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Pennsylvania--Recent Developments in Pennsylvania Jurisprudence Related to Oil and Gas Leasing and Conveyancing

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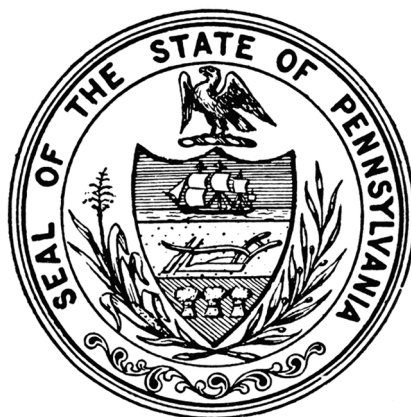


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PENNSYLVANIA
RECENT DEVELOPMENTS IN PENNSYLVANIA JURISPRUDENCE
RELATED TO OIL AND GAS LEASING AND CONVEYANCING

Ross H. Pifer¹

Pennsylvania is the largest producer of shale gas in the United States and is the second-largest natural gas-producing state overall.² Owing to its strategic location atop the Marcellus and Utica Shale Formations, Pennsylvania's position as a major natural gas producer is relatively new. Just a little over a decade ago, Pennsylvania ranked

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2. See *Shale Gas Production*, U.S. ENERGY INFO. ADMIN., available at https://www.eia.gov/dnav/ng/ng_prod_shalegas_sl_a.htm [<https://perma.cc/G3F4-HEEY>] (last visited Nov. 13, 2019) (indicating that Pennsylvania had produced 5,365 Bcf of natural gas in 2017); See also *Natural Gas Gross Withdrawals and Production*, U.S. ENERGY INFO. ADMIN., available at https://www.eia.gov/dnav/ng/ng_prod_sum_a_EPG0_VGM_mmcf_a.htm [<https://perma.cc/JW26-ZZ28>] (last visited Nov. 13, 2019) (indicating that Texas had produced 7,847,102 MMcf while Pennsylvania had produced 6,210,673 MMcf of natural gas in 2018).

sixteenth among states in total natural gas production.³ With this rapid rise in the amount of natural gas development, there has been a corresponding increase in activity in courtrooms across Pennsylvania—both in state and federal courts. As a result, Pennsylvania oil and gas law has evolved within a number of different legal areas, with leasing and title issues perhaps being among the most frequent—and most important—topics that have been addressed by courts. This survey will address the 2019 reported judicial opinions issued by state courts in Pennsylvania that address oil and gas leasing and title issues.

I. PAYMENT IN LIEU OF FREE GAS

During Pennsylvania's long history of conventional oil and gas development, landowners have often sought lease provisions that provided them with free natural gas for use in home heating—a valuable benefit during cold Pennsylvania winters—when wells were drilled on their properties. In these free gas lease provisions, a landowner typically receives up to a specified quantity of natural gas at no cost and in some instances, leases permit the operator to provide payment of a market value price in lieu of providing free gas. In *Mitch v. XTO Energy*,⁴ the Pennsylvania Superior Court provided an interpretation of a payment in lieu of free gas clause in an oil and gas lease. Raymond Mitch owned a 53.28-acre tract of real estate in Butler County, and in 2012, he executed an oil and gas lease with XTO Energy.⁵ This lease provided for the payment of a bonus, 18% royalties, and an additional payment equal to the market value of 300,000 cubic feet of natural gas if certain conditions were satisfied.⁶ The specific conditions that needed to be satisfied in order to trigger the additional payment to the surface estate owner were that a well was “drilled on the lease premises;” that the well was “producing in

3. See Ross H. Pifer, *What a Short, Strange Trip It's Been: Moving Forward After Five Years of Marcellus Shale Development*, 72 U. PITT. L. REV. 615, 619, n.28 (2011) (noting the top sixteen natural gas-producing states in 2005 according to data from the U.S. Energy Information Administration).

4. *Mitch v. XTO Energy, Inc.*, 212 A.3d 1135 (Pa. Super. Ct. 2019).

5. *Id.* at 1137.

6. *Id.*

paying quantities;" and that "the surface owner ha[d] his primary residence on the lease premises."⁷

XTO Energy did not construct a well on the Mitch property. Mitch's acreage, however, was pooled together with other leases, and a well was constructed within the pooled acreage on a neighboring property.⁸ The well that was drilled on the neighboring property was a horizontal well that traversed through the subsurface estate of Mitch's property, but there was no activity at all on Mitch's surface estate.⁹ Following the drilling of this well, Mitch filed suit seeking a declaration that he was entitled to a payment in lieu of free gas pursuant to the terms of his lease.¹⁰ The Butler County Court of Common Pleas rejected his claim, granting a summary judgment in favor of XTO Energy.¹¹

In Mitch's appeal of this decision, the Superior Court determined that a *de novo* review was appropriate because the issue was one of contract interpretation.¹² The parties agreed that the relevant well met the producing in paying quantities standard, and Mitch's primary residence was located on the lease premises. Thus, the issue for the court to resolve was limited to an interpretation of the meaning of the phrase "drilled on the lease premises."¹³ Mitch argued that the horizontal well drilled through his subsurface estate was within the lease premises.¹⁴ XTO Energy countered that the lease required the well to be drilled on the surface estate for the lessor to be entitled to receive the payment in lieu of free gas.¹⁵ The Superior Court accepted the argument of XTO Energy and concluded that the parties intended for the language "drilled on the lease premises" to mean drilled on the surface estate of Mitch's property. According to the court, "[i]t is unreasonable to find that the parties intended to compensate a **surface owner**" (emphasis in original) for a well located on the surface estate of another property.¹⁶

7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.* at 1138.

12. *Id.*

13. *Id.* at 1139.

14. *Id.* at 1140.

15. *Id.*

16. *Id.* at 1141.

II. SCOPE OF SURFACE ESTATE ACCESS

In *Porter v. Chevron Appalachia*,¹⁷ the Pennsylvania Superior Court addressed another issue relating to the surface estate, this time reviewing the scope of the grant conveyed in an oil and gas lease. There, the Superior Court affirmed the grant of a preliminary injunction confirming the right of a drilling company to utilize the surface estate for pre-drilling activities. In 2002, the Porters granted an oil and gas lease on their seventy-six-acre tract to Atlas America, Inc. (“Atlas”).¹⁸ Following the execution of the lease, Atlas drilled conventional vertical wells on the property.¹⁹ By virtue of its acquisition of Atlas assets, Chevron assumed control over the lease in question, and in 2017, Chevron notified the Porters of its intention to construct a well pad on the property that would be utilized for the extraction of oil and gas, including from neighboring properties.²⁰ After the Porters filed litigation objecting to this use of their property, Chevron continued its pre-drilling activities, and its personnel arrived on the property to mark the proposed drilling location.²¹ While this activity was underway, Mr. Porter informed the Chevron personnel that they should “get off [the] property while the getting’s good.” Chevron personnel interpreted this as a threat and vacated the property.²² Chevron then filed a motion for an injunction to prohibit the Porters from restricting their pre-drilling operations on the property.²³ On November 29, 2017, the Fayette County Court of Common Pleas granted the requested injunction, and an appeal ensued.²⁴

The Superior Court reviewed the prerequisites for the grant of a preliminary injunction.²⁵ The court opined that reasonable grounds existed to support the conclusion that Chevron would suffer

17. 204 A.3d 411 (Pa. Super. Ct. 2019).

18. *Id.* at 414.

19. *Id.* at 415.

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.* at 416.

25. *Id.*

irreparable harm if the injunction was not granted.²⁶ Specifically, the Superior Court noted the lower court's findings that the failure to grant the requested injunction would impact other drilling plans and that added delay was particularly troublesome because some activities could not be performed in the winter months.²⁷ The Superior Court also agreed that the testimony supported a finding that it was "impossible to quantify" Chevron's damages caused by delay.²⁸ With regard to the issue of who was altering the status quo among the parties, the Superior Court concluded that it was the Porters who were altering the status quo by preventing Chevron's "contractual right of access."²⁹ Thus, the injunction restored the parties to the status quo position according to the court.³⁰ As such, the Superior Court affirmed the lower court ruling, noting that the injunction was limited to pre-drilling activities undertaken to prepare a permit application with the Department of Environmental Protection.³¹

III. CONVEYANCE OF MINERAL ESTATE THROUGH DEED IN LIEU OF CONDEMNATION

Horizontal drilling, together with hydraulic fracturing, is an essential technology for the extraction of shale gas.³² The widespread use of horizontal drilling has expanded the types of real estate that have value for purposes of natural gas extraction. For example, there now is interest for natural gas development in the subsurface estate beneath roadways. In *O'Layer McCready v. Department of Community and Economic Development*,³³ the Pennsylvania Commonwealth Court addressed the ownership of oil and gas rights beneath a public roadway. Sarah O'Layer McCready acquired title to a parcel of land in Lawrence County in 1978.³⁴ In 1990, she conveyed her interest in a portion of that parcel to the Pennsylvania Turnpike

26. *Id.* at 417.

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.* at 419.

32. See Ross H. Pifer, *A Greener Shade of Blue?: Technology and the Shale Revolution*, 27 NOTRE DAME J. L. ETHICS, & PUB. POL'Y 131, 135 (2013) (discussing the development of technology that enabled the extraction of shale gas).

33. 204 A.3d 1009 (Pa. Commw. Ct. 2019).

34. *Id.* at 1011.

Commission (“Commission”) through a deed in lieu of condemnation.³⁵ The Commission sought to acquire this land for the construction of the Beaver Valley Expressway.³⁶ Pursuant to the language in the deed, the conveyance included “all the estate, right, title, interests, property, claim, and demand whatsoever of [McCready].”³⁷

In 2012, McCready filed a quiet title action seeking ownership of the mineral estate to the parcel.³⁸ In support of her claim, she alleged that she had conveyed her property interest solely to avoid the condemnation action and that it was not necessary for the Commission to own the mineral estate for them to construct the highway.³⁹ Furthermore, she alleged that she did not intend to transfer any interest in excess of that which would have been conveyed through the eminent domain process.⁴⁰ Finally, she claimed that the compensation that she received from the Commission for the property interest conveyed did not account for the value of the mineral estate.⁴¹ The Commission’s claim for ownership of the mineral estate was based on its argument that the language of the deed was clear in expressing the intention of the parties that the mineral estate had been conveyed.⁴²

The court rejected McCready’s arguments, finding there were no allegations to support her claims. First, the court found that the deed was clear and there had been no allegation of mutual mistake to justify the introduction of parol evidence.⁴³ The court also concluded that the Commission did have the authority to obtain a fee simple estate and that the reasonableness of acquiring a fee simple estate was supported by testimony that maintaining control over the subsurface estate benefited the safe operation of the roadway.⁴⁴ Finally, the court found no evidence that the purchase price for the property was inadequate.⁴⁵ Thus, the Commonwealth Court ruled that the deed had

35. *Id.*

36. *Id.* at 1012.

37. *Id.*

38. *Id.* at 1013.

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.* at 1017.

44. *Id.* at 1018.

45. *Id.* at 1019.

conveyed a fee simple interest in the property and that the Commission was the owner of the mineral estate.⁴⁶

IV. USE OF CONSUMER PROTECTION LAWS IN OIL AND GAS LEASING TRANSACTIONS

During the leasing boom at the onset of shale development in Pennsylvania, many landowners raised complaints about company actions in the procurement of leases.⁴⁷ Based upon these complaints, the Pennsylvania Office of the Attorney General (“OAG”) sought to utilize Pennsylvania’s Unfair Trade Practices and Consumer Protection Law (“UTPCPL”)⁴⁸ against oil and gas companies.⁴⁹ OAG filed suit against Anadarko Petroleum Company (“Anadarko”), Chesapeake Energy Corporation (“Chesapeake”), and related companies under the authority of UTPCPL, alleging “deceptive, misleading, and unfair tactics” as well as antitrust violations in the oil and gas leasing process.⁵⁰ OAG alleged that Anadarko and Chesapeake had apportioned the territories in which they each would seek oil and gas leases in an effort to reduce competition.⁵¹ Anadarko and Chesapeake countered these allegations by arguing that UTPCPL only applies to sellers in consumer transactions and that, in the oil and gas leasing context, they were buyers.⁵²

The Commonwealth Court began its analysis by reviewing the purpose of UTPCPL as a remedial statute that attempts to equalize the bargaining power between sellers and consumers.⁵³ Rejecting the argument asserted by Anadarko and Chesapeake, the court found that the alleged conduct came within the definitions of “trade” and “commerce” under UTPCPL.⁵⁴ Additionally, the court concluded that

46. *Id.* at 1019.

47. See Ross H. Pifer, *Drake Meets Marcellus: A Review of Pennsylvania Case Law upon the Sesquicentennial of the United States Oil and Gas Industry*, 6 TEX. J. OIL, GAS & ENERGY L. 47, 53 (2010-2011) (discussing cases alleging that companies had fraudulently induced landowners into signing oil and gas leases).

48. 73 PA. STAT. §§ 201-1 to 201-9.3 (West 2019).

49. *Anadarko Petroleum Corp. v. Pennsylvania*, 206 A.3d 51 (Pa. Cmmw. Ct. 2019).

50. *Id.* at 53.

51. *Id.* at 53–54.

52. *Id.* at 54.

53. See *id.* at 55 (quoting *Com., by Creamer v. Monumental Props., Inc.*, 329 A.2d 812, 815-17 (Pa. 1974)).

54. *Id.* at 56.

based upon Pennsylvania precedent, “leases were, in essence, sales.”⁵⁵ Although Pennsylvania precedent focused on residential leases, the court concluded that business and commercial leases also fell within the ambit of the law.⁵⁶ As a result, OAG had the authority to utilize UTPCPL to pursue enforcement against Anadarko and Chesapeake for claims that they acted in a deceptive, misleading, and unfair manner towards landowners in the oil and gas leasing context.⁵⁷

With regard to OAG’s use of UTPCPL to pursue antitrust violations, the Commonwealth Court rendered a split verdict. The court held that the statutory language of UTPCPL does not authorize OAG to pursue violations for unlawful joint ventures or for market sharing activities between companies.⁵⁸ On the other hand, the court did find that OAG had authority to pursue antitrust violations where companies engage in “unfair methods of competition” or “unfair or deceptive acts or practices.”⁵⁹

V. ABANDONMENT OF LEASE

In *SLT Holdings, LLC, v. Mitch-Well Energy, Inc.*,⁶⁰ the Pennsylvania Superior Court invoked the theory of abandonment to rule that an oil and gas lease was no longer valid and that the lessee’s removal of oil from tanks on the leased premises constituted conversion. SLT Holdings owned oil and gas rights on two parcels where the leases were held by Mitch-Well Energy.⁶¹ The leases contained fairly typical habendum clauses that included a five-year primary term and a secondary term lasting “as long thereafter as oil or gas or other substances covered hereby are or can be produced in paying quantities.”⁶² Under the terms of the leases, the lessee had an affirmative obligation to drill a minimum number of wells in accordance with a prescribed drilling schedule.⁶³ The lease provided that if the lessee failed to comply with this drilling schedule, the lease

55. *Id.*

56. *Id.* at 57.

57. *Id.* at 59.

58. *Id.* at 60–61.

59. *Id.* at 61.

60. ___ A.3d ___, 2019 WL 3980188 (Pa. Super. 2019).

61. *Id.* at *1.

62. *Id.* at *4.

63. *Id.* at *5.

would terminate. In the event of termination, however, the lessee would retain acreage totaling twenty acres around each well.⁶⁴ By lease amendment, the amount of the retained acreage per well was later reduced to five acres.⁶⁵

The lessee did drill wells on the property, but not in compliance with the prescribed drilling schedule.⁶⁶ Additionally, from 1996 through 2013, there was no marketable production from the wells on the property.⁶⁷ Mitch-Well Energy made no royalty payments nor any other payments to SLT Holdings during this time.⁶⁸ Mitch-Well Energy, however, did periodically attend to the wells to ensure that they were in regulatory compliance.⁶⁹ In 2013, Mitch-Well Energy entered the property to empty the storage tanks and then sold the oil recovered, which yielded proceeds in the amount of \$9,069.53.⁷⁰ At this time, SLT Holdings filed suit, seeking a declaration that Mitch-Well Energy had no legal right to be on the premises and that its actions in collecting oil from the storage tanks constituted conversion.⁷¹ Even though there had been no marketable production for a sixteen-year period, the Superior Court relied on the theory of abandonment to rule in favor of SLT Holdings. The court cited *Jacobs v. CNG Transmission Corp.*⁷² for the “proposition that an oil and gas lease may be abandoned.”⁷³ Based upon the extended period of inactivity at the wells, the court found that Mitch-Well Energy’s actions satisfied the requirements to constitute abandonment.⁷⁴ As a result of this abandonment, Mitch-Well Energy had relinquished its legal right to control over the acreage surrounding each well, and its removal of oil from the property did constitute a conversion.⁷⁵

64. *Id.*

65. *Id.*

66. *Id.* at *2.

67. *Id.* at *1.

68. *Id.*

69. *Id.*

70. *Id.* at *8.

71. *Id.* at *2.

72. *Id.* at *8 (citing *Jacobs v. CNG Transmission Corp.*, 332 F.Supp.2d 759, 783-96 (W.D. Pa. 2004)).

73. *Id.* at *7.

74. *Id.* at *7.

75. *Id.* at *8.