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Pennsylvania and Ohio High Courts Issue Decisions Impacting Oil and Gas Operators

*By Luke Liben and Thomas J. Galligan**

The Supreme Courts of Ohio and Pennsylvania both issued decisions of interest to oil and gas operators in their respective jurisdictions. These two cases represent the first major oil and gas decisions in 2015 from both of these high courts.

The Supreme Court of Ohio and the Supreme Court of Pennsylvania both issued decisions of interest to oil and gas operators in their respective jurisdictions. In *Wayne Harrison, et al. v. Cabot Oil & Gas Corp.*,¹ the Pennsylvania high court found that a lessee was not entitled to an equitable extension of the primary term where the lessor brought an unsuccessful declaratory judgment action to invalidate the lease. Meanwhile, in *State ex rel. Morrison v. Beck Energy Corp.*,² the Supreme Court of Ohio reinforced the regulation of oil and gas development at the state level when it struck down city ordinances that imposed additional permitting requirements on oil and gas drilling.

SUPREME COURT OF PENNSYLVANIA DECLINES TO EXTEND PRIMARY TERM OF OIL AND GAS LEASE

In *Harrison*, the Supreme Court of Pennsylvania declined to extend the primary term of an oil and gas lease where a declaratory judgment action seeking to invalidate that lease was decided against the lessor. The court, in a decision joined unanimously by the five currently sitting justices, held that such equitable relief was not warranted in this case because the conduct of the lessor was not sufficient to repudiate the lease under Pennsylvania law. While the court declined to join other oil and gas producing jurisdictions in universally adopting the principle of extension, it held open the possibility that equitable relief may be available in a scenario where the lessor takes additional affirmative steps to repudiate the lease.

The underlying case concerns an oil and gas lease signed by the plaintiffs and Cabot Oil & Gas in 2007. Approximately halfway into the five-year primary term of the lease, the plaintiffs sued Cabot, seeking a declaration that the lease was invalid on several grounds. The United States District Court for the Middle District of Pennsylvania dismissed all of plaintiffs' claims, and Cabot sought summary judgment on a claim for equitable extension of the primary term, arguing that the uncertainty caused by the lessors' legal action had deprived the company of valuable time in which to conduct drilling operations. Cabot's request for equitable relief was denied.

* Luke Liben and Thomas J. Galligan are members of Reed Smith's global Energy and Natural Resources group. A litigator on the firm's Oil and Gas team, Mr. Liben specializes in lease disputes, pipeline encroachments, order of payment issues, condemnations, dormant mineral act claims, and other actions. The authors may be contacted at llopen@reedsmith.com and tgalligan@reedsmith.com, respectively.

¹ Case No. 75 MAP 2014 (Pa. Feb. 17, 2015).

² Case No. 2015-Ohio-485 (Ohio Feb. 17, 2015).

The company appealed to the United States Court of Appeals for the Third Circuit, and moved to certify the question to the Supreme Court of Pennsylvania. The Third Circuit granted the request, and the Supreme Court of Pennsylvania accepted the certified question in July 2014.

In their briefing, the plaintiffs argued that Pennsylvania case law in *Lauchle v. Keeton Group, L.L.C.*,³ and *Derrickheim Co. v. Brown*⁴ supported a finding that the primary term of an oil and gas lease cannot be equitably extended as a result of litigation surrounding the lease. They argued that the express language of a lease cannot be modified simply because its validity has been disputed, regardless of the outcome of that dispute. Lessors, accompanied by amicus briefs filed by several Pennsylvania landowner-lessors, further argued that oil and gas companies have superior bargaining power in drafting leases, and do not need the courts to provide a special remedy for economic hardship arising from litigation.

Cabot, and amici representing the oil and gas industry, urged the Supreme Court of Pennsylvania to join most other oil and gas producing jurisdictions in adopting the equitable extension rule. They argued that the remedy is especially necessary because of the extensive planning and great expense required to complete a well in the Marcellus Shale. The amici also highlighted the significant portion of bargained-for lease terms that operators in Pennsylvania have lost as a result of litigation surrounding the validity of leases. Cabot argued that permitting equitable extension of oil and gas leases is consistent with current Pennsylvania principles of equity, as well as Pennsylvania contract law granting relief for a party who is the victim of a repudiation of a contract.

The Supreme Court of Pennsylvania focused heavily on the last point, and grounded its opinion as a preservation of longstanding Pennsylvania law on anticipatory repudiation of contracts. The court stated that “contractual remedies, including equitable ones, generally flow from the breach of an agreement.” The court was not convinced that an action seeking a declaration that a lease is invalid is an anticipatory repudiation of the lease. The court emphasized that under Pennsylvania law, anticipatory repudiation requires an “absolute and unequivocal refusal to perform or a distinct and positive statement of an inability to do so,” and the mere filing of a declaratory judgment action contesting the validity of an agreement does not rise to that level. The court also noted that in other contexts, bringing a declaratory judgment action has not been considered sufficient to establish repudiation as a matter of law. The court declined to “adopt a special approach to repudiation pertaining to oil and gas leases,” despite noting that “a substantial number [of] other jurisdictions would appear to have done so.”

Notably, the court held that the opinion does not foreclose the availability of equitable relief to oil and gas producers where the lessor affirmatively repudiates the lease. It is unclear exactly what lessor conduct would warrant such equitable relief,

³ 768 F. Supp.2d 757 (M.D. Pa. 2011).

⁴ 451 A.2d 477 (Pa. Super. 1982).

but the court cited cases in which lessors refused rental payments, prevented commencement of drilling operations, or refused lessee access to property as examples of stronger evidence of affirmative repudiation of a lease. Finally, the court largely avoided discussion of the policy considerations implicated by both parties in their briefs, but did note that its decision was bolstered by the fact that oil and gas producers are “free to proceed according to their own devices to negotiate express tolling provisions for inclusion in their leases.”

SUPREME COURT OF OHIO STRIKES DOWN CITY ORDINANCES REGULATING OIL AND GAS DEVELOPMENT

The Supreme Court of Ohio invalidated several city ordinances that imposed restrictions above and beyond those required by Ohio’s state oil and gas regulatory scheme in its decision in *Morrison*. The court, in a 4-3 decision, held that several local ordinances in the city of Munroe Falls impermissibly conflicted with the well permit requirements under R.C. Chapter 1509, which entrusts in the Ohio Department of Natural Resources (“ODNR”) the “sole and exclusive authority” to regulate the permitting of oil and gas operations in the state. The local ordinances, passed between 1980 and 1995, required various approvals from local government before construction of gas wells, including additional permitting and notice requirements at the local level. The ordinances also imposed potential criminal penalties on violators.

In 2011, Beck Energy Corporation obtained a permit from the ODNR to drill an oil and gas well within the city limits of Munroe Falls. The city issued a stop-work order and filed a complaint seeking injunctive relief in the Summit County Court of Common Pleas, alleging that Beck was violating multiple provisions of the Munroe Falls Codified Ordinances. In opposing the city’s request for injunctive relief, Beck argued that the city’s ordinances conflicted with the statewide regulatory scheme in R.C. Chapter 1509. The trial court disagreed and granted the city’s request for a permanent injunction prohibiting Beck from drilling until it complied with all local ordinances. The Court of Appeals for the Ninth District of Ohio reversed, and rejected the city’s argument that the Home Rule Amendment to Ohio’s state constitution allowed it to impose its own permit requirements on oil and gas drilling operations. The Supreme Court of Ohio accepted the city’s appeal in June 2013.

The court first reviewed the extent of power granted to municipalities under the Home Rule Amendment to the Ohio Constitution. The amendment grants local authorities broad powers of self-government in matters that are “strictly local” and do not impinge upon matters that are of a “state-wide nature.” Because the Home Rule amendment does not allow municipalities to exercise their police power in a manner that conflicts with general laws, a municipal ordinance must be struck down if: (1) it is an exercise of police power, rather than of local self-government, (2) the statute in question is a general law, and (3) the ordinance is in conflict with the state statute.

The parties did not dispute that the city’s ordinances prohibiting drilling without a permit were an exercise of police power, but instead focused on whether R.C. 1509 was a “general law.” The city argued that the oil and gas regulatory statute lacked the uniform statewide application necessary for a general law because only Eastern Ohio has economically viable quantities of oil and gas. The court rejected this argument

and found R.C. 1509 was a general law, stating that “a law does not lack uniformity simply because it has a disparate geographic effect.”

The city further argued that there was no real conflict between the statute and the ordinances because they regulated two different things. The city framed the ordinances as performing traditional zoning functions, while the state statute regulated safety and correlative rights. The court disagreed, and relied on Ohio Home-Rule Amendment precedent that has consistently held that a local ordinance conflicts with a state regulatory scheme if the “local ordinance restricts an activity which a state license permits.” The court held that because the zoning regulation extinguished privileges granted in accordance with the state statute, there was a clear conflict between the local ordinances and R.C. 1509. The Supreme Court of Ohio thus affirmed the ruling of the Ninth District Court of Appeals.