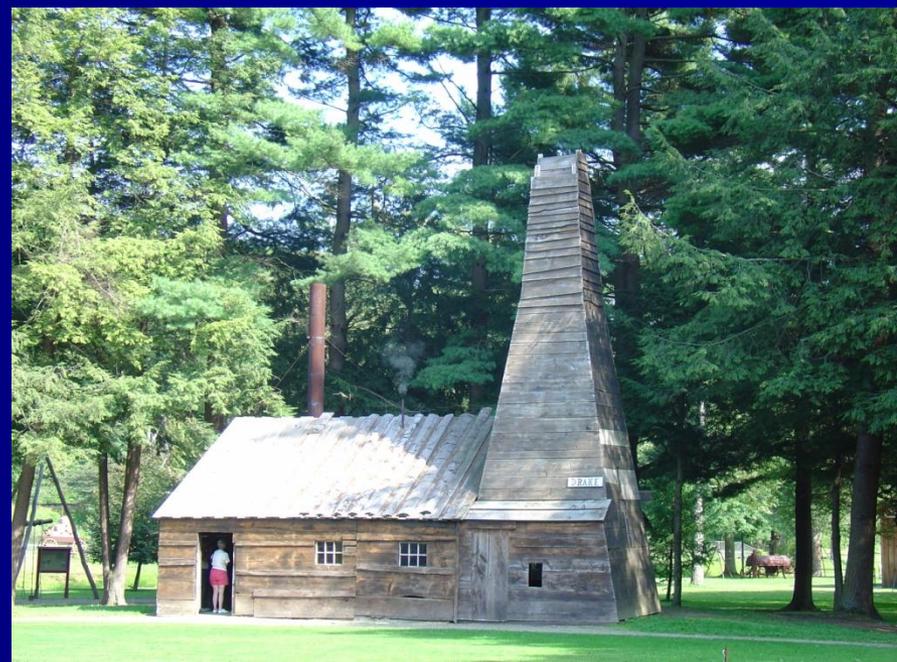




Marcellus Shale in the Courts: Pennsylvania Oil and Gas Case Law

2010 Marcellus Summit
State College, Pennsylvania

October 11, 2010





History of the Agricultural Law Center

- Established through the enactment of the Agricultural Law Resource and Reference Center Act on January 29, 1998.
 - House Bill 1345 (Act 11 of 1998)
 - Codified at 3 P.S. 2201-2009



Purpose of the Agricultural Law Center

■ Section 2205

- “to serve as a resource on agricultural law and related issues for farmers and agribusinesses, attorneys, officials at all levels of government, community groups, and the public.”



Dissemination of Information

- Presentations
- Educational Programs
- Publications
- The Agricultural Law Brief
- Web site Resources



The Agricultural Law Brief

- **Monthly e-newsletter**
- **Addresses five legal developments from prior month that impact agricultural law in Pennsylvania**



Web-based Resources

- <http://law.psu.edu/aglaw>
- Natural Gas Resource Area
 - Penn State Resources
 - Case Law
 - Statutes
 - Regulations
 - Legal-related links



Overview of Presentation

- **Validity and duration of lease agreement**
- **Municipal regulation**
- **Surface estate issues**



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Validity and Duration of Lease Agreement

- **Minimum Royalty Act litigation**
- **Fraudulent Inducement**
- **Failure to Obtain Management Approval of Lease**
- **Enforcement of Arbitration Clauses**
- **Expiration of Secondary Term – “Produced in Paying Quantities”**



Minimum Royalty Act litigation

- Hundreds, possibly thousands, of landowners seek to terminate their lease agreements in suits before state and federal courts.
- General Issue: Does reduction of royalty to pay for post-production costs violate Pennsylvania minimum royalty statute?



58 P.S. 33 – Guarantee of Minimum Royalties

- A lease or other such agreement conveying the right to remove or recover oil, natural gas or gas of any other designation from lessor to lessee shall not be valid if such lease does not guarantee the lessor at least one-eighth **royalty** of all oil, natural gas or gas of other designations removed or recovered from the subject real property.



Kilmer v. Elexco Land Services

- **Susquehanna Co. Court of Common Pleas**
 - **March 3, 2009 – Order ruled in favor of gas company.**
 - **March 16, 2009 – Opinion issued.**

- **On June 16, 2009, Supreme Court granted Petition for Extraordinary Relief.**



Kilmer v. Elexco Land Services

- **Issue accepted by Supreme Court**
 - “Whether 58 P.S. § 33 precludes parties from contracting that post-production costs be factored into the determination of the amount of royalty payable under an oil or natural gas lease.”



Kilmer v. Elexco Land Services

- **Supreme Court opinion issued on March 24, 2010**
 - **GMRA “should be read to permit the calculation of royalties at the wellhead, as provided by the net-back method used in the lease.”**



Fraudulent Inducement

- ***Kropa v. Cabot Oil & Gas Corp., 2010 WL 2346587 (M.D. Pa. June 8, 2010).***
 - **Facts:**
 - **Susquehanna County landowner paid \$25 per acre lease bonus.**
 - **Allegation that landman stated that Cabot would never pay more than \$25 per acre.**



Kropa v. Cabot Oil & Gas Corp.

- **Cabot filed motion to dismiss claim**
 - **Argued that parol evidence rule precluded consideration of evidence outside terms of contract**
- **Court denied motion to dismiss**
 - **Parol evidence rule only applies to valid contract.**
 - **Evidence of fraud permitted to contest contract validity.**



Breach of Contract – Failure to Accept Lease

- ***Hollingsworth v. Range Resources*, 2009 WL 3601586 (M.D. Pa. Oct. 28, 2009).**
 - **Facts:**
 - **June – Hollingsworth received Dear Property Owner letter “offering” lease bonus of \$2,500 per acre.**
 - **August – Hollingsworth signs lease and returns to Range.**
 - **December – Range returns lease to Hollingsworth stamped ‘void.’**



Hollingsworth v. Range Resources

- **Contract did not exist.**
 - **Dear Property Owner letter did not constitute an offer.**
 - **Range did not sign lease agreement.**
 - **By voiding and returning lease, Range was rejecting Hollingsworth offer.**



Breach of Contract – Failure to Accept Lease

- *Lycobetter Homes v. Range Resources* – Docket No. 4:09-cv-249 (M.D. Pa. May 21, 2009).
- *Pigeon Creek Presbyterian Church v. Range Resources – Appalachia*, 2010 WL 256580 (W.D. Pa. Jan. 19, 2010).



Valentino v. Range Resources – Appalachia

- **Facts:**
 - Lease agreement and side agreement provided for bonus payment of \$456,800.
 - Lease not valid until approved by management.
- **Court opinion**
 - Documents did not define management approval
 - Breach of contract claim was facially plausible
 - Motion to Dismiss denied



Enforcement of Arbitration Clauses

- ***Eisenberger v. Chesapeake Appalachia, LLC***
– **2010 WL 457139 (M.D. Pa. Feb. 4, 2010).**
 - Husband, but not wife, signed lease.
 - Landowners sought to revoke lease.
 - Landowners sought declaration that lease was invalid.
 - Chesapeake sought to compel arbitration.



Eisenberger v. Chesapeake

- **Court ruling:**
 - **Validity of lease agreement was at issue.**
 - **Distinct from GMRA claims**
 - **Since contract formation was in dispute, underlying claims would not be decided by arbitrator.**



Expiration of Secondary Term

- ***T.W. Phillips v. Jedlicka*, 964 A.2d 13 (Pa. Super. Ct. Dec. 29, 2008).**
 - **Facts:**
 - Lease was executed in 1928.
 - Lease extended so long as “oil or gas is produced in paying quantities.”
 - Wells were drilled in 1929, 1986, 2004, and 2005.
 - Jedlicka argued that lease terminated in 1959 because lease was not profitable in that year.



T.W. Phillips v. Jedlicka

- **Superior Court opinion**
 - Court relied upon *Young v. Forest Oil Co.* (Pa. 1899) to apply subjective test.
 - Court ruled that Jedlicka had failed to carry burden of establishing lack of good faith.



T.W. Phillips v. Jedlicka

- Issue before Supreme Court:
 - Did the Superior Court misapply [*Young v. Forest Oil*] by holding that Pennsylvania employs a purely subjective test to determine whether an oil or gas lease has produced “in paying quantities.”
- Argument held on April 13, 2010.



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- **Validity and duration of lease agreement**
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- **Surface estate issues**



Oil and Gas Act § 602

- **“Except with respect to ordinances adopted pursuant to the . . . Municipalities Planning Code, and the . . . Flood Plain Management Act, all local ordinances and enactments purporting to regulate oil and gas well operations regulated by this act are hereby superseded. No ordinances or enactments adopted pursuant to the aforementioned acts shall contain provisions which impose conditions, requirements or limitations on the same features of oil and gas well operations regulated by this act or that accomplish the same purposes as set forth in this act.”**



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Oil and Gas Act Preemption of Municipal Regulation

- ***Huntley & Huntley v. Borough of Oakmont***
 - Zoning restriction was permitted in R-1 district.
 - Example of permissible municipal regulation.
- ***Range Resources v. Salem Township***
 - Comprehensive regulatory scheme was not permitted.
 - Example of impermissible municipal regulation.



Municipal Regulation

- ***Penneco Oil Co. v. County of Fayette***
 - **Commonwealth Court opinion**
 - **Issued on July 22, 2010**
 - **Facts: County zoning ordinance allowed wells only by special exception in residential, industrial, and airport zones.**



Penneco Oil Co. **v. County of Fayette**

- **Conditions for grant of special exception:**
 - Well not located in flight path
 - Well not located within 200 feet of residence
 - Well not located within 50 feet of property line or right-of-way
 - Fencing and shrubbery required
 - Zoning Hearing Board may attach conditions to protect public health, safety, and welfare
 - Conditions may include increased setbacks



Penneco Oil Co. **v. County of Fayette**

- **Court opinion**
 - Ordinance was reflection of traditional zoning principles rather than a comprehensive regulatory scheme.
 - Although there was some overlap with purposes of Oil and Gas Act, primary purpose of ordinance was to encourage compatible land use.



Penneco Oil Co.
v. County of Fayette

- Application for reargument denied on September 14, 2010.
- Supreme Court appeal?



Surface Estate Issues

- **Restrictions in Allegheny National Forest**
- **Damages for Improper Reclamation**
- **Termination of Right of Way**



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Restrictions on Surface Use in Allegheny National Forest

- ***Forest Service Employees for Env'tl. Ethics v. United States Forest Service, 2009 WL 960244 (W.D. Pa. Apr. 7, 2009)***
 - **POGAM and Allegheny Forest Alliance were permitted to intervene in lawsuit.**



FSEEE v. US Forest Service

- **Case settled without participation of POGAM and AFA.**
- **Terms of settlement were subject of litigation in *Minard Run Oil Co. v. US Forest Service*.**



Minard Run Oil Company **v. US Forest Service**

- Preliminary injunction granted by District Court on December 15, 2009
 - 2009 WL 4937785
- Temporary moratorium on new drilling in ANF lifted.
- Court opinion based in large part on PA law governing severed estates.



Minard Run Oil Company **v. US Forest Service**

- **Court opinion**
 - **USFS did not have authority to require environmental review.**
 - **USFS had some ability to prevent degradation of surface estate.**
 - **USFS had right to seek judicial intervention to protect rights.**



Damages for Devaluation of Surface Estate

- ***Gates v. Exco Resources*, 2010 WL 1416740 (W.D. Pa. Apr. 8, 2010)**
 - Landowners executed lease agreement and pipeline rights of way.
 - Landowners sought damages for devaluation of property due to improper reclamation after installation of pipelines.



Gates v. Exco Resources

- **Court opinion**
 - Court found that 20 acres was “rendered almost unable to be used again.”
 - Court awarded \$16,000 in damages due to diminution of property value.
 - Court did not rely on contract as basis for recovery.
 - Court awarded damages despite evidence that devalued land was typical of gas production activities.



Coffin v. Medina Resource Company, LLC

- Crawford County case (March 15, 2010)
- Right of way agreement executed in conjunction with lease agreement.
- Landowner sought to terminate right of way when well was no longer productive.



Bankruptcy – *In Re Howard*

- **422 B.R. 568 (W.D. Pa. Dec. 10, 2009)**
- **Facts:**
 - **H acquired natural gas rights prior to marriage.**
 - **H conveyed quit claim deed to W during marriage.**
 - **H and W divorce.**
 - **H filed bankruptcy.**
 - **W signs gas lease – receives \$471,000.**
 - **W records quit claim deed.**



Bankruptcy – *In Re Howard*

- **Court opinion:**
 - **Bankruptcy trustee stood in position of bona fide purchaser**
 - **Trustee had power to invalidate transfer of natural gas right to ex-wife through quit-claim deed.**
 - **Lease proceeds of \$471,000 become property of bankruptcy estate.**



Future Issues

- “Produced in Paying Quantities”
- Municipal regulation gone too far?
- Bad faith unitization



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