

OIL AND GAS LAW UPDATE

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§ 1.01 INTRODUCTION

This paper summarizes and analyzes selected oil and gas cases from across the United States that were decided during 2019 through February 28, 2020. This summary is not exhaustive, but is necessarily limited to some of the more important oil and gas cases selected for discussion by the authors.³

§ 1.02 ADMINISTRATIVE LAW

[1] Federal Court

[a] *W & T Offshore, Inc. v. Bernhardt*, 946 F.3d 227 (5th Cir. 2019).

The Fifth Circuit Court of Appeals held that the Department of Interior did not exceed its statutory authority by changing its election from payment in kind to payment in cash for overdue royalties, but that it improperly promulgated a substantive rule without subjecting it to notice and comment. The court also held that the Department should have credited all the deliveries under the doctrine of equitable recoupment. The court rejected the Operator's argument that the statutory text permits the Department of Interior to require monthly royalties "in amount or value of the production saved, removed, or sold" evinces a disjunctive choice that once the Department of the Interior requires payment in kind for a given month, it cannot later require payment in cash. Nothing in the statutory text or context limits the Department of Interior's royalty

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³ Page limitations of this publication required the omission of some cases of interest. The facts in the cases are sometimes simplified to focus on the legal principles. The authors note that many of these case summaries were previously published in the proceedings of the Institute of Energy Law's 71st Annual Oil & Gas Law Conference, in 2020. The authors also thank the *Oil and Gas, Natural Resources, and Energy Journal* (ONE J) for its permission to publish certain identified case summaries, including those authored by Steptoe & Johnson, PLLC and published in *ONE J's* Annual Survey of Developments in Oil and Gas Law..

collection power, the “or” evidences a grant of discretion to the Department of Interior. The court stated that the Department of Interior is not bound to continue to accept; and the “amount or value” does not create an alternative contract because the language does not permanently lock the Department of Interior into its election for a given month.

The court held that the district court improperly granted the Department of Interior’s summary judgment on the issue of the rule changes being adjudicative orders and not changes to substantive rules. The court reasoned under *Phillips Petroleum Co. v. Johnson*, 22 F.3d 616 (5th Cir. 1994) and *Shell Offshore Inc. v. Babbitt*, 238 F.3d 622 (5th Cir. 2001) that the rule changes imposed obligations and produced other significant effects on private interests.

Lastly, the court held that equitable recoupment can be used as a defense to the Department of Interior’s orders to pay because equitable recoupment can always be used so long as a claim survives, thus the statute of limitations does not apply. The court rejected three arguments by the Department of Interior. First, because Congress has not expressly precluded equitable recoupment as a defense Operator is able to raise it as a defense. Second, the obligations for each month are not separate transactions because they are made under the lease, thus, equitable recoupment applies to payments owed under the lease. Third, the court rejected the argument that the Department of Interior’s application of the statute of limitations to other industry entities with outstanding royalty obligations due presents no real-world inequity. The court reasoned that this logic is unsound because the Department of Interior’s actions does not counteract the inequitable results the Operator suffered.

[2] Wyoming

[a] *Exaro Energy III, LLC v. Wyoming Oil and Gas Conservation Comm’n*, 455 P.3d 1243 (Wyo. 2020).

Facts and Procedural History: Exaro Energy III, LLC (“Exaro”) filed two applications with the Wyoming Oil and Gas Conservation Commission (“Commission”) seeking the approval of adjacent drilling and spacing unit. Jonah Energy, LLC (“Jonah”) opposed the applications.

The parties agreed that the evidence presented at the contested case hearing would apply to both applications. The Commission found and concluded that Exaro met its burden of proof for both applications and satisfied the requirements for a drilling and spacing unit. However, the Commission only approved one application because it believed additional data from the horizontal development should be analyzed prior to approving the application to establish a drilling and spacing unit.

Exaro filed a petition for review of administrative action with the district court and asked the district court to certify the matter to the Supreme Court of Wyoming. The district court granted Exaro’s request for certification and the Supreme Court accepted the certified case.

Issue: Was the Commission’s denial of Exaro’s application to establish a drilling and spacing unit in one application arbitrary and capricious given it found and concluded that Exaro had met its burden of proof and the applicable legal standard, provided actual, empirical data supporting the statutory requirements for the establishment of a drilling and spacing unit in a different application, and granted Exaro’s application based on the same evidence?

Result: The Commission’s decision to grant only one of the application was arbitrary and capricious.

Holding: Wyoming Oil and Gas Conservation Commission’s decision to approve one drilling and spacing unit but to deny the second factually similar unit, with the same evidence, in

a combined contested proceeding where applicant met the statutory and regulatory requirements was arbitrary and capricious.

Reasoning: The lack of data and the prevention of waste was not a reason for denying the second application. The Commission only denied the application because it wanted additional data. But the evidence presented at the hearing applied to both applications. The Commission explicitly found that that the second application would prevent waste.

§ 1.03 ADVERSE POSSESSION

[1] Kansas

[a] *Oxy USA Inc. v. Red Wing Oil, LLC*, 442 P.3d 504 (Kan. 2019).⁴

This case arises from a dispute over a one-half ownership interest in the minerals under a quarter section of land in Haskell County. The Supreme Court of Kansas held that the purported holders could not establish adverse possession based on receipt of royalties for 15 years.

Facts and Procedural History Oxy USA Inc. (“Oxy”) developed a productive oil and gas well on a unitized production unit of land.” Though the well is not on the land, “the owner of the minerals under the Property is entitled to receive royalties from the production by virtue of the unitization agreement.” When Oxy was unable to determine “who owned a disputed one-half mineral interest in and under the Property,” the company initiated an action to quiet title.

The landowners entered into an oil and gas lease, and following their death, Frank Luther took control of the property and lease. Luther sold the property, “reserving an ‘undivided one-half interest in the oil, gas or other minerals in and under and that may be produced from the ...property...for a period of twenty (20) years or as long thereafter as oil, gas or other minerals is produced therefrom.’”

When the mineral interest expired, “the one-half mineral interest reverted to the fee holder at that time,” Alice King’s father, who owned the property at the time. Between the time the term interest expired in 1972 and the time Oxy completed the well in 2009, the term mineral interest holders were receiving royalties from their alleged one-half mineral interest. However, because interest had already expired and the right to receive royalties reverted to King’s father, “the term mineral interest holders should not have been receiving the royalties.” Not until Oxy filed this action did King attempt to enforce her reversionary rights.

The Kansas Supreme Court distilled the case down to one question: “Can King enforce her reversionary interest in the minerals against the term mineral interest holders or is she now prevented from doing so by a statute of limitations or adverse possession?”

Analysis The Supreme Court exercised unlimited review to interpret Sections 60- 503 and 60-507 of the Kansas Code. The court determined that “the term mineral interest holders did not claim that the cause of action accrued more than 15 years prior,” and therefore, there was no concert whether the action was time-barred. Rather, the focus of the case is whether the term mineral interest holders satisfy a claim of adverse possession under Section 60-503.

While a mineral interest is susceptible to adverse possession, the “mere misappropriation of royalties” is insufficient on its own to establish such a claim. Relying on *Stratmann v. Stratmann*, the court determined that royalty payment “represents a portion of the value of minerals after production and therefore; being in open, exclusive, and continuous possession of a royalty can never suffice to establish an adverse claim over minerals *in place*.”

⁴ Case summary by Sarah Trainer, *Kansas*, 5 OIL & GAS, NAT. RESOURCES & ENERGY J. 133, 134 (2019).

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