Pennsylvania Oil and Gas Litigation Update
February 7, 2013

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• Future Litigation and Undecided Issues
  – Implied Covenant to Develop
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Delay Rental Litigation
• Hite v. Falcon Partners
  o One-year “primary” term.
  o “As long thereafter” as oil or gas is produced, as
    operations continue, or as delay rental is paid, or until
    all oil and gas has been removed – whichever shall
    occur last.

Flat-Rate Payment Litigation
• Heasley v. KSM Energy, Inc.
  o Leases had 20 year primary terms, which had
    expired.
  o Lessees admitted that neither oil nor gas was being
    produced.
  o Lessee paid rental payment of $100.00 if flow was
    less than 100,000 cubic feet per 24 hours, while the
    gas from said well is being used.

The court held:
“Lease will not be construed to create a perpetual
term” unless the intent to do so is clearly stated.

The language of the clause in this lease only allowed
Falcon one year in which to begin operations – even if
Falcon paid delay rentals.

The court held:
“The Lease Agreement, by its terms, remained in
effect only so long as production continued. When
production ceased, the lease became an at-will
tenancy, subject to termination by the lessor at any
time.”
“Paying Quantities” Litigation

- **T.W. Phillips Gas & Oil Co. v. Jedlicka**
  42 A.3d 261 (Pa. March 2012)
  - Lessor claimed that the lease terminated because production was not “in paying quantities.”

(1) If a well consistently pays a profit, however small, over operating expenses, it will be deemed to have produced in paying quantities.

(2) Where production on a well has been marginal or sporadic, such that over some period the well’s profits do not exceed its operating expenses, a determination of whether the well has produced in paying quantities requires consideration of the operator’s good faith judgment in maintaining operation of the well.

Minimum Royalty Litigation

- **Kilmer v. Elexco Land Services, Inc.**
  990 A.2d 1147 (Pa. 2010)
  - Lessors asserted that their leases were invalid because it did not provide for 1/8th royalty as guaranteed by the Guaranteed Minimum Royalty Act.
  - Post-production costs were specifically enumerated in the lease.
  - Supreme Court concluded that such deductions did not violate the Guaranteed Minimum Royalty Act.

Open Question:
- What if the lease is vague or silent as to deduction of post-production costs?

Minimum Royalty Litigation

- **Tawney v. Columbia Natural Resources, LLC**
  633 S.E.2d 22 (W. Va. 2006)
  - The court found that “at the wellhead” language in leases was silent as to allocation of post-production costs and thus the provision should be construed against the lessee.
  - The court concluded that post-production costs could not be deducted.
  - The jury entered a verdict for $405 million dollars.

Minimum Royalty Litigation

- **Katzin v. Central Appalachia Petroleum**
  - Lessor wanted to invalidate the lease based on non-compliance with the Guaranteed Minimum Royalty Act because it does not state what costs may be deducted.
  - The court decided that the lease clearly allows the lessor to deduct costs and that the provision complies with the Act on its face.
Minimum Royalty Litigation

- Katzin v. Central Appalachia Petroleum
  - “Vagueness” regarding what costs are deductible is not grounds to invalidate a lease, but perhaps could give rise to a breach of contract claim.
  - Warning: Companies may be subject to damages lawsuits if leases are vague or silent as to deduction of post-production costs.

- Pollock v. Energy Corp. of America
  - The Court opened the door to allow deduction of certain post-production costs even if the lease is silent.
  - The Court was ruling on motions for summary judgment, and determined that the issues needed to be fleshed out at trial.
  - Federal court decision is not binding on Pennsylvania State Courts.

“Operations” Litigation

- Burke v. GAPCO Energy LLC
  - 2007 lease with a primary term of 3 years.
  - Provision allowed the lease to remain in effect beyond the primary term if oil or gas was not being produced but the Lessee was “engaged in operations.”
  - Plaintiffs argued that Lessee’s activities did not constitute “operations” as defined in the lease.

The court held:
  - “[T]here remains doubt as to whether Plaintiffs’ version of facts, if proven, would constitute ‘operations,’ even under the broad terms of the lease.”
  - The court decided the issues needed to be determined at trial.

- Good Will Hunting Club, Inc. v. Range Resources, Inc.
  - One section of the lease could be interpreted to require only commencement of a well during the primary term; however, a different section could be interpreted to require both commencement and actual drilling.
  - Operators engaged in some preparatory activities but had not drilled a well at the expiration of the primary term.

The court could not dismiss Plaintiff’s claim because of the ambiguity.
  - At trial, the court must reconcile the two different clauses in the lease and decide whether the Operator’s activities were sufficient to hold the lease beyond the primary term.
Fraudulent Leasing Litigation

- **Harrison v. Cabot Oil & Gas Corporation**
  - Harrison claimed he was induced to sign the lease by a fraudulent representation.
  - Cabot Oil & Gas Corporation asked the court to extend the lease because this case had prevented it from beginning production during the primary term.
  - The court “split the difference.”

Future Litigation and Undecided Issues

**Implied Covenant to Develop**

- **Delmas Ray Burkett, II Revocable Trust v. EXCO Resources (PA), LLC**
  - The 1916 lease in this case specified that a minimum of two wells were to be drilled during the primary term of the lease.
  - EXCO argued that by drilling two wells within the primary term it had fulfilled the requirements of the lease.

- **Butler v. Powers**
  - Counsel for John and Mary Josephine Butler argued that it is irrelevant whether modern-day experts consider Marcellus shale a "mineral" because it is the intent of the parties to the deed which controls.

Future Litigation and Undecided Issues

**Hydraulic Fracturing and Strict Liability**

- **Kamuck v. Shell Energy Holdings GP, LLC**
- **Berish v. Southwestern Energy Production Co.**
  - “A number of Pennsylvania cases with facts analogous to the instant suit have determined that the activities involved there were not abnormally dangerous.”

QUESTIONS? COMMENTS?