after the Texas Supreme Court spoke, the questions posed by the Texas Oil and Gas Association amicus brief in favor of the lessee still remain unanswered; particularly, is fracturing into another well's matrix—which could damage the triggering well and, at a minimum, create trespass issues but is presently the *only known method of preventing drainage in the Eagle Ford*—required?[23] Alternatively, is the Supreme Court instead saying there is *no* way to protect against drainage in these tight formations? Does this reinstate the heavy burden of proving drainage, otherwise only required by the implied covenant to prevent against drainage, into modern offset well provisions? The holding is, however, a win for textualism and basic contract interpretation principles: these questions remain unanswered because the court followed the textualist route to determine the provision at issue did not require consideration of drainage.

The flood of litigation that the appellate court decision made way for is still on the brink, or at the very least, lessors should be primed for a new negotiation battle. If the courts will not enforce the definition of "offset well" as one preventing drainage, lessors will strive to incorporate new terms into

22 *Id.* (citing *Coastal Oil & Gas Corp. v. Garza Energy Trust*, 268 S.W.3d 1, 14 (Tex. 2008) (applying classic rule of capture and offset well concepts in the tight formation context)).

23 Brief for Texas Oil and Gas Association as Amici curiae Supporting Petitioner at 23, *Murphy Expl. & Prod. Co.-USA v. Adams*, 16-0505, 2018 WL 2449313 (Tex. June 1, 2018).

leases. But if that definition *is* incorporated, lessees will be even more reluctant to permit any requirements outside of the implied covenant to protect against drainage.

This case further raises the question of what extent the Court's willingness to interpret leases through modern, tight-formation and horizontal fracturing drilling will have on other classic oil and gas concepts and lease provisions. This also could increase the wager in oil and gas litigation as expert testimony becomes more and more important to explain that the type of formation and drilling scheme *do* matter, particularly to interpret a modern lease, as the strong dissent in this case motivates parties to challenge intent of the negotiating parties.

Louisiana Oil Well Lien Act Amended with Regard to Wastes "Produced in Association with Hydrocarbons, After it is Placed in a Truck, Rail-Car, Pipeline, or Other Means of Transportation for Disposal Away from the Well Site."

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Louisiana Revised Statutes 9:4861 through 9:4873 are commonly known as the Louisiana Oil Well Lien Act (LOWLA). These provisions provide for a privilege[1] that can arise in favor of a person who provides services, equipment, or supplies for "operations" at the "well site" of a well that is used to explore or produce hydrocarbons, to produce water for use in oil and gas operations, or to inject, for purposes of disposal, wastewater generated by oil and gas activities.[2]

Louisiana Revised Statute 9:4861(4)(b) specifies certain activities that do not constitute "operations" for purposes of LOWLA, and which therefore do not qualify for a privilege under LOWLA. A category of activities that previously have been expressly defined as not constituting "operations" were activities involving "transporting, handling, processing, treating, or otherwise dealing" with "[s]alt water or another waste substance produced in association with hydrocarbons, after it is placed in a truck, rail-car, pipeline, or other means of transportation for disposal away from the well site." The effect of that provision, which was found at Louisiana Revised Statute 9:4861(4)(b)(iii), was to prevent LOWLA from applying to those activities. But Act 245 of the 2018 Regular Session of the Louisiana Legislature repeals 9:4861(4)(b)(iii).

The effect of the repeal would seem to be to allow LOWLA to continue to apply after waste substances are placed on a truck for transport away from the well. However, portions of LOWLA seem to restrict the Act's effect to work performed at the well site itself. For example, LOWLA creates a privilege in favor of contractors for the price of their contract for "operations,"[3] and Louisiana Revised Statute 9:4861 defines "operations" as being certain activities conducted "on a well site." The privilege also applies in favor of "laborers or employees" for the price of their "labor performed at the well site."[4] Provisions of LOWLA also create a privilege in favor of someone who transports "movables" (a civil law term that is more or less equivalent to the common law concept of personal property, as opposed to real property) "to" a well site,[5] and in favor of someone who transports "persons" either to or from wells located in "waters of the state,"[6] but arguably the literal terms of these two transportation provisions do not apply to someone who transports wastes away from a well site. Thus, someone could argue that LOWLA does not apply once a truck carrying wastes leaves the well site.

[1] The Louisiana-law term for a secured interest in favor of one person that results in a lien on property belonging to someone else is a "privilege." Louisiana Civil Code article 3186 states: "*Privilege* is a right, which the nature of a debt gives to a creditor, and which entitles him to be preferred before other creditors, even those who have mortgages." The Louisiana Oil Well Lien Act itself states that it creates a "privilege." *See* La. Rev. Stat. 9:4862.

[2] La. Rev. Stat. 9:4861.

[3] La. Rev. Stat. 9:4861(A)(1).

[4] La. Rev. Stat. 9:4862(A)(3).

[5] La. Rev. Stat. 9:4862(A)(4).

[6] La. Rev. Stat. 9:4862(A)(5)

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