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On Appeal of an Order Remanding a Case that was Removed Pursuant to the Federal Officer Removal Statute, the Federal Appellate Court may Consider the Entire Remand Order

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The Mayor and City Council of Baltimore (collectively, "Baltimore") sued multiple oil and gas companies in state court, asserting that the companies had harmed Baltimore by promoting fossil fuels and concealing environmental impacts.[1] The defendants removed the case to federal court, relying on the federal officer removal statute[2] and several other removal statutes. The federal officer removal statute authorizes removal of an action against a federal officer, or any person acting under a federal officer, if the action asserts claims "relating to any act under color of such office."[3] The defendants argued that the federal officer removal statute applies because some of the conduct at issue spanned a period during World War II, when the companies were conducting activities under the direction of federal officials.

Baltimore moved to remand the case to state court and the federal district court granted the motion, concluding that none of the defendants' purported bases for removal applied. Typically, remand orders are not subject to appeal, but 28 U.S.C. § 1447(d) creates two exceptions. It states that "an order remanding a case to the State court from which it was removed pursuant to [the federal removal statute or the civil rights removal statute] shall be reviewable by appeal or otherwise." The defendants appealed, still arguing that removal was proper under the federal officer removal statute, as well as under other removal statutes.

The Fourth Circuit affirmed, addressing only the propriety of removal under the federal officer removal statute. The appellate court concluded that the district court's rejection of other bases for removal was not subject to review. This created a circuit split because the Seventh Circuit has held that, if a remand order is subject to review because the removal was based at least in part on the federal officer removal statute, the federal appellate court can consider all issues relating to the order. The United States Supreme Court granted certiorari to resolve the circuit split.

The United States Supreme Court agreed with the defendants, holding that 28 U.S.C. § 1447(d) authorizes review of any issue in a district court order remanding a case that was removed in part based on the federal officer removal statute. A key point in the Court's reasoning was that § 1447(d) does not state that a federal appellate court may review the district court's conclusion that the federal officer removal statute was inapplicable. Instead, § 1447(d) authorizes review of the "order"

[1] *BP P.L.C. v. Mayor and City Council of Baltimore*, 141 S. Ct. 1532 (2021).
[2] 28 U.S.C. § 1442.
[3] 28 U.S.C. § 1442(a)(1).

remanding the case. Thus, the plain language of the statute appears to allow review of the entire order.

Further, the Court's majority opinion (written by Gorsuch) drew support from the Court's 1996 decision in *Yamaha Motor Corp., U.S.A. v. Calhoun*, which dealt with the scope of a district court's authority to certify "an order" to an appellate court pursuant to 28 U.S.C. § 1292(b). In *Yamaha*, the Court held that an appellate court "may address any issue fairly included within the certified order because it is the *order* that is appealable," not just the issue identified by the district court in its certification. Justice Sotomayor dissented.

There are several other "climate litigation" cases in which state or local governments have sued oil and gas companies that have responded by removing the cases to federal court, relying on the federal officer removal statute and other removal statutes. In at least three of those, the district courts issued a remand order, the defendants appealed, and the appellate courts affirmed, but considered only the propriety of federal officer removal, and the defendants sought Supreme Court review of the appellate court's decision not to consider issues other than federal officer removal. The Supreme Court has now remanded those cases "for further consideration in light of" *BP P.L.C. v. Mayor and City Council of Baltimore*.[4]

[4] *See Suncor Energy, Inc. v. Board of Comm'rs Boulder County*, --- S. Ct. ---, 2021 WL 2044533 (2021); *Chevron Corp. v. San Mateo County*, --- S. Ct. ---, 2021 WL 2044534 (2021); *Shell Oil Products Co. v. Rhode Island*, --- S. Ct. ---, 2021 WL 2044535 (2021).

Louisiana Second Circuit Upholds Trial Court Ruling that Assignor Did Not Reserve Rights to Haynesville Formation

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The Louisiana Second Circuit Court of Appeal recently affirmed a trial court ruling that interpreted the mineral interests acquired by way of a purchase and sale agreement and related documents. In *Goodrich Petroleum, LLC v. Columbine II Limited Partnership,*[1] the court applied Texas contract law in finding no error in the trial court's decision that the assignment of mineral interests from Atlantic Richfield Company ("ARCO") to Aviva, Inc. ("Aviva") was not limited only to the then-producing zones. Consequently, the court affirmed the trial court's judgment entitling Aviva's successor-in-interest, Columbine II Limited Partnership ("Columbine"), to all overriding royalties for the disputed royalty interests, including interest in the Haynesville Formation.

The case originated when Goodrich Petroleum Company, LLC filed a concursus action in the Forty-Second Judicial District for the Parish of DeSoto, Louisiana, after a dispute arose between Columbine and ARCO's successor-in-interest, BP America Production Company ("BP"), as to which entity should be entitled to the overriding royalties on the production of natural gas from the Haynesville Formation. At the time of the assignment in 1992, the Pettit Formation and Hosston Formation were unitized and producing in Northwest Louisiana, but not the Haynesville, which was unitized seventeen years later, in 2009.

The case went to trial in April 2019. After trial, State Court District Judge Amy Burford McCartney ruled in relevant part: (1) Paragraph 4 of Exhibit A to the assignment from ARCO to Aviva expanded the assignment to include zones that were producing in July 1992, but did not limit the overriding royalties to only producing zones; (2) the Description of Lands in Exhibit A to the assignment does not contain any limitation to a zone or formation; and (3) the inclusion of "UI" in the "Intr Type" column in Exhibit A does not operate to convey an interest only in a unitized formation. BP appealed to the Second Circuit, arguing that the inclusion of the term "UI" conveyed only an interest in a unitized formation, and ARCO clearly did not intend to transfer the then non-existent unitized interest in the Haynesville. Columbine argued in response that the interest being conveyed was described in the "Description of Lands" section, that the term "UI" was used only to indicate that the property had been unitized, and in the cases where ARCO had intended to limit the sale to certain depths or formations, it had done so in the "Description of Lands" section of Exhibit A.

The Second Circuit, in its *de novo* review, agreed with the conclusions of the trial court, specifically noting the assignment to be ambiguous and the trial court "correctly interpreted the language of the contract 'in light of the circumstances

[1] 53,820-CA, 2021 WL 1396417 (La. App. 2 Cir. Apr. 14, 2021).

surrounding its execution.'" In doing so, the Court of Appeal rejected BP's argument that the "UI" limited the interest assigned, pointing to the "Description of Lands," which was defined as "the description of the lands and depths in the Royalty interests." The "Description of Lands" pertaining to the property in dispute contained no limits as to formation or depth. Further, no language in the agreement or the assignment placed Aviva on notice that ARCO reserved certain interests for itself and did not intend to sell zones that were not producing. The Second Circuit also emphasized ARCO to be the drafter of the assignment, and any ambiguity must be strictly construed against it under Texas law. Lastly, the Court cited the plentiful trial testimony that ARCO had advertised all zones for sale and if it had intended to sell only the producing zones, it did not take appropriate action to communicate that intent.

This ruling has the potential to impact other existing litigation concerning disputes between BP and Columbine and takes one more step toward the conclusion of disputes over the Haynesville Formation in Louisiana.

Landowners Not Entitled to Disgorgement of Defendant's Profits When Pipeline Intruded Onto Landowners' Property

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Mary v. QEP Energy Co., 2021 WL 1096593 (W.D. La.) held that a disgorgement of a pipeline company's profits was not an appropriate remedy for landowners when a pipeline intruded onto their land without authority.

In 2006, Cynthia and Paul Mary granted oil and gas leases to Whitmar Exploration Company, which later assigned those rights to QEP Energy Company. In 2011, the Marys granted a servitude (the "Pedro Servitude") to QEP, allowing QEP to install pipelines across the Marys' property to serve the "Pedro Wells" on neighboring property.[1] QEP constructed a gas pipeline and a saltwater pipeline, but the gas pipeline strayed thirty-one feet outside the boundaries designated for the Pedro Servitude and the saltwater pipeline strayed about fifteen feet outside the boundaries. The misplacement of the pipeline was apparently inadvertent.

After the Marys discovered that the pipelines ran outside the servitude boundaries, they sued, seeking a disgorgement of any profits that QEP earned from oil and gas operations that utilized the pipelines. The plaintiffs relied in part on Louisiana's law of accession, which provides that the owner of a thing generally owns "everything that it produces,"[2] including "fruits" and "products." For purposes of accession, "[f]ruits are things that are produced by or derived from another thing without diminution of its substance."[3] There are two types of fruits. First, *natural fruits* "are products of the earth or of animals."[4] Second, *civil fruits* are "revenues derived from a thing by operation of law or by reason of a juridical act, such as rentals, interest, and certain corporate distributions."[5] In contrast to fruits, "products" are derived from a thing as a result of a diminution of its substance.[6]

If a person possesses land without permission of the landowner, and this possessor collects fruits from the land, the landowner may or may not be entitled to recover the fruits, depending on whether the possessor was in "good faith" or "bad faith." Civil Code article 486 provides that a good faith possessor "acquires the ownership of fruits he has gathered," and the landowner is not entitled to recover the fruits or their value. On the other hand, article 486 states that a landowner is

[1] Under Louisiana law, a pipeline servitude is a type of "personal servitude" called a "right of use." A right of use "confers in favor of a person a specified use of an estate less than full enjoyment." La. Civ. Code art. 639.
[2] La. Civ. Code art. 482.
[3] La. Civ. Code art. 551.
[4] *Id.*
[5] *Id.*
[6] *See, e.g.*, La. Civ. Code art. 488.

entitled to recover the fruits, or their value, gathered by a bad faith possessor, subject to the possessor's claim for reimbursement of expenses.

For purposes of accession, "a possessor is in good faith when he possesses by virtue of an act translative of ownership and does not know of any defects in his ownership."[7] Here, the Marys asserted that QEP was a bad faith possessor because it did not have an act translative of ownership for the portion of the Marys' land outside the Pedro Servitude.

The federal district court previously had granted summary judgment for the QEP and rejected the Marys' claim for disgorgement.[8] The court relied on Civil Code article 670, which applies when "a landowner constructs in good faith a building that encroaches on an adjacent estate," and the owner of the adjacent estate does not complain until after the building is substantially complete. The article states that, "The owner of the building acquires a predial servitude on the land occupied by the building upon payment of compensation for the value of the servitude taken and for any other damage that the neighbor has suffered." The United States Fifth Circuit reversed and remanded, holding that article 670 did not apply because that article only applies to encroaching *buildings*, not other constructions.

On remand, the district court again concluded that the Marys were not entitled to disgorgement based on accession. The Marys relied on the accession articles dealing with fruits derived from a plaintiff's land. However, QEP derived its profits from natural gas, which is a product, not a fruit.[9] Perhaps more important, given that a landowner's right to "reclaim" products from a possessor is broader than the landowner's right to recover fruits from a possessor,[10] the natural gas on which QEP earned a profit was not derived from the Marys' land. Rather, the gas was derived from the neighboring land. The natural gas merely passed through a pipeline that trespassed on the Marys' land. Further, the Marys failed to show that QEP earned any additional profits by placing a portion of the two pipelines outside the servitude boundaries. Accordingly, the court held that the Marys were not entitled to a disgorgement of profits based on the law of accession.

The Marys also asserted a trespass claim. The court noted that, under Louisiana tort law, a plaintiff who successfully brings a tort claim is entitled to a damages award that will put the plaintiff "in the position he would have occupied had the injury not occurred." Such a plaintiff has no claim for disgorgement of a defendant's profits. Finally, although the Marys did not explicitly assert a claim for breach of contract, portions of their pleadings suggested that QEP breached the servitude agreement. The district court noted, however, that disgorgement of profits is not available as a remedy for breach of contract. Accordingly, the court

[7] La. Civ. Code art. 487.

[8] *Mary v. QEP Energy Co.*, 2017 WL 6273739 (W.D. La.)

[9] La. Civ. Code art. 488.

[10] *Id.*

granted a partial summary judgment that the Marys have no claim for a disgorgement of profits.

Louisiana Second Circuit Court of Appeal Applies *Nunez* in the Context of the Drilling of a Cross-Unit Well

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In *Diamond McCattle Co., LLC v. Range Louisiana Operating*, No. 53,896 (La. App. 2d Cir. 4/14/21), 2021 WL 1396603, the owners of a tract of land in Jackson Parish, Louisiana, Diamond McCattle Co., LLC and BWW Holdings, LLC, sued Range Louisiana Operating, LLC ("Range"), for subsurface trespass. The well at issue, the Tri Delta 13-12 H No. 1 well (the "Well"), was drilled by Range from a surface location in Section 13, Township 16 North, Range 1 West into the previously-unitized Lower Cotton Valley Formation (the "LCV Formation") in both Section 13 and the adjacent section ("Section 12"), with a portion of the well bore being drilled through the subsurface of the plaintiffs' tract in Section 12. The plaintiffs' tract was unleased. Because the Well's initial permit identified the target formation as the non-unitized "L Gray Sand" and the name of the Well did not initially include LCV Formation unit nomenclature, the plaintiffs claimed that the Well was drilled as a lease well, not a unit well, resulting in a subsurface trespass on their tract. The plaintiffs sought damages and ownership of the portion of the wellbore beneath their tract.

Range filed a motion for summary judgment, arguing that, under *Nunez v. Walnoco Oil & Gas Co.*, 488 So. 2d 955, 964 n. 28 (La. 1986), what determines whether operations are unit operations or lease operations is the "intent of the operator and the operations conducted," not the initial permit. Range argued that because the well was drilled to and completed in the previously unitized LCV Formation, the Well's operations should be considered unit operations, and, as a result, the plaintiffs were precluded under *Nunez* from asserting a claim for subsurface trespass. The trial court granted Range's motion for summary judgment, dismissed the plaintiffs' claims, and the plaintiffs appealed.

The Louisiana Second Circuit Court of Appeal affirmed. According to the court, Range applied for and obtained a drilling permit from the Louisiana Office of Conservation, dated October 2, 2017, authorizing the drilling of a lease well to test the non-unitized "L Gray Sand." However, the initial permit listed 14,243 feet as the target depth, a depth within the LCV Formation, not the deeper L-Gray Sand. The LCV Formation in both Sections 12 and 13 had been unitized prior to the Well's being drilled. The Well was completed on January 10, 2018, within the LCV Formation in both sections. On February 28, 2019, Range filed an application with the Office of Conservation to recognize the Well as the unit well for the two previously existing LCV Formation units. On March 27, 2018, the Office of Conservation entered an order, so recognizing the Well.

On appeal, the plaintiffs attacked the admissibility of the affidavits adduced by Range in support of its motions for summary judgment. In his affidavit, Philip N. Asprodites, a former Commissioner of Conservation, stated that it is a "common, normal, accepted practice" for the Office of Conservation to permit a well to a deeper, non-unitized formation although the operator's main objective is to test a shallower, unitized formation. Bob Anderson, a petroleum engineer and 20-year employee of the Office of Conservation, explained that it is common practice in the Office of Conservation for cross-unit wells to be first named as lease wells in order to accommodate the operator's need to drill before a hearing can be held recognizing the well as cross-unit well. James Browning, Range's drilling supervisor for the Well, stated that, from day one, Range's target for the Well was the "Lower Red," a depth entirely within the previously-unitized LCV Formation. Finally, Jeffrey Klam, Range's land manager, stated that, from the commencement of operations, it was Range's intention that the Well would be drilled to the unitized LCV Formation

The Second Circuit found Asprodites' and Anderson's expert opinions were "helpful in understanding the Office of Conservation's procedures and practices." The court further found that Browning's and Klam's affidavits were based on their personal knowledge and not rebutted. According to the court, *Nunez* controlled, Range's affidavits were sufficient to resolve all issues of material fact, and the plaintiffs did not counter these affidavits with their own summary judgment evidence. "After our *de novo* review of this record, we find that there are no genuine issues of material fact which render summary judgment in favor of defendants improper at this time." The plaintiffs have filed an application for a writ of review to the Louisiana Supreme Court, which is pending.

Louisiana Supreme Court Holds that the State Constitution Authorizes an Award of Attorney Fees when a Person Incurs a Loss Because of an Expropriation Proceeding

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In *Bayou Bridge Pipeline, LLC v. 38,0 Acres, More or Less*, 2021 WL 192119 (La. 2021), the Louisiana Supreme Court held that the Louisiana Constitution authorizes an award of attorney fees and costs to a landowner in an expropriation proceeding.

Bayou Bridge Pipeline, LLC constructed a pipeline to carry crude oil from Lake Charles to St. James, Louisiana. As part of its project, Bayou Bridge sought pipeline servitudes for the land that the pipeline would cross. This case involves a tract of approximately 38 acres in St. Martin Parish. The tract was co-owned by several hundred individuals. Bayou Bridge sought and obtained servitude agreements with many co-owners, but was not successful in obtaining agreements with all the co-owners. In late July 2018, Bayou Bridge filed a petition for an expropriation of servitude rights from the co-owners with whom the company had not reached agreement. However, Bayou Bridge began construction activities on the tract earlier that month, before filing the expropriation petition.

Some of the defendant landowners in the expropriation action sought damages for trespass and a violation of due process. They also argued that the expropriation process contained in Louisiana Revised Statute 19:2(8), Louisiana Revised Statute 45:251, and Article I, §IV(B)(4) of the Louisiana Constitution itself are unconstitutional. The trial court sided with Bayou Bridge on several issues by rejecting the defendants' argument that the expropriation statute is unconstitutional, rejecting the defendants' assertion that their due process rights had been violated, and agreeing with Bayou Bridge that $75 represented the fair market value of the defendants' share of the pipeline servitude being taken in the expropriation proceeding. However, the court found that Bayou Bridge was liable for trespass for entering the tract and beginning construction of the pipeline before having secured a judgment of expropriation. The court awarded $75 in trespass damages.

The defendants appealed and the case was heard by a five-judge appellate panel. Like the trial court, the appellate court upheld the constitutionality of Louisiana's expropriation process. Further, the appellate court let the $75 expropriation award and the additional $75 trespass award stand, concluding that the defendants had not properly raised an assignment of error regarding those amounts. However, the appellate court concluded that the defendants' due process rights had been violated because Bayou Bridge had begun pipeline construction prior to obtaining a judgment of expropriation. The appellate court awarded $10,000 in damages for the alleged due process violation. A dissenting judge disagreed with the due process portion of the decision, reasoning that Bayou Bridge's premature entry onto the land was simply a trespass, not a due process violation. The appellate court also awarded attorney fees to the defendants, relying on Louisiana Revised Statute 13:5111.

Bayou Bridge sought and obtained review from the Louisiana Supreme Court on the attorney fee issue. Bayou Bridge noted that the express language of 13:5111 authorizes awards of attorney fees in cases involving certain takings claims against “the state of Louisiana, a parish, or municipality or other political subdivision or an agency of any of them.” Bayou Bridge argued that it was not an agency of the state or other governmental unit and that this statute does not authorize an attorney fee award against a private company. The Louisiana Supreme Court agreed. Nevertheless, it upheld the attorney fee award, finding that it is authorized by article I, § IV of the Louisiana Constitution, which entitles a person whose property is taken in an expropriation proceeding to receive compensation for “the full extent” of their loss, which “shall include, but not be limited to, the appraised value of the property … and all other damages actually incurred by the owner because of the expropriation.” The Court reasoned that the loss incurred by the defendants in this case included any attorney fee expenses they incurred. Therefore, although the constitutional provision does not explicitly refer to attorney fees, the appellate court had not erred by awarding such fees. The Court remanded for a determination of fees.

One justice dissented. He agreed that the article I, § IV implicitly authorizes an award of attorney fees to a person who incurs a loss because of an expropriation. Here, Bayou Bridge offered the defendants $75 for their fractional interest in a pipeline servitude before filing the expropriation proceeding and that is the amount that the defendants later obtained in judgment for the expropriation. The dissenting justice reasoned that the defendants’ attorney fees therefore were not incurred because of the expropriation.

North Dakota Supreme Court Confirms that the Oil Royalty under Oil and Gas Leases at Issue Should be Valued at the Well

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The North Dakota Supreme Court recently issued a decision holding that oil royalties are properly valued at the well when the royalty clause provides that the Lessee is to deliver "to the credit of the Lessor, free of cost, in the pipeline to which Lessee may connect wells on said land, the equal [fractional] part of all oil produced and saved from the leased premises."[2]

The plaintiffs or their predecessors entered into multiple oil and gas leases containing the above oil royalty clause. The plaintiffs brought five putative class actions against oil and gas operators in the United States District Court for the District of North Dakota. The plaintiffs alleged that those operators breached the leases by deducting post-production costs from plaintiffs' oil royalties, including costs incurred in bringing oil produced from the leased lands to market. The plaintiffs specifically alleged that their oil royalties were to be paid "free of cost." The plaintiffs asserted their breach of contract claims on behalf of themselves and a putative class of others alleged to be similarly situated. These five class actions were amongst approximately fifteen putative class actions pending before the United States District Court for the District of North Dakota, all of which make similar allegations.[3]

Each of the five operators filed motions to dismiss under Fed.R.Civ.P. 12(b)(6). The operators argued that their obligation to provide the oil royalty "in the pipeline to which Lessee may connect wells on said land" fixed the valuation location for the oil royalty at the well, after which point the plaintiffs' oil royalties were subject to their proportionate share of post-production costs. The plaintiffs countered by arguing that the valuation location was independent of the well's location because "the pipeline" referenced in the oil royalty clause meant a downstream commercial pipeline used to transport oil to a refinery. The plaintiffs

[1] Disclaimer: Crowley Fleck PLLP represents multiple oil and gas operators involved in the litigations discussed.

[2] *Blasi v. Bruin E&P Partners, LLC*, 2021 ND 86, —N.W.2d—.

[3] *See White River Royalties, LLC v. Hess Bakken Invs. II, LLC*, Case No. 1:19-cv-00218 (D.N.D. 2019); *Blasi v. Bruin E&P Partners, LLC*, Case No. 3:20-cv-00085 (D.N.D. 2020); *Blasi v. Lime Rock Res. Operating Co., Inc.*, Case No. 3:20-cv-00091 (D.N.D. 2020); *Blasi v. Kraken Dev. III, LLC*, Case No. 3:20-cv-00092 (D.N.D. 2020); *Blasi v. Continental Res., Inc.*, Case No. 3:20-cv-00093 (D.N.D. 2020); *Blasi v. EOG Res., Inc.*, Case No. 3:20-cv-00094 (D.N.D. 2020); *Heggin Lewis v. Nine Point Energy, LLC*, Case No. 1:20-cv-00124 (D.N.D. 2020); *Heggin Lewis v. XTO Energy Inc.*, Case No. 1:20-cv-00125 (D.N.D. 2020); *Nelson v. Equinor Energy LP*, Case No. 1:20-cv-00133 (D.N.D. 2020); *Ceynar v. Oasis Petroleum North America LLC*, Case No. 1:20-cv-00139 (D.N.D. 2020); *Double Diamond C Mineral LLC v. Zavanna, LLC*, Case No. 1:20-cv-00149 (D.N.D. 2020); *Hystad Ceynar Minerals, LLC v. Whiting Oil & Gas Corp.*, Case No. 1:20-cv-00216 (D.N.D. 2020); *Blasi v. QEP Energy Co.*, Case No. 1:21-cv-0033 (D.N.D. 2021); *Powell Family Mineral LLC v. Slawson Exploration Co., Inc.*, 1:21-cv-00047 (D.N.D. 2021).

maintained that the leases required their oil royalties be paid "free of cost" until the oil entered that downstream commercial pipeline.

After considering the parties' arguments, and without ruling on the motions to dismiss, the United States District Court for the District of North Dakota certified a question of law to the North Dakota Supreme Court. That question was as follows:

> Whether the instant oil royalty provision is interpreted to mean the royalty is based on the value of the oil "at the well:"
>
> > Lessee agrees … "[t]o deliver to the credit of the lessor, free of cost, in the pipeline to which lessee may connect wells on said land, the equal [fractional] part of all oil produced and saved from the leased premises."[4]

On May 20, 2021, the North Dakota Supreme Court answered that question in the affirmative in *Blasi v. Bruin E&P Partners, LLC*, 2021 ND 86, —N.W.2d—.

The North Dakota Supreme Court began its analysis by exercising its discretion to answer the certified question. The court noted that the oil and gas industry is significant in North Dakota. The court also noted that the particular oil royalty language at issue had been used in North Dakota for decades.[5] The court finally noted that answering the certified question would avoid the possibility of a split occurring within the United States District Court for the District of North Dakota concerning how to properly interpret the oil royalty clause.

By way of background, the North Dakota Supreme Court recognized that oil generally increases in value as costs are incurred in bringing the oil to market. The court noted that it had previously endorsed the work-back method for determining the market value on which a royalty was to be calculated, under which the market value is determined by taking the sales price received at a downstream point of sale and then subtracting the reasonable post-production costs incurred.[6] Although the work-back method applies when the valuation point is at the well, the court noted that the parties are free to contract for a different valuation location.

Addressing the merits, the North Dakota Supreme Court held that the oil royalty clause unambiguously established the valuation point at the well. The court began its analysis by observing that the oil royalty clause provided for an in-kind delivery of the oil royalty at a specified location. The court noted that the oil royalty clause unambiguously identified that point of delivery: "in the pipeline to which lessee may connect wells on said land." The court rejected plaintiffs' argument that the royalty should be valued at the point it entered a commercial pipeline at some distant downstream location because the clause's reference to "the pipeline"

[4] *Blasi v. Lime Rock Res. Operating Co., Inc.*, No. 20-cv-00091, Doc. No. 27 (D.N.D. Nov. 30, 2020).
[5] *See, e,g., MacMaster v. Onstad*, 86 N.W.2d 36, 39-40 (N.D. 1957).
[6] *See Bice v. Petro-Hunt, L.L.C.*, 2009 ND 124, ¶ 20, 768 N.W.2d 496.

connoted the pipeline’s location in relation to the well. The court also expressed concern that valuing the oil royalty when it first entered an undefined downstream commercial pipeline would introduce considerable uncertainty into the royalty valuation because that pipeline could change over time, or the oil may never enter any commercial pipeline because of the availability of alternative modes of transportation. The court held, “as a matter of law, that the oil royalty provision in this case unambiguously sets a valuation point at the well.” The court noted that this conclusion was consistent with case law from other jurisdictions.[7] The North Dakota Supreme Court, accordingly, answered the certified question, “yes.”

[7] *See Kretni Development Co. v. Consolidated Oil Corp.*, 74 F.2d 497, (10th Cir. 1934); Molter v. Lewis, 134 P.2d 404, 404-05 (Kan. 1943); *Burlington Resources Oil & Gas Co. v. Texas Crude Energy, LLC*, 573 S.W.3d 198, 201 (Tex. 2019); *BlueStone Nat. Res. II, LLC v. Nettye Engler Energy, LP*, No. 02-19-00236-cv, 2020 WL 3865269, at *4-5 (Tex. App. July 9, 2020).

Ohio Co-Tenant Acquires All-Depths Oil and Gas Rights by Adverse Possession Through Shallow Production

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Tomechko v. Garrett is the type of case your oil and gas law professor is tempted to put on the final exam.[1] Owner conveys property to Cotenant, reserving “all the mineral rights in and under" the property. Cotenant leases property to Producer, who drills and produces from two shallow wells located on the property for 25 years. Producer discovers the potential interest of Owner and reduces its royalty payments to Cotenant, who then files suit to quiet title to 100% of the oil and gas underlying the property. Cotenant claims: (i) that the original reservation did not include the oil and gas estate and (ii) that, even if the reservation did include the oil and gas estate, Cotenant had acquired Owner’s interest through adverse possession. And add to the mix the fact that Owner failed to timely respond to requests for admission asking Owner to concede that the reservation was not intended to reserve the oil or gas underlying the property. There are enough issues here to account for at least a third of the final exam!

Overall outcome: The Court of Appeals for the Seventh Appellate District found that while the mineral reservation did include the oil and gas underlying the property, Cotenant had acquired the entire oil and gas estate by adverse possession, despite the fact that there was no production from the deeper depths.

Mineral reservation: The Court reviewed earlier case law acknowledging that “[i]n general, [the term] minerals include[s] oil and gas,” and that "the more recent the deed, the more likely it is oil and gas were intended to be included as minerals." Here, “[t]he language in the Deed of Fiduciary states that [Owner] was ‘RESERVING from the above-described one-half interest **all** the mineral rights in and under’ the property (emphasis added [by the Court]).” Moreover, “appellants failed to establish that oil and gas development was not occurring in Noble County in 1977 when the reservation was made. In fact, the trial court found otherwise.” As a consequence, the Court rejected Cotenant’s argument that the language was ambiguous and failed to reserve the oil and gas underlying the property.

Adverse Possession: Nevertheless, Cotenant argued that it had acquired not only the shallow rights to the oil and gas estate of Owner, but also the deep rights, by adverse possession: “Cotenant maintain[s] that under the [Subject] Lease, [it] adversely possessed the oil and gas on the surface and below when [it] entered into a lease with Trans Atlantic, leased the entire oil and gas estate in the property, authorized Trans Atlantic to drill for and produce oil and gas, oil and gas were produced, and [it was] paid royalties for the production.” And more particularly, that “the two wells on the property constituted open, obvious, notorious, continuous and exclusive possession of all of the interests in the property, including deep rights.” The Court agreed.

[1] 2021-Ohio-1377.

Quoting earlier case law in the district, the Court observed: "Minerals which have been severed from the title to the surface may be acquired by adverse possession, but this can take place only when the possession is actual, continuous, open, notorious and hostile. It cannot be accomplished by secret trespass upon the owner's rights." Further, "[i]t has been held in many cases that where there has been a severance of the minerals from the surface, neither the owner of the surface nor the owner of the minerals can claim the other's estate merely by force of the possession of his own estate. Neither does the owner of the minerals lose his right by mere nonuse. His title can only be defeated by acts which actually take the minerals out of his possession." And regarding the type of use that can establish possession, "[o]nly productive uses [as compared to maintenance] are sufficient for actual possession." Productive uses, according to the Court, are any that take the minerals out of the record owner's possession. "This requires the actual development of the oil and gas mineral rights."

Here, the Court agreed that there was actual development of the oil and gas estate. While leasing alone would be insufficient, "oil and gas were actually produced from the two wells placed on the property through [Producer], and [Cotenant was] paid 100% of the royalties from that production. This actual development of the oil and gas rights took the minerals out of [Owner's] possession." But what about the fact that Owner and Cotenant were joint owners of the oil and gas estate? The Court observed, "[a] tenant in common cannot assert title by adverse possession against his co-tenant unless he shows a definite and continuous assertion of adverse right by overt acts of unequivocal character clearly indicating an assertion of ownership of the premises to the exclusion of the right of the co-tenant."[2] Here, that required Cotenant to have taken "an overt act of unequivocal character that clearly showed an assertion of ownership" to the exclusion of Owner – mere possession is insufficient because possession is presumed to be consistent with both parties' right to enter the property at any time. That requirement appears to be satisfied by the fact that Owner "received no royalty payments despite the placement of the wells on the property via Cotenant's lease with Trans Atlantic which were producing oil and gas for over 21 years."

What about the fact that the production related only to shallower depths? Does that limit the adverse possession to those depths, or does Cotenant acquire the oil and gas estate even to those depths that have not yet been produced? The Court found that the adverse possession applied to all depths. Finding little guidance on the issue, it relied heavily on a court of appeals decision out of Kentucky, *Diederich v. Ware*, 288 S.W.2d 643 (C.A. Ky. 1956): "The court found that the operation of the two wells on the property modified the subterranean structure under the large tract of land and this constituted constructive possession of all of the minerals underlying the entire 56-acre estate. *** [Further, it] discussed the fugacious nature of oil and gas and how it alters property and the strata upon withdrawal of oil and gas by drilling. Id." Thus, the Kentucky court "held that the adverse possessors exercised constructive possession over all of the minerals in the entire tract of land due to this alteration and permeation of oil and gas."

[2] Quoting the Ohio Supreme Court in *Gill v. Fletcher*, 74 Ohio St. 295 (1906).

In the case before it, the Court found the same. "Adverse possession of the deep rights should follow the shallow rights due to the alteration of the surface and subsurface from drilling and removing the oil and gas. Merely because drilling had not yet affected the deep rights should not yield a finding that there is no adverse possession of the deep rights." Thus, Cotenant "possesse[d] the deep rights in this case based upon the adverse possession of the shallow rights, the permeating nature of the drilling and production of oil and gas, and the lease with Trans Atlantic which provided for drilling to all strata."

Requests for admission: And if that weren't enough, the Court also held that the trial court did not err by failing to deem admitted that the phrase "mineral" did not include oil and gas due to Owner's failure to respond to the admission request in the time permitted by rule. "[Owner] in the instant case responded to the requests for admissions well before [Cotenant] filed the motion for partial summary judgment and one year and eight months before a hearing was held on that motion. *** Further, ***, [Cotenant] in this case presented evidence under Civ. R. 56(C) to raise a genuine issue to be resolved by the trial court." It preferred, instead, to decide the case on the merits.

Law students beware – this fact pattern could be on your next exam!

Commencement Operations in One Section Within a Multi-Unit Horizontal Well Were Found to Constitute Commencement Activities Within the Other Section, Thereby Perpetuating the Oil and Gas Lease Into its Secondary Term

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In *Harold Lawson, Trustee of the Harold Lawson Living Trust v. Citizen Energy II, LLC,*[1] Harold Lawson had entered into an oil and gas lease in 2014 covering lands in Section 11. Section 11 was a drilling and spacing unit under order of the Oklahoma Corporation Commission (OCC). The governmental section immediately to the south (Section 14) was pooled as a separate horizontal drilling and spacing unit. Citizen Energy II, LLC (Citizen II) and Roan Resources, LLC (referred to as Roan or Operator) applied for a multi-unit horizontal well with the completion interval in Sections 11 and 14. In May 2017, the Oklahoma Corporation Commission (OCC) granted the application.

The Operator commenced the McWhirther 1H-14-11 well from a surface location in Section 14, and it drilled a horizontal lateral from south to north eventually penetrating Section 11. However, the lateral did not penetrate the Section 11 unit until *after* expiration of the Lawson Lease's primary term, although commencement operations began on Section 14 before the expiration of the Lawson Lease. The primary issue before the court was whether the leased acreage included in the Section 11 unit was extended into its secondary term as a matter of law by commencement activities off-unit in Section 14.

After reviewing certain principles of contract interpretation, application of statutory law and administrative rules, the Court of Appeals assessed the issue of whether the district court's summary judgment ruling in favor of Citizen II and Roan, and against Lawson's contention that the oil and gas lease had expired, was in error. The court acknowledged that Section 14 was not within the legal description for the leased premises. However, the court found:

> The real issue is whether commencement operations to drill on the Section 14 unit satisfies the commencement clause of the Lawson Lease, which contemplates drilling on acreage pooled with the Section 11 unit. In Oklahoma, no appellate court has addressed commencement operations on acreage off-unit, that is, property not included in an existing spacing unit or included in a pending application for a drilling and spacing unit. This presents an issue of first impression.[2]

The court observed that a key aspect of this case was that the OCC authorized a multi-unit horizontal well for Sections 11 and 14, two separate drilling and spacing units. It also noted that the OCC's authority to regulate horizontal

[1] 2021 OK CIV APP 1, 481 P.3d 287.
[2] *Id.* at ¶ 9.

drilling in Oklahoma[3] arose in later years through the enactment of the 2011 Shale Reservoir Development Act.[4] After reviewing part of the history of the 2011 Act, and the development of new technologies in recent years, the court stated:

> Therefore, a multi-unit horizontal well drilled in the Section 14 unit is treated as a well in the Section 11 unit. Commencement operations in the Section 14 unit during the Lease's primary term extended the lease as a matter of law, provided the well so commenced is completed as a producing well.[5]

In sum, commencement activities in the Section 14 unit were treated as commencement activities in the Section 11 unit. The Lease was thereby perpetuated into its secondary term as a matter of law. The Court of Appeals affirmed the judgment of the district court.

[3] *Id.* at ¶ 11.

[4] 52 O.S. 2011, § 87.6 *et seq.*

[5] 2021 OK CIV APP 1, 481 P.3d 287, at ¶ 14.

Oil and Gas Operators Classified as “Buyers” Not Subject to the Uniform Trade Practices Consumer Protection Law

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In a recent decision, *Commonwealth v. Chesapeake Energy Corporation,*[2] the Pennsylvania Supreme Court (the “Court”) ruled on an issue of first impression regarding whether the Office of the Attorney General (the “OAG”), on behalf of the Commonwealth of Pennsylvania, could bring legally cognizable claims under the Unfair Trade Practices and Consumer Protection Law (the “UTPCPL”) against an oil and gas lessee for its allegedly unfair and deceptive conduct as a purchaser of mineral estates.

Background

The UTPCPL was enacted in 1968 to level the playing field between consumers and sellers with regard to commercial transactions, with the intent to protect consumers from fraud and unfair or deceptive business practices by sellers.[3] Section 3 of the UTPCPL declares unlawful “unfair methods of competition and unfair or deceptive acts or practices in the conduct of any *trade or commerce* as defined by [Section 2(4)(i)-(xxi)] and regulations promulgated [by the Attorney General] under section 3.1[.]”[4] (emphasis added). The case in question specifically dealt with Section 2(3) of the UTPCPL, which defines the terms trade and commerce as “the advertising, offering for sale, sale or distribution of any services and any property, tangible or intangible, real, personal or mixed, and any other article, commodity, or thing of value wherever situate, and includes any trade or commerce directly or indirectly affecting the people of this Commonwealth.”[5] The UTPCPL gives either the attorney general, district attorney or even the individual themselves the power to bring an action under the UTPCPL.

Anadarko Petroleum Corporation and Anadarko E&P Onshore, L.L.C. (collectively, “Anadarko”), are oil and gas operators, that were heavily involved in operations and leasing in the Marcellus Shale formation in northeastern

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[2] 2021 WL 1114660 (Pa. 2021).
[3] *Id.* at 1.
[4] *Id.* citing 73 P.S. § 201-3.
[5] *Id.*

Pennsylvania. Anadarko acquired oil and gas interests from landowners by utilizing contract landmen. Additionally, Anadarko entered into a joint venture with other companies also active in the Marcellus Shale formation, including Chesapeake Energy Corporation, Chesapeake Appalachia, L.L.C., Chesapeake Operating, L.L.C., and Chesapeake Energy Marketing, L.L.C. (collectively, "Chesapeake"). As part of the joint venture Anadarko and Chesapeake agreed to split the territory in northeastern Pennsylvania by county and took leases only in their designated counties with the option to then participate in the other companies' leases.

The OAG brought suit against both Anadarko and Chesapeake pursuant to Section 3 of the UTPCPL, alleging that the Anadarko and Chesapeake joint venture eliminated competition with regard to the lease terms offered to landowners and also violated antitrust laws. As damages, the OAG sought to "recover for Pennsylvania Landowners money wrongfully deducted from royalty checks as a result of the wrongful conduct of [Anadarko and Chesapeake]."[6] Anadarko filed preliminary objections to the OAG's complaint arguing that three counts of the complaint were legally insufficient because Anadarko was not a seller and was in fact the buyer/purchaser of the oil and gas interests in the transactions in-question. The trial court overruled Anadarko's preliminary objections, concluding that the UTPCPL applied because Anadarko was involved in "trade and commerce" as defined in the UTPCPL.[7] However, the trial court *sua sponte* identified two issues for immediate interlocutory appeal, being "(1) whether the OAG may bring claims under the UTPCPL in this case; and (2) whether the OAG's antitrust allegations are cognizable under the UTPCPL "catchall" provision in Section 2(4) (xxi)."[8]

The Commonwealth Court on appeal, affirmed in part and reversed in part the trial court order overruling Anadarko's preliminary objections. Similar to the trial court, the Commonwealth Court used the Court's decisions in *Commonwealth, by Creamer v. Monumental Props. Inc.*[9] and *Danaganan v. Guardian Protection Services*[10] as well as dictionary definitions in determining that Anadarko's actions constituted "trade and commerce" as defined by the UTPCPL.[11] The only point where the Commonwealth Court differed from the trial court was with regard to the OAG's anti-trust allegation in Count III which they found not legally viable. Anadarko appealed the Commonwealth Court's decision and the Court allowed Anadarko's appeal to consider two issues: "(1) Are the claims by the Commonwealth, brought on behalf of private landowners against natural gas extractors alleging that the extractors used deceptive misleading, and unfair tactics in securing natural gas leases from landowners, cognizable under the [UTPCPL]? [and] (2) May the

[6] *Id.* at 3.
[7] *Id.*
[8] *Id.* at 4.
[9] 459 Pa. 450 (1974) (The Court concluded that residential leases are sales that are regulated by the UTPCPL).
[10] 645 Pa. 181 (2018).
[11] *Chesapeake*, 2021 WL at 4.

Commonwealth pursue antitrust remedies under the UTPCPL?"[12] The Court determined that these issues were "pure legal questions of statutory interpretation;" therefore, the Court's standard of review was de novo with the scope being plenary.[13]

Sufficiency of OAG's claims?

The Court initially addressed the correctness of the Commonwealth Court's determination that the OAG's claims under the UTPCPL were legally sufficient. The first step in the Court's analysis was to turn to the UTPCPL's definition of "trade" and "commerce" in Section 2(3) of the UTPCPL. The Court disagreed with the Commonwealth Court's interpretation of the definition of "trade" and "commerce", which determined the UTPCPL covered conduct by buyers as well as sellers, finding that the UTPCPL "clearly regulates the conduct of sellers, and it does not provide a remedy for sellers to exercise against buyer."[14] The Court agreed with Anadarko that the legislature clearly chose to define trade and commerce as pertaining only to acts related to selling and was free to deviate from the dictionary definition of those terms. The Court recognized that it could not disregard the legislature's choice to use a specialized definition of trade and commerce and found that the Commonwealth Court erred by using the dictionary definitions of trade and commerce when the legislature had already provided such definitions in the statute itself. Furthermore, the Court disagreed with the Commonwealth Court's analysis that treated the second portion of the definition of trade and commerce in Section 2(3) of the UTPCPL as being a "catch-all" provision in addition to the specific acts that the UTPCPL had already provided for trade and commerce in the first portion of Section 2(3). The Court indicated that because the UTPCPL had already defined trade and commerce in the first part of Section 2(3) then when it was used in the second part, the same definition had to be applied and the terms could not be used differently within the same sentence.

The Court also pointed out that the Commonwealth Court misapplied the Court's decisions in both *Monumental Properties* and *Danganan*. The Court indicated that its decision in *Monumental Properties* had determined that leasing commercial properties was an activity that fell within in the purview of the UTPCPL, but that even in that instance it only applied to the protection of tenants and not to the protection of lessors. The Court indicated that its decision in *Danaganan* was not a decision to interpret the second portion of the definition of trade and commerce in Section 2(3) of UTPCPL as a "catch-all" provision, but was merely a determination that the second portion extended the protections of the UTPCPL to out-of-state consumers who had contracted with a Pennsylvania based business. Therefore, the Court applying the plain meaning of trade and commerce as defined

[12] *Id.* at 6.
[13] *Id.*
[14] *Id.*

in Section 2(3) of the UTPCPL overruled the Commonwealth Court's decision and determined that the OAG's claims were not legally cognizable under the UTPCPL. The Court ruled that Anadarko was in effect operating as a buyer and the various landowners were the sellers in the oil and gas leasing transactions and claims cannot be brought against buyers under the UTPCPL. In addition, the Court ruled that the OAG's claims of antitrust were also not cognizable for the same reason and did not address the second question as it was moot.

It is worth noting that Justice Dougherty (the "Justice") filed a dissenting opinion. In his dissent the Justice explained his full agreement with the majority's interpretation and ruling on the definition of trade and commerce being limited to only sellers. The Justice dissented with the majority on their determination that Anadarko was operating as a buyer, clarifying that in his view Anadarko was the buyer when it came to the land itself; however, Anadarko was also a seller when it came to offering oil and gas production services. The Justice pointed out that Anadarko approached the landowners about operating on their land and noted various representations made by Anadarko's agents to the landowners to "pitch an oil and gas lease." Based on the power differential in favor of the lessee in these transactions, the Justice noted that the landowners are not in the same position as a seller seeking to sell a product in the usual buyer-seller relationship.

Conclusion

This ruling is a positive outcome for oil and gas operators in the Commonwealth of Pennsylvania. In light of this decision, the Court has put an end to any claims under the UTPCPL, as currently drafted, against oil and gas operators. Barring any statutory changes, this should eliminate exposure to producers against liability under the UTPCPL. Nonetheless, operators still need to be cognizant of actions that could be construed as unfair methods of competition or that could be perceived as misleading or deceiving landowners.

BlueStone v. Randle: Supreme Court of Texas Holds that Producer Could Not Deduct Post-Production Costs when "Gross Value Received" Royalty Clause Controlled, and Must Pay Royalty on Off-Lease Use of Gas Not Covered by "Free Use" Lease Fuel Clause

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I. Introduction

In *BlueStone Natural Resources II, LLC v. Randle* the Supreme Court of Texas held that a "gross value received" royalty clause in an addendum to an oil and gas lease superseded a conflicting "at the well" clause found in the same instrument, when the parties to the lease included express language dictating that the addendum's "gross value received" clause controlled.[1] Therefore, Bluestone could not deduct postproduction costs in calculating gas royalties. The decision, however, reaffirmed prior holdings in *Heritage Resources Inc. v. NationsBank*[2] and *Burlington Resources Oil & Gas Co. LP v. Texas Crude Energy, LLC*[3] that "into the pipelines" and "at the well" language in a royalty clause created a wellhead valuation point. The court in *BlueStone* applied the longstanding principle of contract interpretation that courts must apply contracts as they are written. The Court also held that a lease clause allowing "free use" of gas was limited to operations on the lease and that royalty was due on gas used off the lease, at least where other provisions of the lease, including the royalty clause, would require such royalties.

II. Case Facts

BlueStone involved oil and gas leases executed in 2003. The leases at issue had a two-page form lease and an attached addendum. Importantly, the addendum stated that "its language 'supersedes any provisions to the contrary in the printed lease[.]'"[4] The form lease contained an "at the well" royalty provision, which stated that gas royalties were to be on "the *market value at the well* … of the gas so sold or used [off the premises]."[5] The addendum, however, stated "that the '[l]essee agrees to compute and pay royalties on the *gross value received*, including any reimbursements for severance taxes and production related costs[.]'"[6] The addendum also stated that "all royalties accruing under this lease (including those paid in kind) shall be without deduction, directly or indirectly, for the cost of producing, gathering, storing, separating, treating, dehydrating, compressing,

[1] 620 S.W.3d 380, 384 (Tex. 2021).
[2] 939 S.W.2d 118, 130 (Tex. 1996) (Owen, J.) (plurality op.)
[3] 573 S.W.3d 198, 208 (Tex. 2019), *reh'g denied* (May 31, 2019).
[4] *BlueStone*, 620 S.W.3d at 384 (alteration in original).
[5] *Id.* (emphasis and alterations in original).
[6] *Id.* (emphasis and alterations in original).

processing, transporting, and otherwise making the oil, gas and other products hereunder ready for sale or use."[7]

BlueStone acquired the lease in 2016 and proceeded to pay royalties based on an "at the mouth of the well" valuation, which resulted in reduced royalties because the prior lessee, Quicksilver, had paid royalties on a "gross value received" valuation.[8] After suit was brought, it was discovered that BlueStone "was not paying any royalties on commingled volumes of gas used as plant fuel by a third-party processor (Plant Fuel) or on commingled gas the fuel processor returns to BlueStone to fuel compressors on and off the leasehold premises."[9]

III. The Court Holds that "Gross Value Received" Clause Controlled Because of Express Language in Addendum

The critical issue involved whether the phrase "gross value received" in the Addendum conflicts with the phrase "at the mouth of the well" in the printed lease as necessary to invoke the Addendum's superseding clause.[10] BlueStone argued that the *Burlington* decision requires that the Court give the "at the well" language "decisive force when present," and because the Addendum did not contain a superseding valuation point, the printed form's "at the well" point of valuation controls.[11]

The Court disagreed with BlueStone's proposed interpretation, holding that "[a] provision requiring computation based on 'gross value received' inherently conflicts with a computation based on value received 'at the mouth of the well.'"[12] Addressing the differences between the clauses, the court explained that the "former is a gross-proceeds equivalent from which postproduction costs may not be deducted, and the latter is a net-proceeds equivalent that contemplates deductions."[13] Therefore, the lower courts correctly concluded that the lessee's deduction of postproduction costs was improper because the mineral lease "explicitly resolves the conflict in favor of the gross-proceeds calculation."[14] Because "at the well" and "gross value received" are polar opposites, the addendum's express language resolving the conflict in favor of the "gross value" language found in the addendum controlled.[15]

Significantly, in footnote 64, the court explained that it was *not* considering the effect of the "no deducts" language in the lease addendum, and whether, absent the "gross value received" language, the court would have found a conflict between the "no deducts" language in the addendum and the "at the well" provision in the lease. In effect, the court expressly let stand its prior decisions saying there is no conflict because "no deducts" language is surplusage when the

[7] *Id.* at 384 n.5.
[8] *Id.* at 385.
[9] *Id.*
[10] *Id.* at 384.
[11] *Id.* at 386.
[12] *Id.* at 384.
[13] *Id.*
[14] *Id.*
[15] *Id.* at 393.

valuation point is at the well. The court explained that the only conflict it found in *BlueStone* was between the "at the well" clause in the form lease and the "gross value received" clause in the addendum.

IV. The Court Holds that Royalty Was Due on Fuel Gas Used Off Lease Because of Express Language of "Free Use" Clause

As to the second issue regarding the "free use" clause, the court held that "[c]onstrued contextually, the lease's free-use clause is limited to on-lease uses," and declined to undergo an analysis of whether gas used off lease benefited or furthered lease operations.[16]

In so holding, the court focused on the specific language of the lease, which used the term "hereunder" to describe what operations were free from royalty.[17] Specifically, the clause provided that "Lessee shall have free from royalty or other payment the use of … gas … produced from said land in all operations which Lessee may conduct hereunder, including water injections and secondary recovery operations, and the royalty on … gas … shall be computed after deducting any so used."[18]

The court addressed a handful of decisions from other jurisdictions, ultimately agreeing with the Tenth Circuit's holding in *Anderson Living Trust v. Energen* as to Colorado leases that contained substantially similar language.[19] The Colorado leases use of "hereunder" qualified the "operations" that were free of royalty, meaning that the operations that were free of royalty were limited to those on the leased premises.[20] The court declined to follow cases from New Mexico and North Dakota that held that off-lease use of gas was free of royalty.[21]

The court followed the Tenth Circuit's lead, finding that the plain meaning of the term "hereunder," meant that a failure to pay royalties on Plant Fuel was a breach of the lease.[22] The court further explained that the lack of a limiting principle to BlueStone's suggested interpretation further supported the on-the-lease requirement, as parties would end up in disputes as to what benefited or furthered lease operations.[23] The court then concluded that "the free-use clause in the BlueStone lease does not authorize a royalty-free use of gas off-lease."[24] Significantly, the court also pointed to provisions in the royalty clause in the *Anderson* case as support for its conclusion that off-lease use was not royalty-free.

[16] *Id.* at 384.
[17] *Id.* at 398; *see also id.* at 398 n.110 (citing *Hereunder*, BLACK'S LAW DICTIONARY (11th ed. 2019)).
[18] *Id.* at 394 (alterations in original) (emphasis removed).
[19] *Id.* at 397 (quoting *Anderson Living Trust v. Energen*, 886 F.3d 826 (10th Cir. 2018)). The Colorado lease "stated the lessee had 'free use of oil, gas and water from said land … *for all operations hereunder*.'" *Id.* (emphasis in original) (quoting *Anderson Living Trust*, 886 F.3d at 848).
[20] *Id.* (quoting *Anderson Living Trust*, 886 F.3d at 848).
[21] *Id.* at 395-97 (discussing *Bice v. Petro-Hunt, LLC*, 768 N.W.2d 496 (N.D. 2009) and *ConocoPhillips Co. v. Lyons*, 299 P.3d 844 (N.M. 2012)).
[22] *Id.* at 399-400.
[23] *Id.* at 398.
[24] *Id.* at 399.

The court referred to a provision in the royalty clause in *Anderson* providing for "'royalty on gas…sold or used off the leased premises.''"

With regard to gas used as Compressor Fuel, the court found that neither party was entitled to summary judgment because "the stipulations [were] vague as to what portion of the fractional share [was] returned to each lease and consumed in on-premises operations."[25] If the gas used as Compressor Fuel was used on the leased premises, then BlueStone was entitled to use it free of royalty.[26] The court reversed and remanded that issue to the trial court.

V. Implications of *BlueStone* for Texas Royalty Law

The *BlueStone* decision will only have an effect on royalty obligations in Texas when a royalty clause contains the same "gross value received" language as in the *BlueStone* addendum. "At the well" and "in the pipelines" language in leases will continue to allow for deduction of postproduction costs, as the court has previously held in *Burlington* and reaffirmed in *BlueStone*. "At the well" language will only be trumped when a lease contains an addendum that states that "its language 'supersedes any provisions to the contrary in the printed lease[,]'"[27] and the addendum has directly conflicting gross-proceeds language. Thus, the impact of *BlueStone* may be relatively limited.

The second holding in *BlueStone,* regarding the meaning of "free use" clauses, may prompt litigation over the off-lease use of gas. But the mere presence of a "free use" clause in a lease should not be sufficient in itself to resolve the associated royalty issues. In *BlueStone*, that clause existed in a lease requiring royalties on the "gross value received" and the court relied on another case with a royalty provision providing for royalties on gas "used off the lease premises." A different result may occur when a "free use" clause is in a lease where royalties are based on "net proceeds" or an "at the well" valuation point or when royalties are due only on hydrocarbons that are "produced, saved, and marketed," as many leases provide. Also, the granting clause in a lease may impact the lessee's right to use gas for operations off the lease royalty-free. Therefore, the effect of the *BlueStone* opinion may be limited in other cases involving different or additional lease provisions.

VI. Conclusion

The *BlueStone* opinion did not change the landscape of Texas royalty law, but merely re-emphasized the long-standing principle that "courts must enforce unambiguous contracts as written." In the face of the addendum's unmistakable command that the addendum controlled in the event of a conflict, the "gross value received" language superseded the conflicting "at the well" language and disallowed deduction of postproduction costs in calculating royalties. As for the "free use" clause issue, the court again re-affirmed the principle that plain language controls, finding that the specific clause at issue, when coupled with consistent royalty provisions, only allowed royalty-free use of gas for operations on the lease.

[25] *Id.* at 400.
[26] *Id.* at 400.
[27] *Id.* at 384.

But the effect on royalties of a “free use” clause in a lease will depend on the type of royalty provision and granting clause in a lease.

Texas Supreme Court Interprets Continuous Drilling Clause

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HJSA No. 3 LP (HJSA), as lessor, and several companies (collectively, "Sundown"), as lessees, disputed the meaning of a continuous drilling provision in an oil and gas lease.[1] Pursuant to that provision, after the lease's six-year primary term, the lessee was obligated to release its rights as to non-producing areas, unless the lessee satisfied the provision's continuous-drilling requirement. The provision stated (emphasis added):

> The obligation … to reassign tracts not held by production shall be delayed for so long as Lessee is engaged in a continuous drilling program on that part of the Leased Premises outside of the Producing Areas. The first such continuous development well shall be *spudded-in* on or before the sixth anniversary of the Effective Date, with no more than 120 days to elapse between completion or abandonment of operations on one well and *commencement of drilling operations* on the next ensuing well.

The lessor argued that, for the lessee to avoid the obligation to release acreage, this clause required the lessee to spud a well within 120 days of completing or abandoning each prior well. The lessee had drilled numerous wells, but the lessor argued that, on at least six occasions, the lessee had not spud a well within 120 days of completing the prior well. Accordingly, the lessee was obligated to release acreage, according to the lessor.

The lessee argued that, once the first "continuous development well" was spudded, a lessee need only commence *drilling operations* for each subsequent well within 120 days of completing or abandoning each prior well. Further, the lessee asserted that the meaning of "drilling operations" is defined in section 18 of the lease itself, which states:

> Whenever used in this lease the term "drilling operations" shall mean: [1] actual operations for drilling, testing, completing and equipping a well (spud in with equipment capable of drilling to Lessee's object depth); [2] reworking operations, including fracturing and acidizing; and [3] reconditioning, deepening, plugging back, cleaning out, repairing or testing of a well.

The lessor conceded that, if the meaning of "drilling operations" contained in Paragraph 18 of the lease applies in the continuous drilling operations clause, the lessees had always commenced "drilling operations" within 120 days of completing each prior well. Thus, the lessees would not be required to release acreage.

[1] *Sundown Energy LP v. HJSA No. 3, Limited Partnership*, 2021 WL 1323406 (Tex. 2021).

However, the lessor argued that, for purposes of the continuous-drilling clause, the term “drilling operations” meant spudding-in a well.

The trial court rejected the lessor’s argument on summary judgment. The appellate court reversed. The Texas Supreme Court granted review and, like the trial court, rejected the lessor’s argument that the term “drilling operations” has a different meaning in the continuous-drilling clause than it has in Section 18 and elsewhere in the lease. The Supreme Court noted that Section 18 of the lease stated that its definition of “drilling operations” applies *whenever* the term is used in the lease. Further, the continuous-drilling clause used “spudded-in” when specifying the deadline to drill the first well, but used “commencement of drilling operations” when specifying the deadline to start work on subsequent wells. The Court stated that the use of different terms for the two deadlines suggested that the parties did not mean for “commencement of drilling operations” to mean the same thing as “spudded-in.”

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