Institute for
ENERGY LAW

THE CENTER FOR AMERICAN
AND INTERNATIONAL LAW

OIL & GAS E-REPORT

ISSUE 1 APRIL 2024

Editorial Board

The IEL Oil & Gas E-Report is a publication the Institute for Energy Law of The Center for American and International Law. Please forward any comments, submissions, or suggestions to any of the editors or IEL's Co-Director, Vickie Adams.

Iowa Federal Court Holds That Local Ordinance Restricting CO_2 Pipelines Was Preempted

Keith B. Hall
LSU Law School

In 2022, the Shelby County Board of Supervisors ("Shelby County Board") enacted Ordinance No. 2022-4 in response to the plans of Summit Carbon Solutions, LLC ("Summit") to develop an interstate network of CO_2 pipelines, part of which would pass through Shelby County, Iowa.[1] The planned network would involve more than 650 miles of pipelines in five states, including Iowa. The network would carry CO_2 captured at thirty-one locations, including twelve ethanol and fertilizer plants in Iowa. The pipeline network would pass through thirty of Iowa's counties.

State statutes in Iowa delegate authority over pipelines to the Iowa Utilities Board (IUB). As part of the process required to obtain approval for the portion of its pipeline network planned for Iowa, Summit held information meetings in the thirty Iowa counties through which its planned pipeline network would run. Summit then filed a Petition for a Hazardous Liquid Pipeline Permit with the IUB.

While Summit's permit application with the IUB was pending, some residents of Shelby County submitted a petition to the Shelby County Board, requesting that it enact an ordinance to regulate pipelines. The Shelby County Board referred the petition to the Shelby County Planning and Zoning Commission in August 2022. The Commission considered the issue and later recommended that the Shelby County Board adopt an ordinance to govern hazardous liquids pipelines. The Shelby County Board did so in November 2022, enacting Ordinance No. 2022-4.

This Ordinance explicitly referred to Summit, asserting that a rupture of its pipeline "could threaten the health and lives of county residents." Ordinance No. 2022-4 provided that anyone seeking to operate a pipeline within Shelby County must first apply for a "conditional use permit." The permit application must include a copy of the person's complete application to the IUB, maps indicating the pipeline route, an emergency response and hazard mitigation plan, a template of a proposed agreement that the person would use in attempting to negotiate for pipeline

[1] *Couser v. Shelby County*, 2023 WL 4420442 (S.D. Iowa 2023). William Couser was one of two plaintiffs, with Summit being the other. Mr. Couser does not reside or own land in Shelby County. He resides in Story County, Iowa and owns a feed lot that produces corn that he sells to a company that uses it to make ethanol. Couser asserts that, if a CCS project is developed in Iowa, and captures CO_2 from the ethanol refineries there, he will be able to sell this corn at a higher price because there will be increased demand for ethanol that has a lower carbon footprint. Further, he asserted that Shelby County's ordinance would prevent development of CCS, thereby causing him injury. The court concluded that this alleged injury was too speculative and that Couser therefore lacked standing to sue. *Id.* at *9. The court held, on the other hand, that Summit had standing. *Id.* at *8.

easements, certain fees, and other information.[2] The ordinance also prohibited local landowners from entering easement agreements with a pipeline company unless the landowners first pays a fee to the County and obtains their own conditional use permit.[3] In addition, Ordinance No. 2022-4 imposed certain obligations to restore the land and remove pipelines at the end of the life of the CCS facility. Finally, Ordinance No. 2022-4 imposed setback requirements. Some of the setback distances were large—such as at least half a mile from certain locations, at least one-quarter of a mile from others, and at least 1,000 feet from still others.[4]

On November 15, 2023, the plaintiffs filed suit against the Shelby County Board in the United States District Court for the Southern District of Iowa. They asserted in their complaint that Ordinance No. 2022-4 is preempted by the federal Pipeline Safety Act and by Iowa Code § 479B, which gives the IUB authority to issue permits approving the construction of pipelines.[5] The parties later agreed to a temporary restraining order to bar enforcement of the Ordinance until the court held a hearing and ruled on a motion for a preliminary injunction. The court conducted that hearing in March 2023, and in July 2023 the court issued its decision, granting the preliminary injunction sought by Summit to enjoin enforcement of the Ordinance.[6]

The court's opinion explained its reasoning. The court noted that, in 1978, Iowa amended its Constitution to grant home rule authority to local governments. This expanded the authority of local governments, which previously could not regulate on a subject unless they had been delegated specific authority to do so. Under home rule authority, however, local governments were given authority to enact ordinances on any subject they choose, unless a state statute denies them authority to regulate on that subject.

A state statute can deny this authority "in an express or an implied manner."[7] Express preemption occurs when the state legislature expressly prohibits local regulation.[8] An implied preemption occurs when the legislature regulates a subject in a manner that "demonstrate[s] a legislative intention that the field is preempted by state law" or when a local ordinance purports either to prohibit an act permitted by a state statute or to permit an act prohibited by state statute.[9]

---

[2] *Id.* at *2.
[3] *Id.* at *3. The Shelby County Planning and Zoning Commission later sent letters to some landowners who had granted easements to Summit, threatening the landowners with fines of up to $750 per day, unless the landowners somehow terminated the easement agreements that they already had granted. *Id.* at *4.
[4] *Id.* at *4.
[5] *Id.* at *4.
[6] *Id.* at *4.
[7] *Id.* at *5.
[8] *Id.* at *5.
[9] *Id.* at *5. Notably, this preemption scheme for determining whether state law preempts local law is similar to that used to analyze whether federal law preempts state or local law.

The Shelby County ordinance's setbacks would make it difficult or impossible to route a pipeline that had been expressly authorized under state law, so those requirements were preempted. The local permitting requirements were preempted because the requirements built into state law suggested that the legislature had not contemplated a role for local governments in the pipeline permitting process. The ordinance's prohibition on landowner's entering agreements with pipeline companies unless the landowners first obtained conditional use permits was also invalid under implied preemption.

EPA Grants Primacy to Louisiana for Class VI Wells

Keith B. Hall
LSU Law School

Lauren Brink Adams
Baker Donelson

On January 5, 2024, the U.S. Environmental Protection Agency published a notice in the Federal Register of a final rule that grants primacy to the Louisiana Office of Conservation for Class VI wells under the Safe Drinking Water Act.[1] This grant of primacy was effective February 5, 2024.

Background

Congress enacted the Safe Drinking Water Act ("SWDA") in 1974 "to assure that water supply systems serving the public meet minimum national standards for protection of public health."[2] The SDWA protects drinking water systems in various ways. For example, Part C of the SDWA seeks to protect underground sources of drinking water ("USDW") by directing the EPA to develop regulations for State underground injection control ("UIC") regulations, including "minimum requirements for effective programs to prevent underground injection which endangers drinking water sources."[3]

Federal regulations promulgated to implement the SDWA establish six classes of injection wells and provide regulations for each class.[4] Class VI wells are wells used for injection of carbon dioxide for carbon capture and storage ("CCS").

Primacy

Part C of the SDWA provides a process for States to seek primary enforcement authority—commonly called "primacy"—to implement and enforce the SDWA within their jurisdictions. When primacy for UIC regulations is granted, it is granted on a class-by-class basis. Thus, a state can receive primacy for one or more classes of injection wells, without receiving primacy for all classes. Indeed, a majority of states have primacy for some classes of injection wells, without having primacy for all classes.

Section 1422 of the SDWA (42 U.S.C. § 300h-1) provides that a state may obtain primacy for a class of wells by demonstrating to the EPA that the state has implemented UIC rules for that class of wells that meet the federal standard for protecting USDWs. Pursuant to Section 1422, Louisiana obtained primacy for Class

---

[1] 89 Fed. Reg. 703 (Jan. 5, 2024).
[2] H.R. Rep. No. 93-1185 (1974).
[3] 42 U.S.C. § 300h(a)-(b).
[4] 40 C.F.R. § 144.6.

I, III, IV, and V wells in 1982. The year before, in 1981, Louisiana obtained primacy for Class II wells pursuant to Section 1425 of the SDWA (42 U.S.C. § 300h-4), which provides an alternative standard for a state to obtain primacy for Class II wells, (though a state may use the Section 1422 process to obtain primacy for Class II wells if the state wishes). At the time Louisiana was obtaining primacy for Classes I through V, federal SDWA regulations did not yet recognize CCS injection wells as a separate class of wells.

Louisiana's Primacy Application

In 2009, Louisiana enacted the "Louisiana Geologic Sequestration of Carbon Dioxide Act," which authorized the Louisiana Office of Conservation to promulgate rules for CCS.[5] The legislation also contemplated that Louisiana would seek primacy for Class VI wells.[6] The Office of Conservation promulgated regulations for Class VI wells, and in September 2021, Louisiana applied for primacy for Class VI wells.

The EPA conducted a comprehensive technical and legal evaluation of Louisiana's Class VI application. After that, EPA published a proposed rule in the Federal Register on May 4, 2023, to approve Louisiana's primacy application. The EPA held a three day in-person public comment period in June 2023, as well as a virtual hearing the same month, and accepted written comments for several weeks.

At the end of June 2023, Louisiana supplemented its application by noting that Louisiana Acts 2023 No. 378 strengthened Louisiana's Class VI rules by amending a portion that previously would have allowed a CCS operator to apply to turn over liability for a CCS facility to the state ten years after injections had ceased. Under the amended statute, a CCS operator generally cannot seek to hand over liability to the state until fifty years after injections cease, and after also demonstrating that the operator has complied with all facility closure rules.

In addition to increasing the waiting period that a company must wait before seeking to hand over liability to the state, Louisiana also entered a memorandum of agreement with the EPA, in which Louisiana agreed not to approve a hand-off of liability from a CCS operator to the state until coordinating with the EPA.

EPA Grants Primacy

On January 5, 2024, the EPA published a final rule granting primacy to Louisiana for Class VI wells, effective February 5, 2024.[7] The final rule states that "[t]he EPA has determined that the application meets all applicable requirements for approval . . . and the state is capable of administering a Class VI program in a

[5] La. Rev. Stat. 30:1104.
[6] See La. Rev. Stat. 30:1104(F).
[7] 89 Fed. Reg. 703 (Jan. 5, 2024).

manner consistent with the terms and purposes of SDWA and applicable UIC regulations." The EPA also stated that the Louisiana Department of Natural Resources has the expertise needed to implement and administer a Class VI regulatory program. EPA stated, "[t]he LDNR UIC program is comprised of staff with expertise in the variety of technical specialties needed to issue and oversee Class VI permits, including site characterization, modeling, well construction and testing, and finance." The EPA's final rule also stated that Louisiana's Class VI rules for monitoring and emergency response are as stringent as EPA's own rules.

Sixth Circuit Affirms Dismissal for Noncompliance with Lease's Condition Precedent of Pre-suit Notification

David E. Sharp, FCIArb
Law Offices of David E. Sharp P.L.L.C.

Kirkbride v. Antero Resources Corp., No. 23-3484, 2024 WL 340782, (6th Cir. Jan. 30, 2024) enforced a lease's pre-suit notification clause that was phrased as a condition precedent to filing suit.

Facts

Kirkbride's lease contained a pre-suit notice clause providing that "service of said notice shall be a condition precedent to the commencement of any action by [Kirkbride] for breach of any obligation or covenant hereunder and no such action shall be commenced before ninety days from [Antero's] receipt of written notice."[1] Without providing any notice, Kirkbride filed a putative class action against Antero alleging underpayment of royalties.[2] After dismissing the second amended complaint with leave to amend, the district court granted a motion to dismiss the next complaint for failure to state a claim and Kirkbride appealed.[3]

Opinion

Kirkbride argued that "*post*-lawsuit notice satisfies a contract's *pre*-lawsuit notice requirement" under Ohio law "because service of the complaint in a breach-of-contract lawsuit constitutes de facto notice, thereby satisfying the . . . notice requirement, making the absence of pre-lawsuit notice harmless, and overcoming a defense based on that requirement (condition precedent)."[4] Calling that argument "questionable on its face", the Court found that five cases cited by Kirkbride merely stated "the unremarkable proposition that actual notice can overcome . . . technical non-compliance with the contractually specified means of notice. None . . . suggests that a lawsuit complaint can serve as pre-lawsuit notice sufficient to satisfy a contract's mutually-agreed-upon pre-lawsuit-notice requirement, i.e., condition precedent."[5]

Kirkbride also contended that *Northfield Park Associates v. Northeast Ohio Harness,* 521 N.E.2d 466 (Ohio Ct. App. 1987) established that the mere service of

---

[1] *Id*. at *1.
[2] *Id*.
[3] *Id*. at *1 & n.1. Kirkbride amended the complaint twice after serving it on June 1, 2022; without answering, Antero moved to dismiss the second amended complaint and Kirkbride responded that the original complaint served 91 days before provided the notice. *Id*. The district court granted the initial motion to dismiss because satisfaction of the pre-suit notice provision had not been alleged in any complaint and ordered than the third amended complaint must do so. *Id*.
[4] *Id*. at *2.
[5] *Id*. at *2.

a complaint satisfied the pre-suit notice provision.[6] The Sixth Circuit concluded that Kirkbride's argument that *Northfield* had found service of a second amended complaint to be "*the* notice" required by a lease was based on an unreasonable and implausible reading of an "isolated sentence" that actually indicated that there had been "overwhelming actual notice" by the time of such service.[7] The Court also rejected Kirkbride's argument that *Northfield* held that technical non-compliance with a notice requirement should not be strictly applied if there was actual knowledge with sufficient time to cure because: (1) that was "not the holding", and (2) even if had been, it was "an enormous leap to contend that, even without any other notice at all, the mere service of the complaint . . . constitutes actual notice sufficient to satisfy the contract's pre-lawsuit-notice requirement."[8]

Finally, the Court observed that, having failed to "provide any notice at all—not actual notice, constructive notice, or technically deficient notice", Kirkbride had not satisfied the "contractual requirement (condition precedent) for bringing the lawsuit and the district court properly dismissed."[9]

---

[6] *Id*. at *3.
[7] *Id*. *Northfield* involved a 10-day pre-suit notice provision in two identical "overlapping leases" with the same lessee such that plaintiff's notices gave "the defendant actual notice as to its actions that had breached both leases". *Id*. The Sixth Circuit indicated that, in *Northfield,* there had been "three written notices (over two years) and numerous verbal warnings" prior to the lawsuit and repossession, which explained what the *Northfield* opinion meant by saying there had "certainly" been notice by the time the second amended complaint was served. *Id.*
[8] *Id*.
[9] *Id*. at *4.

Ohio's Seventh Appellate District "Breaks the Seal" and Issues First Decision Determining Whether a Grant or Reservation Created a Fixed or Floating Royalty Interest

Casey N. Valentine
Vorys, Sater, Seymour and Pease LLP

There are two recognized methods for describing a non-participating royalty interest (NPRI):

1) A fixed, also known as "fractional," interest that does not change from lease to lease; and
2) A floating, also known as "fraction of," interest that varies depending on the amount of the landowner's royalty set forth in each specific lease.[1]

Prior to 2023, there was no reported decision from an Ohio Court of Appeals interpreting whether the language in a grant or reservation created a fixed or floating royalty interest. However, the topic has recently become a favorite of Ohio's Seventh District Court of Appeals, which issued a trio of such decisions in the final months of 2023.[2] In each case, the Court began its analysis with the presumption that the intent of the parties was reflected in the language used in the agreement and that it would attempt to give effect to every provision of the contract. This means that, if possible, a court will always follow the interpretation of a clause that gives it meaning, as opposed to an interpretation rendering the clause contradictory or meaningless.

For example, in *Moore Family Trust* (the first of the three opinions to be issued), the Court held that the following language assigned a 1/2 floating royalty:

> [Grantors] . . . do hereby grant, bargain, sell and convey to the said [Grantees] their heirs and assigns forever [the] full equal one sixteenth (1/16) of all the petroleum oil and gas in and under the premises described, that may hereafter be produced from said premises, under and by virtue of a certain oil and gas lease entered into the 30 day of November 1894 to one S.D. Griffith or to any other party or partys [sic] to whom said premises may hereafter be leased, for oil and gas purpose . . . said 1/16 interest being the one half part of the royalty to be set apart to me free of charge into tanks or pipe lines receiving said oil which is hereby conveyed to the grantee and to be reserved to them in any contract of lease hereinafter to be entered by us or our assigns, heirs, executors, or administrators.

The Court observed that the assignment described two different interests: (1) a royalty interest in the 1894 lease and (2) a royalty interest in any future lease. The

[1] Williams & Meyers, Oil and Gas Law § 327.1.
[2] See *Moore Family Trust v. Jeffers*, 2023-Ohio-3653, *Crum v. Mooney*, 2023-Ohio-4451, and *Mineral Development, Inc. v. SWN Production (Ohio), LLC, et al.*, 2023-Ohio-4749.

Court found that the only reasonable interpretation that would give effect to both the "one sixteenth (1/16)," "1/16," and "one half part" references in the assignment was to conclude that the 1894 lease paid a 1/8 royalty to the lessor. Following this interpretation, the Court held that the royalty assignment assigned (i) 1/2 of the presumed 1/8 royalty paid by the 1894 lease and (ii) 1/2 of the royalty paid by any future lease, which would presumably be a 1/8 royalty.

According to the Court, if it had it found that a 1/16 fixed royalty interest was assigned, that interpretation would (i) not give effect to every clause in the assignment and (ii) result in future conflict if any future lease paid the lessor an amount other than a 1/8 royalty. For example, if a future lease paid a 20% royalty to the lessor, then "1/16" (6.25%) would not equal "the one half part" of the 20% royalty (10%). Furthermore, the clause "said 1/16 interest being the one half part of the royalty" would be rendered contradictory or meaningless. By interpreting the royalty assignment as assigning a 1/2 floating royalty interest, the Court reasoned that it was able to harmonize and give effect to the reference to "one sixteenth (1/16)" in the description of the first assigned interest (i.e., the royalty interest in the existing 1894 lease) and the reference to "said 1/16 interest being the one half part of the royalty" in the description of the second assigned interest (i.e., the royalty interest in any future lease).

Ohio Appellate Court Affirms Summary Judgment for Leaseholder-Defendant

Keith B. Hall
LSU Law School

In *SJBK, LLC v. Northwood Energy Corp.*, 2023 WL 8890826 (Ohio Ct. App. 7th Dist.), the plaintiff was a limited liability company that owned approximately 79.8 acres in Monroe County, Ohio. The land was covered by an oil and gas lease granted by a prior owner of the land. The landowner sued the oil and gas leaseholder, asserting that the leaseholder had breached the lease by creating a pooled unit that included about 65.8 acres of the leased premises, rather than the entire leased premises, without obtaining the landowner's consent to pool only part of the acreage.

The landowner argued that the consequence of this alleged breach was that the entire lease terminated. In contrast, the leaseholder argued that, under the circumstances, and under a proper interpretation of the lease as a whole, the lease terminated as to the unpooled acreage, but the lease remained in effect as to the pooled acreage because there was unit production in paying quantities. The Monroe County Common Pleas Court granted summary judgment to the leaseholder and the landowner appealed.

The appellate court noted that paragraph 5 of the printed text of the lease authorized the leaseholder to pool all or a portion of the leased premises, and to create one or more pooled units. But paragraph 17 of an addendum also addressed pooling. Paragraph 17 stated in part: "Lessee agrees that the entirety of the leased premises shall be include[d] in any pooled unit formed, unless Lessee receives the prior written consent of the Lessor." The landowner based its claim on that portion of paragraph 17.

The leaseholder argued, however, that its failure to pool a portion of the leased premises was not a breach. The leaseholder asserted that the portion of paragraph 17 on which the landowner relied had to be read in conjunction with the remainder of paragraph 17. According to the leaseholder, paragraph 17 does not make it a breach if the leaseholder pools part, but only part of the leased premises. Rather, read as a whole, paragraph 17 specifies the consequences if the leaseholder creates a pooled unit that did not include the entirety of the leased premises. In particular, the leaseholder asserted that, if the leaseholder pools part of the leased premises, paragraph 17 acts as a modified Pugh clause by providing that any production from the pooled unit could only maintain the lease in effect as to the unpooled acreage for a maximum of two years after the end of the primary term.

The lease language on which the leaseholder relied stated (emphasis added):

> Any drilling or reworking on or production from a well located on a pooled unit shall continue this Lease in full force and effect as to that part of the premises contained within a pooled unit. If the entirety of the leased premises is not included in a single unit, [the] leasehold on any portion of the leased premises not contained in a pooled unit can only be maintained for a period of two years after the expiration of the primary term ***unless it is included*** in one or more pooled unit(s) or otherwise maintained under the terms of this lease.

According to the leaseholder, this modified Pugh clause (modified in the sense that it only has effect starting two years after the end of the primary term, rather than immediately) specifies the only effect that results from the leaseholder pooling only part of the leased premises. Further, the emphasized language seems to contemplate that a portion of the leased acreage might not be included in any unit.

The appellate court also noted that paragraph 12 of the printed text of the lease stated: "If this Lease is forfeited, terminated or canceled for any cause, it shall, nevertheless remain in full force and effect as to * * * any part of said land included in a pooled unit on which there are Operations." This would not necessarily defeat the landowner's argument because one possible interpretation of this language is that it conflicts with the landowner's interpretation of paragraph 17 of the addendum as a provision that causes the entire lease to terminate if the leaseholder pools part of the leased premises without pooling the entirety. And the addendum of the lease stated that the addendum would control over any conflicting provisions in the printed text.

The appellate court noted, however, that an introductory clause to a lease addendum, stating that the addendum would control over any conflicting portion of the main text of the lease, does not eliminate the rule of contract interpretation that requires a court to harmonize different portions of a contract if it is reasonably possible to do so. The leaseholder's reading of paragraph 17 provided a plausible way to harmonize the provisions. The initial part of paragraph 17 generally requires the leaseholder to pool the entire leased premises in the event that it pools any portion, but the remainder of paragraph 17 specifies the consequences of failing to do so by acting as a Pugh clause. This gives effect to the entirety of paragraph 17 of the addendum, as well as paragraph 12 of the printed text, which states that if part of the lease terminates, the lease will remain in effect as to a pooled unit from which there is production.

The landowner acknowledged that the latter portion of paragraph 17 operated as a Pugh clause, but the landowner argued that this Pugh clause applied only when the leaseholder obtains the landowner's consent to pool a portion of the leased premises without pooling the entirety. The appellate court disagreed, concluding that the provisions of the lease were best interpreted and harmonized by the interpretation advanced by the leaseholder. Accordingly, the appellate court affirmed the lower court's grant of summary judgment in favor of the leaseholder-defendant.

Fifth Circuit Asks the Texas Supreme Court to Determine Whether Off-Lease Fuel May be Deducted from Royalties Valued at the Well

Sam Allen, James T. Kittrell, & Jana Grauberger
Liskow & Lewis, APLC

The United States Court of Appeals for the Fifth Circuit's recent decision in *Carl v. Hilcorp Energy Co.*, 91 F.4th 311 (5th Cir. Jan 12, 2024), concerns how three related provisions in an oil and gas lease interact: (1) a royalty clause; (2) a free-use clause; and (3) an off-lease clause.

When parties to an oil and gas lease reserve royalties, they stipulate where those royalties are to be valued—sometimes referred to as the "valuation point"—in the royalty clause. When royalties are valued "at the well," royalties must be calculated based on either comparable sales or, when comparable sales are not readily available (which is often the case), by subtracting the post-production costs incurred to prepare production for sale from the proceeds received by the lessee from the sale of that production. "Post-production costs" include any costs incurred by a lessee after production is brought to the surface to make the production marketable. Common examples of post-production costs include gathering, transportation, processing, and compression.

Related to royalty provisions are "free-use clauses" and "off-lease clauses." When oil and gas lessees produce oil and gas, that process requires fuel to power the production process and subsequent processes to treat the production and prepare it for sale. Lessees often use gas produced from a leased premises to power those processes. In recognition of this practice, many oil and gas leases contain free-use clauses, which generally grant lessees the right to use gas produced from a leased premises as fuel for operations on the leased premises without paying royalties on that gas. But to ensure lessees remain obligated to pay royalties on gas that is not used as fuel on the leased premises, leases may also contain an off-lease clause requiring lessees to pay royalties on any gas sold or used off the premises.

These clauses can conflict, though, when royalties are valued at the well because the royalty provision would permit all post-production costs to be deducted from the value of royalties, whereas the off-lease clause would provide, without limitation, that royalties must be paid on gas that is used for a post-production purpose off the leased premises. As such, if gas is used as fuel off the leased premises to power the process of treating production in preparation for sale, is that gas deductible as a post-production cost under the royalty provision, or is it subject to royalty payments under the off-lease provision? This was the question presented to the Fifth Circuit in *Carl*.

Carl concerned an oil and gas lease between the Carl/White Trust, as lessor, and Hilcorp Energy Company, as lessee (the "Lease"). The Lease required royalties to be valued at the well, and it contained a free-use clause and an off-lease clause. When Hilcorp produced gas on the Leased Premises, it transported the gas off the Leased Premises, where it used some of the gas produced from the Leased Premises to make the remaining gas marketable. Hilcorp viewed the gas used as fuel as a post-production cost that could be deducted from the value of the Trust's royalties because the fuel was used to make the gas marketable and the Lease's at-the-well valuation point allowed for costs used to make the gas marketable to be deducted. The Trust, on the other hand, argued that royalties were owed on the gas Hilcorp used as fuel pursuant to the off-lease clause because the off-lease clause expressly stated that royalties were owed on gas "sold or used off the premises."

The Fifth Circuit determined that it could not confidently make an *Erie* guess as to how the provisions should be interpreted. The Fifth Circuit's uncertainty centered around the Texas Supreme Court's decision in *BlueStone Natural Resources II, LLC v. Randle*, 620 S.W.3d 380 (Tex. 2021). The Court in *Randle* held that a lease's free-use clause, which was nearly identical to the free-use clause at issue in *Carl*, was limited to the free use of gas on the leased premises—not off the leased premises—and, as such, royalties were owed on any gas used as fuel off the leased premises. The royalty provision in *Randle*, however, valued royalties based on the gross value received by the lessee, moving the valuation point to the place of sale. Consequently, that lease's royalty clause did not permit the lessee to deduct post-production costs from its proceeds. As such, whether an off-lease clause required royalties to be paid on gas used as fuel off the leased premises was irrelevant—as long as the free-use clause did not apply, royalties were owed pursuant to the royalty provision. The effect of the off-lease clause in *Carl*, however, was crucial, because even if the free-use clause did not apply, the royalty clause would nonetheless permit gas used as fuel off the leased premises to be deducted from the value of the royalties. Thus, *Randle* was not directly applicable, and no other Texas precedent existed concerning whether off-lease clauses prevail over royalty clauses that fix the valuation point of the well.

The Texas Rules of Appellate Procedure permit the Texas Supreme Court to answer questions of law certified by a federal appellate court when no controlling Supreme Court precedent answers the question. The Fifth Circuit utilized that Rule and certified to the Supreme Court the question of whether gas used off a leased premises may be deducted from a royalty's value when the controlling lease values royalties at the well and contains both a free-use clause and an off-lease clause. Additionally, the Fifth Circuit certified the question of whether, if such gas may be deducted, the deduction should influence the value per unit of gas, the total number of units of gas on which royalties must be paid, or both.

Sonda Decision: The Fourth Circuit Sends Motion to Dismiss Challenge to West Virginia Pooling Act Back to Federal Court

Bridget D. Furbee and Garrett M. Spiker[1]
Steptoe & Johnson PLLC

On January 31, 2024, the U.S. Court of Appeals for the Fourth Circuit (the Fourth Circuit) reversed and remanded the opinion of the U. S. District Court for the Northern District of West Virginia (the District Court), holding that the District Court erred in its abstention order in *Sonda v. The West Virginia Oil and Gas Conservation Commission*, No. 22-2271.

In 2022, West Virginia amended its oil and gas conservation law by adding West Virginia Code § 22C-9-7a (the Statute), authorizing the unitization of nonconsenting interest owners' mineral tracts in horizontal well units. Two mineral interest owners (the Interest Owners) filed suit against the West Virginia Oil and Gas Conservation Commission (the Commission) in the District Court, challenging the constitutionality of the Statute. The Interest Owners claimed that the Statute violated their rights under provisions of the U.S. Constitution and the Constitution of West Virginia. The Commission filed a motion to dismiss, arguing that the Interest Owners lacked standing and failed to state a claim upon which relief can be granted. Subsequently, the District Court dismissed all but two claims, which were brought pursuant to the U.S. Constitution. However, the District Court did not address the Commission's arguments for dismissal of the remaining two claims, including the lack-of-standing defense. The District Court abstained from ruling on the two counts, invoking the Pullman abstention doctrine, asserting that West Virginia constitutional law was "directly germane to the issues presented." Thus, the District Court stayed the matter so that the Interest Owners could present the state law issues in West Virginia state court. The Commission appealed.

On appeal, the Fourth Circuit held that the District Court abused its discretion by abstaining and staying the federal court case. While a federal court may abstain and invoke the Pullman doctrine, such action is an extraordinary and narrow exception to the rule that a federal court must exercise its jurisdiction. The Pullman doctrine only applies when "there is (1) an unclear issue of state law presented for decision [and] (2) the resolution of which may moot or present in a different posture the federal constitutional issue such that the state law issue is potentially dispositive." Here, the Fourth Circuit recognized that the District Court improperly applied the Pullman doctrine. First, the District Court merely concluded that West Virginia law was "directly germane" without further analysis or clarification. Second, the District

[1] *DISCLAIMER: These materials are public information and have been prepared solely for educational purposes. These materials reflect only the personal views of the authors and are not individualized legal advice. It is understood that each case is fact-specific, and that the appropriate solution in any case will vary. Therefore, these materials may or may not be relevant to any particular situation. Thus, the authors and Steptoe & Johnson PLLC cannot be bound either philosophically or as representatives of their various present and future clients to the comments expressed in these materials. The presentation of these materials does not establish any form of attorney-client relationship with the authors or Steptoe & Johnson PLLC. While every attempt was made to ensure that these materials are accurate, errors or omissions may be contained therein, for which any liability is disclaimed.*

Court issued a stay so that the Interest Owners "may" present their claims in state court. Third, an "unclear issue of state law" was not identified pertaining to the remaining two claims, the federal law claims. Additionally, the District Court did not address the Commission's argument that the Interest Owners lacked standing. Because standing relates to the District Court's jurisdiction over the matter, the Fourth Circuit held that the District Court should have decided the issue of standing first. Therefore, the Fourth Circuit reversed the District Court and instructed that it address the Commission's standing argument prior to any other arguments on remand.

11 Key Elements of New EPA Rule Regulating Methane and VOC Emissions

Andrew F. Gann, Jr., Charles H. Kuo, Ryan J. Frankel, Kristen L. Mynes
McGuireWoods LLP

On Dec. 2, 2023, the Environmental Protection Agency issued its final rule titled "Standards of Performance for New, Reconstructed, and Modified Sources and Emission Guidelines for Existing Sources: Oil and Natural Gas Sector Climate Review." This rule involves the regulation of methane and volatile organic compound (VOC) emissions from sources in the crude oil and natural gas source category and revises the New Source Performance Standards (NSPS) for new, modified, and reconstructed sources in that source category. The final rule also establishes for the first time emission guidelines that govern how states should regulate methane emissions from existing sources in the source category. Although states are responsible for establishing the performance standards for existing sources, the EPA expects that the same requirements applicable to new sources should also apply to existing sources.

The final rule has not yet been published in the Federal Register. Once that occurs, parties wishing to challenge it have 60 days to file a petition for review in the U.S. Court of Appeals for the D.C. Circuit pursuant to Clean Air Act requirements.

Summary of the Methane Rule

Key elements in the final rule include:

1. *Flaring Restrictions:* The rule phases out routine flaring of gas from new oil wells, categorizing them based on construction date. New wells constructed after specified dates must route gas to sales lines, use it on-site, reinject it or meet specific criteria for flaring.
2. *Super Emitter Program:* The introduction of a first-of-its-kind "Super Emitter Program" allows third parties to detect and report events where emissions exceed 100 kilograms or more of methane per hour and report them to the EPA. The EPA will verify the validity of the notifications and then contact operators, who will be required to investigate and report back to the EPA on their findings.
3. *Storage Vessels:* The final rule changes the definition of "storage vessel" to include not just a single storage facility, but also groups of adjacent tanks known as "tank batteries."
4. *Methane Leak Requirements:* The EPA revised its leak detection and repair requirements to provide options for advanced measurement technologies and alternative inspection frequencies.
5. *Well Closure:* Fugitive emissions monitoring is required until well closure, with a final optical gas imaging survey. Results must be submitted to the EPA, and any detected emissions must be eliminated.

6. *Pneumatic Pump and Controller Requirements:* All pneumatic pump affected facilities must have zero emissions, with exceptions for specific situations. Pneumatic controllers outside Alaska must also have zero methane and VOC emissions.
7. *Well Liquids Unloading and Well Completions:* The final rule includes requirements to minimize venting during well liquids unloading events and to regulate well completions, including the routing of flowback and the utilization of salable gas.
8. *Centrifugal and Reciprocating Compressors:* Centrifugal compressors with wet seals must reduce emissions, while reciprocating compressors must meet a performance-based emissions standard.
9. *Covers, Closed Vent Systems and Combustion Control Devices:* The EPA included requirements for covers and closed vent systems in the final rule to demonstrate compliance through monitoring. The rule also requires combustion control devices to undergo performance tests every five years.
10. *Equipment Leaks at Natural Gas Processing Plants:* The rule mandates inspection requirements for equipment at onshore natural gas processing plants, including pumps, pressure relief devices, open-ended valves and flanges.
11. *Sweetening Units:* Affected facilities with a sulfur production rate of at least five long tons per day must reduce sulfur dioxide emissions by 99.9%.

Institute for ENERGY LAW

Oil & Gas E-Report
Institute for Energy Law
The Center for American and International Law
5201 Democracy Drive
Plano, TX USA 75024

IEL is an Institute of
THE CENTER FOR AMERICAN AND INTERNATIONAL LAW

OIL & GAS E-REPORT

Issue 1 April 2024