6TH LAW OF SHALE PLAYS CONFERENCE

Litigation Update – Hot Topics and Future Disputes

in West Virginia

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I. Introduction.

Drilling activity has slowed down, but litigation seems to continue unabated. As in past years, much of the litigation falls in four main categories: 1) "lease busting"; efforts to terminate or re-negotiate the terms of a lease, or prevent the extension or renewal of a lease; 2) surface owner denials of access and property damage claims; 3) partition and missing and unknown heirs actions to obtain judicial approval for a lease in cases where 100% of the mineral owners will not lease or cannot be located[1]; and, 4) royalty disputes.[2]

II. Hot Topics and Trends.

Add to the four litigation "mainstays" an uptick in claims for the following:

A. Nuisance Claims. Adjoining and nearby property owners are alleging that odors, noise, road traffic and other construction activities have resulted in the unreasonable interference with the use and enjoyment of property, annoyance and inconvenience and emotional distress. As a general rule, a fair test as to whether a particular use of real property constitutes a nuisance is the reasonableness or unreasonableness of the use of the property in relation to the particular locality involved, and ordinarily such a test to determine the existence of a nuisance raises a question of fact. *Sticklen v. Kittle*, 287 S.E.2d 148, 149 (W. Va. 1981). In *Sticklen*, the court held it was error to dismiss a claim for nuisance caused by construction activities related to the building of a school where there were no allegations of negligence, because "whether a particular use of real property constitutes a nuisance is the reasonableness or unreasonableness of the use of the property in relation to the particular locality involved." *Id.* at 161. Thus, despite the fact an operator has a legal right to construct a well site, compressor station or other surface facility, adjoining landowners can claim the activity is not reasonable in relation to use and enjoyment of their land. Litigation of these cases requires a close examination of the facts and competing land uses in the locality.

B. Private Property Rights Movement. An abundant supply of gas and the need for infrastructure to process and transport it has resulted in much publicity about proposed pipeline projects to ship gas out of state. A number of environmental and property rights activists have been mobilizing to oppose any such development. It is an open question at this time whether the eminent domain laws of West Virginia will

[1] West Virginia generally does not allow forced pooling except in the case of deep wells. It is therefore necessary in some cases to seek partition to divide property or compel the sale of the mineral interest for shallow formations such as the Marcellus, or to obtain a judicial sale of the interest of missing and unknown owners. W. Va. Code § 37-4-1 (Partition); W. Va. Code § 55-12A-1 (Missing or Unknown Owners).

[2] Royalty litigation is being covered in the stand alone presentation, "Recent Developments in Royalty Litigation in the Shale Plays."

allow the acquisition of land by condemnation for the numerous pipeline projects needed to move the gas to markets outside West Virginia, and the result will likely require a case-by-case analysis of whether the proposed development is for "public use".

C. Deep Well Spacing and Forced Pooling. The number of permit applications for the drilling of Utica wells is on the rise. The Utica is below the top of the Onandaga and by statutory definition considered a "deep" formation under West Virginia law. W. Va. Code § 22C-9-2(a)(12). The Oil and Gas Conservation Commission of West Virginia has jurisdiction to grant exceptions to the requirement that all deep wells must be at least 3,000 feet from the nearest deep well, and compel forced pooling of any unleased interests. W. Va. Code § 22C-9-7. The Commission is generally agreeable to granting spacing exceptions so laterals can be drilled from a common drill pad, but is more cautious about forced pooling requests in light of the fact it is a divisive and politically charged issue in West Virginia.

D. Failure to Diligently Develop; Dual Purpose Leases. Mineral owners subject to existing leases held by production from vertical wells, or in the case of dual purpose leases, held by storage or protection of storage formations, are testing whether the operator can be compelled to drill horizontal, unconventional wells, or if the storage rights are "severable" from the production rights. Whether West Virginia law allows the production rights to be severed from the storage rights where a unified lease clearly states the lease is held in the secondary term by production or storage is currently on appeal to the Fourth Circuit Court of Appeals. *K&D Holdings, LLC v. Equitrans, L.P., EQT Production Co.*, No. 15-166 (4th Circ.).[3]

Below are summaries of several opinions from the West Virginia Supreme Court of Appeals and the United States District Courts of West Virginia. These cases represent the issues which are arising with more frequency as gas development continues to grow throughout West Virginia. Please note that these summaries provide only a brief overview of the applicable cases with a particular focus on the oil and gas issues addressed therein. Thus, the cases identified below may have included issues and legal arguments in addition to those highlighted in the individual summaries.

[3] Contrast the District Court's interpretation of West Virginia law with the holding of the West Virginia Supreme Court of Appeals in *Smith v. Chestnut Ridge Storage, LLC*, No. 2014 WL 6607569, 2014 WL 6607569 (W. Va. Nov. 21, 2014) (memorandum decision), discussed in Section III.B.

III. Case Summaries.

A. Negotiation of Leases

***Barber v. Magnum Land Services, LLC*, No. 1:13CV33, 2014 WL 5148575 (N.D.W.Va. Oct. 14, 2014)**

Magnum Land Services acquired leases for approximately 7500 acres in Preston County, West Virginia. All of the leases contained the same material terms: the lessor would receive a twenty-five dollar per acre bonus with a one-eighth royalty on produced gas. Magnum then assigned those leases to Belmont Resources, LLC, who then sold the leases at a premium to Enerplus Resources Corporation. The lessors realized that they had received extremely low bonus payments as compared to other landowners in neighboring counties and filed suit alleging: (i) that the leases were unconscionable; and (ii) that Magnum had fraudulently induced them into the leases by having their landmen advise lessors that even if they did not sign the lease the gas could still be collected by drilling wells on neighboring properties.

Upon lessors' motion for summary judgment, the United States District Court for the Northern District of West Virginia dismissed lessors' claims of fraudulent inducement because, according to the court, even if the landmen had said that they could retrieve the lessors' gas without a lease through the use of deviated or horizontal wells, the lessors' purported reliance on those statements was unjustified because "no reasonable person would accept such a representation as true and sign the lease without first looking into the validity of the statement or consulting someone knowledgeable in the oil and gas field." The court further held that the leases were not unconscionable because: (i) a one-eighth royalty is standard within the industry; and (ii) there is no *per se* inequity simply because Belmont was able to sell the leases at a premium compared to the bonus payments accepted by the lessors. This case is currently on appeal in the Fourth Circuit.

Although the court dismissed plaintiffs' fraudulent inducement claims, in the wake of *Barber* operators should make an effort to take note of the language and methods used by their landmen to ensure that no fraudulent procedures are being used. Operators should also be aware that there is no *per se* rule that an undesirably low bonus payment will invalidate the lease as unconscionable.

B. Operator's Surface Rights & Implied Duty to Develop

***Adams v. Cabot Oil & Gas Corp.*, No. 13-1299, 2014 WL 6634396 (W. Va. Nov. 24, 2014)**

Plaintiff-lessors entered into a lease with Cabot which granted Cabot the rights to explore, drill, and build roads on the lessor's property. The parties then executed a "Certificate

of Consent and Easement" wherein Cabot paid lessor $5000 as damages in advance of a proposed well site and access road which Cabot was going to construct on lessor's property. Several years later, Cabot had to replace the access road and lessor objected and denied Cabot access to his property. Cabot filed a complaint for declaratory judgment and injunctive relief seeking an order declaring that it has the right to enter lessor's land and "use the surface in any manner reasonably necessary to the use and development of the mineral estate…"

The circuit court granted Cabot's motion for summary judgment on the basis that: (i) the lease granted Cabot "the express right to produce the mineral estate and to build roads and other things which are necessary, useful or convenient to said production"; and (ii) the owner of the underlying mineral estate has the right to use the surface in such manner and with such means as would be necessary for the enjoyment of the mineral estate. On appeal, the Supreme Court of Appeals of West Virginia affirmed on the same grounds.

Under *Adams*, operators should be aware that even absent express language allowing the lessee's use of the surface, operators are entitled to the reasonable use of the surface for the construction of reasonably necessary items such as access roads or well pads.

***Smith v. Chestnut Ridge Storage, LLC*, No. 2014 WL 6607569, 2014 WL 6607569 (W. Va. Nov. 21, 2014) (memorandum decision)[4]**

In 1987, the lessors' predecessor in interest entered into a three-year lease with lessee Chestnut Ridge's predecessor in interest which stated, "[i]t is agreed that Lessee *may drill or not drill on said land as it may elect*…" (emphasis added). The parties also entered into a Gas Storage Addendum, whereby lessees were granted the exclusive right to store gas in "any depleted oil or gas stratum underlying the Lands." In 2007, Chestnut Ridge applied for and was granted a Federal Energy Regulatory Commission certificate authorizing construction and operation of a natural gas storage field on the lessors' property. Lessors filed suit against Chestnut Ridge alleging: (i) that under the implied duty to develop Chestnut Ridge was obligated to develop the Marcellus Shale strata; and (ii) that Chestnut Ridge had breached the lease by obtaining the FERC certificate to store gas on undepleted portions of the property. The circuit court denied plaintiffs' motion for summary judgment and Chestnut Ridge appealed.

The West Virginia Supreme Court of Appeals held that the lessors had waived any implied duty to develop the Marcellus Shale strata because the lease language explicitly stated that the lessee "may or may not drill...as it may elect." The Court further held that development of the Marcellus Shale strata was inconsistent with the terms of the Gas Storage Addendum because, at the time the Addendum was entered into, the Marcellus Shale strata was not being developed and marketed within the industry but instead was generally understood to be used as a caprock to seal in the stored gas. Finally, held that Chestnut Ridge had not violated the lease by

[4] Under West Virginia law, memorandum decisions may be cited as legal authority but the citation must indicate that the opinion is a memorandum opinion. *See* W.Va.R.C.P. No. 21(e).

obtaining the FERC certificate because, under the industry definition of "depleted," some gas would be left in the storage strata to provide a cushion for the stored gas and, therefore, Chestnut Ridge did not have to extract every drop of gas prior to receiving a certificate for storage.

Following *Smith*, operators should be aware that under West Virginia law they may waive the implied duty to develop by including language expressly reserving the right to elect whether to drill or not. Storage operators should be aware that if the lease does not define depleted the court will apply the industry standard, which allows for remaining gas to serve as a cushion for the stored gas.

***Cunningham Energy LLC v. Ridgetop Capital II, LP*, 5:13-CV-78, 2015 WL 136624 (N.D. W. Va. Jan. 9, 2015)**

Plaintiff-lessee Cunningham entered into two separate leases with defendant-lessor Ridgetop. Pursuant to lease language which stated that lessee "agrees to pay as Delay Rental, the rate of Four Hundred Dollars ($400.00) per net mineral acre owned by Lessor under this agreement per year, *paid up*," Cunningham paid Ridgetop $382,100 for the leases at signing. The parties also agreed to an addendum which contained the following provision:

> *DRILLING COMMITMENT*: Lessee hereby commits to drill two (2) 'horizontal' Marcellus Shale wells within the first twenty four (24) months of the effective date of this agreement, and upon their completion, if it appears that gas is present in commercial quantities, Lessee commits to drill two (2) additional horizontal wells within twelve (12) months of the completion of the initial wells drilled.

Notably, neither the provision nor the addendum defined the term "drill." However, the definition of operations contained in the lease stated:

> "drilling (which includes applying for permits, the commencement of clearing operations on or adjacent to the well site area such as the removal of trees, the construction of access roads in preparation for drilling, the delivery of heavy equipment, and the use of bona fide good faith continuing efforts to diligently prepare the physical well site area as required prior to the commencement of actual drilling activities)."

Cunningham began preparing its drilling permits in March 2013. In May, Cunningham retained a surveyor to survey, map, and stake the well locations. In June, the permits were ultimately denied because Cunningham failed to submit the required bond. On July 1, 2013, Ridgetop notified Cunningham that it was forfeiting the leases because Cunningham had violated the drilling commitment.

The United States District Court for the Northern District of West Virginia ultimately held that Cunningham had violated the drilling commitment by not actually boring holes into the

ground. In support of its holding, the Court determined that the sub-definition of "drilling" contained in the lease's definition of "operations" was not the controlling definition because other provisions within the lease distinguished between a well which is "commenced" versus a well which is "drilled," and to apply the sub-definition to the addendum would be to make the distinction unnecessary because the sub-definition was identical to the industry definition of "commenced," which is a violation of basic contract principles. The court also drew a distinction between the terms "drilling" and "drilling operations," holding that "drilling" requires actual boring into the ground whereas "drilling operations" is broader and more inclusive of other precursor activities. The Court further held that, notwithstanding the lease designation as delay rentals, the $382,100 payment constituted a bonus payment as opposed to delay rentals because Cunningham had an express obligation to drill and, therefore, the payment could not constitute delay rentals, which are typically made to avoid drilling while still holding the lease. Therefore, because the parties had created an express obligation to develop by including the drilling commitment provision, the lease did not allow Cunningham to secure the lease for the primary term without drilling. Finally, the court determined that although Cunningham had violated the drilling requirement, under West Virginia law, the lease remained valid because there was no express reservation of power for the lessor to forfeit the lease upon breach by the lessee.

After *Cunningham*, operators should be conscious of carefully defining terms contained in the lease to ensure that both parties are aware what activities will secure the leasehold, especially considering that the default definitions which will apply may not be favorable to the industry. Moreover, operators should carefully consider whether to include express forfeiture language within the lease because, under West Virginia law, the absence of such language will allow the lease to remain valid notwithstanding a breach by the lessee.

C. Term & Extension of Lease

***Dwyer v. Range Resources-Appalachia, LLC*, No. 5:14CV21, 2015 WL 366441 (N.D. W. Va. Jan. 26, 2015)**

Lessees entered into identical leases with lessor Range Resources, all of which contained a habendum clause which stated:

> "[t]his lease shall continue in force and the rights granted hereunder be quietly enjoyed by lessee for a term of Five (5) Years and so much longer thereafter as oil, gas, and/or coalbed methane gas or their constituents are produced…"

Paragraph 22 of the leases further stated "[r]egardless of any language to the contrary, this is a paid up lease for a period of Five (5) years." Lessors filed suit alleging: (i) that the leases were void for lack of a definite term; and (ii) Paragraph 22 expressly limits the lease to a 5 year term and, therefore, the leases expired after 5 years notwithstanding the habendum clause. Chesapeake moved for summary judgment claiming that the unambiguous language of the lease allowed for an extension beyond the initial five year term.

The United States District Court for the Northern District of West Virginia ultimately held that the habendum clause, which contained typical industry language, clearly established the standard "primary" and "secondary" terms and, therefore, a definite term had been established. The Court further held that the two clauses did not conflict with each other and instead the second clause merely ensured that lessees did not have to make any further payments to secure its interest for the primary five year term.

In the wake of *Dwyer*, it is clear that the West Virginia courts will recognize and uphold the standard industry habendum clause language. However, operators should carefully consider the utility of using multiple clauses to describe the lease term because the court will consider all of the lease terms as a whole and, therefore, the clauses must not contain conflicting language.

***Bissett v. Chesapeake Appalachia LLC*, No. 5:13-CV-20, 2014 WL 1689928 (N.D. W. Va. April 29, 2014)**

Plaintiff-lessor entered into a lease with defendant-lessee in July 2007. The lease contained a habendum clause for a primary term of five years, with a provision for an extension into a secondary term only if oil, gas, or constituents of either are being produced or are capable of being produced, or in the event lessee explores or searches for the minerals as provided in the leases. The lease also contained a provision, Paragraph 19, which stated:

> In consideration of the acceptance of this lease by the Lessee, the Lessor agrees for himself and his heirs, successors and assigns, that no other lease for minerals covered by this lease shall be granted by the Lessor during the term of this lease or any extension or renewal thereof granted to the Lessee herein. Upon expiration of this lease and within sixty (60) days thereinafter, Lessor grants to Lessee an option to extend or renew under similar terms a like lease.

Prior to the expiration of the lease, Chesapeake executed and recorded a Notice of Extension of Oil and Gas Lease and tendered payment to the lessor. Lessors filed suit against lessee claiming that Chesapeake had failed to comply with Paragraph 19 of the lease and, therefore, the lease had expired. Chesapeake filed a counterclaim seeking declaratory judgment that Paragraph 19 allowed it to extend the lease at its sole option at any time up to sixty days after the expiration of the primary term and that Chesapeake had complied therewith.

Upon cross-motions for summary judgment, the United States District Court for the Northern District of West Virginia ultimately held that by using the term "extend" in Paragraph 19, the parties had agreed that Chesapeake could unilaterally extend the existing lease for an additional term. The court further held that Chesapeake's decision to extend the lease prior to its expiration did not invalidate the extension because the expiration language in Paragraph 19 was not material to the extension provision and, therefore, failure to comply with that language did not render the extension invalid. This case is currently on appeal in the Fourth Circuit.

Post-*Bissett*, operators should be aware that by including a right to "extend" like that included in the lease at issue they will ensure themselves a unilateral option to extend the lease for an additional term. Further, operators should also note that they may exercise the extension option early in an effort to quickly secure an additional term.

D. Waiver

***Stricklin v. Fortuna Energy, Inc.*, No. 5:12CV8, 2014 WL 2619587 (N.D. W. Va. June 12, 2014)**

Plaintiff-lessors alleged that defendant-lessees breached the leases by assigning their interests therein to Range Resources-Appalachia, LLC without first obtaining the lessors' consent. Paragraph 22 of the leases stated: "If the interest of either Lessor or Lessee is assigned, and the right to assign in whole or in part is expressly permitted, all rights, duties and liabilities under this Lease shall inure to the benefit of and be binding on the assignee and the assignee's respective heirs, executors, administrators, successors and assigns." The lease also contained a provision requiring the lessors to provide written notification of any alleged breach by lessee prior to initiating a lawsuit.

Several assignees moved for summary judgment alleging that the lessors had waived their rights to a breach of contract claim because they had not provided lessees with the written notification of breach which was required under the terms of the lease. The court ultimately held that the lessors had waived their breach of contract claim by failing to provide lessees with the required written notification of breach. Therefore, operators should consider including language which requires lessors to notify the operator of any alleged breach prior to the institution of a lawsuit related thereto.

After *Stricklin*, operators should be aware that they can include language which specifically requires lessors to notify them of any potential litigation prior to the initiation of a lawsuit. Inclusion of such language could not only provide operators an opportunity to settle claims prior to litigation but, as in *Stricklin*, it could also act as a waiver provision if lessors fail to comply with the language.