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Natural Gas Litigation Update

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Selected Litigation

I. Lease Termination Cases

A. *Kropa v. Cabot Oil & Gas Corporation*, Civil Action 3:08-cv-00551 (M.D. Pa. filed Mar. 25, 2008).

1. Facts – Plaintiff owns 51 acres in Susquehanna County. He signed a five year lease with Defendant for $25 per acre on March 7, 2006.

2. Plaintiff claims that the lease agreement is void because:

    a) Defendant fraudulently induced him into entering into the lease by stating that it would never pay more than $25 per acre.

    b) The royalty provision of the lease agreement violates Pennsylvania's Minimum Royalty Act, 58 P.S. § 33.

        58 P.S. § 33 – "A lease or other such agreement conveying the right to remove or recover oil, natural gas or gas of other designation from lessor to lessee shall not be valid if such lease does not guarantee the lessor at least one-eighth royalty of all oil, natural gas or gas of other designations removed or recovered from the subject real property."

3. Current procedural posture

    a) Plaintiff filed a Complaint in the Susquehanna County Court of Common Pleas on March 7, 2008. The case was removed to federal court on March 25, 2008.

    b) Defendant filed a Motion to Dismiss on March 31, 2008.

    c) Oral argument before Judge Munley was heard on September 16, 2008. The court asked for briefing on the issue of whether the contractual integration provision was affected by fact that the lease bonus payment of $1275 was not made pursuant to the lease agreement, but rather to a separate payment letter.

    d) *Amicus* briefs have been filed on both sides of the litigation.

    e) Through a series of letters, counsel on both sides have informed the court of the status of the court order and appeals in the *Kilmer* case (see below).

f) The court has not yet ruled on the Motion to Dismiss.

4. Issues to be Resolved:

a) Contract Integration Issue – Are representations of gas company barred by the parole evidence rule where terms of the bonus payment were not included in the lease agreement?

b) Minimum Royalty Act Issue – Does the Minimum Royalty Act address only production expenses or does it permit a landowner's guaranteed minimum one-eighth royalty to be reduced to pay for post-production expenses? What is the definition of royalty under the Minimum Royalty Act?

c) Termination Issue – If the court determines that the lease violates the Minimum Royalty Act, is termination of the lease agreement an appropriate remedy or is reformation of the lease the appropriate remedy?

B. *Lauschle v. The Keeton Group, LLC,* Civil Action 4:08-cv-01868 (M.D. Pa. filed Oct. 9, 2008).

1. Facts – The more than 100 plaintiffs own a total of 18,200 acres in Sullivan and Lycoming Counties. They signed lease agreements with Defendant in 2005 and 2006. Defendant has assigned these leases to various entities.

2. Plaintiffs claim that the lease agreements are void because the royalty provision of the lease agreements violate Pennsylvania's Minimum Royalty Act, 58 P.S. § 33.

a) 58 P.S. § 33 – "A lease or other such agreement conveying the right to remove or recover oil, natural gas or gas of other designation from lessor to lessee shall not be valid if such lease does not guarantee the lessor at least one-eighth royalty of all oil, natural gas or gas of other designations removed or recovered from the subject real property."

b) The lease agreements provide for a royalty of one-eighth less any taxes, assessments, and adjustments from production from the leasehold.

3. Current procedural posture

a) Plaintiffs filed a Complaint on October 9, 2008.

b) Defendant filed a Motion to Dismiss the case on November 24, 2008.

c) Oral argument on the motion has been scheduled to occur before Judge Jones on May 29, 2009, in Williamsport. Arguments in *Beach v. MK*

Resource Partners II and *Hooker v. The Keeton Group, LLC*, also will occur at that time.

d) Through a series of letters, counsel on both sides have informed the court of the status of the court order and appeals in the *Kilmer* case (see below).

C. *Frederick v. Range Resources – Appalachia, LLC,* Civil Action 1:08-cv-00288 (W.D. Pa. filed Oct. 17, 2008).

1. Facts – Plaintiffs hold royalty interests pursuant to lease agreements with Defendant. Plaintiffs have received and continue to receive royalty payments from said lease agreements.

2. Plaintiffs seek injunctive relief and a declaration that the lease agreements are terminated based on the following claims:

    a) Violation of Pennsylvania's Minimum Royalty Act, 58 P.S. § 33;

    b) Breach of contract;

    c) Conversion; and

    d) Unjust enrichment.

3. Current procedural posture

    a) Plaintiffs filed a Complaint in the Warren County Court of Common Pleas on September 15, 2008. The case was removed to federal court on October 17, 2008.

    b) Defendant filed a Motion to Dismiss the case on November 10, 2008.

    c) Plaintiffs filed a Motion to Remand to State Court on November 13, 2008. On February 16, 2009, the Motion to Remand was withdrawn.

    d) Oral argument on the Motion to Dismiss has been scheduled to occur before Judge McGlaughlin on April 15, 2009.

D. *Kilmer v. Elexco Land Services, Inc., and Southwestern Energy Production Co.,* Civil Action No. 2008-57 (Susquehanna Co.).

1. Issue – Whether Pennsylvania Minimum Royalty Act prohibits the deduction of post-production costs from a one-eighth royalty.

2. Proceeding in Court of Common Pleas

    a) The parties filed cross motions for summary judgment.

b) On March 3, 2009, the court issued an order granting Defendants' motion for summary judgment. The order stated that the court found "that 58 P.S. Sec. 33 does not preclude parties from contracting that 'post-production' costs be factored into the determination of the amount of royalty payable under and [sic] oil or gas lease."

c) On March 16, 2009, the court issued a three-page opinion. In this opinion, the court recited the language of the contract between the parties as well as the national custom of the inclusion of post-production expenses in the royalty calculation. The court's reasoning in ruling for Defendants was stated as follows: "The statute in question does not prohibit the inclusion of 'post-production' costs to calculate the one-eighth royalty. The parties are, therefore, free to negotiate how that royalty shall be calculated, so long as the net result is not less than one-eighth. This they did."

3. Proceedings on appeal

a) On March 13, 2009, Plaintiffs filed a Notice of Appeal with the Pennsylvania Superior Court. The appeal has been docketed as 464 MDA 2009.

b) On April 6, 2009, Defendants filed a Petition for Extraordinary Relief with the Pennsylvania Supreme Court requesting immediate review of the petition and the provision of guidance to the various federal and state courts addressing this issue.

E. Other Cases

1. *Kilmer v. Elexco Land Services, Inc*., Civil Action 3:08-cv-01613 (M.D. Pa. filed Aug. 27, 2008). NOTE: This case involves different Plaintiffs than the *Kilmer* case described above.

2. *Beach v. MK Resource Partners, II*, Civil Action 4:08-cv-01950 (M.D. Pa. filed Oct. 24, 2008).

3. *Humber v. Elexco Land Services, Inc.*, Civil Action 3:08-cv-02016 (M.D. Pa. filed Nov. 6, 2008).

4. *Hooker v. The Keeton Group, LLC*, Civil Action 4:08-cv-2091 (M.D. Pa. filed Nov. 19, 2008).

5. *Carey v. New Penn Exploration, LLC*, Civil Action 3:09-cv-00188 (M.D. Pa. filed Jan. 29, 2009).

6. *Kovach v. Elexco Land Services, Inc*., Civil Action 3:09-cv-00186 (M.D. Pa. filed Jan. 29, 2009).

7. *Stone v. Elexco Land Services, Inc*., Civil Action 3:09-cv-00264 (M.D. Pa. filed Feb. 10, 2009).

8. *Wartman v. New Penn Exploration, LLC,* Civil Action 3:09-cv-00271 (M.D. Pa. filed Feb. 10, 2009).

9. *Bliss v. New Penn Exploration, LLC,* Civil Action 3:09-cv-00376 (M.D. Pa. filed Feb. 27, 2009).

10. *Price v. Elexco Land Services, Inc*., Civil Action 3:09-cv-00433 (M.D. Pa. filed Mar. 9, 2009).

11. *Williams v. Elexco Land Services, Inc*., Civil Action 3:09-cv-00464 (M.D. Pa. filed Mar. 12, 2009).

12. *Belcher v. The Keeton Group, LLC,* Civil Action 3:09-cv-00506 (M.D. Pa. filed Mar. 18, 2009).

13. *Julia v. Elexco Land Services, Inc*., Civil Action 3:09-cv-00590 (M.D. Pa. filed Mar. 31, 2009).

14. *Puza v. Elexco Land Services, Inc*., Civil Action 3:09-cv-00589 (M.D. Pa. filed Mar. 31, 2009).

15. *Hayes v. Chesapeake Appalachia, LLC,* Civil Action 3:09-cv-00619 (M.D. Pa. filed Apr. 3, 2009).

II. Eminent Domain – Gas Storage Fields

Steckman Ridge Bedford County Litigation

1. Facts – Steckman Ridge Group, a Texas-based energy company, seeks to acquire subsurface natural gas storage rights to a number of parcels of real estate in Bedford County. The subject landowners object to the establishment of the storage field because it will limit their ability to profit from gas drilling into the Marcellus Shale formation.

2. Current procedural posture

    a) The Federal Energy Regulatory Commission (FERC) issued a certificate of public convenience to Steckman Ridge on June 5. The landowners filed a motion for reconsideration with FERC.

    b) From June 26, 2008, and July 16, 2008, Steckman Ridge filed various suits in the Western District of Pennsylvania seeking to condemn the

subject real estate using the power of eminent domain pursuant to the Natural Gas Act, 15 U.S.C. § 717f(h).

c) On November 21, 2008, FERC ultimately denied rehearing of the matter.

d) On December 5, 2008, the court consolidated the various cases into one action for further proceedings under docket number 3:08-cv-154-KRG.

e) On December 8, 2008, a pre-trial order was issued, scheduling the trial date for the week of May 11, 2009. On March 27, 2009, the trial date was rescheduled for the week of June 15, 2009, with the pre-trial conference scheduled for May 14, 2009.

f) On February 27, 2009, the court granted Steckman's motion for a preliminary injunction to obtain immediate entry onto the properties. Specifically, the order stated "that Steckman is granted immediate entry into the Oriskany Sandstone formation underlying the properties owned by defendants . . . for the purpose of periodically injecting, storing, retrieving and withdrawing natural gas, and to protect the stored gas, and otherwise operating and maintaining the interstate natural gas storage facility that was approved by the Federal Energy Regulatory Commission through the issuance of the FERC certificate, together with the right of ingress and egress to these properties to periodically monitor, inspect and maintain the gas storage facilities; such rights do not include unlimited rights of ingress and egress on defendants' properties, but only rights directly necessary for the limited purposes of monitoring, inspecting and maintaining the gas storage facility."

g) Pursuant to the February 27, 2009, order, Steckman is required to post security for compensation in the amount of $1,000,000, which is three times an appraised value of the property rights acquired.

III. Environmental Litigation

A. *Pennsylvania Oil and Gas Association v. U.S. Forest Service,* Civil Action 1:08-cv-162 (W.D. Pa. filed May 27, 2008).

1. Plaintiffs in the litigation are Pennsylvania Oil and Gas Association (POGAM) and the Allegheny Forest Alliance (AFA). POGAM's members include owners of oil, gas, and mineral estates within the Allegheny National Forest. AFA is a coalition of public school districts, municipalities, and

businesses located within, or with interests connected to, the Allegheny National Forest.

2. Plaintiffs' allegations:

    a) The Forest Service issued a Draft Revised Forest Plan for the Allegheny National Forest in May 2006. The public was provided with an opportunity for comment on the draft plan.

    b) The Forest Service issued a final Revised Forest Plan in March 2007. The plan included a number of measures to restrict the development of oil, gas, and mineral estates within the Allegheny National Forest. Many of these measures had not been subjected to the public comment provisions.

    c) Plaintiffs appealed the final plan with the Forest Service. On February 15, 2008, the Deputy Chief of the Forest Service issued an Appeals Decision. This Appeals Decision found three areas where the plan was not in compliance with the National Environmental Policy Act, but it nevertheless affirmed the plan.

3. Plaintiffs seek a declaration that the Revised Forest Plan violates the National Environmental Policy Act and other related legal authorities. Plaintiffs also seek to have the approval of the plan vacated and remanded to the Forest Service to fulfill the required public comment provisions.

4. Current procedural posture

    a) Plaintiffs filed a Complaint on May 27, 2008, and Defendant filed an Answer on September 5, 2008.

    b) A Case Management Conference was conducted on November 19, 2008.

    c) On January 30, 2009, per Joint Motion, the matter was stayed so that the parties could pursue a settlement. On March 12, 2009, Defendant filed the Administrative Record, apparently indicating that settlement attempts were unsuccessful.

B. *Forest Service Employees for Environmental Ethics v. U.S. Forest Service,* Civil Action 1:08-cv-323 (W.D. Pa. filed Nov. 20, 2008).

1. Plaintiffs in the litigation are Forest Service Employees for Environmental Ethics, Allegheny Defense Project, and Sierra Club.

2. Plaintiffs claim that the Forest Service has been violating the National Environmental Policy Act (NEPA) by failing to conduct Environmental Impact Statements or Environmental Assessments prior to issuing Notices to

Proceed for natural gas exploration and development activities within the Allegheny National Forest. Plaintiffs claim that the Forest Service has issued at least 34 such Notices to Proceed in the time period beginning on September 13, 2007, and ending June 25, 2008.

3. Plaintiffs seek a declaration that the Forest Service has failed to comply with the NEPA and the Administrative Procedures Act. Plaintiffs also seek an injunction barring the Forest Service from issuing any further Notices to Proceed until it has complied with these statutory requirements. Finally, plaintiffs seek reasonable attorney fees and costs.

4. Plaintiffs filed a Complaint on November 20, 2008, and an Amended Complaint on December 4, 2009.

5. On April 9, 2009, the parties settled this matter. The terms of the settlement recognized that the Forest Service has legal authority to establish reasonable conditions upon the use of the surface estate. The Forest Service agreed to undertake NEPA analysis prior to issuing Notices to Proceed in the future. Plaintiffs agreed not to challenge Notices to Proceed already issued unless they are located in specifically designated sensitive areas. The Forest Service agreed to pay Plaintiffs' attorney fees in the amount of $19,221.60. The parties agreed not to use the terms of this settlement as legal precedent in any other matter.

C. *Duhring Resource Co. U.S. Forest Service,* Civil Action 1:07-cv-314 (W.D. Pa. filed Nov. 8, 2007).

1. Plaintiff, a natural gas development company, claims that as a result of its interest in the mineral estate beneath the Allegheny National Forest, it has a right to access the surface estate in order to reasonably develop the oil and gas resources. In March 2007, plaintiff provided the Forest Service with notice of its intent to develop the natural gas resource. To address certain objections, plaintiff prepared a revised plan of operation in May 2007. The Forest Service did not issue a Notice to Proceed until several months later and included several conditions in this Notice to Proceed. Plaintiff objects to the imposition of the conditions.

2. Pennsylvania Oil and Gas Association is an Intervenor-Plaintiff in the litigation, and the Allegheny Defense Project is an Intervenor-Defendant in the litigation.

3. Current procedural posture

    a) Plaintiff filed a Complaint on November 8, 2007; a First Amended Complaint on March 1, 2008; and a Second Amended Complaint on June 19, 2008. On June 20, 2008, the Pennsylvania Oil and Gas Association filed an Intervenor Complaint.

b) Plaintiffs filed a Motion for Partial Summary Judgment on August 8, 2008. The Forest Service filed a Motion to Dismiss on August 19, 2008. The Allegheny Defense Project filed a Motion to Dismiss on August 25, 2008.

c) On March 6, 2009, the court issued an Order dismissing some of the counts asserted by Plaintiff and allowing some counts to proceed. On March 20, 2009, the court denied a Motion for Reconsideration.

d) On March 27, Defendants filed Answers to the Amended Complaints.

e) On April 3, 2009, a Status Conference was held. On April 9, 2009, a Case Management Order was issued establishing deadlines for discovery and the filing of motions. A trial date of February 1, 2010, was scheduled.

D. *Belden & Blake Corp. v. Department of Conservation and Natural Resources,* No. 25 MD 2006 (Pa. Commw. Ct. Mar. 5, 2007), *appeal docketed,* 35 MAP 2007 (Pa. Apr. 4, 2007).

1. Facts – Belden & Blake holds the rights to oil and gas for certain parcels of land beneath Oil Creek State Park. Belden & Blake gave notice to the Department of Conservation and Natural Resources (DCNR) of its intention to develop gas wells on the tracts. DCNR imposed the following conditions upon Belden & Blake: (a) execution of a right-of-way/coordination agreement; (b) posting of a $10,000 performance bond for each of the wells; and (c) payment of $74,885 for double stumpage fees for removal of timber. Belden & Blake seeks a declaration that it has an implied easement to use of the surface estate for the purpose of developing its natural gas interest and an injunction to prevent DCNR from interfering with its use of the surface estate.

2. Commonwealth Court ruling – "The law recognizes Petitioner's right to enter upon the land to exercise its oil and gas rights, [. . .], and consequently, the Department has no power to condition Petitioner's exercise of those rights by requiring it to enter into the coordination agreement." Similarly, the court ruled that DCNR had no authority to impose a bond or to assess stumpage fees. The court did allow that "[t]he parties are not precluded, however, from entering into an agreement setting forth their cooperative efforts with regard to Petitioner's exercise of its right, but such agreement may not impose requirements on Petitioner not founded in statute or in case law authority."

3. The Supreme Court accepted oral argument on the following issues:

    a) Does the common law require that a subsurface owner's right to reasonable use of the surface be balanced with the surface owner's interest?

b) As the manager of State parks, which are declared to be public natural resources to be maintained and preserved for the people by Section I, Article 27 of the Pennsylvania Constitution and the Conservation and Natural Resources Act, does DCNR have a duty to ensure Belden & Blake makes reasonable use of the surface of Oil Creek State Park in developing its oil and gas?

c) Can DCNR, as the manager of Oil Creek State Park, require a written agreement to document the measures needed to reasonably protect the surface of the park by Belden & Blake during its oil and gas development activities?

d) Can DCNR, in order to fulfill its fiduciary duty to conserve and maintain State parks, require measures it believes are reasonably necessary to protect Oil Creek State Park during oil and gas development activities?

e) Does the recognition by the legislature and the public of the importance of protecting State parks weigh in favor of finding that DCNR has a duty to ensure that Belden & Blake's use of the surface of Oil Creek State Park is reasonable?

4. Current procedural posture

a) The Commonwealth Court opinion was filed on March 5, 2007.

b) DCNR filed a Notice of Appeal on April 4, 2007. Briefing was concluded on April 14, 2008. The Supreme Court heard oral argument on April 14, 2008.

IV. Preemption

A. *Range Resources – Appalachia, LLC v. Salem Township,* 964 A.2d 869 (Pa. 2009).

1. Facts – Salem Township enacted an ordinance to regulate surface and land development associated with oil and gas drilling operations. Plaintiff filed suit challenging the township's authority to enact the ordinance. The Westmoreland County Court of Common Pleas ruled that the township's ordinance was preempted by the Oil and Gas Act. The Commonwealth Court and Supreme Court affirmed.

2. Commonwealth Court ruling – "Here, the trial court examined the challenged provisions of the Township's oil and gas operations to conclude that those provisions regulated aspects of oil and gas operations that are preempted by the state legislation. We discern no error in common pleas' conclusions. . .

[W]e affirm based on the well-reasoned analysis set forth in the trial court's opinion." 931 A.2d 101 (Pa. Commw. Ct. 2007).

3. Supreme Court ruling – "In sum, not only does the Ordinance purport to police many of the same aspects of oil and gas extraction activities that are addressed by the Act, but the comprehensive and restrictive nature of its regulatory scheme represents an obstacle to the legislative purposes underlying the Act, thus implicating principles of conflict preemption. . . Furthermore, its stated purposes overlap substantially with the goals as set forth in the Oil and Gas Act, thus implicating the second statutory basis for express preemption of MPC-enabled local ordinances. In view of the Ordinance's focus solely on regulating oil and gas drilling operations, together with the broad preemptive scope of Section 602 of the Act with regard to such directed local regulations, we agree with the common pleas court's conclusion that each of the oil and gas regulations challenged in Appellee's complaint is preempted by the Oil and Gas Act and its associated administrative regulations."

4. Procedural history

    a) The Commonwealth Court opinion was filed on July 27, 2007.

    b) The Supreme Court granted allocatur on May 27, 2008. Briefing was concluded on August 5, 2008. The Supreme Court heard oral argument on September 9, 2008. The Supreme Court opinion was issued on February 19, 2009.

    c) The Pennsylvania State Association of Township Supervisors and Nockamixon Township filed Amicus Curiae briefs supporting the arguments of Appellant. The Pennsylvania Department of Environmental Protection filed an Amicus Curiae brief supporting the arguments of Appellee.

B. *Huntley & Huntley, Inc. v. Borough of Oakmont,* 964 A.2d 855 (Pa. 2009).

1. Facts – Plaintiff sought a conditional use permit to conduct natural gas drilling operations in an R-1 Residential zoning district. The Borough of Oakmont Council denied the application, and the Allegheny County Court of Common Pleas affirmed the Council's decision.

2. Commonwealth Court ruling – "In summary, at least with regard to well site location, we conclude that the trial court erred in concluding that the Oil and Gas Act does not preempt ordinances that seek to regulate the location of wells. However, our decision does not foreclose the possibility that other ordinance provisions that do not address a feature of the Oil and Gas Act may apply." 929 A.2d 1252 (Pa. Commw. Ct. 2007).

3. Supreme Court ruling – "[A]bsent further legislative guidance, we conclude that the Ordinance serves different purposes from those enumerated in the Oil and Gas Act, and hence, that its overall restriction on oil and gas wells in R-1 districts is not preempted by that enactment."

4. Procedural history

    a) The Commonwealth Court opinion was filed on July 27, 2007.

    b) The Supreme Court granted allocatur on May 27, 2008. Briefing was concluded on August 7, 2008. The Supreme Court heard oral argument on September 9, 2008. The Supreme Court opinion was issued on February 19, 2009.

    c) The Pennsylvania Department of Environmental Protection, the Pennsylvania State Association of Boroughs, and Nockamixon Township filed Amicus Curiae briefs supporting the arguments of Appellant.

C. *Arbor Resources LLC v. Nockamixon Township,* No. 2008-4801-31-1, slip op. (Bucks Ct. Com. Pl. Sept. 29, 2008)*, appeal docketed,* 1972 CD 2008 (Pa. Commw. Ct. Oct. 9, 2008).

1. Facts – Four gas companies sought a declaration that the Oil and Gas Act precluded Nockamixon Township from applying its zoning ordinance to regulate drilling operations. In response, the township filed preliminary objections, arguing that the matter was not properly before the court because the gas companies had not presented the matter to the township's Zoning Hearing Board prior to filing suit.

2. Court of Common Pleas ruling – The court acknowledged that the Oil and Gas Act had some preemptive effect on municipal regulation. The court, however, concluded that it could not reach the question of whether any township ordinances had been preempted in the instant case because the gas companies had failed to utilize available statutory remedies.

3. Current procedural posture

    a) The Memorandum Opinion and Order of the Bucks County Court of Pleas was issued on September 29, 2008.

    b) A Notice of Appeal was filed with the Commonwealth Court on October 9, 2008. Briefing was concluded on February 13, 2009. Argument was held on February 23, 2009.