Texas Wesleyan Law Review

Volume 18 | Issue 3 Article 5

3-1-2012

Arkansas

Thomas A. Daily

ARKANSAS

By: Thomas A. Daily[1]

Unlike some other jurisdictions,[2] Arkansas does not typically have large annual volumes of oil and gas related cases or legislation. The most recent year was pretty normal in that respect. This Article will review several changes in Arkansas oil and gas law: (a) one legislative change, itself inspired by a Justice's dissenting opinion in a case interpreting the previous statute; (b) three fairly unremarkable opinions of the Arkansas Court of Appeals; (c) and two noteworthy federal district court opinions—the first determined the ownership of coal-bed methane gas between competing gas and coal owners, and the second, rather interesting ruling, involved a group of landmen's possible unauthorized practice of law.

A. *Legislative Change*

Arkansas has a statute popularly known as its "Statutory Pugh Clause." Like the true Pugh Clause in an oil and gas lease, this statute is designed to prevent perpetuation of a lease, as to non-producing acreage, after expiration of its primary term. Unfortunately, the Arkansas Statute[3] has never been a model of clarity. As originally enacted, it read as follows:

1. The Author, Thomas A. Daily, is a member of Daily & Woods, P.L.L.C., Fort Smith, Arkansas, and practices almost exclusively in the area of Natural Resources Law. He is also an Adjunct Professor at The University of Arkansas School of Law, teaching Oil and Gas Law courses. Mr. Daily received a Bachelor of Arts degree from the University of the South (1967) and a Juris Doctorate from the University of Arkansas (1970).

2. E.g., Texas and Oklahoma.

3. ARK. CODE ANN. § 15-73-201 (Supp. 2011).

DOI: https://doi.org/10.37419/TWLR.V18.I3.4

Lease Extended by Production – Scope

(a) The term of an oil and gas, or oil or gas, lease extended by production in quantities in lands in one (1) section or pooling unit in which there is production shall not be extended in lands in sections or pooling units under the lease where there has been no production or exploration.
(b) This section shall not apply when drilling operations have commenced on any part of lands in sections or pooling units under the lease within one (1) year after the completion of a well on any part of lands in sections or pooling units under the lease.
(c) The provisions of this section shall apply to all oil and gas, or oil or gas leases entered into on an after July 4, 1983.[4]

Critics of the above statute have cited a litany of flaws. Among those is the use of the terms "sections" and "pooling units" separated by "or." To begin with, Arkansas' statutes do not define "pooling units." Rather, the term "drilling unit" is used in Arkansas' unitization statute.[5] Thus, we first must assume that "pooling units" really means "drilling units."

Moreover, drilling units and governmental sections, while frequently one and the same, are not always so. That exposes an even more serious potential problem. Suppose an oil and gas lease covers all of two governmental sections, Sections 1 and 2, which have each been divided into four, 160-acre quarter-section units. Suppose that only one of those units, the Northwest Quarter of Section 1, contains a producing well at the expiration of the primary lease term. A literal reading of the statute requires the conclusion that the lease then expires, as to all of Section 2, but as to none of Section 1, not even the three non-producing quarter sections.

Also, unlike the Pugh Clause sometimes inserted into an oil and gas lease, the statute does not require continuous exploration or production in a section or unit to perpetuate the lease as to that section or unit. Rather, any exploration or production appears to be sufficient, regardless of the exploration's success, or lack thereof, or whether the production is ongoing or has long-ago ended.

Then, there was the issue of the meaning of subpart (b) and of its relationship to subpart (a). The literal meaning seems pretty clear, though it likely was one never intended by the legislature. That meaning is that the statute does not apply if a second well is commenced on the lease within one year after completion of the first well. In other words, a producer who drilled a second well within one year of completion of the first earned a free pass from the effect of the statute, even if it did nothing further. To the industry's credit, to the best of the Author's knowledge, no producer has taken that position, in spite

4. Act 330 of 1983, 1983 Ark. Acts vol. II bk. 1 at 504 (codified as amended at ARK. CODE ANN. § 15-73-201 (Supp. 2011)).
5. ARK. CODE ANN. § 15-72-303 (2009).

of the statute's literal meaning. Rather, producers have taken the more conservative approach that each commencement, within a year of the prior well's completion, earned the lease another year of life as to the entire leased premises.

Surprisingly, the meaning of this statute, which became effective July 4, 1983, was not litigated until mid-2010. Then, two cases reached the Arkansas Supreme Court, on similar facts, but with opposite results in the lower courts. In both *Snowden v. JRE Investments, Inc.*[6] and *Southwestern Energy Production Co. v. Elkins*,[7] lessors contended that subpart (b) of the statute only authorized a single one-year extension of the lease, beyond the primary term, regardless of additional drilling operations beyond that one additional year. It is hard to find that interpretation within the statutory language, but the lessors argued that it was the legislative intent. The lessors' arguments were rejected by the lower court in *Snowden* but actually prevailed in a different lower court in *Elkins*.

The Supreme Court affirmed *Snowden* and reversed *Elkins*, holding that subpart (b) of the statute did require continuous drilling operations (each within one year of completion of the previous operation). Rather, the number of one-year extensions which could be earned was unlimited.

Importantly, the Court also noted that the statute did not repeal the common law implied covenant to fully develop a lease, the performance of which is measured by the Prudent Operator Standard. So, in an appropriate case, continuous development on one part of the lease may not justify failure to attempt to develop the remainder. *Snowden* and *Elkins* were good decisions, giving reasonable interpretation to statutory language which, read literally, is near nonsensical.

In a dissenting opinion in *Elkins*, Associate Supreme Court Justice Danielson suggested that the lessors' interpretation was consistent with legislative intent.[8] Then, he suggested that the legislature amend the statute to clearly express that intent. On cue, Arkansas' 2011 General Assembly then rewrote the statute. This is the result:

Lease Extended by Production – Scope

(a) (1) The term of an oil and gas, or oil or gas, lease extended by production in quantities in lands in one (1) section or pooling unit in which there is production shall not be extended in lands in sections or pooling units under the lease where there has been no activity.

6. Snowden v. JRE Invs., Inc., No. 09-1149, 2010 WL 2210644 (Ark. June 3, 2010).

7. Sw. Energy Prod. Co. v. Elkins, No. 10-516, 2010 WL 5059709, at *10 (Ark. Dec. 9, 2010).

8. *Id.* at *13 (Danielson, J., concurring in part and dissenting in part). Justice Danielson did not participate in *Snowden v. JRE Invs., Inc.*

> (2) Subsection (a) of this section does not prevent the parties to the lease from agreeing to a continuous drilling provision in order to extend the lease term to additional lands drilled or included in another section or unit if the lessor's waiver of the right to terminate the lease to the additional lands, sections or units where no activity has occurred before the expiration of the lease is fully set forth in the lease or another agreement in bold, enlarged, or other distinctive print.
>
> (b) After the primary term of a lease in an uncontrolled oil field with no spacing requirements, a producing well shall contain a maximum of one (1) governmental quarter-quarter section as a production unit.[9]

Thus, in subpart (a), "production or exploration" has been replaced with "activity," hardly an improvement in clarity. The former subpart (b) is gone altogether, replaced by (a)(2) which permits a lessor to opt out of the statute by language "set forth . . . in bold, enlarged, or other distinctive print." The new subpart (b), dealing with the rare "uncontrolled oil field,"[10] apparently seeks to deal with a problem which is unlikely to arise, caused by subpart (a)'s confusion of sections and "drilling units," while introducing a new term: "production unit."[11]

The statutory amendment did not contain an emergency clause. Thus, it became effective on July 17, 2011. While we cannot rule out a contention that the amended statute has retroactive application to existing leases, a more constitutional interpretation is that it only applies to leases entered into after that date. From all of that, we are compelled to conclude that the statute remains confusingly ambiguous, though somewhat different.

B. *Arkansas Court of Appeals Decisions*

Three recent Arkansas Court of Appeals cases are *Barger v. Ferrucci*,[12] *Robison v. Lee*,[13] and *Burgess v. Lewis*.[14] All three were correctly decided, and none is remarkable. In *Barger*, the court held that the phrase "[s]ubject to reservation of all oil, gas and other minerals," following a warranty deed's legal description, was a valid mineral res-

9. ARK. CODE ANN. § 15-73-201 (Supp. 2011).

10. Uncontrolled oil fields are those producing from "those pools that, prior to February 20, 1939, have been developed to an extent and where conditions are such that it would be impracticable or unreasonable to use a drilling unit at the present stage of development." ARK. CODE ANN. § 15-72-302(b)(1) (2009).

11. ARK. CODE ANN. § 15-73-201(b) (Supp. 2011). The Author, for purposes of this Article, presumes the term "production unit" is synonymous with "pooling unit," which is presumably synonymous with "drilling unit."

12. Barger v. Ferrucci, No. CA 10-797, 2011 WL 514662 (Ark. Ct. App. Feb. 9, 2011).

13. Robison v. Lee, No. CA 10-87, 2010 WL 5131917 (Ark. Ct. App. Dec. 15, 2010).

14. Burgess v. Lewis, No. CA 10-1272, 2011 WL 1795523 (Ark. Ct. App. May 11, 2011).

ervation rather than a mere limitation upon the grantor's warranty.[15] In *Robison*, the court held that the Parol Evidence Rule bars a party who, admittedly, signed a ratification of another owner's oil and gas lease, which recited receipt of token consideration, from claiming failure-of-consideration as a basis for avoiding the ratification.[16] In *Burgess,* the court refused to limit a deed's reservation of an otherwise perpetual fractional non-participating royalty interest, which referred to an existing oil and gas lease, to the term of that existing lease.[17]

C. *Federal District Court Opinions*

Two United States District Court opinions are worthy of note. *Enervest Operating, LLC v. Anadarko Petroleum Corp.*[18] was a dispute between separate owners of subsurface gas and coal, as to ownership of coal bed methane gas. It was before the district court via diversity of citizenship, and the issue was one of first impression in Arkansas. In an extremely well written opinion, the court followed the lead of the decisions of most states west of the Mississippi River, holding that coal bed methane is gas, not coal.

Vanoven v. Chesapeake Energy Corp.[19] is a putative class action involving, primarily, the propriety of Chesapeake's practice of calculating gas royalties after deduction for certain costs, such as compression, treating, gathering, transportation, and marketing of the gas. The recent ruling is one of partial summary judgment in the still-pending case. It dismissed the royalty owners' contention that since their leases were prepared and negotiated by non-lawyer landmen, who were employed by Chesapeake's lease broker, an unlicensed practice of law had occurred that caused the resultant leases to be void. While the pertinent portion of the district court's opinion acknowledged that there was uncertainty whether the landmen's activities constituted the unlicensed practice of law in violation of rules of the Arkansas Supreme Court, the royalty owners had not shown how the putative class was damaged thereby.

15. *Barger*, 2011 WL 514662, at *3.

16. *Robison*, 2010 WL 5131917, at *2.

17. *Burgess*, 2011 WL 1795523, at *2.

18. Enervest Operating, L.L.C. v. Anadarko Petroleum Corp., No. 2:09-CV-02135-PKH (W.D. Ark., Mar. 31, 2011), *available at* http://ar.findacase.com/research/wfrmDocViewer.aspx/xq/fac.20110331_0000268.WAR.htm/qx.

19. Vanoven v. Chesapeake Energy Corp., No. 4:10CV0158 BSM, 2011 U.S. Dist. LEXIS 36057 (E.D. Ark., Mar. 22, 2011).