

**Oil and Gas Law:
2010 Litigation Update**

By
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I. Very brief overview.

A. Statutory and common law background.

1. Oil and gas law in Pennsylvania is made up of both statutory mandates plus a century and a half of common law. There are approximately a half dozen major Pennsylvania statutes on the books and literally hundreds of cases that define Pennsylvania's law on oil and gas.

2. The following statutes are the major enactments of Pennsylvania oil and gas law.

a) Oil and Gas Conservation Law, Act of July 25, 1961, P.L. 825, Act No. 359, 58 P.S. §§ 401, *et seq.* (OGCL).

(i) The OGCL encourages the discovery, exploration and the development of resources while limiting waste of those resources. The act also regulates the drilling, equipping, locating, spacing and operating of oil and gas wells so as to protect correlative rights and prevent waste of oil and gas and to protect the rights of royalty owners and producers of oil and gas. A purpose of the act is to maximize the benefit of these natural resources. 58 P.S. §§ 401, 403, 405.

b) Underground Storage Act, Act of Nov. 26, 1978, P.L. 1300, Act No. 314, 58 P.S. §§ 451, *et seq.* (USA)

(i) Enacted in 1978, the Underground Storage Act regulates the underground storage of natural or artificial gas in natural or man-made caverns. The USA established a basis for the promulgation of regulations, bonding requirements (of \$100,000 per facility) and established a regulatory basis for construction standards for underground storage facilities. It also gave the Department of

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Environmental Protection (DEP) regulatory enforcement authority over such facilities. 58 P.S. § 451.

(ii) The USA repealed the earlier Liquefied Petroleum Gas Act, Act of Dec. 27, 1951, P.L. 1793, No 475, and transferred regulatory authority from the Department of Labor and Industry to DEP's predecessor, the Department of Environmental Resources.

c) Coal and Gas Resource Coordination Act, Act of Dec. 18, 1984, P.L. 1069, Act No. 214, 58 P.S. §§ 501, *et seq.* (CGRCA).

(i) Enacted in 1984, the purpose of the Coal and Gas Resource Coordination Act is to attempt to coordinate work and to resolve disputes between coal operators and gas producers. The act applies to most gas wells which penetrate a workable coal seam. By its own terms, the CGRCA does not apply to certain defined oil wells, injection wells or storage wells. The act also does not apply to wells permitted under the Oil and Gas Conservation Law, 58 P.S. §§ 401, *et seq.* 58 P.S. 503(b)(1).

d) Oil and Gas Act, Act of Dec. 19, 1984, P.L. 1140, Act No. 223, 58 P.S. §§ 601.101, *et seq.*

(i) Enacted in 1984, the Oil and Gas Act initially increased the Commonwealth's responsibilities for permitting and regulating the oil and gas industry, over and above earlier piecemeal enactments, in order to protect the environment. The law also required reporting by drillers on drilling activities and production. The new law required either bonding or plugging of all wells, plus enforcement of regulations protecting wetlands and potable water supplies.

(ii) The Oil and Gas Act is the principal mechanism for the regulation of the conservation of oil and gas and environmental aspects of oil and gas drilling and production in Pennsylvania.

e) Dormant Oil and Gas Act, Act of July 11, 2006, P.L. 1134, Act No. 115, 58 P.S. §§ 701.1, *et seq.* (DOGA)

(i) Enacted in 2006, the act allows for the creation of trusts to benefit the owners of oil and gas rights where such owners are unknown and whose identity, present residence or present address is unknown and cannot be determined by diligent efforts. 58 P.S. § 701.4. The purpose of the DOGA is to allow for the development of oil and gas tracts where ownership of the oil and gas is fragmented and difficult, if not impossible to determine. 58 P.S. § 701.2.

3. It should be noted that there are many individual statutory provisions which are not a part of the general enactments, but which are also quite significant and relevant to the practice of oil and gas law. While some of these provisions are ancient, they are still a part of Pennsylvania law. Examples include:

a) Right of action established benefiting persons performing labor or furnishing materials for any drilling, pumping or producing oil or gas well for recovery for labor done or materials furnished. Act of May 16, 1891, P.L. 41, 58 P.S. § 31.

b) Creation of cause of action for failure to plug abandoned well. Act of May 26, 1891, P.L. 122, 58 P.S. § 3.

c) Plugging of abandoned wells. Act of May 17, 1921, P.L. 912, 58 P.S. § 1.

d) Prescribed method for plugging abandoned wells and wells drilled through marketable coal seams. Act of May 17, 1921, P.L. 912, 58 P.S. § 4.

e) Creation of a misdemeanor for willfully allowing any oil or gas well to remain uncapped or the willful opening of any valve to admit air in a gas well. Act of May 17, 1921, P.L. 912, 58 P.S. § 6.

f) Establishment of rights of existing well owner vis a vis owners and operators of new wells. Act of May 17, 1921, P.L. 912, 58 P.S. § 9.

g) Guaranteed minimum royalty payments: “A lease or other such agreement conveying the right to remove or recover oil, natural gas or gas of any other designation from lessor to lessee shall not be valid if such lease does not guarantee the lessor at lease [sic] one-eighth royalty of all oil, natural gas or gas of other designations removed or recovered from the subject real property.” Act of July 20, 1979, P.L. 183, Act No. 60, 58 P.S. § 33.

h) Escalation of royalties for existing oil and gas wells upon the alteration of the old well by new drilling, deeper drilling, etc.. Act of July 20, 1979, P.L. 183, Act No. 60, 58 P.S. § 34.

4. This article assumes that the reader is well-aware of the Marcellus Gas Play and has a working knowledge of oil and gas law in Pennsylvania.

5. This article does, however, describe the cases from 2009 (and a few relevant earlier cases) to keep the reader up to date in this fast growing area of the law.

B. Other resources.

1. No attempt is made herein to delve into the nuts and bolts of gas leases and oil and gas law, since that topic is covered much more extensively elsewhere. *See, e.g.*, Joel R. Burcat, “Oil and Gas Drilling—The Company’s Perspective,” ch. in *Gas Leasing: The Marcellus Shale ‘Gold Rush’ and its Impact on Pennsylvania*, PBI No. 2008-5526; Joel R. Burcat & Emily H. Bensinger, “Oil and Gas Law: 2009 Case Law Update,” ch. in *Oil and Gas Law Colloquium*, PBI No. 2009-6020 (co-author). Steven Beckman, “Oil and Gas Law,” ch. in *Pa. Environmental Law and Practice*, Terry R. Bossert & Joel R. Burcat, eds. (5th Ed. 2008), PBI No. 5203.

II. Litigation Update

A. Oil and gas leases.

1. General interpretation of oil and gas instruments.

a) *Szymanowski v. Brace*, 2009 Pa. Super. 218, ___ A.2d ___, 2009 WL 790561 (Nov. 13, 2009).

Plaintiff partners in a gas drilling venture brought a breach of contract and fiduciary duty action against their co-partners seeking damages from the alleged usurpation of revenue from producing gas wells. The Court of Common Pleas of Erie County granted summary judgment in favor of the defendants and the Superior Court affirmed.

In 2002, plaintiffs entered into a gas well agreement this was found to be the substance of their partnership agreement with the defendants. The agreement explicitly identified an interest in two new gas wells that were being drilled, the Dougherty #1 and Danylko #1 wells, as being the subject of the partnership. Plaintiffs invested \$30,000 which entitled them to receive 10% net profit after royalties and other expenses were deducted. The Superior Court found that the gas well agreement did not make any express or implied reference to any other oil and gas ventures or any other well. It also held that while there had been some discussion regarding other wells, there was no agreement regarding any other wells. Nevertheless, the plaintiffs contended that the partnership owned an oil and gas lease called the Danylko oil and gas lease as well as the Danylko #2 and #4 gas wells and they were entitled to an accounting of the profits from these properties.

The Superior Court cautioned regarding the interpretation of instruments dealing with oil and gas:

The legal effect of words clearly understood when used in other contexts, therefore, becomes murky when considered in the context of oil and gas instruments. The fact, for example, that an instrument is titled a ‘lease,’ ‘deed,’ or ‘agreement’ is not determinative. Even the use of the words ‘grant and convey’ does not necessarily create a fee simple estate in the grantee. Applying

the literal meaning to words and phrases found in oil and gas documents is fraught with the opportunity for injustice.

The court required that the object when interpreting instruments relating to oil and gas interests, “like any written instrument, ‘is to ascertain and effectuate the intention of the parties.’” *Citing Hess v. Jones*, 335 Pa. 569, 7 A.2d 299 (1939).

As to the partnership agreement itself, the court held that the agreement did not indicate any intent, express or implied to include anything other than the Dougherty #1 and Danylko #1 wells. Further the plaintiffs themselves testified at depositions that they did not understand the partnership assets to include anything other than the two wells.

The court rejected the plaintiffs’ contention that language in an income tax return indicated that the assets of the partnership were greater than the language contained in the agreement, that one of the defendant’s retention of an overriding royalty created a material fact or that the development of other wells usurped the business opportunities of the partnership. Further there was no breach of any fiduciary obligations of the partnership.

b) *In re Howard*, ___ Bankr. Rep. ___, 2009 WL 4729674 (Bankr., W.D. Pa., Dec. 10, 2009).

A Bankruptcy Court, interpreting Pennsylvania law in a bankruptcy dispute, rules on the necessity of recording a mineral lease in order for it to be valid and binding. The court ruled in favor of a Trustee in Bankruptcy, requiring that the Trustee’s rights were superior to those of the defendant (who was the former wife of the debtor) and the recoupment of the amounts paid to the defendant.

The debtor filed a Chapter 11 bankruptcy that was converted to a chapter 7 bankruptcy. The debtor had also filed an individual bankruptcy case. The court made a point of noting that it had appointed a Chapter 11 Trustee as “the Debtor had demonstrated a consistent pattern of either dishonesty and incompetence with respect to the management of his and his corporations’ affairs, both before the filing of the instant case and thereafter.” At the conclusion on the debtor’s divorce in 1998, the husband and wife deeded back to the husband, who was now the debtor, all mineral rights associated with his property in Greene County. In 2008, some 10 years after the conclusion of divorce proceedings and four months after the filing of the bankruptcy, the defendant, who was the former wife of the debtor, recorded an oil and gas lease and a quitclaim deed from the husband to the former wife for the same property. The recording of the lease took place four months after the bankruptcy had been filed and with no notice to the Trustee. The gas exploration company paid the former wife over \$600,000 for the gas rights. By the time of the court’s ruling the former wife had spent \$129,000 of that money. The Trustee in Bankruptcy sought to compel the turnover to the Trustee of mineral rights and the proceeds of the oil and gas lease, and the voiding of defendant’s claimed interest in mineral rights.

“Pennsylvania courts have consistently held transfers in mineral, oil and gas rights are considered transfers of real property. As such, any mineral, oil or gas rights, such as those under consideration in this case at bar, are ‘statutorily required to be recorded.’” *Citing Lesnick v. Chartiers Natural Gas Co.*, 889 A.2d 1282, 1284-85 (Pa. Super. 2005).

Further, the court agreed with the Trustee who argued that oil and gas leases are required to be recorded pursuant to 21 P.S. §§ 351 and 356, otherwise they are void as to any subsequent bona fide purchaser.

2. Minimum royalty provision litigation.

a) *Stone v. Elexco Land Servs., Inc.*, 2009 U.S. Dist. LEXIS 45897 (M.D. Pa. June 1, 2009).

Plaintiff landowners sought a declaration that the oil and gas lease the parties signed was invalid under Pennsylvania law because it did not provide a minimum royalty payment as required by statute. *Id.* at *4. The lease provided for a royalty of one-eighth of the amount realized from the sale of gas produced from the well, less one-eighth of the post-production costs and one-eighth of the taxes incurred on the gas. *Id.* at *6. Plaintiff argued that because the lease called for the subtraction of costs from the royalty, it did not comply with Pennsylvania law. *Id.*

The court noted that “a plain reading” of the statute supported the Plaintiff’s position because it does not provide for subtraction of any costs. The law provides:

A lease or other such agreement conveying the right to remove or recover oil, natural gas or gas of any 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 or natural gas recovered or removed.

58 P.S. § 33.

Defendants argued that reduction of costs is standard in the industry and the court noted that the question would turn on how “royalty” should be interpreted. Plaintiffs pointed to other jurisdictions’ definitions of “royalty” and to the “First Marketable Product Doctrine,” which provides that post-production costs should not be deducted from a royalty. *Id.* at *10. The court noted that Pennsylvania recognized this theory over 100 years ago, and that it is apparently still good law. *Id.*

The court declined to dismiss the case because two schools of thought exist as to what the term “royalty” means, *id.* at *12, and because the court would be required to look to materials outside of the pleadings to determine “industry practice,” which the court could not do at the motion to dismiss stage of the litigation, *id.* at *13.

See also, Price v. Elexco Land Servs., Inc., 2009 WL 2045135 (M.D. Pa., July 9, 2009) (same result).

b) *Kilmer v. Elexco Land Servs., Inc.*, No. 2008-57 (Susquehanna Co. C.P., March 3, 2009), *appeal granted*, No. 63 MAP 2009 (Pa.).

In *Kilmer*, the Susquehanna County Court of Common Pleas ruled in favor of the gas company that had deducted the post-production costs from the royalty. The court ruled 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) *Kropa v. Cabot Oil & Gas Corp.*, 609 F. Supp.2d 372 (M.D. Pa. 2009)

Gas rights lessor brought action against lessee, alleging that he was fraudulently induced to enter into an oil and gas lease, and seeking a declaratory judgment that the lease was invalid. Lessee moved to dismiss. The court granted the motion in part and denied it in part.

The defendant paid a bonus of \$25 per acre to the plaintiff for 521 acres, amounting to a total bonus payment of \$1,275. Plaintiff claimed the defendant’s representative told him, it would “never pay any more than \$25 per acre so he better take the \$25 per acre.” After learning that others received more money, plaintiff sued seeking to void the contract claiming fraudulent inducement and also sought a declaration that the royalty provision, which pays 1/8th less certain expenses, violates Pennsylvania law.

The court examined the integration clause of the lease but also examined three writings that were all a part of the contract at the time it was signed. One did not contain an integration clause. The court refused to dismiss that portion of the claim dealing with the statement that plaintiff would never be offered more than \$25, since that part of the claim was not covered by an integration clause. 609 F. Supp.2d at 378. The court did dismiss that part of the claim that there was fraud regarding the statements having to do with the amount of royalty, since that was covered by an integration clause. *Id.*

As to the royalty issue, the court held that “a plain reading of 58 P.S. § 33 guarantees one-eighth royalty and does not provide for the subtraction of any costs.” *Id.* at 379. This court disagreed with the holding of the Pa. Court of Common Pleas in *Kilmer*.

d) *Kilmer v. Elexco Land Servs., Inc.*, No. 63 MAP 2009 (Pa.)

On June 16, 2009, the Pennsylvania Supreme Court asserted its extraordinary jurisdiction to take a case directly from the Court of Common Pleas of Susquehanna County explicitly on the question of whether a lease violated the statute because post-production costs were to be deducted from the royalty. The Court identified the question before it as:

Whether 58 P.S. § 33 precludes parties from contracting that post-production costs be factored into the determination of the amount of royalty payable under an oil or natural gas lease.”

Seven amicus curiae briefs were filed. The case was argued before the Supreme Court on September 16, 2009. No ruling has yet been handed down by the Court.

3. Preferential rights purchase provision/rule against perpetuities.

a) *Power Gas Marketing & Transmission, Inc. v. Cabot Oil & Gas Corp.*, 948 A.2d 807 (Pa. Super. Ct. 2008)

The parties entered into a Joint Operating Agreement (“JOA”) whereby each signatory was to contribute oil and gas leases and ownership rights in an area known as Pineton Prospect in Indiana and Cambria Counties. *Id.* at 808. The purpose of the JOA was to “explore and develop [the contributed] leases and interests for oil and gas.” *Id.* The parties agreed that all interests arising under the JOA were assignable, but the JOA included a preferential purchase rights provision which required a party wishing to sell its interest to notify the other parties, who would have ten days to purchase on the same terms. *Id.* After a series of assignments, one party instituted a breach of contract action for failure to give notice and the opportunity to purchase under the preferential purchase provision. *Id.* at 809.

Defendant filed a motion for summary judgment contending that the rule against perpetuities rendered the JOA’s preferential purchase rights provision unenforceable. The court first determined that the preferential purchase provision was a right of first refusal rather than an option. *Id.* at 810. Next, the court had to determine whether a right of first refusal, specifically, “whether the rule against perpetuities applies to a right of first refusal which grants the promise the first opportunity to purchase a percentage interest of an aggregation of ever-changing leases when each lease in the larger aggregate encumbers a portion of the same underlying estate.” *Id.* at 812.

The court noted that the rule against perpetuities is an “archaic device best suited to an ancient time” and that the General Assembly eliminated the rule for any interest created subsequent to January 1, 2007. *Id.* at 815-16 (citing 20 Pa. C.S. § 6104(d)). The court noted that subjecting the JOA’s preferential purchase rights provision to the rule against perpetuities would adversely impact the oil and gas industry in the Commonwealth, as the provision “encourages investment in oil and gas exploration by performing two vital functions: (1) guaranteeing that the parties who bear the initial risk have the first opportunity to acquire a greater interest before a third party, and (2) that the parties to the joint venture can exclude undesirable partners who may not have the requisite financial resources or engineering expertise to ensure the continued vitality of the venture. *Id.* at 817.

The court held that the JOA’s preferential purchase rights provision was not subject to the rule against perpetuities. *Id.* at 818.

4. Application of habendum clause.

a) *T. W. Phillips Gas and Oil Co. v. Jedlicka*, 964 A.2d 13 (Pa. Super Ct. Dec. 29, 2008), petition for allowance of appeal granted, 978 A.2d 347 (Pa., July 29, 2009).

Defendants asserted that a lease with an exploration company had terminated because of the habendum clause, which requires that the lease is valid so long as “oil or gas is produced in paying quantities.” They argued that because the wells suffered a loss in 1959, the lease terminated.

The Court of Common Pleas of Indiana County evaluated the “in paying quantities” provision of the habendum clause consistent with the Supreme Court’s 1899 ruling in *Young v. Forest Oil Co.*, 45 A.2d 121 (Pa., 1899). That case established a “subjective test,” i.e. guided by

the circumstances and construing the phrase “in paying quantities”, “with reference to the operator, and by his judgment exercised in good faith.” 964 A.2d at 16.

The Court of Common Pleas rejected the defendants’ requested application of an “objective test” based on *Reese Ents., Inc. v. Lawson*, 553 P.2d 885 (Kan. 1976), in which the court computes the production receipts, minus royalty, minus expenses including marketing, labor, trucking, repair, taxes, fees and other expenses. *Id.*

The Superior Court affirmed, noting that although *Young* is over a century old it is still the law as established by the Supreme Court. 964 A.2d at 18-19.

b) *T. W. Phillips Gas and Oil Co. v. Jedlicka*, 978 A.2d 347 (Pa., July 29, 2009).

On July 29, 2009, the Supreme Court granted the petition for allowance of appeal from the Superior Court’s determination.

The issue accepted on appeal is:

Did the Superior Court misapply the decision of this Court in *Young v. Forest Oil Co.*, 45 A. 121 (Pa. 1899), by holding that Pennsylvania employs a purely subjective test to determine whether an oil or gas lease has produced ‘in paying quantities.’

978 A.2d at 347.

B. Breach of contract and invalidation of contract cases.

1. Action for breach of contract for failure of gas exploration company to pay bonus payment.

a) *Hollingsworth v. Range Res. Appalachia, LLC*, 2009 WL 3601586 (M.D. Pa., Oct. 28, 2009).

Plaintiff landowners brought a breach of contract action against a gas exploration company for alleged failure to pay a lease bonus and delay rental in a lump sum of \$165,000. In response to defendant’s motion to dismiss, the Magistrate Judge recommended and the District Court concurred in defendant’s motion to dismiss the case.

The plaintiffs owned 66 acres of land located in Bradford County under which was located Marcellus shale. The exploration company had sent to the plaintiff-landowners a letter enclosing a lease of plaintiffs’ land. The lease was not signed by the exploration company. Plaintiffs executed the lease and sent it back to the exploration company in June 2008. In December 2008, the defendant returned the lease to the plaintiffs, having marked the lease “void” and indicating that the lease was not approved. The exploration company’s cover letter stated that:

The above-referenced oil and gas lease that you offered to Range Resources-Appalachia, LLC (“Range”) has been reviewed by Range’s senior management and was not approved. Factors considered in Range’s decision included the drastic drop in oil and gas prices, the downturn of the U.S. economy and the resulting effects on the credit markets. It is unfortunate that circumstances beyond Range’s control have caused us to come to this decision. Accordingly, the proposed lease is being returned to you with this correspondence.

Plaintiffs brought suit in the Court of Common Pleas seeking to obtain damages. After the defendant removed the case to Federal District Court, it filed a motion to dismiss. Essentially, the defendant argued that assuming all of the facts in the complaint were true, the plaintiffs failed to show that any contract existed between the parties. Defendant’s position was that the plaintiffs had made an offer to the exploration company to enter into a lease, which the exploration company declined to accept. Both the Magistrate Judge and the District Judge agreed with the defendant.

The District Court explicitly held that on the facts as stated in the complaint, “no contract exists.” In particular, the court held that “no contract could be formed absent defendant’s manifestation of an intent to be bound.”

Significantly, the court found that merely preparing a lease which is sent to another party is not the same as making an offer to which the plaintiffs could accept:

Preparing a lease and giving it to plaintiffs for their signature is not plausibly an offer where the defendant did not sign the lease and stated that plaintiffs’ signed lease would be subject to review. Rather, as the magistrate found, the only offer made was by the plaintiffs, when they signed the lease and mailed it to defendant.

The District Court went one step further and ruled that it would not provide an opportunity to amend the complaint as “such amendment would be futile.” Even though the plaintiffs submitted a draft complaint to the court that contained additional facts on their breach of contract claim and added a promissory estoppel claim, the court found the plaintiffs alleged no facts that would support the contract claim or adequately give rise to a promissory estoppel claim.

2. Invalidation of lease as a result of late tender of payment.

a) *Sylvester v. Southwestern Energy Prod. Co.*, 2009 WL 3633835 (M.D. Pa., Nov. 2, 2009).

Plaintiff landowners brought a declaratory judgment action against a gas exploration company to declare a natural gas lease “null and void” for failure of the defendant to make payment within the time frame set out in the lease. In response to defendant’s motion to dismiss, the District Court dismissed the case.

Plaintiffs and defendant entered into a 10-year natural gas lease.² The lease provided that the defendant would pay to plaintiffs \$15,665 within 60 days of the defendant's receipt of a signed copy of an order of payment. The lease contained a provision that allowed the exploration company 90 days to cure any breach following notice by the plaintiffs of a breach. Additionally, the lease did *not* contain any provision stating that "time is of the essence."

The order was received and the payment was due no later than February 6, 2008. On February 29, 2008, 23 days after the due date, the defendant tendered the full payment by check. On March 17, 2008, the plaintiffs returned the check and requested the return of the original signed document so that it could be destroyed. Thereafter, they brought suit seeking to have the lease declared invalid.

The court agreed with the plaintiffs that their complaint "plainly disclose[d] a breach of contract: tender of the lump sum payment was late." However, the court held that "[a] mere breach of contract. . . does not necessarily discharge the non-breaching party's contractual obligations." The court then recited Pennsylvania law that only a "material breach of contract by one party discharges the other party's duties. An immaterial failure does not operate as such a discharge." *Citing Schlein v. Gross*, 186 Pa. Super. 618, 142 A.2d 329, 333 (1958).

While the lump sum payment was late, the court found that the defendant "cured its breach by making a good faith tender of payment to Plaintiffs on February 29, 2008, which would have been well within the 90-day cure period had Plaintiffs given notice with an opportunity to cure." Furthermore, the court found it significant that there was no "time is of the essence" provision. It found that under Pennsylvania law, a "brief delay" in performance does not constitute an actionable breach of contract.

C. Interpretation of partnership agreement relating to oil and gas drilling.

1. *Szymanowski v. Brace*, 2009 Pa. Super. 218, ___ A.2d ___, 2009 WL 790561 (Nov. 13, 2009).

See discussion, above.

D. Preemption of Local Ordinances

1. *Range Res. – Appalachia, LLC v. Salem Twp.*, 964 A.2d 869 (Pa., Feb. 19, 2009).

In February 2009, the Pennsylvania Supreme Court issued two opinions in two preemption cases, which raised primarily the same issue on different sets of facts. In *Range Res.*, the court affirmed the Commonwealth Court's ruling that the Oil and Gas Act preempted a township's ordinance when that ordinance attempted to regulate surface and land development

² The lease was originally between the plaintiffs and New Penn Exploration, LLC. On September 15, 2008, the lease was assigned to the defendant, Southwestern Energy Production Company. Because it has no bearing on the outcome and for purposes of this article, both New Penn and Southwestern Energy will be deferred to collectively as the "defendant."

associated with oil and gas drilling operations. *Range Res.*, 964 A.2d at 877, *affirming Great Lakes Energy Partners v. Salem Twp.*, 931 A.2d 101 (Pa. Commw. Ct. 2007).

Appellees, oil and gas producers, filed suit for declarative and injunctive relief upon Salem Township's ("Township") enactment of the ordinance, and alleged the Oil and Gas Act preempted it. The Township had adopted "a comprehensive subdivision and land development ordinance" ("SALDO") during the initial phase of the litigation, and adopted the oil and gas regulations as part of it. *Range Res.*, 964 A.2d at 870.

The Supreme Court allowed the appeal to address the topic of Oil and Gas Act preemption and invited the Department of Environmental Protection to file an amicus brief on its view of whether the Act and its regulations preempt local regulations. *Id.* at 872.

The court noted that in the companion case, *Huntley*, it concluded that the Act's preemptive scope is not total in the sense that it does not prohibit municipalities from enacting traditional zoning regulations that identify which uses are permitted, even if such regulations preclude drilling in certain zones. *Id.* That holding is not to be understood to suggest that any and all zoning regulation of oil and gas development would be allowable under Section 602 of the Act simply because the ordinance was enacted pursuant to the Municipalities Planning Code ("MPC"). *Id.*

The court held that the Ordinance was an attempt by the Township to enact a comprehensive regulatory scheme relative to oil and gas development in the Township. *Id.* at 875. The Ordinance purported to establish permitting procedures for oil and gas wells, impose bonding requirements, regulate well heads, and regulate site restoration. The permitting, bonding, restoration, and casing and plugging issues are addressed by the Oil and Gas Act and implemented by DEP. *Id.* The court also noted that some of the ordinance's provisions appear to impose costs on drilling entities. *Id.* at 876. As the ordinance focused not on zoning or development, but on regulating oil and gas, its objectives conflict with the Act's objectives and was preempted. *Id.* at 877.

2. *Huntley & Huntley, Inc. v. Borough Council of the Borough of Oakmont*, 964 A.2d 855, 864 (Pa., Feb. 19, 2009).

In *Huntley & Huntley*, the Court granted review to address the preemption issue, and to address whether municipalities must use the definition of minerals employed in the MPC verbatim. 964 A.2d at 860.

The Borough's ordinance restricted "extraction of minerals" only in an R-1 district as a conditional use. *Huntley* filed a conditional-use application, and argued that natural gas drilling was not the "extraction of a mineral" and that the Borough's power to restrict the location of gas drilling and wellheads was preempted by the Act.

The Court noted that the preemption directive of the Act, which is applicable to MPC-enabled ordinances, preempts ordinances which impose conditions, requirements or limitations on features of oil and gas well operations regulated by the Act or which accomplish the same purposes as set forth in the Act. *Id.* at 863. The Court held that the "feature" of oil and gas well

operations provision pertains to the technical aspects of well functioning and matters ancillary thereto (such as registration, bonding, and well site restoration), rather than the well's location.

The court's second inquiry involved whether the challenged zoning restriction accomplished the same purposes as those set forth in the Act. The court found that the ordinance's purpose was to serve the police power objectives relating to safety and welfare of citizens, encouraging the most appropriate use of land through the borough, conserving the value of property, minimizing overcrowding and traffic congestion, and providing adequate open spaces. *Id.* at 865. The court held that the ordinance serves different purposes from those in the Oil and Gas Act, and that its overall restriction on oil and gas wells in R-1 district was not preempted.

Next, the Court considered whether the Commonwealth Court mistakenly superimposed the MPC's definition of "mineral" upon the relevant portion of the zoning ordinance. Because the ordinance did not define the term mineral, the Supreme Court found that the Commonwealth Court's reliance on that definition to be appropriate. Moreover, the Supreme Court noted that it would be unwise to defer automatically to a local governing body regarding a term that is expressly defined in the MPC and used in a zoning ordinance, as that approach would invite litigation by fostering uncertainty as to zoning terms. *Id.* at 868.

3. *Arbor Res. LLC v. Nockamixon Twp.*, 2009 Pa. Commw. LEXIS 208 (Pa. Commw. Ct., May 21, 2009)

Objectors, owners of 240 oil and gas leasehold interests, filed a declaratory judgment action before the Court of Common Pleas of Bucks County challenging the substantive validity of the Township's zoning ordinance related to the regulation of oil and gas drilling. The Common Pleas court sustained the Township's preliminary objections because the MPC vests jurisdiction over challenges to the validity of ordinances with the local zoning hearing board. *Id.* at *10.

The objectors appealed to the Commonwealth Court and argued that the trial court had equity jurisdiction over their declaratory judgment action because the ordinance operationally regulates oil and natural gas, which exceeds the traditional land use controls. *Id.* at *13. Objectors argued that, under the MPC, there is no need to exhaust zoning remedies when a challenge is brought on an operational regulation.

The court held that the ordinances do not contain operational provisions. Rather, the ordinances identified zoning districts within the Township where oil and gas drilling was a permitted use. *Id.* at *22. The court noted that such a provision is a quintessential land use control logically connected to land use planning. The challenged ordinance also addressed setback requirements and provided environmental controls. The court found that the challenged provisions were neither inextricably linked or intended to extensively regulate oil and gas drilling, so the Objectors would have to seek the statutory remedy before the zoning hearing board rather than the Common Pleas Court. *Id.* at *25-26.

E. Rights of Oil and Gas Lessees on Lands Owned by the Government

1. *Belden & Blake Corp. v. Dep't of Conservation & Nat. Res.*, 969 A.2d 528 (Pa., 2009)

Belden & Blake owns and leases oil and natural gas estates on three parcels of property located in Oil Creek State Park. The Commonwealth owns the Park's surface. *Id.* at 529. When Belden & Blake sought a permit to develop wells on the parcels, the Department of Conservation and Natural Resources ("DCNR") sought to impose a "coordination agreement" on Belden & Blake before allowing it access to the parcels. *Id.*

Belden & Blake sought review of DCNR's coordination agreement requirement before the Commonwealth Court, arguing that DCNR lacked the power to condition the exercise of Belden & Blake's rights by requiring it to enter into a coordination agreement. The Commonwealth Court agreed with Belden & Blake's argument, and DCNR appealed to the Pennsylvania Supreme Court.

The Supreme Court affirmed, noting that DCNR may not "unilaterally impose additional conditions on Belden & Blake's exercise of its right to enter" the parcels. *Id.* at 532. Although it recognized that DCNR has a duty to maintain and preserve state parks, the court reiterated that it is the surface owner's burden to challenge the subsurface owner's reasonable exercise of its rights, not the reverse. *Id.* The court noted that a subsurface owner's rights cannot be diminished because the surface comes to be owned by the government, and the government must be held to the same standard as any other surface owner. *Id.* at 532-33.

The court concluded that although DCNR may *seek* additional conditions because of its duty to protect state parks, it does not have the authority to *impose* additional conditions unilaterally without compensation under the Eminent Domain Code. *Id.* at 533.

2. *Minard Run Oil Co. v. U.S. Forest Service*, No. 09-125 Erie (W.D. Pa, Dec. 15, 2009).

In the Allegheny National Forest (ANF), owned and operated by the U.S. Forest Service (USFS), subsurface oil and gas rights are largely owned by private landowners. This is due to the stated purpose of the legislation establishing the ANF which was to acquire land suitable for timber production and watershed protection. Also, since at the time the ANF was established, the land had been entirely private land, it was significantly less costly for the Federal Government to acquire only the surface and not the minerals. Over 93% of the mineral estates in the ANF are privately owned.

From 1980 until 2008, the USFS, in accordance with a settlement agreement that was filed in Federal District Court in 1980, reviewed requests by oil and gas drilling companies to conduct drilling operations and approved those requests, issuing Notices to Proceed largely in under 60-days. *United States v. Minard Run Oil Co.*, 1980 U.S. Dist. Lexis 9570 (W.D. Pa. 1980) ("1980 *Minard Run* Settlement Agreement")

In 2008, the USFS decided that the Federal National Environmental Policy Act (NEPA) applied to Notices to Proceed. Subsequently, the USFS was sued by environmental interest

groups demanding that the USFS require Environmental Impact Statements (EIS) for all requests to conduct drilling in the ANF. On April 9, 2009, the USFS and environmental interest groups entered into a settlement agreement (“2009 Settlement Agreement”) in which the USFS agreed to analyze all future drilling proposals on split mineral estates in the Allegheny National Forest pursuant to NEPA prior to issuing notices to proceed to oil and gas drilling companies. It was estimated that it would take a minimum of one year to as much as five years to process each EIS. The public was not given any opportunity to comment on the 2009 Settlement Agreement prior to its being entered in Federal District Court.

The natural gas industry led by the Pennsylvania Oil and Gas Association, filed suit seeking both a preliminary and permanent injunction to stop the new practice and return to the previous practice under the 1980 *Minard Run* Settlement Agreement. The District Court agreed with the industry plaintiffs and issued a preliminary injunction.

The court conducted a hearing and examined the lengthy history of oil and gas drilling and mineral rights in the ANF. It concluded that the rights were subject to limited review by the USFS as established by the Weeks Act of 1911. 16 USC § 518. Also, in response to the 1980 *Minard Run* Settlement Agreement, the Court found that the regulation of oil and gas drilling by the USFS was severely limited. The limitations contained in the 1980 *Minard Run* Settlement Agreement were codified in § 2508 of the Energy Policy Act of 1992. 30 USC §226(o), 106 Stat. 3108 (1992). None of these obligations included the obligation of conducting an EIS under NEPA.

The court pointed out that “NEPA is triggered only by a proposal for *major* federal action.” Slip op. at 37 (emphasis in original). The court found that the review of the drilling requests, which were the only federal actions, did not constitute major Federal Action. Slip op. at 41, 46. Furthermore, the Weeks Act did not supply the USFS with the regulatory authority that it claimed to have. *Id.* at 43. Likewise, “the deeds do not provide the Forest Service with the regulatory authority that it contends it possesses here.” *Id.*

The court granted the preliminary injunction and enjoined the USFS “from requiring the preparation of a NEPA document as a precondition to the exercise of private oil and gas rights in the ANF.” It also preliminarily enjoined the forest-wide drilling ban in the ANF that had been imposed by the USFS. It then ordered the USFS to comply with the 1980 *Minard Run* Settlement Agreement requirements. *Id.* at 50-51.