RECENT DEVELOPMENTS IN TEXAS, UNITED STATES, AND INTERNATIONAL ENERGY LAW

I. INTRODUCTION

This section of Recent Developments in Texas, the United States, and International Energy Law consists of selected discussions of recent case law and legislation that affect the energy industry. The first section focuses on Texas and includes short summaries of recent appellate court decisions regarding Texas law. The second section focuses on the United States, including summaries of several recent federal court decisions.

II. RECENT DEVELOPMENTS IN TEXAS ENERGY LAW

A. Texas Oil, Gas, and Energy Case Summaries

1. Big Rock Investors Ass'n v. Big Rock Petroleum, Inc., 409 S.W.3d 845 (Tex. App.—Fort Worth 2014, pet. denied).

Issue: Does an oil and gas investors association have standing to pursue claims for its members when the relief sought is damages?

From November 1994 to June 2005, approximately 226 investors invested $26.8 million in 117 different projects offered by Big Rock Petroleum, Inc. (Big Rock). Big Rock Investors Association (BRIA), a nonprofit association formed for the purpose of prosecuting its members' claims against Big Rock, filed suit on the investors behalf, alleging that Big Rock's investment opportunities were an oil and gas Ponzi scheme that had caused them significant financial damages. BRIA asserted the following causes of action in its complaint: violations of the Texas Securities Act, breach of fiduciary duty, constructive trust, and attorney's fees. Additionally, BRIA requested relief in the form of actual, special, and exemplary damages; rescission; constructive trust; attorney's fees; court costs; and pre- and post-judgment interest.[1]

In response to BRIA's allegations, Big Rock asserted that BRIA could not pursue the claims on behalf of its members because both the claims and relief sought "required the participation of each individual member of BRIA."[2] Therefore, argued Big Rock, BRIA fails the third prong of the associational standing test set out by the U.S. Supreme Court and adopted by the Texas Supreme Court.[3] The trial court granted Big Rock's plea and dismissed BRIA's claims. BRIA appealed, contending that it possesses both associational standing and standing as an agent.

Prior to delving into the merits of the appeal, Justice Walker set out the standard of review—the standing question is a matter of law to be reviewed de novo—and the plaintiff's pleadings must be construed in favor of the plaintiff.

Justice Walker began her analysis of the standing question with a review of the source and operation of the associational standing test. She noted that, under the "case or controversy" requirement in Article III of the U.S. Constitution, an association such as BRIA must have standing to raise each claim it asserts.[4] Justice Walker then laid out the elements of

1. Big Rock Investors Ass'n v. Big Rock Petroleum, Inc., 409 S.W.3d 845, 847 (Tex. App.—Fort Worth 2014, pet. denied).
2. *Id*.
3. *Id*.
4. *Id*. at 848.

the test: "[a]n association has standing to bring suit on behalf of its members when (1) its members would otherwise have standing to sue in their own right, (2) the interests it seeks to protect are germane to the organization's purpose, and (3) neither the claim asserted nor the relief requested requires the participation in the lawsuit of each of the individual members."[5] Big Rock conceded the first two prongs of this associational standing test—that the individual BRIA members would have standing to sue Big Rock and, since BRIA was created for the sole purpose of suing Big Rock, the interests it seeks to protect are germane to its purpose.[6] Thus Justice Walker turned to the third and final prong of the test, asking whether the claim or relief requested requires participation of each individual member.

Analysis of this third prong, Justice Walker observed, turns on "matters of administrative convenience and efficiency, not on elements of a case or controversy within the meaning of the Constitution."[7] She then portended that associational standing claims often fail on the third prong because each individual member must usually participate to establish his or her own damages. Justice Walker cited *Warth v. Seldin*, in which the U.S. Supreme Court held that a construction firm association failed the third prong because, regardless of injury, "both the fact and extent of injury would require individualized proof."[8] As such, "when claims for damages have not been assigned to an association, when the relief sought by an association is monetary damages for alleged injuries to individual members, and when the damages claimed are not common to the entire membership, nor shared by all to an equal degree, then each individual member must be a party to the suit."[9] But, Justice Walker excepted, when the relief sought by an association is equitable in nature—as with a declaration or injunction—no such individualized treatment is necessary. Justice Walker also observed, however, that merely pleading for some equitable relief does not automatically satisfy the test's third prong; conversely, consideration of some individualized evidence does not automatically preclude associational standing.[10] The key consideration, she emphasized, is whether the claims can be resolved without a "fact-intensive-individual inquiry" such that "any individualized evidence required to prosecute the claim would be duplicative and redundant." If so, the third prong of the test is satisfied.[11]

5. *Id*. (citing Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333, 343 (1977); Tex. Ass'n of Bus. v. Tex. Air Control Bd., 852 S.W.2d 440, 447 (Tex. 1993)).
6. *Id*. (quoting Warth v. Seldin, 422 U.S. 490, 515–16 (1975)).
7. *Id*. at 849.
8. *Id*.
9. *Id*. at 850 (citing *Warth*, 422 U.S. at 516).
10. *Id*. at 850–51.
11. *Id*. at 851.

In this vein, Justice Walker highlighted BRIA's contention that its expert's damage testimony, combined with the testimony of a court-appointed receiver, would be sufficient to establish the losses of individual members while requiring minimal participation from them. However, the Justice found that this approach would not reduce the fact-intensiveness of the inquiry, despite the testimony coming from one witness as opposed to many. Therefore, she held that BRIA had failed the third prong of the associational standing test, and affirmed the ruling of the trial court.[12] Justice Walker proceeded to BRIA's secondary contention—that it possessed standing as an agent of its members, and therefore was not required to satisfy the associational standing test. She quickly disposed of the issue, finding that "BRIA cite[d] no authority for the proposition that by virtue of obtaining a power of attorney from its members, it exempted itself from establishing the third prong of the associational standing test."[13] As a result, BRIA failed the associational standing test, and the court affirmed dismissal.

2. Exelon Wind 1, L.L.C. v. Nelson, 766 F.3d 380 (5th Cir. 2014).

Issue: Can the Texas Public Utilities Commission interpret the Public Utilities Regulatory Policies Act to require power generators to provide "firm power" to qualify for special pricing options—thus excluding wind power that is not dependable?

In 2005 and 2006, Exelon, a collection of wind generation facilities, negotiated power purchase contracts with utility Southwestern Public Service Co. (Southwestern), a subsidiary of Xcel Energy Services, Inc.

The Public Utilities Regulatory Policies Act of 1978 (PURPA),[14] and regulations implemented by the Federal Energy Regulatory Commission (FERC),[15] is a federal scheme governing the purchase of energy between public utilities and certain energy production facilities, known as qualifying facilities. Cogeneration and small power production facilities, including renewable energy providers such as wind and solar generators, are qualifying facilities.[16] In the present case, and under PURPA, Exelon comprises qualifying wind generation facilities; Southwestern is the public utility.

PURPA sought to increase electricity production from non-traditional sources by creating "independent power producers," called non-utility generators (NUGs). PURPA required existing electric utilities to

12. *Id*. at 852.
13. *Id*. at 853.
14. 16 U.S.C. § 2601 (2013).
15. 18 C.F.R. § 292.304(d) (2014).
16. *See* 16 U.S.C. §§ 796(17), 824a-3(a) (2013); *Id.* §§ 292.101(b)(1), 292.203.

purchase the full output of electric energy from one of these private electric generators as part of the utilities' "avoided cost"—the cost the utility saved to obtain electricity by purchasing from an NUG project rather than producing it itself or purchasing it elsewhere. PURPA also mandated the use of long-term power purchase agreements (PPAs) between NUGs and utilities. Parties negotiated pricing under PPAs based on reasonably assured long-term predictable energy rates.

Under PURPA, qualifying facilities have two ways to sell power to utilities.[17] First, a qualifying facility may provide power to the utility on an "as-available" basis and price the power at the "time of delivery."[18] Second, a qualifying facility can sell its power pursuant to a "legally enforceable obligation," where it can either calculate the price at the moment of delivery or choose to fix the price "at the time the obligation is incurred."[19] Therefore, under the legally enforceable obligation provision, section 292.304(d)(2), qualifying facilities can select between current (as-available) and past (time of obligation) market prices for power.

Against this backdrop, the Texas Public Utilities Commission (PUC)[20] authored rules[21] interpreting FERC's regulations. PURPA, in fact, orders states to adopt rules in compliance with FERC's regulations and implement PURPA[22]—a unique mandate against the backdrop of the Tenth Amendment that nevertheless is permissible.[23] The PUC rule in question prohibited power generators from receiving special pricing above as-available rates—under the legally enforceable obligation option—unless they produce "firm power."[24]

"Firm power" is "power or power-producing capacity that is available pursuant to a legally enforceable obligation for scheduled availability over a specified term."[25] More helpful, perhaps, is how the PUC defines non-firm power from a qualifying facility: "[p]ower provided under an arrangement that does not guarantee scheduled availability, but instead provides for delivery as available."[26] As the court summarized, only qualifying facilities "able to forecast when they will deliver energy to the utility—and capable of delivering the specified amount of energy at the

17. *See* 18 C.F.R. § 292.304(d) (2014).
18. *Id*. § 292.304(d)(1).
19. *Id*. § 292.304(d)(2).
20. As the court in *Exelon* explained, the Texas Legislature created the PUC in 1975 by enacting the Public Utility Regulatory Act (PURA). The PUC regulates utilities and implements legislation, among other duties.
21. 16 TEX. ADMIN. CODE § 25.242(c) (2014).
22. Power Res. Grp. v. Pub. Util. Comm'n, 422 F.3d 231, 233 (5th Cir. 2005) (citing 16 U.S.C. § 824a-3(f) (2013)).
23. *See* FERC v. Miss., 456 U.S. 742, 751, 760 (1982).
24. 16 TEX. ADMIN. CODE § 25.242(c) (2014).
25. *Id*. § 25.242(c)(5).
26. *Id*. § 25.242(c)(9).

scheduled time—are eligible to take advantage of the pricing options in subsection (d)(2)."[27] Facilities without firm power can only charge as-available market price for the power. Thus, the PUC excluded intermittent power generators from obtaining (and enforcing) above-market rates under PURPA.

In *Exelon*, PURPA required Southwestern to buy all of Exelon's wind-generated energy.[28] As a result, Exelon demanded that Southwestern purchase its energy output for twenty years at predetermined rates. According to Southwestern (and its biggest customer, Occidental Permian Ltd.), Exelon's requested rates greatly exceeded the as-available prices other generators offered.

Southwestern complained to the PUC, alleging that Exelon could not charge more than as-available rates since it could not guarantee that certain quantities of energy would be available at any given time—*i.e.,* Exelon did not provide firm power under the PUC's rule. As a result, the PUC issued an order prohibiting Exelon from charging above as-available rates for its wind-purchase contract with Southwestern.

Exelon initiated legal proceedings against the PUC. Exelon argued that the PUC wrongly interpreted and implemented PURPA's statutory and regulatory scheme and impermissibly limited Exelon's ability to contractually set its wind-energy rates.

The trial court held in favor of Exelon and determined that the PUC unlawfully barred Exelon from charging more than the as-available market price for its wind energy. The PUC appealed to the Fifth Circuit Court of Appeals.

In a 2-1 ruling, the appellate court reversed. The Fifth Circuit upheld the PUC rule requiring power generators to provide firm power in order to qualify for special pricing options—those above as-available rates.

The majority held that the PUC receives deference when defining state parameters for legally enforceable obligations under PURPA. According to the court, an important component in assessing the firm-power provision was the definition of firm power. The court held that the PUC reasonably defined firm power; it adequately distinguished between those facilities that can and cannot provide consistent, reliable power. As a result, utilities and qualifying facilities could adequately determine which facilities did not qualify under the firm-power provision—as Exelon did in this case.

In upholding the firm-power rule, the court noted that PURPA regulations requiring mandatory long-term contracts between generators and utilities—for example, requiring Southwestern to buy all of Exelon's

27. Exelon Wind 1, LLC v. Nelson, 766 F.3d 380, 385 (5th Cir. 2014).
28. *See* 16 U.S.C. § 824a-3(a)(2) (2013).

wind-generated energy—can be problematic for markets. Historically, twenty to thirty year forecasts on energy rates, as required in PPAs, were not always accurate—often due to incorrect expectations for a substantial rise in prices. Inaccurate forecasts often injured customers by imposing above-market prices.

As a result, the court accepted the PUC's attempt to limit contracts establishing above-market pricing. Furthermore, the court found the PUC's methods of limiting such contracts reasonable, limiting their availability to generators capable of providing firm power.

In addition to upholding the PUC's firm-power provision, the court also held that the PUC properly applied it to Exelon. Prior to litigation, the PUC determined that Exelon could not provide firm power, thereby prohibiting it from obtaining anything other than as-available rates in its Southwestern contract. The court noted that, importantly, the PUC did not categorically make this determination; rather, the PUC based its decision on fact-specific inquiries. Thus, the PUC rules do not categorically bar wind energy from being a source of firm power. Instead, the PUC had reasoned that Exelon's facilities, operating in the Texas Panhandle, simply could not store wind power in an effective method that would provide consistent service. On the contrary, the facilities' energy production depends on "a notoriously fickle energy source" in that part of the state—wind.[29] As a result, Exelon, an intermittent, rather than firm, power source, could not create "legally enforceable obligations" under PURPA that secured above-market rates.

In the end, the PUC did not impermissibly interpret FERC's regulations or implement PURPA. The PUC rule reasonably sought to limit the number of energy contracts based on above-market pricing by regulating who could qualify for those contracts—qualifying facilities capable of providing firm power. The PUC also adequately defined firm power and applied its rules. The PUC's rule, 16 Tex. Admin. Code § 25.242(c), that a qualifying facility must provide firm power to enter a legally enforceable obligation—and secure above-market prices—with a purchaser under 18 C.F.R. § 292.304(d) was reasonable and within the PUC's discretion.

3. French v. Occidental Permian Ltd., 440 S.W.3d 1 (Tex. 2014).

Issue: Is gas recovered by CO_2 injection under a standard "market value at the well" royalty clause valued in its native state or at the wellhead commingled with CO_2? Is removing CO_2 from gas a production, as opposed to a postproduction, cost?

29. *Exelon Wind 1*, 766 F.3d at 385.

Plaintiffs-petitioners (collectively, French) own royalty interests under oil and gas leases. Defendant-respondent, Occidental Permian Ltd. (Oxy), owns the working interest—the right to drill and produce oil and gas on the land. The lease in question calls for royalties on gas, including casinghead gas,[30] equal to "the market value at the well of one-eighth (1/8th) of the gas so sold or used."[31]

Under their contract, French gave Oxy discretion to determine whether and how to conduct operations. French consented to Oxy's use of enhanced recovery operations, which are used to extract oil and gas resources that may otherwise go to waste.[32]

Oxy initially used secondary recovery methods to enhance production, such as water floods. The effectiveness of these operations dwindled. Oxy then began tertiary recovery operations by injecting carbon dioxide (CO_2) into the reservoir. The injections increased oil production. As a result, the injections produced a casinghead gas stream with CO_2. To recover natural gas liquids (NGLs) and to obtain CO_2 for reinjection, Oxy elected to process the casinghead gas rather than reinject it into the reservoir. To accomplish this, Oxy built a multimillion-dollar processing plant. Oxy considered the processing of casinghead gas a postproduction, rather than a production, expense. Oxy thus charged the royalty owners so that the royalty owners proportionately shared in the cost.

The royalty owners, however, disputed the expenses. French filed suit against Oxy, arguing that the costs to remove CO_2 from casinghead gas were production expenses. According to French, the royalty should be calculated based on the value of the hypothetical "native" casinghead gas stream that existed before the CO_2 injection, rather than the actual condition of the gas produced at the wellhead.

Oxy argued that the standard "market value at the well" royalty clause is clear under Texas law: the calculation of royalty interests is based on the market value of the gas in its actual condition "at the well," before its value is enhanced by processing or transportation to market. Since the processing of casinghead gas was a postproduction expense, Oxy argued, French should share in the costs. French argued, conversely, that Oxy's decision to process casinghead gas was a production expense; therefore, the royalties due on the casinghead gas should be calculated as if injected

30. "Casinghead gas" is "[g]as produced with oil in oil wells, the gas being taken from the well through the casinghead at the top of the well, as distinguished from gas produced from a gas well." R.R. Comm'n of Tex. v. Lone Star Gas Co., 844 S.W.2d 679, 684 n.5 (Tex. 1992) (citations omitted) (internal quotation marks omitted).

31. French v. Occidental Permian Ltd., 440 S.W.3d 1, 1 (Tex. 2014).

32. Enhanced recovery operations typically require a substantial capital investment by oil and gas operators; yet, such investments can yield substantial economic benefit to royalty owners and operators. To assess economic shrewdness, operators often rely on the terms of their negotiated oil and gas lease contracts.

carbon dioxide were not present and French should not share in processing expenses.

The trial court agreed with French and awarded French $10 million in damages, which added to the $100 million in royalties French had already received from Oxy's enhanced recovery operations. The court held that the separation and reinjection of CO_2 from casinghead gas were production operations to produce more oil and gas, rather than postproduction operations for marketing gas. As such, Oxy was solely responsible for the production expenses.

The Court of Appeals for the Eleventh District of Texas, however, reversed. The court held that the CO_2 removal costs were postproduction expenses to make the gas marketable, which Oxy and French must share.

The Supreme Court of Texas heard oral argument on February 5, 2014. On June 27, 2014 the Supreme Court of Texas issued a unanimous opinion; it affirmed the Eleventh District's reversal of the trial court in favor of Oxy. The court held that the removal of CO_2 utilized in tertiary operations is a postproduction expense to be deducted from royalties due to a leaseholder.

The court adhered to what it called fundamental principles of Texas oil and gas law in calculating royalties. A royalty is free of the expenses of production, but subject to postproduction costs, which include costs that make the product marketable.[33] Because removal of CO_2 from casinghead gas extracts marketable NGLs, the process is a postproduction expense. As such, the royalty due is determined by the gas's condition "at the well," rather than as if CO_2 were not present.

In determining that the process was a postproduction expense, the court reasoned that Oxy had no obligation to process the casinghead gas, but that its decision to do so created an economic benefit to royalty owners. First, separation was unnecessary for continued oil production. Second, Oxy could have simply reinjected the casinghead gas directly into the field—limiting royalties. Instead, Oxy used its permitted discretion to separate the casinghead gas to obtain NGLs, which could be marketed, and concentrated CO_2, which could be used for reinjection. The royalty owners shared in the value of the extracted NGLs and, as a result, "must share in the cost of CO_2 removal."[34]

The court added that the market price of processed gas can only reflect the value of the unprocessed gas at the well if reasonable postproduction processing costs are deducted. Furthermore, as a matter of state policy

33. Heritage Res., Inc. v. NationsBank, 939 S.W.2d 118, 121–23 (Tex. 1996) (citations omitted).

34. *French*, 440 S.W.3d at 7.

the court also recognized that processing casinghead gas encourages the full recovery of hydrocarbons and precludes waste. Therefore, processing the casinghead gas was not a production expense and removal costs must be deducted from the market value of the gas at the well—pursuant to the contractual language.

In sum, the court rejected the royalty owners' argument that the costs of removing CO_2 are a production expense, which would allow royalties to be calculated on a hypothetical native gas at the well. The court unanimously adhered to long-standing Texas law concerning the calculation of royalties, even with respect to enhanced recovery operations. The court seemingly held that expenses to make gas marketable, or more marketable, are postproduction expenses in which royalty owners must share.

The court did note, however, that its ruling is limited to leases using historically standard oil and gas provisions, such as the ones used in the contracts between Oxy and French and many older leases. Parties are, of course, "free to agree on what royalty is due, the basis on which it is to be calculated, and how expenses are to be allocated."[35]

The ruling is seen as an important decision for the energy industry, especially as enhanced recovery methods—like CO_2 injections—become more common. The court's decision furthers its previous ruling in *Heritage Resources, Inc. v. NationsBank* by extending that case's principle—that costs to make gas marketable can be proportionally charged to royalty owners—to enhanced recovery operations.

The court denied rehearing on October 3, 2014.

4. Gilbert Wheeler, Inc. v. Enbridge Pipelines (East Texas), L.P., No. 13-0234, 2014 WL 4252273 (Tex. Aug. 29, 2014).

Issue: Does the general temporary-versus-permanent rule in assessing real property damages apply when the wrongful conduct stems from breach of contract rather than tort? If so, does the intrinsic-value-of-trees exception apply?

The Wheeler family, by way of closely-held corporation Gilbert Wheeler, Inc. (Wheeler), owns a 153-acre tract in Shelby County, used as a family retreat. Wheeler contracted with Enbridge Pipelines to grant an easement to construct a pipeline across the tract. In order to preserve the trees on the property, as a condition of granting the easement, Wheeler required that the pipeline be installed by boring underground. Enbridge assented, and it was expressly set out in the contract between Wheeler and Enbridge. Enbridge hired a construction company to construct the

35. *Id.* at 5.

pipeline, but failed to mention the requirement that an underground boring method be used, resulting in the destruction of a large swath of trees.[36]

Wheeler brought suit against Enbridge for breach of contract and trespass for their violation of the express provision and for exceeding the scope of the easement granted. At trial, Enbridge argued that the trespass submission was improper insofar as Wheeler's claims sounded only in contract. Additionally, Enbridge requested a question as to whether the damage done to Wheeler's land was temporary or permanent, to determine whether the jury should award the cost of restoring the trees or damages equal to diminution in the fair market value of the property. The trial court submitted the charge to the jury absent the question, and the jury found Enbridge liable on both the breach of contract and the trespass claims—$300,000 on the contract claim for the reasonable cost to restore the property, and $288,000 on the trespass claim for the intrinsic value of the destroyed trees. Wheeler chose to recover the damages for breach of contract.[37]

Enbridge appealed, and the court of appeals reversed and rendered a take-nothing judgment in Enbridge's favor. The court held that, because Wheeler failed to submit a question regarding whether the damage to the property was temporary or permanent, it had waived its right to a damage award. Wheeler petitioned the Texas Supreme Court for review.

Justice Lehrmann wrote the opinion for the majority. He began by outlining the contours of the temporary-versus-permanent distinction in real property damages due to the confusion in the lower courts surrounding the issue. The Justice observed that the rules, built on the distinction, are premised on the idea that when there is a temporary injury to land the "ordinary measure of damages is the cost to restore the property."[38] When there is a permanent injury to land where restoration is not possible, however, the damages awarded are equal to the "loss in fair market value of the property as a whole."[39] Wheeler argued that the distinction is irrelevant when damages stem from a breach of contract rather than a tort; cost of restoration is the proper method because it would give it "the benefit of its bargain under the right-of-way agreement."[40] First noting that this precise issue was one of first impression in the Court, Justice Lehrmann held that application of the distinction in cases involving real property damage is not limited to tort; it

36. Gilbert Wheeler, Inc. v. Enbridge Pipelines (East Texas), L.P., No. 13-0234, 2014 WL 4252273, at *1 (Tex. Aug. 29, 2014).
37. *Id.* at *1–2.
38. *Id.* at *3.
39. *Id*. at *3.
40. *Id*.

includes causes of action for breach of contract.[41] He reasoned that the injury underlying either cause of action is identical, and exceptions to the general rule operate to ensure that landowners are adequately compensated.

The Justice went on to clarify the definitions of temporary and permanent injuries to real property, setting out the following formulations:

> An injury to real property is considered permanent if (a) it cannot be repaired, fixed, or restored, *or* (b) even though the injury can be repaired, fixed, or restored, it is substantially certain that the injury will repeatedly, continually, and regularly recur, such that future injury can be reasonably evaluated. Conversely, an injury to real property is considered temporary if (a) it can be repaired, fixed, or restored, *and* (b) any anticipated recurrence would be only occasional, irregular, intermittent, and not reasonably predictable, such that future injury could not be estimated with reasonable certainty.[42]

With these definitions in hand, Justice Lehrmann held that the issue of whether an injury to real property is temporary or permanent is a matter of law for a court to decide. Any dispute regarding facts underlying such a decision is for a jury to resolve.

Finally, Justice Lehrmann proceeded to delineate the exceptions to the general damages rule: the economic feasibility exception and the intrinsic value of trees exception.[43] The former, he wrote, "applies when the cost of required repairs or restoration exceeds the diminution in the property's market value to such a disproportionately high degree that the repairs are no longer economically feasible."[44] Such a situation renders an ordinarily temporary injury permanent. The latter, however, was "created to compensate landowners for the loss of the aesthetic and utilitarian value that trees confer on real property" when the proper measure of damages is loss in fair market value and no diminution in value can be shown to the have occurred.[45] Importantly, Justice Lehrmann clarified that while the Court in *Porras v. Craig* held that a showing of "no" diminution in market value is required for the exception,[46] the standard should be expanded to include nominal losses in value so that adequate compensation of the landowner can be achieved.

41. *Id*. at *4.
42. *Id*.
43. *Id*. at *5–7.
44. *Id*. at *6.
45. *Id*.
46. Porras v. Craig, 675 S.W.2d 503, 506 (Tex. 1984).

To the extent that precedent holds otherwise, the Justice expressly overruled it.[47]

Applying the principles outlined above, Justice Lehrmann turned to the facts of the case at bar, answering three questions: (1) whether Wheeler was required to submit a question to the jury as to whether the injury was temporary or permanent; (2) the propriety of the jury's award of cost-to-restore damages; and (3) whether the jury question on the intrinsic value of trees was properly submitted. The Justice quickly disposed of the first two questions, explaining that the court of appeals' decision was erroneous because it relied on the notion that the temporary-versus-permanent distinction was a question of fact. Rather, held the Justice, "whether the injury was temporary or permanent is a question of law and . . . therefore [Wheeler] was not required to submit a jury question on that issue."[48] He went on to hold that, due to the parties' agreement on the issue and application of the economic feasibility exception, the injury to Wheeler's land is permanent. Therefore, the trial court improperly instructed the jury to calculate damages based on the cost to restore the property, given that such a measure is reserved for temporary injuries to land.

As to the third and final question, Justice Lehrmann held that the diminution in the fair market value of Wheeler's property was essentially nominal—the stipulated value of Wheeler's property at the date of the injury was $383,000, and Enbridge's expert testified that the reduction in value was $3,000.[49] As such, the intrinsic value exception was properly submitted to the jury. But regardless, Enbridge argued, the intrinsic value instruction was submitted in conjunction with the trespass action, which itself was improperly submitted. Justice Lehrmann found that resolution of Enbridge's contention was unnecessary even if the submission was in error, as such an error would be harmless because "breach of contract was a valid theory of liability on which Wheeler prevailed . . . ."[50] Ultimately, Justice Lehrmann reversed the court of appeals and remanded the case so that several issues not reached due to that court's disposition of the case could be resolved.

5. Key Operating & Equip., Inc. v. Hegar, 435 S.W.3d 794 (Tex. 2014).

Issue: When only one lease in a pooled unit is producing, does a mineral lessee have the right to use the surface of the non-producing lease in the same pooled unit to access the producing lease?

47. *Wheeler*, 2014 WL 4252273 at *9.
48. *Id*. at *8.
49. *Id*. at *9.
50. *Id*. at *10.

Beginning in 1987, the defendant, Key Operating & Equipment, Inc. (Key), operated the Richardson No.1 well on the sixty-acre Richardson tract near Washington County, Texas. Seven years later, Key obtained a lease on the adjoining 191-acre Curbo/Rosenbaum tract to rework an existing well known as the Rosenbaum No. 2 well. Key also built a road across the 191-acre tract to access both wells. The Rosenbaum No. 2 well ceased production in 2000 resulting in the expiration of Key's lease on the Curbo/Rosenbaum tract. In the same year, however, Key's owners acquired an undivided 12.5% mineral interest in the Curbo/Rosenbaum tract and leased their interest back to Key. Because Key's lease provided for the right to pool, Key formed a forty-acre pooled unit comprised of ten acres from the Curbo/Rosenbaum tract and thirty acres from the Richardson tract.

The Plaintiff, the Hegars, purchased eighty-five acres from the Curbo/Rosenbaum tract in 2002, including the road used to access the Richardson No. 1 well on the Richardson tract. At the time of purchase, the Hegars knew that Key used the road in its mineral operations and yet built a house to raise a family, relying on the same road for access. For several years, the Hegars did not raise any concerns with Key. Around 2004, however, Key increased its use of the road to drill another well, Richardson No. 4, on the Richardson tract. As a result of this increase, the Hegars filed suit to enjoin Key's use of the road alleging that such use constituted a trespass on their land. The Hegars also sought a declaratory judgment that Key lacked the legal right to use their surface to produce minerals from the Richardson tract. The trial court conducted a bench trial and enjoined Key from using the Hegars' surface, including the road previously used to access the Richardson No. 1 well. The court's findings of fact and conclusions of law stated:

> (1) Key's use of the surface of the Hegar Tract to access the Richardson Tract constituted a trespass, (2) the use of the surface of the Hegar tract was not reasonably necessary to extract minerals from beneath the Hegar Tract, and (3) no minerals were being extracted from beneath the Hegar tract by wells located on the Richardson Tract.[51]

On appeal, the court of appeals reversed the trial court, but later affirmed after granting the Hegars' motion for rehearing and withdrawing its initial opinion.[52] The court determined that the evidence supported the trial court's findings. Accordingly, it held that Key had the right to

51. Key Operating & Equip, Inc. v. Hegar, 435 S.W.3d 794, 797 (Tex. 2014).
52. Key Operating & Equip, Inc. v. Hegar, 403 S.W.3d 318, 322 n.1 (Tex. App.—Houston [1st Dist.] 2013), *rev'd*, 435 S.W.3d 794 (Tex. 2014).

use the Hegars' surface only to produce beneath the same tract. Moreover, the court held that the Hegars' chain of title excluded Key's lease and pooling agreements and that the accommodation doctrine protects the Hegars' surface rights.

On appeal to the Texas Supreme Court, Key argued that it had the right to use the Hegars' surface to produce minerals from any part of the pooled unit. In Key's view, the court of appeals erred in its reliance on *Robinson v. Robbins Petroleum Corp.*[53] and the accommodation doctrine. In response, the Hegars argued that Key had waived its arguments by failing to file a brief in opposition to its motion for rehearing before the court of appeals. Moreover, the Hegars argued that "a mineral owner has an implied easement to use the surface of a property *only* if production is from that property."[54]

The Texas Supreme Court reversed without dissent and rendered judgment for Key. First, the court dismissed the Hegars' waiver argument by noting that Key was not required to file a brief in opposition to the Hegars' motion. Then, the court invoked *Merriman v. XTO Energy, Inc.*[55] to reason that a mineral lessee has the right to use the surface of the land—and any incidental rights reasonably necessary—to produce minerals. The court further reasoned that a mineral lessee "may pool some or all of the tracts by combining them into a single unit, *provided pooling is authorized by the leases*."[56] Noting that both the Richardson and Curbo/Rosenbaum leases authorized pooling,[57] the court concluded that Key had to right to use the Hegars' surface because "production and operations anywhere on the pooled unit are treated as if they have taken place on each tract within the unit."[58]

The Texas Supreme Court then turned to the issue of implied surface rights. The court of appeals had relied on *Robinson* to limit Key's implied surface right to the land beneath which it was producing—the Richardson tract.[59] In *Robinson*, the mineral lessee was prohibited from using one surface estate exclusively for the operations on another tract.[60] The lessee in *Robinson* attempted to use an existing oil well to product salt water for use on other tracts.[61] Robinson, the owner of the surface

53. 501 S.W.2d 865 (Tex. 1973).
54. *Key Operating & Equip, Inc.*, 435 S.W.3d at 797.
55. 407 S.W.3d 244, 248–49 (Tex. 2013).
56. *Key Operating & Equip, Inc.*, 435 S.W.3d at 798 (emphasis added).
57. The Curbo/Rosenbaum lease, for example, provided the lessee "the right and power to pool or combine the acreage covered . . . with any other land, leases, or leases in the immediate vicinity thereof." *Id.*
58. *Id.* (quoting Pipe Line Co. v. Tichacek, 997 S.W.2d 166, 170 (Tex. 1999)) (internal quotation marks omitted).
59. *Key Operating & Equip, Inc.*, 403 S.W.3d at 330–33.
60. Robinson v. Robbins Petroleum Corp., 501 S.W.2d 865, 866–68 (Tex. 1973).
61. *Id.* at 866.

estate, brought suit against the mineral lessee to recover for the misappropriated salt water because the lease did not authorize pooling. The *Robinson* court reasoned that the salt water was "for the benefit of owners outside of and beyond [the] premises" of Robinson's land and thus held that the owner of the surface estate, absent consent, was entitled to recover damages.[62]

The Texas Supreme Court, however, distinguished *Robinson* by the terms of the lease, contrasting the *Robinson* lease that did not authorize pooling with Key's lease that permitted pooling with other tracts. The court further distinguished when the implied surface right was established. The owner of the surface estate in *Robinson* had acquired title before the formation of the tracts used by the lessee. In contrast, however, the Hegars had acquired title to their eighty-five acres in 2002 subject to the mineral lease assigned to Key in 2000. Thus, the court concluded that *Robinson* did not control and "that once pooling occurred, the pooled parts of the Richardson and Hegar Tracts no longer maintained separate identities insofar as where production from the pooled interests was located."[63]

Finally, the Texas Supreme Court sidestepped review of the application of the accommodation doctrine because the parties effectively waived the issue when neither one raised it in the trial court or before the court of appeals. Thus, in reversing the court of appeals' judgment, the Texas Supreme Court held that Key had the right to use the road crossing the Hegar Tract to produce minerals from the pooled unit. While the Texas Supreme Court in *Hegar* did not address the issue, a footnote in the opinion mentioned that an owner of the surface estate may bring a claim of bad-faith pooling to challenge a lessee's surface use.[64] When creating a pooled unit, mineral lessees, who are seeking to use the surface on a non-producing tract for production on another tract in the unit, should ensure that pooling is properly authorized by the leases and executed in good faith.

6. Southwest Royalties, Inc. v. Combs, No. 03-12-00511-CV, 2014 WL 4058950 (Tex. App.—Austin Aug. 13, 2014, no pet.) (mem. op.).

Issue: Is oil and natural gas extraction equipment exempt from Texas sales and use taxes?

Southwest Royalties, Inc. (Southwest), a wholly owned subsidiary of Clayton Williams Energy Inc., filed a tax-refund claim. Southwest filed the claim with the Comptroller of Public Accounts of the State of Texas

62. *Id.* at 868.
63. *Key Operating & Equip., Inc.*, 435 S.W.3d at 799.
64. *Id.* at 799 n.3.

(Comptroller) for taxes that it paid from January 1, 1997, through April 30, 2001. Southwest's alleged refund was for (1) taxes paid on the purchase of equipment and (2) oil and natural gas extraction and mining services (collectively, extraction services) performed by the purchased equipment. Specifically, Southwest sought exemptions for "casing, tubing, pumps, and related parts"[65] as well as for services pertaining to that equipment. In its refund request for nearly $500,000.00, Southwest claimed that the equipment and services were exempt from taxation pursuant to a manufacturing exemption[66] and for services applied to exempt property.[67]

The Comptroller denied Southwest's refund request after convening a hearing. Southwest then filed suit against the Comptroller and Attorney General of the State of Texas in 2009. Southwest reiterated its tax-refund claim based on the above-mentioned exemptions. The district court ruled against Southwest and, following an appeal to the Texas Court of Appeals, Third District, the Texas appeals court affirmed. Southwest failed to carry its burden, and the court deferred to the Comptroller's determination.

The Texas Tax Code applies sales and use taxes (collectively, sales taxes).[68] It also enumerates various exemptions. The manufacturing exemption[69] lists items "exempted from" sales taxes "if sold, leased, or rented to, or stored, used, or consumed by a manufacturer."[70] In its tax-refund claim, Southwest relied on three subsections of the manufacturing exemption, which grants exemptions to "tangible personal property" used in "manufacturing, processing, or fabrication" that: (1) directly makes or causes a chemical or physical change to the product; (2) must be used to comply with public health regulations; or (3) is essential to pollution control processes.[71]

On appeal, Southwest argued that subsection 151.318(a)(2) applied because Southwest's extraction process had caused a *direct* physical change to the petroleum products, rather than an indirect cause as the lower court held.

Southwest also contended that its equipment was necessary and essential to a pollution control process, 151.318(a)(10), and to comply with public health regulations, 151.318(a)(5). For support, it cited required compliance with Texas Railroad Commission mandates.

65. Southwest Royalties, Inc. v. Combs, No. 03-12-00511-CV, 2014 WL 4058950, at *3 (Tex. App.—Austin Aug. 13, 2014, no pet.) (mem. op.).
66. TEX. TAX CODE ANN. § 151.318 (West 2013).
67. *Id.* § 151.3111.
68. *Id.* §§ 151.051, .101.
69. *Id.* § 151.318 (titled "Property Used in Manufacturing").
70. *Id.* § 151.318(a).
71. *Id.* §§ 151.318(a)(2), (5), (10).

Despite no specific language in the subsections, Southwest appeared to acknowledge that pollution-control and public-health exemptions require some kind of product change to meet the exemptions. Southwest argued, however, that *indirect* changes to the oil and gas during extraction sufficed for the pollution-control and public-health exemptions—unlike the exemption found in subsection 151.318(a)(2), which requires showing that equipment *directly* caused a product change.

In addition to its three arguments under section 151.318, Southwest claimed that the services performed by its equipment afforded the company tax exemptions under section 151.3111, which exempts services performed by exempted property.[72] In other words, Southwest argued that since the manufacturing exemption applies to its equipment, the services performed using that exempt equipment are also exempt under section 151.318.

Contrarily, the Comptroller argued that the equipment and services used for extracting oil and gas could never qualify for the three above-listed exemptions because the equipment and services are not used in "manufacturing, processing, or fabrication." Thus, issues of chemical or physical change, public health regulations, and pollution control are immaterial; extraction, the Comptroller argued, does not satisfy the manufacturing exemption's threshold requirements.

The court agreed with the Comptroller. The court began its analysis by recognizing that the manufacturing exemption is ambiguous; it is not readily apparent from its text whether "manufacturing, processing, or fabrication" include the extraction of oil and gas. The court concluded, however, that the statute's plain meaning, coupled with legislative clarifications, show that extraction is not exempt. The legislative and dictionary definitions of "manufacturing" did not encompass extraction.[73] Furthermore, the legislature distinguished "manufacturing" from mining and extraction in other contexts.[74]

Moreover, given the statute's ambiguity, the court deferred to the Comptroller's interpretation of the manufacturing exemption. The Comptroller found that extraction is more akin to an act "in preparation

72. *Id.* § 151.3111(a) (exempting from taxation "a service that is performed on tangible personal property that, if sold, leased, or rented, at the time of the performance of the service, would be exempted under this chapter because of the nature of the property, its use, or a combination of its nature and use, is exempted from this chapter").

73. *See id.* § 151.318(d) ("'[M]anufacturing' includes each operation beginning with the first stage in the production of tangible personal property and ending with the completion of tangible personal property having the physical properties (including packaging, if any) that it has when transferred by the manufacturer to another.").

74. *See id.* § 171.1012 (explaining that for franchise taxes "'Production' includes . . . manufacture, . . . mining, [and] extraction").

for production" than manufacturing,[75] and that the terms "processing" or "fabrication" are inapplicable to extraction as well.[76] Most importantly, according to the court, the Comptroller declared that reading the manufacturing exemption as including equipment and services used in the extraction of oil and gas would render superfluous other provisions of the Tax Code dealing with extraction.[77]

In affirming the district court's ruling in favor of taxation, the Texas appeals court noted Southwest's uphill battle. The court recognized that the manufacturing exemption's ambiguity alone could potentially thwart Southwest's case "due to the strict construction that tax exemptions are given, to the fact that all doubts regarding the applicability of an exemption are resolved in favor of taxation, and to the fact that the right to an exemption must be clearly apparent from the language of the statute."[78] Moreover, the court recognized Southwest's additional trouble of "requiring courts to defer to an agency's interpretation of an ambiguous statute unless that interpretation is plainly erroneous or inconsistent with the language of the statute."[79]

In the end, the court recognized that Southwest's interpretation of the manufacturing exemption "might not be an unreasonable one."[80] The court nevertheless held that Southwest did not establish its right to a tax refund under the manufacturing exemption and that the Comptroller's interpretation was not plainly erroneous or inconsistent with the language of the statute.

7. Warren v. Chesapeake Exploration, L.L.C., 759 F.3d 413 (5th Cir. 2014).

Issue: When does an oil and gas lease permit the deduction of postproduction costs from the sale proceeds of natural gas?

The Warrens filed suit against the defendants, Chesapeake Exploration, L.L.C. and Chesapeake Operating, Inc., alleging that the defendants improperly deducted postproduction costs from the sale of natural gas before calculating royalties. In their complaint, the Warrens sought compensatory relief under a breach of contract claim and equitable accounting to disgorge the defendants of all money owed to the Warrens. The complaint also included class action allegations for other

75. *See* 34 TEX. ADMIN. CODE § 3.300(a)(9) (2014) ("The first production stage means the first act of production, and it shall not include those acts in preparation for production.").

76. *See id.* § 3.300(a)(5), (10) (defining fabrication and processing).

77. *See, e.g.,* TEX. TAX CODE ANN. §§ 151.324, .317 (West 2013).

78. Southwest Royalties, Inc. v. Combs, No. 03-12-00511-CV, cf2014 WL 4058950, at *6 (Tex. App.—Austin Aug. 13, 2014, no pet.) (mem. op.).

79. *See* Combs v. Roark Amusement & Vending, L.P., 422 S.W.3d 632, 635 (Tex. 2013).

80. *Southwest Royalties*, WL 4058950, at *6.

royalty owners who had similar oil and gas leases with the defendants. In response, the defendants moved to dismiss both the Warrens' personal claims and the class claims. However, the court permitted the Warrens to join the Javeeds (collectively Plaintiffs) in an amended complaint before considering the defendants' motion.

At issue were three leases covering tracts of land in Texas. The Plaintiffs originally executed oil and gas leases with FSOC Gas Co. Ltd., who then assigned their interests to the defendants to develop and operate wells.[81] Despite the subsequent joinder, the district court ruled on all claims—including those asserted by the Javeeds—"[b]ecause the relevant contractual language . . . [was] functionally equivalent" in the three leases.[82] The court found that the leases contained an "at the well" royalty provision authorizing the defendants to deduct postproduction costs before calculating the royalty based on the amount realized at the mouth of the well. Applying the decisions in *Heritage Resources, Inc. v. NationsBank*[83] and *Judice v. Mewbourne Oil Co.*,[84] the court granted the motion to dismiss all claims with prejudice.

On appeal, the plaintiffs criticized the district court's decision for failing to consider the specific lease language when applying *Heritage* and *Judice*. Specifically, the leases contained a pre-printed form with a royalty clause and a typed addendum regarding postproduction costs. The pre-printed lease provided for a 22.5% royalty on "the amount realized by [the] Lessee, computed at the mouth of the well . . . ."[85] The typed addendum provided for a royalty "free of all costs and expenses related to the exploration, production and marketing of oil and gas production . . . including, but not limited to, costs of compression, dehydration, treatment and transportation."[86] Despite this apparent prohibition of postproduction cost deductions, the addendum further indicated that the lessor should "bear a proportionate part of all those expenses imposed upon [the] Lessee by its gas sale contract to the extent incurred subsequent to those that are obligations of Lessee."[87] Moreover, the addendum included a supremacy clause mandating that in

81. *See* Potts v. Chesapeake Exploration, L.L.C., 760 F.3d 470, 476–77 (2014) (affirming summary judgment for a lessee who deemed the point of sale to be at the wellhead because it sold the gas produced to an affiliate). For a summary of the district court case, see Case Summaries, *Recent Developments in Texas, United States, and International Energy Law*, 9 TEX. J. OIL GAS & ENERGY L. 165, 171–74 (2013).

82. Warren v. Chesapeake Exploration, LLC, No. 3:12-CV-03581-M, 2013 WL 2233950, at *1 n.1 (N.D. Tex. May 20, 2013), *aff'd as modified sub nom.* Warren v. Chesapeake Exploration, L.L.C., 759 F.3d 413 (5th Cir. 2014).

83. 939 S.W.2d 118 (Tex. 1996).

84. 939 S.W.2d 133 (Tex. 1996).

85. Warren v. Chesapeake Exploration, L.L.C., 759 F.3d 413, 416 (5th Cir. 2014).

86. *Id.*

87. *Id.*

the event of inconsistent provisions the addendum's language would control.

The Fifth Circuit disagreed with the plaintiffs' criticism because Texas precedent required, within the context of specific royalty provisions, "careful examination of the various terms and phrases the parties use[d]."[88] While the terms and phrases in *Heritage* did not factor into the final outcome,[89] the provisions in *Judice* contained three different royalties that were ambiguous.[90] Namely, the lease included a "market value at the well" provision, one division order with a royalty provision for "gross proceeds at the well," and another division order defining the royalty based "on the net proceeds realized at the well."[91] The appellate court contrasted the plainly ambiguous terms in *Judice*, with the terms of the Warrens' leases. First, the appellate court defined the term "amount realized" to require using the amount actually received by the lessee in accordance with its gas sales agreement to calculate the royalty. The court then turned to the term "at the well," which applied the royalty to all gas sold, regardless of where the lessee had sold it. Thus, "at the well" included gas sold "at the mouth of the well, off the leased premise, or at some point in between."[92] The court concluded that the Warrens' pre-printed lease provided for a royalty based on the net proceeds realized at the mouth of the well, where net proceeds included postproduction costs.

After addressing the pre-printed lease, the appellate court reviewed the addendum. Despite including a supremacy clause, the court determined that the two provisions in the pre-printed lease and the addendum were not inconsistent with each other. Most importantly, the addendum maintained the mouth of the well as the point for calculating the royalty. Moreover, the plaintiffs conceded that the first sentence of the addendum prohibiting the deduction of compression, dehydration, treatment, and transportation costs was "functionally equivalent to the 'no deductions' clause in *Heritage*."[93]

Nevertheless, the plaintiffs argued that the *second* sentence of the addendum was unique. By requiring the lessor to bear a proportionate share of burdens beyond the defendants' responsibilities, the plaintiffs argued that the provision gave rise to two distinct categories of obligations: exclusive and shared obligations. The exclusive obligations, according to the Plaintiffs, were defined in the first sentence of the

88. *Id.* at 417.
89. *Id.* at 417 n.13 (quoting Heritage Res., Inc. v. NationsBank, 939 S.W.2d at 118, 121 (Tex. 1996) ("The critical clause in all three leases is the requirement that Heritage pay the royalty interest owners their fractional interest of 'the market value at the well' of the gas produced.")).
90. *See* Judice v. Mewbourne Oil Co., 939 S.W.2d 133, 135–37 (Tex. 1996).
91. *Id.*
92. *Warren*, 759 F.3d at 417.
93. *Id.* at 418.

addendum and were the sole responsibility of the defendants. In contrast, the shared obligations, defined in the second sentence, were the joint responsibility of the parties and included any costs incurred after the exploration, production, and marketing of gas. Under the plaintiffs' dual-obligation theory, compression, dehydration, treatment, and transportation costs were the exclusive responsibility of the defendants. In support, the plaintiffs relied on a recent Texas case holding that the lessors were "entitled to an overriding royalty free of all production and post-production costs, subject only to their portion of production taxes."[94]

The Fifth Circuit rejected the plaintiffs' view of the addendum. To interpret the meaning of the second sentence, the court pointed to the pre-printed lease and construed the lessee's exclusive obligation against the backdrop of the royalty calculation and not merely the costs incurred. The royalty owed to the lessor under the pre-printed lease was defined as the net proceeds at the mouth of the well, and net proceeds necessarily included the deduction of reasonable postproduction costs incurred beyond the mouth of the well. Thus, the court construed the second sentence of the addendum to impose an obligation on the lessor to bear a proportionate share of the expenses when the lessee delivered gas to a point of sale beyond the mouth of the well.

Moreover, the court characterized the recent Texas case, *Chesapeake Exploration, L.L.C. v. Hyder*, as distinguishable. The *Hyder* provision based the royalty calculation on "the price actually received" by the lessee for the gas.[95] The parties in *Hyder* expressly agreed to exclude the deduction of postproduction costs between the well and the point of sale.[96] In contrast, the plaintiffs' leases specified a royalty calculation based on the amount the defendants realized at the mouth of the well—without any stipulation prohibiting postproduction cost deductions. Thus, the court concluded that *Hyder* did not control and affirmed the dismissal of the Warrens' claims.[97]

Finally, the court considered the unique provisions in the Javeeds' lease. Notably, the addendum included a provision defining the royalty as "the market value at the point of sale of 20% of the gas so sold or used."[98] Despite recognizing that the district court erred in equating the Warrens' leases with the Javeeds' lease, the appellate court refused to

94. Chesapeake Exploration, L.L.C. v. Hyder, 427 S.W.3d 472, 480 (Tex. App.—San Antonio 2014, pet. filed). The plaintiffs likely invoked the holding in *Hyder* at oral argument, which was held less than a week after the decision.

95. *Id.* at 476.

96. *Id.* at 477–78.

97. The Fifth Circuit did not consider the relationship between the lessee and its affiliates. *See Warren*, 759 F.3d at 419. The Texas court of appeals in *Hyder* refused to consider the affiliate sales as a sale to a third party. *Hyder*, 427 S.W.3d at 482.

98. *Warren*, 759 F.3d at 420.

consider the substantial difference because the plaintiffs failed to raise the issue in their opening brief. Nevertheless, the court modified the district court judgment to dismiss the Javeeds' claims without prejudice.

The Fifth Circuit has suggested a number of ways in which a lease can prohibit the deduction of postproduction costs,[99] and a Texas court of appeals has cautioned that the relationship between affiliates may prohibit deductions. Following *Warren*, *Potts*, and *Hyder*, mineral lessees should pay particular attention to the language in the royalty provisions of an oil and gas lease.

III. RECENT DEVELOPMENTS IN UNITED STATES ENERGY LAW

A. United States Oil, Gas, and Energy Case Summaries

1. Electric Power Supply Ass'n v. FERC, 753 F.3d 216 (D.C. Cir. 2014).

Issue: Did FERC act within its statutory authority in issuing Order 745, which incentivizes retail customers to reduce electricity consumption by paying them not to make retail purchases?

In March of 2011, FERC issued Order 745, a final rule establishing an incentive program encouraging "retail customers to reduce electricity consumption when economically inefficient."[100] Operation of the rule aimed to establish "uniform compensation levels for suppliers of demand response resources who participate in the 'day-ahead and real-time energy markets'"[101] by directing Regional Transmission Organizations (RTOs) and Independent System Operators (ISOs)—wholesale market administrators—to pay suppliers the marginal value of resources in each market typically reserved to compensate generators. FERC conditioned payment on the ability of suppliers to supplant a generation resource and that the demand response be cost effective. Per the rule, such cost effectiveness would be determined by a "net benefits test" administered by RTOs and ISOs.[102] Costs of demand response payments were to be allocated proportionally across all entities purchasing from the relevant energy markets when demand response resources enter the market.

Requests for rehearing and clarification were filed by RTOs and ISOs, state regulatory commissions, trade associations, publicly owned utilities,

99. *Id.* at 418 (suggesting the avoidance of the phrase "computed at the mouth of the well" or the clarification in an addendum entitling the lessor to a royalty of the actual proceeds at any point of sale).

100. Elec. Power Supply Ass'n v. FERC, 753 F.3d 216, 218 (D.C. Cir. 2014).

101. *Id.* at 219 (quoting Demand Response Compensation in Organized Wholesale Energy Markets, 134 FERC ¶ 61.187, 2011 WL 890975, at *30 (Mar. 15, 2011)).

102. *Id.*

transmission owners, and suppliers, among others. The Commission affirmed the rule, and petitioners in the instant case filed in the District of Columbia Court of Appeals for review, arguing that the rule goes beyond FERC's authority by encroaching on states' exclusive jurisdiction to regulate the retail market. FERC contended that the rule only permits retail consumers to participate voluntarily in the wholesale market, and therefore is within its exclusive jurisdiction. Petitioners retorted that FERC does not have the authority to draw retail customers into the wholesale market by essentially paying them not to make retail purchases.

Justice Brown, writing for the majority, first looked to the source of FERC's authority to regulate the transmission and sale of electric power in interstate commerce—the Federal Power Act (FPA). Section 201 of the FPA, Justice Brown observed, splits jurisdiction on the transmission and sale of electricity between the states and the federal government based on the type of service provided and the nature of the energy sale, with federal jurisdiction confined to the sale of electricity in the wholesale market. He went on to note that, for more than a decade, FERC has allowed RTOs and ISOs to use demand-side resources to meet their needs for wholesale services, and that in 2005, Congress declared that "unnecessary barriers to demand response participation . . . shall be eliminated."[103]

Justice Brown then outlined the federal agency constraints imposed by the Administrative Procedure Act, and applied the *Chevron* doctrine to FERC's assertion of statutory authority, which first asks "whether the statutory text forecloses the agency's assertion of authority."[104] But if the statute is silent or ambiguous in that regard, he commented, then deference must be given to the agency's reasonable construction of the statute.[105]

Going on to the specifics of the relevant regulations at hand, Justice Brown observed that there is a single definition of "demand response"—a reduction in electric energy consumption in response either to a price increase or to incentive payments. While FERC acknowledged that the former—price-responsive demand—is a retail-level response, it argued that the latter is a wholesale demand response, despite the fact that demand response resources in a wholesale market do not actually involve a sale. Given this, in addition to its section 201 argument, FERC argued that sections 205 and 206 of the FPA authorize it to issue Order 745

103. *Id*. (quoting Ind. Util. Reg. Comm'n v. Ferc, 668 F.3d 735, 736 (D.C. Cir. 2012)) (internal quotation marks omitted).

104. *Id*. at 220 (quoting City of Arlington, Tex. v. FCC, 133 S.Ct. 1863, 1870–71 (2013)) (internal quotation marks omitted).

105. *Id*.

because reducing retail consumption through demand response payments will affect wholesale markets by lowering the wholesale price.

Justice Brown disagreed, stating that the logical conclusion of FERC's rationale would result in limitless authority to regulate any number of markets. Instead, Justice Brown looked to the overall statutory scheme to outline the limits of sections 205 and 206. Section 201 of the FPA, Justice Brown observed, limits FERC's reach to "those matters which are not subject to regulation by the States,"[106] and reiterated that states retain exclusive authority to regulate the retail market. But "[d]emand response," Justice Brown found, "is part of the retail market . . . . It involves *retail* customers, their decision whether to purchase at *retail*, and the levels of *retail* electricity consumption."[107] Moreover, the Justice continued, FERC cannot rely on the 2005 Congressional policy statement mandating elimination of unnecessary barriers to demand response participation as a source of authority, as such statements are not delegations of regulatory authority. Therefore, Justice Brown held, "[b]ecause the Federal Power Act unambiguously restricts FERC from regulating the retail market, we need not reach *Chevron* step two. . . . [But] even if we *assume* FERC had statutory authority to execute the Rule in the first place, Order 745 would still fail because it was arbitrary and capricious."[108] He supported this arbitrary and capricious determination by noting FERC's failure to consider and engage one of the Commissioner's concerns that the Order would result in unjust and discriminatory rates.

In a lengthy dissent, Justice Edwards emphasized that "because of the specified conditions, Order 745 requires compensation of demand response resources *only when* their participation in a wholesale electricity market actually lowers the market-clearing price for wholesale electricity."[109] He continued to opine that the court's task is not to determine whether a demand response resource under Order 745 should be considered a matter of wholesale or retail regulation, but rather is to interpret the relevant statutes within the *Chevron* framework. According to Justice Edwards, the proper question is whether retail purchasers' promise to reduce electricity consumption that otherwise would have been purchased in a retail market unambiguously constitutes a sale of electric energy under section 201 of the FPA. The Justice contended that the statute was ambiguous in this regard, and as such "we are obliged to defer under *Chevron* to the Commission's permissible construction of 'a

106. *Id*. at 221 (quoting 16 U.S.C. § 824(a)) (internal quotation marks omitted).
107. *Id*. at 223.
108. *Id*. at 224.
109. *Id*. at 226.

statutory ambiguity that concerns the scope the agency's statutory authority (that is, its jurisdiction).'"[110]

2. Lenau v. CoeXprise, Inc., No. 780 WDA 2013, 2014 WL 4696215 (Pa. Sept. 23, 2014).

Issues: Does a broker serving as an intermediary between a landowner and operator in executing an oil and gas lease owe a fiduciary duty to the landowner? Does an oil and gas lease constitute a security as a matter of law?

CoeXprise, Inc. (Co-eXprise) is a business entity engaged in the aggregation of potential lessors with intent to negotiate favorable oil and gas leases with exploration and production companies. Acting as intermediary, Co-eXprise encourages landowners in a given geographic area to unite their interests in an effort to procure the most favorable lease terms possible from a given company. A contract between the landowners and Co-eXprise—a "Marketplace Agreement"—authorizes Co-eXprise to competitively bid landowners' mineral rights. Per the agreement, once Co-eXprise obtains a qualifying bid that surpasses a set threshold for bonus and royalty payments, landowners are obligated to then execute leases with the bidding company. In exchange, Co-eXprise typically receives a payment equal to 5% of the up-front per-acre bonus paid to the lessor as part of the consideration for execution of the lease.[111]

In line with this business plan, Co-eXprise approached landowners in Beaver County, Pennsylvania, to pool their interests. Co-eXprise engaged in extensive marketing efforts by both traditional advertising and conducting landowner meetings, through which it assured landowners that it would be able to obtain the most favorable lease terms. Included with its promotional materials was a terms summary explaining various terms commonly used, in Co-eXprise's legal opinion, in oil and gas leases. In 2011, based on the above representations, a group of landowners (appellants) entered into Marketplace Agreements with Co-eXprise. Co-eXprise was to receive 5% of the bonus in exchange for its services, to be paid by the energy company to Co-eXprise directly when the landowner and energy company entered into a lease agreement.[112] Chesapeake Appalachia, LLC (Chesapeake) was the highest bidder following Co-eXprise's efforts, and despite the fact that the terms of Chesapeake's bid were lower than the threshold provided for in the Marketplace Agreements, appellants agreed to the terms given

110. *Id*. at 227 (quoting *City of Arlington*, 133 S.Ct. at 1868).
111. Lenau v. CoeXprise, Inc., No. 780 WDA 2013, 2014 WL 4696215, at *1 (Pa. Sept. 23, 2014).
112. *Id*. at *2.

assurances offered by Co-eXprise that they represented the best market terms available.[113]

In November of 2012, appellants filed a class action suit against Co-eXprise asserting several causes of action, "including: (1) breach of contract; (2) unauthorized practice of law; (3) violation of the Pennsylvania Unfair Trade Practices and Consumer Protection Law ("UTPCPL"); (4) violation of the Pennsylvania Securities Act of 1972; (5) breach of fiduciary duty; and (6) unjust enrichment/disgorgement."[114] In January of 2013, Co-eXprise successfully moved to have the case assigned to the Commerce and Complex Litigation Center of Allegheny County, after which it filed preliminary objections to the effect that the appellants' claims were legally insufficient. The trial court sustained Co-eXprise's objections, and in April 2013 dismissed all of the appellants' claims.[115]

Writing for the majority, Justice Wecht outlined the four issues presented by appellants, in which they argued that the trial court erred as a matter of law: (1) by interpreting certain contractual terms in the Marketing Agreements as unambiguous; (2) by concluding that the allegations and support thereof "do not raise a factual issue as to whether [Co-eXprise] have engaged in the unauthorized practice of law"; (3) by holding that the leases in question are not securities as defined by Pennsylvania law; and (4) by dismissing the claims of breach of fiduciary duty and unjust enrichment.[116] He also stated the standard of review in reviewing preliminary objections—whether the trial court committed an error of law—and the standard of dismissal on preliminary objections—whether "it is clear and free from doubt that the pleader will be unable to prove facts legally sufficient to establish the right to relief."[117]

Justice Wecht proceeded to address the appellants' first claim—that the trial court erred in sustaining Co-eXprise's preliminary objections because there exists an ambiguity regarding the payment of transaction fees to Co-eXprise. In particular, appellants argued that the contract language[118] "does not clearly delineate which party bears the burden of

113. *Id*.
114. *Id*. at *3.
115. *Id*.
116. *Id*. at *4.
117. *Id*.
118. The relevant contract language reads:

> **3. Transaction Fee**. For the following addresses identified in Exhibit B, Owner shall pay a "Transaction Fee," through the Lease Agreement with the successful Bidder, in an amount equal to 5% multiplied by the gross up front bonus payment upon the completion of each Negotiation Event. The payment of the Transaction Fee shall be a written obligation imposed on the successful Bidder in the Lease Agreement. In the event that while this MarketPlace Agreement is in effect, Owner breaches this MarketPlace Agreement and enters a Lease Agreement on any of the Parcels outside of

paying a 'transaction fee' . . . ."[119] After outlining the applicable principles of contract interpretation, Justice Wecht adopted the reasoning of the trial court and held that the contested section "unambiguously states that [appellants] . . . bear the financial responsibility of paying Co-eXprise's transaction fee out of the proceeds of their initial bonus payment."[120] Justice Wecht continued on to appellants' second claim—that the trial court erred in dismissing their claim that Co-eXprise had engaged in the unauthorized practice of law. Appellants argued that Co-eXprise undertook an array of activities requiring a license to practice law, including the solicitation of appellants' participation in their bidding process, use of a written agreement for appellants to execute to receive services, explanation of terms used in the potential leases, recommendation to accept the highest bid, and inclusion of protections to appellants in the lease agreements not typically included in Chesapeake's form leases.[121] The Justice, however, upheld the trial court's finding because "the mere fact that a company utilizes documents prepared by lawyers, and relies upon the opinions of lawyers in conducting its business, does not, ipso facto, indicate that a company is practicing law . . . ."[122]

On to the third issue presented by appellants—that Co-eXprise violated the Pennsylvania Securities Act of 1972 (the Act) by providing investment advice without proper state registration—Justice Wecht noted the trial court's observation that resolution of the issue turns on whether the Act defines participation in an oil, gas, or mining lease to be a security subject to the Act. The Act, the court observed, includes in its definition of "security" a "fractional undivided interest in oil, gas or other mineral rights . . . ."[123] Justice Wecht looked to the court's decision in *Commonwealth v. Yaste*, in which the court held "that a 'working interest in and to the net proceeds from the sale of . . . oil and gas' constituted a 'security' because 'sale of oil rights in a variety of forms were intended to be made subject to the [state's] regulatory powers . . . in [the Act].'"[124]

However, the court then stated that the *Yaste* court had specifically exempted from this sort of regulation the kind of royalty agreements at issue in the case at bar. The Justice relied on the U.S. Supreme Court's holding in *SEC v. C.M. Joiner Leasing Corp.*, in which the Court

> the MarketPlace Agreement, Owner shall be responsible to pay the Transaction Fee pertaining to such Parcel.

Id. at *6.

119. *Id*.
120. *Id*. at *7.
121. *Id*.
122. *Id*. at *9.
123. *Id*. at *12 (quoting 70 P.S. § 1–102(t)) (internal quotation marks omitted).
124. *Id*. (quoting Commonwealth v. Yaste, 166 70 A.2d 685, 686 (Pa. Super. Ct. 1950)).

construed an identical definition from the Federal Securities Act of 1933 to include "only that form of splitting up of mineral interests which had been most utilized for speculative purposes."[125] In *Joiner*, noted Justice Wecht, the Court emphasized legislative intent to regulate oil and gas rights that could be the "notorious subjects of speculation and fraud," while leaving unburdened "leases and assignments," considering them to be "indispensable instruments of legitimate oil exploration and production."[126] Given the dearth of Pennsylvania state case law addressing the question, Justice Wecht looked to federal case law for guidance. In doing so, the court found that several circuits had addressed the specific question and determined that if a fractional undivided interest is created exclusively to sell that interest, it is a security, but "general leases and assignments of oil and mineral rights do not constitute securities."[127]

With this precedent in hand, Justice Wecht turned to the Marketplace Agreement at issue and determined that it "does not split up the interest in the leasehold for speculative purposes or to finance the development of wells, but simply contracts for a 'direct purchase of an oil lease, with the purchase guaranteed by oil production[.]'"[128] Therefore, the court went on to conclude that the interest would not qualify as a fractional undivided interest in the mineral rights under federal precedent—meaning that it would not be characterized as a security—and held that "this approach is consistent with our own case law, which emphasizes that 'a royalty interest in an oil lease, as the subject matter of sale, ha[s] been held not to be a security within the definition of the Act[.]'"[129]

The final issue remained, in which appellants asserted that the trial court erred in dismissing their claims of breach of fiduciary duty and unjust enrichment. Justice Wecht quickly disposed of the unjust enrichment claim, as it was tied directly to the unauthorized practice of law and breach of the Pennsylvania Securities Act claims.[130] Regarding the breach of fiduciary duty, appellants argued that Co-eXprise had assumed a fiduciary duty with respect to them in three ways: "(1) by agreeing to undertake to represent [appellants'] interest in dealing with

125. *Id*. at *13 (citing S.E.C. v. C.M. Joiner Leasing Corp., 320 U.S. 344, 352 (1943)).
126. *Id*.
127. *Id*. at *15 (citing Adena Exploration, Inc. v. Sylvan, 860 F.2d 1242, 1245 (5th Cir. 1988)); *see also* Woodward v. Wright, 266 F.2d 108, 112 (10th Cir. 1959), *cited in* Adena Exploration, Inc. v. Sylvan, 860 F.2d 1242, 1246 (5th Cir. 1988) (summarizing that "if a fractional undivided interest is created for the purpose of a sale, the conveyance of the interest is the sale of the security"); Nolfi v. Ohio Ky. Oil Corp., 675 F.3d 538, 546 n.5 (6th Cir. 2012) (holding that a "direct purchase of an oil lease, with the purchase guaranteed by oil production, is distinct from partnership and joint-venture investments in speculative oil wells").
128. *Id*. at *16 (quoting *Nolfi*, 675 F.3d at 546 n.5).
129. *Id*. (quoting *Yaste*, 70 A.2d at 687).
130. *Id*.

the potential bidders which duty arose [by] virtue of the Market [P]lace Agreement, (2) by engaging in the unauthorized practice of law, and (3) by acting as an investment advisor."[131] Justice Wecht upheld the trial court's dismissal of "Appellants' bald claim that a breach of fiduciary duty occurred," observing that "a fiduciary relationship [does not arise] merely because one party relies on and pays for the specialized skill or expertise of the other party."[132] Ultimately, therefore, Justice Wecht found in Co-eXprise's favor and upheld the trial court on all issues presented.

3. PPL Energyplus, LLC v. Solomon, 766 F.3d 241 (3d Cir. 2014).

Issue: Whether the Federal Power Act preempts a state legislature's attempt to develop renewable electricity generation.

Several electric energy generators, the Plaintiffs, brought suit against the President and other Commissioners of the New Jersey Board of Public Utilities (the BPU, collectively defendants) seeking to enjoin the enforcement of the New Jersey Long-Term Capacity Pilot Project (LCAPP) and asking for declaratory relief because the Federal Power Act (the FPA) preempts LCAPP. In January 2011, the New Jersey legislature ratified LCAPP to increase the state's electricity capacity, reduce electricity prices, and facilitate the creation of energy-efficient generation facilities.[133] LCAPP provided for Standard Offer Capacity Agreements, which "guaranteed new generators a fixed level of revenue over a fifteen-year contract term."[134] In accordance with LCAPP, the BPU received thirty-four competitive bids from electric generation companies seeking to construct new facilities. The BPU selected two proposals from CPV Power Development, Inc. and NRG Energy, Inc.[135]

After a bench trial, the district court held in favor of the Plaintiffs because the FPA field preempted and conflict preempted LCAPP.[136] In regards to field preemption, the district court reasoned that the agency responsible for implementing the FPA, the Federal Energy Regulatory Commission (FERC), had exclusive regulatory power over wholesale

131. *Id*. at *17.
132. *Id*. at *17–18 (quoting eToll, Inc. v. Elias/Savion Adver., 811 A.2d 10, 23 (Pa. Super. Ct. 2002)) (internal quotation marks omitted).
133. *See* N.J. STAT. ANN. §§ 48.3-98.2(b), (e), (f) (West 2014).
134. PPL Energyplus, LLC v. Solomon, 766 F.3d 241, 249 (3d Cir. 2014).
135. NRG's proposal did not progress due, in part, to NRG's failure to clear the regional interconnection organization's annual capacity planning auction. *See id.* at 252.
136. 16 U.S.C. § 824(a) (2013) (exercising federal power over "the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce"); PPL EnergyPlus, LLC v. Hana, 977 F. Supp. 2d 372 (D.N.J. 2013).

interstate capacity and that LCAPP intruded on this power.[137] Moreover, in regards to conflict preemption, the regional transmission organization overseen by FERC, PJM Interconnection LLC (PJM), set a method for determining wholesale interstate capacity prices, which the district court determined was undermined by LCAPP. In contrast, however, the district court rejected the plaintiffs' argument that LCAPP violated the dormant Commerce Clause. Nevertheless, on the grounds of field and conflict preemption, the district court held "LCAPP unconstitutional, invalidated the Standard Offer Capacity Agreements, and enjoined New Jersey from enforcing the statute."[138]

On appeal, the Third Circuit, in addressing the issue of "whether LCAPP has strayed into the exclusive federal area of interstate wholesale rates,"[139] affirmed the district court's determination of field preemption, but left open the issues of conflict preemption and the dormant Commerce Clause. To determine field preemption, the court addressed the scope of the federal government's regulation and LCAPP respectively.

First, the court looked to PJM's Reliability Pricing Model, which was approved by FERC to establish a framework for interstate wholesale prices in the region. PJM's model utilizes an annual auction to ensure that sufficient capacity exists in the future to meet expected demand.[140] The auction establishes the market-clearing price as the highest bid necessary to satisfy expected demand and binds PJM to "pay for all accepted auction bids."[141]

Second, the court looked to LCAPP's "focus[] on capacity and capacity prices."[142] Embedded in LCAPP was a price in the Standard Offer Capacity Agreements, which "provid[ed] long-term price assurance to new energy generators."[143] The BPU enabled the contracts' price to focus on capacity and capacity prices by awarding generators a defined generation capacity provided that they submit winning bids. To achieve this end, the BPU guaranteed a fixed price for the generators who "participate and clear" the annual PJM auction.[144] The fixed price guarantees were structured as "contracts-for-differences" defined as the

137. *But see* 16 U.S.C. § 824(b) (2013) (exempting from federal jurisdiction the "facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce").

138. *Solomon*, 766 F.3d at 249.

139. *Id.* at 250.

140. Expected demand is calculated using "all generation capacity within the PJM region that has been prearranged between suppliers and users of energy. This includes, for example, capacity associated with state-run monopolies or capacity privately exchanged between load-serving entities and energy generators." *Id.* at 251.

141. *Id.*

142. *Id.*

143. *Id.* at 251–52 (citing N.J. STAT. ANN. § 48:3–98.3(c)(4) (West 2014)).

144. N.J. STAT. ANN. § 48:3-98:3(c)(12) (West 2014).

difference between the market clearing price established at the PJM auction and the price fixed within the Standard Offer Capacity Agreements. Moreover, the BPU guarantees provided financial assurance by enduring for fifteen years and with an annual price increase.

Finally, the court compared the two regulatory schemes and concluded that both of them regulate the same subject matter: "electric capacity prices and sales."[145] FERC regulated the subject matter via PJM's Reliability Pricing Model and the Standard Offer Capacity Agreements within LCAPP effectively "raise[d] the prevailing capacity price to an amount of New Jersey's liking."[146] Furthermore, the court rejected two of the defendants' arguments that LCAPP was merely a hedge to isolate the generators from the risk of market volatility and that the reasonableness of the fixed rates within LCAPP would be subject to FERC's review. Instead, the court concluded that LCAPP, regardless of its risk-reducing benefits, unequivocally "provide[d] for the supply and sale of capacity"[147] and "[w]hat matters is that the [Standard Offer Capacity] Agreements have set capacity prices in the first place."[148]

Moreover, the court distinguished LCAPP from *Northwest Central Pipeline v. State Corp. Commission of Kansas*,[149] where the Supreme Court upheld a Kansas regulation on natural gas because it would only *indirectly* affect interstate rates. "By contrast, LCAPP does not regulate the construction of new power plants, causing an incidental effect on the interstate price of capacity. Rather, LCAPP sets a price of capacity that will lead to the construction of new power plants."[150] The court concluded that such a direct impact could not be saved by incorporating the market-clearing price rather than replacing it altogether.[151]

Despite the broad acknowledgement of FERC's regulatory power, the court stressed that the state retained significant "authority over local energy matters, including the construction of power plants."[152] In the court's view, New Jersey could also have achieved similar incentives for generators via tax exemptions, favorable land development agreements, expedited regulatory approvals, or direct subsidies "not essentially setting wholesale prices."[153] None of these incentives would invade FERC's

145. *Solomon*, 766 F.3d at 252.
146. *Id.*
147. *Id.*
148. *Id.* at 253.
149. 489 U.S. 493, 512–13 (1989).
150. *Solomon*, 766 F.3d at 254.
151. The Third Circuit adopted the Fourth Circuit view that "[t]he fact that [these sorts of payments] do[ ] not formally upset the terms of a federal transaction is no defense, since the functional results are precisely the same." *Id.* (quoting PPL EnergyPlus, LLC v. Nazarian, 753 F.3d 467, 477 (4th Cir. 2014)) (internal quotation marks omitted).
152. *Id.*
153. *Id.* at 253 n.4.

exclusive control. Thus, the court refused to hold that any change in the supply of electricity generating capacity would be field preempted for influencing the market-clearing price. Rather, the state regulation must have more than an "incidental effect on interstate commerce."[154] While the court did affirm that the FPA preempted LCAPP, state officials continue to have significant power to regulate electricity generation where the effect on interstate commerce is indirect or incidental, without an explicit purpose to regulate electric generation capacity and wholesale prices.

4. Rainbow Gun Club, Inc. v. Denbury Onshore, L.L.C., 760 F.3d 405 (5th Cir. 2014).

Issue: Whether the failure of a well is a single event or occurrence ineligible for federal court jurisdiction as a mass action under the Class Action Fairness Act.

Denbury Onshore, Specter Exploration, and SKH Energy (collectively, the defendants) contracted with a group of 167 entities including associations, trusts, and individuals (collectively, the plaintiffs) to develop and produce oil and gas. The defendants drilled the Rainbow Gun Club Well No. 1 in early 2003, and began producing in the following year. The well did not produce as expected and in 2008 the defendants plugged and abandoned it. As a result, the plaintiffs brought suit in Louisiana state court alleging that the defendants breached their duty under the mineral leases as a reasonable and prudent operator. The plaintiffs alleged in their complaint that the defendants greatly reduced the producing capacity of the well by permitting extraneous water to enter the gas reservoir beneath the surface. Namely, the plaintiffs alleged that the defendants were negligent in five instances: (1) failing to heed methods of operation intended to avoid getting the drill pipe stuck; (2) failing to isolate the reservoir by properly cementing the well; (3) failing to properly cement the casing in a sidetrack well; (4) failing to heed increased differential pressures in the drilling of the original well; and (5) failing to correct the defective cement job.[155]

In response to the complaint, the defendants removed the action to federal court contending that the district court had federal jurisdiction of the case because it was a mass action under the Class Action Fairness Act (CAFA).[156] The plaintiffs then filed a motion to remand. They argued

154. *Id.* at 255.
155. Rainbow Gun Club, Inc. v. Denbury Onshore, L.L.C., 760 F.3d 405, 407 (5th Cir. 2014).
156. *See* 28 U.S.C. § 1332(d)(11)(A)–(B) (2013) (defining "mass action" as "any civil action . . . in which monetary relief claims of 100 or more persons are proposed to be tried jointly on the ground that the plaintiffs' claims involve common questions of law or fact").

that two exclusions under the definition of "mass action" applied to the case: the local single event exclusion and the amount in controversy exclusion.

Under the local single event exclusion, a mass action excludes "any civil action in which . . . all of the claims in the action arise from an event or occurrence in the State in which the action was filed, and that allegedly resulted in injuries in that State or in States contiguous to that State."[157] The plaintiffs asserted that their claims arose and their injuries occurred from an event or occurrence in Louisiana. Accordingly, under this exception, the plaintiffs requested the district court to remand the entire case back to state court.

Under the amount in controversy exclusion, federal jurisdiction exists "only over those plaintiffs whose claims in a mass action satisfy the jurisdictional amount."[158] Federal jurisdiction relying on diversity of the parties requires "the matter in controversy [to] exceed[] the sum or value of $75,000, exclusive of interest and costs."[159] The plaintiffs requested the district court to remand all claims that failed to satisfy the $75,000 jurisdictional requirement. Accordingly, under the amount in controversy exclusion, the district court would split the case into two sets of claims dependent on the amount in controversy, with one set in federal court sand the other in state court.

The magistrate judge held that all claims fell under the local single event exclusion and recommended that the case be remanded back to state court. Specifically, the plaintiffs claims arose under the same statute imposing the duty of a reasonable and prudent operator. The magistrate concluded that the occurrence giving rise to the claims was the "manner in which [the] defendants drilled the well."[160] Moreover, the magistrate noted that the well itself was developed over several years and the associated allegations "reflect[ed] a logical series of happenings."[161]

The defendants petitioned to the district court to reconsider the magistrate judge's unfavorable order. The district court noted that although "there must be a limit to what constitutes a single event or occurrence," the meaning of an event or occurrence does not limit the exclusion to a particular moment in time.[162] Accordingly, the court held that the order was not clearly erroneous and denied the defendants'

157. *Id.* §§ 1332(d)(11)(B)(ii), (ii)(I).
158. *Id.* § 1332(d)(11)(B)(i).
159. *Id.* § 1332(a).
160. *Denbury*, 760 F.3d at 408.
161. *Id.*
162. *Id.*

challenge.[163] Still unsatisfied with the reasoning, the defendants petitioned to the court of appeals to review the remand order.

In granting the defendants' petition, the Fifth Circuit limited the appeal to review of the district court's remand of the case to state court because the claims arose from an event or occurrence.[164] In its review, the court considered the text of the statute, the legislative history, and relevant prior judicial decisions. Turning first to the text of the statute, the court acknowledged that both parties agreed that the exclusion includes at least a *single* event or occurrence. The notion, in the court's view, was rooted in judicial authority refusing to confine the exclusion to "a specific incident with a fixed duration of time."[165] Moreover, the court found support in *Black's Law Dictionary*, which defines "occurrence" as "[s]omething that happens, or takes place; specif., an accident, event, or *continuing condition* that results in personal injury or property damage."[166] The court also reviewed other dictionary definitions, concluding that none of them imposed a time limitation and stressed that a *continuing condition* in *Black's Law Dictionary* explicitly discredits the requirement for a discrete moment in time.

Unsatisfied by the ambiguity in the scope of an event or occurrence, the court then turned to the legislative history and found further support for its textual analysis. Prior to adopting the final language in CAFA, Congress had considered and rejected an alternate proposal limiting the exclusion to a "single sudden accident."[167] In contrast, the defendants pointed to the Senate Report on CAFA arguing that the exclusion was limited to "a truly local event with no substantial interstate effects."[168] The Senate Report further contrasted a case involving an environmental tort, where the exclusion would apply, with a case involving a product liability or insurance claim, where the exclusion would not apply to the product sales. The defendants analogized the product sales with their mineral leases and argued that the legislative history supported a narrower view of the single local event exclusion.

The court, however, rejected this argument, finding no reason to limit the exclusion to environmental torts. Pointing to the text of the statue, the court noted that Congress defined the exclusion as encompassing

163. Neither the district court nor the appellate court considered the amount-in-controversy exclusion. *See id.* at 407 n.1.

164. *See id.* at 409 n.2 (noting that defendants waived the second portion of the local single event exclusion).

165. *Id.* at 409 (citing Abraham v. St. Croix Renaissance Grp., L.L.L.P., 719 F.3d 270, 277 (3d Cir. 2013)).

166. Black's Law Dictionary 1248 (10th ed. 2014) (emphasis added).

167. *See* 151 CONG. REC. S1076-01 (daily ed. Feb. 8, 2005) (statement of Sen. Dodd suggesting the enacted language in CAFA *expands* the exclusion from a single sudden accident to all "mass actions in which all claims arise from any 'event or occurrence.'").

168. S. REP. 109-14, at 47 (2005), *reprinted in* 2005 U.S.C.C.A.N. 3, 44–45.

"*any* civil action" arising from an event or occurrence.[169] Moreover, the court characterized the plaintiffs claims—arising out of allegedly negligence—as more similar to an environmental tort than a product liability claim, reasoning that "[t]he only distinction between this case and an environmental tort is the source of the damages—the plaintiffs' claims of financial harm due to lost productivity from the [w]ell as opposed to a claim for property damage from an explosion or spill from the [w]ell." Thus, the court concluded that the legislative history supported the text.

Finally, the court considered prior judicial decisions. Denbury argued for the appellate court to adopt an interpretation similar to the Ninth Circuit's view limiting the exclusion to environmental accidents.[170] The Fifth Circuit, however, found the Ninth Circuit's view ambiguous and instead preferred the Third Circuit's explanation in *Abraham*, where the local single event exclusion included a continuing set of circumstances.[171] Thus, the court held that the local single event exclusion applies not only to a discrete moment in time, but also to a single event or occurrence "constituted by a pattern of conduct . . . leading to a single focused event that culminates in the basis of the asserted liability."[172]

Against this background, the court further held that the plaintiffs' case constituted a single event or occurrence, excluding the mass action basis for federal jurisdiction. First, the court addressed the number of events. The defendants argued that the five acts of alleged negligence were independent events. The court, however, agreed with the plaintiffs' argument that there are two distinct concepts: the event or occurrence itself and the underlying actions giving rise to the event or occurrence. Accordingly, the event or occurrence was the failure of the well, while the alleged acts of negligence were the contributing underlying actions. Second, the court addressed the failure of the well. The defendants argued that the local single event exclusion cannot be satisfied by a mere allegation of the well's failure. The court, however, characterized the argument as a matter of semantics because there was no dispute that the well was no longer producing.[173] Thus, the court concluded that the dispute centered only on the cause of the well's failure and left the plaintiffs to argue the case on its merits before the state court.

Given the expansive definition of the local single event exclusion, lessees seeking to remove breach of contract suits to federal court should

169. 28 U.S.C. § 1332(d)(11)(B)(ii)(I) (2013) (emphasis added).

170. Nevada v. Bank of Am. Corp., 672 F.3d 661, 665, 668 (9th Cir. 2012).

171. *See* Abraham v. St. Croix Renaissance Grp., L.L.L.P., 719 F.3d 270, 276–77 (3d Cir. 2013).

172. Rainbow Gun Club, Inc. v. Denbury Onshore, L.L.C., 760 F.3d 405, 412 (5th Cir. 2014).

173. The court noted that the event or occurrence could be defined in several ways: the failure of the well, the depletion of the well, or the untimely cessation of production of well. *Id.* at 413.

consider the limits of federal jurisdiction for mass actions before filing notice with the state court.

5. South Carolina Public Service Authority v. FERC, 762 F.3d 41 (D.C. Cir. 2014).

Issue: Does FERC have regional planning authority, specifically regarding electricity transmission planning and cost allocation?

In July 2011, the Federal Energy Regulatory Commission (FERC) finalized Order No. 1,000,[174] which addresses regional electric transmission planning and cost allocation. The Order spawned controversy at its inception; industry groups and state regulators opposed it. Opponents alleged that FERC had overstepped its authority in implementing the rules under the Federal Power Act (FPA).[175]

The Order contains two main, relevant components: planning requirements for U.S. transmission providers and cost-allocation principles. Specifically, the Order requires each transmission owning and operating public utility to participate in regional transmission planning. In other words, providers across the nation must help develop regional transmission plans. Moreover, the Order requires transmission providers in neighboring transmission regions to coordinate with each other to develop interregional facilities.

The plans must adhere to need-based public policy requirements and avoid undue discrimination and preference. FERC envisions such planning as a way to increase efficiency and cost-effectiveness while meeting providers' mutual needs.

The Order also enumerates cost-allocation principles. For each planning process, the costs of new transmission facilities are generally allocated among the project's beneficiaries. The cost is divided prior to construction. The guiding allocation principles are similar for interregional and cross-region transmission facilities.

Another contentious mandate in the Order deals with changes to the federal right of first refusal (ROFR). Existing providers had previously possessed a ROFR for the development of transmission facilities. Under the Order, however, the ROFR must be removed from open-access transmission tariffs (OATTs) and other agreements. The Order also requires reciprocity—access on comparable terms—from non-public utilities that choose to access a public utility's transmission lines.

In response to the Order, forty-five petitioners and sixteen intervenors—encompassing state regulatory agencies, electric

174. 136 FERC ¶ 61,051, as reaffirmed and clarified in Order Nos. 1000-A and 1000-B.
175. 16 U.S.C. § 791a (2013).

transmission providers, regional transmission organizations, and electric industry trade associations (collectively, petitioners)—filed suit against FERC to challenge the Order. The petitioners were consolidated into a single appeal in the U.S. Court of Appeals for the District of Columbia Circuit.

The FPA served as FERC's alleged authority for adopting the Order. FERC justifies the Order as using necessary means to reach desired ends: spurring new transmission investment by requiring utilities to create regional plans and by providing a framework for cost allocation—a method to recoup project expenses. For example, FERC claims that the reciprocity and ROFR provisions help increase competition while preventing undue discrimination and preference in transmission service. The cost-allocation provision intends to remove the "theoretical threat" of existing processes to the hindrance of developing more efficient and cost-effective transmission solutions.

Petitioners challenged FERC's authority to adopt these provisions under the FPA, arguing that it stripped utilities and state regulators of their rights to determine their own public policy and the needs of their customers. Petitioners argued that the inability to decide their own policy and conduct would increase costs and inefficiencies, as opposed to improving transmission grids.

FERC's broad cost-allocation authority especially troubled petitioners. Petitioners argued that the only restraint on that authority is discretion—FERC's choice whether to extend allocations beyond certain regional boundaries. Contrary to FERC's claims, petitioners also argued that the Order would limit providing customers with affordable and reliable power due to unnecessary and unsubstantiated hurdles to transmission planning. Opponents claimed that the Order directs utilities to fund transmission developers regardless of whether they take service from them; rather, they alleged, the Order should focus on the allocation of costs by a utility among its customers.

Petitioners argued that the cost-allocation and ROFR provisions violated the *Mobile-Sierra* doctrine established by the U.S. Supreme Court.[176] To them, *Mobile-Sierra* prevents FERC from requiring cost allocation because a utility's right to collect costs is established by voluntary contractual or commercial relationships, not by FERC. Regarding the inability to create a ROFR, petitioners argued that *Mobile-Sierra* created a presumption that freely-negotiated, wholesale-

176. *See* United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956); *see also* FPC v. Sierra Pac. Power Co., 350 U.S. 348 (1956); NRG Power Mktg., LLC v. Me. Pub. Utils. Comm'n, 558 U.S. 165, 167 (2010).

energy contracts are just and reasonable unless found to seriously harm the public interest—a presumption FERC allegedly did not rebut.

The appeals court ruled in favor of FERC. In determining whether FERC was within its statutory authority, the court deferred to FERC's reasonable interpretation concerning the scope of its statutory authority and the application of that authority. The court stated that it is particularly deferential in rate-related matters under FERC's purview because such matters are either rather technical or involve policy judgments. The court added that a final rule of FERC must be upheld unless it is arbitrary, capricious, an abuse of discretion, or in violation of some other law. To comply, FERC must demonstrate a rational connection between the evidence on which it relied and how that evidence supports the conclusion it reached. The court stated that FERC's factual findings are considered conclusive if supported by substantial evidence.[177]

Under this framework, the court held that FERC had authority under the FPA to enact the Order. Most significant was section 206 of the FPA,[178] which provides broad authority to correct "unjust, unreasonable or unduly discriminatory" practices affecting interstate electricity transmission rates. Even where authority for FERC's Order was less clear, FERC had reasonably interpreted its authority under the FPA. As a result, the court gave "substantial deference" to FERC's interpretations and rejected that FERC had misinterpreted the statute.

Thus, FERC had authority under section 206 of the FPA to require transmission providers to participate in regional planning processes. Principally, the court rejected petitioners' view that section 202(a) of the FPA[179] prohibited FERC from mandating transmission planning and that section 202(a) trumped authority under section 206.

Section 202(a) provides, in relevant part, that FERC "is empowered and directed to divide the country into regional districts for the voluntary interconnection and *coordination* of facilities for the generation, transmission, and sale of electric energy . . . ." The court disagreed that section 202(a) precludes FERC from requiring planning arrangements because "coordination" encompasses transmission planning. Instead, the court deferred to FERC's interpretation that section 202(a) posed no bar because "coordination" refers to the coordinated operation of existing transmission facilities, not to the planning of future facilities.

Additionally, the court rejected arguments that FERC's rationale for the Order lacked evidence or support. A theoretical threat from

177. 16 U.S.C. § 825l(b) (2013).
178. *Id.* § 824e.
179. *Id.* § 824a(a).

inadequate existing practices—preventing more efficient and cost-effective transmission solutions—was a sufficient basis for rate regulation. Furthermore, there was substantial evidence of such a theoretical threat to support the Order. The court, for example, cited significant input from industry players, agencies, and consultants, among others, that FERC used to identify the Order's ends and create its means. Thus, the theoretical threat proffered by FERC to justify the Order was viable, supported by evidence, and explained; the threat was not speculative.

Moreover, the court held that FERC had authority under section 206 to require removal of federal ROFR provisions. The court rejected arguments that the ROFR violated the *Mobile-Sierra* doctrine. FERC had determined that ROFRs were unjust and unreasonable practices affecting rates—a determination supported by substantial evidence. Furthermore, the Order required FERC to analyze ROFRs on a case-by-case basis using the *Mobile-Sierra* doctrine, which holds that a FERC-jurisdictional contract that has a public interest clause cannot be overturned except in extraordinary circumstances. In other words, FERC does not require providers to eliminate federal ROFRs before it makes a determination regarding whether an agreement is protected by a *Mobile-Sierra* provision.[180] As a result, FERC will hear *Mobile-Sierra* arguments when reviewing OATTs.[181] Lastly, the court held that, despite the above, determining whether or how *Mobile-Sierra* will ultimately apply to particular contracts is not ripe.

Regarding other provisions of the Order, FERC had authority under section 206 to require the *ex ante* allocation of the costs of new transmission facilities among beneficiaries; its decision regarding scope was not arbitrary or capricious. Additionally, the court rejected that the *Mobile-Sierra* doctrine barred the provision. The court reasoned that the *Mobile-Sierra* cases govern FERC's authority "to modify rates set bilaterally by contract rather than unilaterally by tariff."[182] The doctrine did not address the issues before the court where FERC's "power under Section 206 to require public utilities to include in their OATTs rate-affecting provisions, such as cost allocation method(s) that may be adopted during regional transmission planning."[183] Rather, the court held that FERC can act without first finding that the rates charged by

180. *See, e.g.*, Order No. 1000-A ¶ 389, 77 Fed. Reg. 32,184, 32,245 (May 31, 2012).

181. Despite the court's reasoning, in practice FERC has rejected several regional transmissions plans because they did not go far enough in removing ROFR provisions; in fact, whenever there was an inappropriate ROFR, the commission found that the *Mobile-Sierra* doctrine did not apply. Keith Goldberg, *FERC Gains Upper Hand in Regional Power Planning Fights*, LAW360 (Aug. 22, 2014, 6:23 PM), http://www.law360.com/articles/570014/ferc-gains-upper-hand-in-regional-power-planning-fights.

182. Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1, 554 U.S. 527, 532 (2008); Mobile, 350 U.S. at 332; Sierra, 350 U.S. at 348.

183. S.C. Pub. Serv. Auth. v. FERC, 762 F.3d 41, 86 (D.C. Cir. 2014).

individual utilities are unjust or unlawful if *any* tariff violating the rule would have such an adverse effect on the interstate gas or energy market.

Regarding the final challenges to the Order, the court found reasonable the reciprocity condition imposed to encourage non-public utility transmission providers to participate in the regional planning process; it adequately justified a policy change. Finally, FERC reasonably determined that regional planning must include consideration of transmission needs driven by public policy requirements. FERC, therefore, could mandate procedures for addressing the impact of public policy requirements.

In the end, the court upheld all challenged provisions of the Order. FERC had authority under the FPA to correct what substantial evidence demonstrated to be previously unjust or unreasonable practices affecting transmission rates. Furthermore, the court substantially deferred FERC's reasonable interpretations of its authority and rejected all *Mobile-Sierra* doctrine arguments.

Petitioners are allegedly weighing their options following the ruling. The Large Public Power Council, which represents twenty-six of the largest locally owned and operated not-for-profit utilities in the United States, filed an *en banc* rehearing petition—specifically targeting the cost-allocation provision. On October 17, 2014, the court denied the petition for rehearing *en banc*. Significant challenges to the scope of FERC's granted power under the Order and ruling are likely in the future, especially as FERC begins to implement the Order.

6. Wallach v. Town of Dryden, 23 N.Y.3d 728 (N.Y. 2014).

Issue: Can municipalities ban oil and gas production activities within municipal boundaries through the adoption of local zoning ordinances, or are such ordinances preempted by state laws governing the regulation of oil and gas production?

In 2006, the predecessors of Norse Energy Corporation USA (Norse) began acquiring oil and gas leases in the town of Dryden, New York, in order to explore and develop natural gas resources through hydraulic fracturing (hydrofracking). Similarly, in 2007, Cooperstown Holstein Corporation (CHC) executed two leases with a landowner in Middlefield, New York, to explore the possibility of producing natural gas through hydrofracking. Both Dryden and Middlefield, however, took the position that their respective zoning ordinances prohibited natural gas exploration and production activities within municipal limits. Despite this initial belief, each town engaged in a lengthy review of the zoning plan and the impact natural gas exploration would have on the town and its residents. In 2011, the Town Boards of Dryden and Middlefield (the Towns) voted unanimously to amend their respective zoning ordinances to explicitly prohibit the gas exploration and production activities contemplated by Norse and CHC, reasoning that such operations would endanger the welfare of their residents as well as their rural environments.

Norse and CHC each promptly filed suit against the Towns, challenging the validity of the zoning amendments. Both companies argued that the zoning ordinances were preempted by New York's Oil, Gas and Solution Mining Law (OGSML), which supersedes "all local laws or ordinances relating to the regulation of the oil, gas and solution mining industries . . . ." The New York Supreme Court granted Dryden's motion for summary judgment and Middlefield's motion to dismiss the complaint, upholding the legality of each town's zoning amendments on the basis that such amendments were valid exercises of the home rule powers enjoyed by the Towns. The Appellate Division affirmed both Supreme Court decisions.

In a consolidated case before the New York Court of Appeals, Norse and CHC continued to contend that Dryden and Middlefield lacked the authority to ban hydrofracking activities within their municipal boundaries. The companies argued that New York energy policy requires a uniform approach across all municipalities, and that the OGSML supersession clause expressly preempts all local zoning laws restricting or prohibiting oil and gas activities within a municipality. The Towns argued that the OGSML, per New York precedent, does not preempt their zoning powers. Additionally, the Towns argued that they acted within the power granted to them by New York's home rule provision, and that the ability to restrict industrial use of lands to preserve the welfare of their people and environment is "the very essence of municipal governance."[184]

Justice Graffeo, writing for the majority, began by analyzing the source of municipal authority to regulate land use—the New York Constitution "home rule" provision—noting that "we have repeatedly highlighted the breadth of a municipality's zoning powers to 'provide for the development of a balanced, cohesive community' in consideration of 'regional needs and requirements.'"[185] However, he went on to highlight the preemption doctrine, stating that any law enacted under municipal authority is invalid if it is inconsistent with a state law. But, Justice Graffeo emphasized that such a hurdle is a high one: a local zoning law is invalidated only in the case of clear legislative intent to preempt local control over land use.

184. Wallach v. Town of Dryden, 23 N.Y.3d 728, 742 (N.Y. 2014).
185. *Id.* at 743 (quoting Gernatt Asphalt Prods. v. Town of Sardinia, 664 N.E.2d 1226, 1235 (N.Y. 1996)).

With these principles in mind, Justice Graffeo proceeded to assess the argument pressed by Norse and CHC that the OGSML supersession clause preempts any attempt by a municipality to prohibit oil and gas activities within its bounds. The Justice first set out the three-factor analytical framework laid out in *Frew Run Gravel Prods. v. Town of Caroll*[186] used to determine whether a supersession clause expressly preempts a local zoning law: "(1) the plain language of the supersession clause; (2) the statutory scheme as a whole; and (3) the relevant legislative history."[187] He continued to note that the goal of the inquiry is to determine the legislature's intent in the supersession clause.

Applying the three *Frew Run* factors to the Norse and CHC appeals, Justice Graffeo held that the Towns acted well within their authority in enacting the zoning laws in question. He first construed the plain language of the OGSML supersession clause, explaining that the most natural reading of the clause language leads to the conclusion that the clause preempts only local laws that regulate the "actual operations of oil and gas activities," not zoning laws that restrict land usage within municipal boundaries.[188] Second, the Justice examined the statutory framework of the OGSML. Looking at the stated purposes of the OGSML and the regime under which the New York State Department of Environmental Conservation (the Department) is entrusted—the regulation of oil and gas activities—he held that nothing in the OGSML indicates that the supersession clause was meant to do anything more than "preempt conflicting local laws directed at the technical operations of the industry."[189] Finally, applying the third and final *Frew Run* factor, Justice Graffeo analyzed the legislative history of the OGSML. He found that the pertinent history made no mention of zoning at all, and instead revealed a predominant legislative preoccupation with preventing waste and providing the Department with the ability to regulate the technical aspects of the industry.

Norse and CHC, however, had made an additional argument—that even if the OGSML does not preempt local zoning laws, it should be read as preempting such laws that affect complete bans on activities like hydrofracking. Justice Graffeo quickly dismissed this contention[190] on the basis of *Gernatt Asphalt Prods. v. Town of Sardinia*, in which the court held that a town's complete ban on all mining activity by way of a zoning law was within its authority.[191]

186. Frew Run Gravel Prods. v. Town of Carroll, 71 N.E.2d 920, 922–23 (N.Y. 1987).
187. *Wallach*, 23 N.Y.3d at 744.
188. *Id*. at 746.
189. *Id*. at 750.
190. *Wallach*, 23 N.Y.3d at 753.
191. *Gernatt*, 664 N.E.2d at 1239.

In a dissenting opinion, Justice Pigott contended that the zoning laws at issue relate to the regulation of the oil and gas industries, and, as such, "encroach upon [the Department's] regulatory authority."[192] The Towns' zoning laws, argued Justice Pigott, go beyond mere regulation of land use under the pretext of zoning—they create a "blanket ban on an entire industry without specifying the zones where such uses are prohibited."[193] He contended that such an action is, in practical effect, regulation.

7. Warren Drilling Co., Inc. v. Equitable Prod. Co., No. 2:12–cv–425, 2014 WL 4243769 (S.D. Ohio Aug. 26, 2014).

Issue: Did a drilling contract require a natural gas well owner to defend and indemnify its drilling subcontractor from a tort suit brought by property owners against the drilling subcontractor for allegedly contaminating their water? If so, could the indemnitee-drilling subcontractor recover costs and fees incurred in suing to enforce its indemnity rights against the indemnitor-well owner?

In 2006, plaintiff Warren Drilling Company, Inc. (Warren) contracted with defendant Equitable Production Company (EQT). EQT retained Warren as a subcontractor to conduct drilling operations at three EQT natural gas wells in West Virginia (the Drilling Contract).

In October 2010, Dennis and Tamera Hagy (the Hagys) filed suit in West Virginia state court against Warren. The Hagys claimed that hazardous chemicals from Warren's drilling activities had contaminated their water well. According to the Hagys, wells located less than one-quarter of a mile from their property had defective cement casing. The complaint alleged that the Hagys drank water from the well and became physically sick—exhibiting neurological symptoms associated with toxic exposure to heavy metals.

After the Hagys filed suit, Warren sought coverage from its insurer, which its insurer denied. Warren then sought indemnification under the Drilling Contract from EQT. EQT denied the request. As a result, Warren allegedly spent approximately $194,000 defending the Hagy suit, $40,000 of which came from settling with the Hagys.

Following settlement with the Hagys, Warren filed suit for indemnification against EQT in the Southern District of Ohio. Warren alleged that, under the Drilling Contract, EQT agreed to defend and indemnify Warren against any environmental claims.

On April 16, 2014, the court granted summary judgment for Warren, finding as a matter of law that the parties' Drilling Contract required

192. *Id*. at 755 (Pigott, J., dissenting).
193. *Id*. at 756.

EQT to defend and indemnify Warren for the Hagys' contamination claim against Warren. Furthermore, the court directed the parties to submit briefing concerning the reasonableness of the amount of Warren's: (1) settlement with the Hagys, (2) attorney's fees and costs in the Hagy litigation, and (3) attorney's fees and costs in the EQT litigation.

EQT filed a motion for reconsideration of the April 16, 2014 Opinion and Order. The court subsequently ruled on the reasonableness briefing and reconsideration motion. The court upheld its ruling that EQT must indemnify Warren for the Hagy litigation, but rejected Warren's request for attorney's fees and costs in the suit against EQT seeking indemnification.

In its motion for reconsideration, EQT argued that sections 11.1.f and 11.3 of the Drilling Contract actually required Warren to indemnify EQT, rather than requiring EQT to indemnify Warren. Looking first to section 11.3, the court rejected this argument. The court reasoned that those sections were general insurance and indemnity provisions that applied, as section 11.3 stated, "except to the extent [the Drilling Contract] specifically provides otherwise." According to the court, the Drilling Contract did provide otherwise. Two provisions of the Drilling Contract, sections 11.5 and 11.6, specifically addressed a duty of indemnification for losses or claims relating to "pollution and contamination." Because the Hagys' claim was one of water contamination, it required EQT to indemnify Warren.

EQT also argued that section 11.1.f trumped the more specific provisions of the Drilling Contract. Section 11.1.f states that Warren "shall be solely responsible for any deductible or self-insured retention provisions of its insurance, any loss or damage in excess of the policy limits, and/or any loss or damage that is not covered by the insurance required under this Insurance Section." This language, according to EQT, made Warren responsible for any loss not covered by insurance, and Warren's insurer undisputedly denied coverage for the Hagys' claim.

The court rejected EQT's second contention as a matter of contractual interpretation. Pennsylvania law, which governed the contract pursuant to a choice-of-law provision, provides that "the specific controls the general."[194] The Drilling Contract required Warren to obtain primary insurance. The Drilling Contract also said that Warren generally would bear uncovered losses. Yet, sections 11.5 and 11.6 created specific duties of indemnification for a "claim" asserted by a third party for pollution or contamination—such as the Hagy litigation. The Drilling Contract

194. Baltic Dev. Co. v. Jiffy Enters., Inc., 257 A.2d 541, 543 (Pa. 1969); Trombetta v. Raymond James Fin. Servs., Inc., 907 A.2d 550, 560 (Pa. Super. Ct. 2006).

provided further support for indemnification; section 11.6 made EQT liable to indemnify "except to the extent" such claim was "covered by [Warren's] insurance." In other words, the duty to indemnify arose only when the claim was not covered by Warren's insurance. Therefore, the general provision of section 11.1.f must yield to the specific language of section 11.6. According to the court, any other interpretation would render section 11.6 meaningless.[195] As a result, the court held that EQT must indemnify Warren.

After holding that EQT must indemnify Warren for the Hagy litigation, the court turned the reasonableness of Warren's settlement amount and litigation expenses. The court noted that Warren bears the burden of demonstrating reasonableness.[196] Warren settled the Hagy litigation for $40,000. Warren demonstrated that at the time of the settlement, it expected to incur a minimum of $43,000 to $68,000 in additional attorney's fees solely for pre-trial matters. As to its attorney's fees and costs, Warren demonstrated that in a year and a half of litigation, it incurred a total of 465 hours of legal services at rates from $65 to $190 per hour. In all, Warren incurred: $84,477.50 in attorney's fees; $8,000.50 in costs—largely court reporter fees; and $61,911.44 in expert fees, which it incurred pursuant to a fee-sharing agreement with EQT. EQT stipulated to reasonableness while reserving its right to contest on appeal the issue of its liability to defend and indemnify Warren. As a result, the court held that the settlement and Warren's attorney's fees and costs were reasonable.

Despite awarding fees and costs in the Hagy litigation, the court declined to award Warren such for its lawsuit against EQT to enforce the indemnification provisions—despite prevailing. The court found persuasive EQT's argument that Pennsylvania law follows "the general, American rule that there can be no recovery of attorney's fees from an adverse party, absent an express statutory authorization, a clear agreement by the parties, or some other established exception."[197]

Section 11.6 of the Drilling Contract stated that EQT would hold Warren "harmless from and against any loss, damage [or] expense . . . for pollution or contamination . . . arising out of or connected with services performed [by Warren] . . . ."

The court assessed the "hold harmless" language pursuant to Pennsylvania law's adherence to the American rule and its exceptions.

195. *See* Shehadi v. Ne. Nat'l Bank of Pa., 378 A.2d 304, 306 (Pa. 1977) ("It is fundamental that one part of a contract cannot be so interpreted as to annul another part . . . .").

196. Cnty. of Del. v. J.P. Mascaro & Sons, Inc., 830 A.2d 587, 593 (Pa. Super. Ct. 2003).

197. *See* Herd Chiropractic Clinic, P.C. v. State Farm Mut. Auto. Ins. Co., 64 A.3d 1058, 1066 (Pa. Super. Ct. 2013); *see also* Putt v. Yates–Am. Mach. Co., 722 A.2d 217, 226 (Pa. Super. Ct. 1998).

The court held that the "hold harmless" language could not shift the obligation for attorney's fees incurred in enforcing the indemnification agreement to EQT unless the agreement expressly included attorney's fees as an item against which the indemnitee is held harmless.[198] In the Drilling Contract, section 11.6 did not even mention attorney's fees. As a result, the "hold harmless" language in section 11.6 was not an express contractual agreement to shift fees; therefore, Warren could not recover costs and fees associated with enforcing the contractual indemnity provision.

In sum, the court held that: (1) the Drilling Contract provided a duty for EQT to defend and indemnify Warren against the Hagy litigation, (2) the settlement and fees and costs associated with the Hagy litigation were reasonable, and (3) Warren could not recover fees and costs from EQT for suing to enforce its indemnity rights.

8. West Deptford Energy, LLC v. FERC, 766 F.3d 10 (D.C. Cir. 2014).

Issue: When a utility files multiple rates with FERC while negotiating with a prospective customer, which filed rate governs: the rate filed when negotiations commenced or the rate filed when the agreement was executed?

West Deptford, the petitioner, requested an interconnection from PJM Interconnection, L.L.C. (PJM), an independent organization operating transmission facilities in a region including thirteen states and the District of Columba.[199] Eight years prior to the petitioner's request, three other generators—Mantua Creek, Liberty Electric, and Marcus Hook—submitted interconnection requests after which PJM determined that a $13 million upgrade to its transmission facilities was necessary to support the additional combined load. Because the upgrade was only necessary for the latter two requests, Mantua Creek, the first requestor of the triad, entered the interconnection request queue without the burden of paying for the upgrade. As a result, Liberty Electric and Marcus Hook bore the burden of paying for the upgrade with Marcus Hook covering over 90% of the cost totaling over $10 million.[200]

198. *See* 41 AM.JUR.2D *Indemnity* § 30 (2014) ("If the indemnification clause at issue does not specifically say that it includes attorney's fees, they are excluded."); Delle Donne & Assoc., LLP v. Millar Elevator Serv. Co., 840 A.2d 1244, 1249, 1256 (Del. 2004) (finding that fee shifting was appropriate because the indemnification provision expressly included all "reasonable attorneys' fees").

199. For more detail regarding the operation of the interconnection request queue pursuant to PJM's Open Access Transmission Tariff, see West Deptford Energy, LLC v. FERC, 766 F.3d 10, 12–14 (D.C. Cir. 2014).

200. FPL Energy Marcus Hook, L.P. v. FERC, 430 F.3d 441, 444 (D.C. Cir. 2005). In return for funding transmission-facility upgrades, generators receive auction revenue rights to future sales associated with the upgrade. *See* PJM Tariff § 231.1, J.A. 764.

Despite the upgrade nearing completion, Mantua Creek, free from any responsibility for the upgrade's cost, terminated its generation project and withdrew its interconnection request from the queue. The upgrade was thus no longer necessary. PJM, nevertheless, evaluated the upgrade and determined that its completion was the least costly solution.[201] Dissatisfied with PJM's decision, Marcus Hook sought to receive a refund in excess of $9 million by filing a complaint with FERC.[202] FERC then rejected Marcus Hook's refund—a decision upheld by the appellate court.[203]

After reviewing West Deptford's interconnection request submitted in 2006, PJM determined that West Deptford would also bear the burden of the upgrade, more than three years after its completion.[204] In 2008, PJM submitted to FERC a proposal to amend its tariff. Under the amended tariff, PJM's ability to seek reimbursement for completed upgrades was limited to a five-year period measured by "the execution date of the Interconnection Service Agreement for the project that initially necessitated the" upgrade.[205] While the new tariff did not specify its effective date, PJM sent a transmittal letter to FERC requesting that certain provisions of the new tariff take effect on August 1, 2008. Shortly afterward, a proceeding challenging the tariff began before FERC, in which a third-party challenger inquired into the scope of the new tariff; specifically, whether the new tariff would apply to all projects in the interconnection queue or only to requests submitted on or after August 1st. PJM clarified its effective requested date by stating that the published date applies to an amended provision regarding upgrades of less than $5 million[206] and to the U2-Queue, which had been scheduled to close on the published date. While PJM intended for all amendments to be effective on the same date, with the U2-Queue subject to initial application, FERC only referenced the provision regarding upgrades of less than $5 million in its order accepting the new tariff. Subsequent to this order, PJM insisted that West Deptford pay a reimbursement for the upgrade. In response, West Deptford objected on several occasions to PJM's allocation of the upgrade costs. While West Deptford agreed that the superseded tariff permitted PJM to seek reimbursement, West

201. PJM completed the upgrade in June 2003. *West Deptford*, 766 F.3d at 14–15.

202. *See Marcus Hook*, 430 F.3d at 444.

203. *Id.* at 447–49.

204. PJM's Tariff provides for the reimbursement of completed upgrades when the new project request "(i) used the added capacity created by the upgrade or would have required the upgrade itself, (ii) the cost of the upgrade was at least $10 million, *and* (iii) the upgrade was 'placed in service no more than five years prior to the affected Interconnection Customer's Interconnection Queue Closing Date.'" *West Deptford*, 766 F.3d at 15 (quoting PJM Superseded Tariff § 37.7, J.A. 745) (emphasis added)).

205. PJM Tariff § 219(a), J.A. 762.

206. PJM Tariff § 217.3a, J.A. 761.

Deptford challenged the application of the superseded tariff because FERC had approved of the new one under which PJM would be barred by a five-year limitation expiring in 2008.[207]

In response to West Deptford's challenge, PJM sought administrative review to resolve the dispute. In opposition, West Deptford asserted that the filed rate doctrine and the commission's precedent foreclosed the application of the superseded tariff. West Deptford reasoned that even if the superseded tariff were to apply, it should be entitled to offsetting rights to auction revenue. In its order and subsequent rehearing, FERC rejected West Deptford's arguments. First, the commission concluded that the superseded tariff governed West Deptford's obligation to reimburse the costs of the upgrade because a tariff in effect when an interconnection request enters the queue governs and provides notice to the requestor. FERC also noted that PJM clarified the new tariff "would only apply starting with projects in the U2-Queue"[208] and that PJM's interconnection studies further provided West Deptford with notice of the application of the superseded tariff's cost-reimbursement provision. Second, FERC concluded that its prior decisions were not binding. Finally, FERC found West Deptford's auction revenue argument unripe until the interconnection agreement was executed between West Deptford and PJM.

On West Deptford's appeal to the D.C. Circuit, the appellate court vacated FERC's order and remanded the case for proper explanation. The court noted that the Federal Power Act (FPA) required "[a]ll rates and changes made, demanded, or received by any public utility . . . shall be just and reasonable."[209] Moreover, any public utility that files rate schedules with FERC is required to keep the filed rates "open in convenient form and place for public inspection."[210] The publication of such rates provides notice to the public by "stating plainly" the changes made and the relevant effective dates.[211]

In applying the statute, the appellate court held that PJM and FERC failed to satisfy its requirements. Not only was the effective date of the changes not stated plainly, but FERC also failed to endorse PJM's intent to apply the effective date to the provision relevant to West Deptford. Moreover, PJM's letter to FERC merely included "explanatory rather than operative language."[212] In fact, the court determined that FERC plainly stated that the effective date would apply "only for those

207. The provision subject to the new tariff effective date concerned upgrades less than $5 million. *See id*.
208. *West Deptford*, 766 F.3d at 17.
209. 16 U.S.C. § 824d(a) (2013).
210. *Id.* § 824d(c).
211. *Id.* § 824d(d).
212. *West Deptford*, 766 F.3d at 18.

generators in the U2 queue, and not for those generators in earlier queues."[213] The court also noted that FERC had failed to explain the legal importance of information contained in letters to the commission, rather than its official orders.

The appellate court then turned to FERC's precedent that applied the tariff in effect when the parties executed the interconnection agreement or when the agreement was filed, rather than the tariff in effect when the generator entered the queue, unless a grandfather provision existed in the amended tariff.[214] In *MISO III*, for example, Midwest Independent Transmission System Operator, Inc. (MISO), another independent organization operating transmission facilities, filed an amended tariff with FERC with an effective date in the same month as PJM's amended tariff. In the month afterward, MISO filed two interconnection agreements seeking to apply the superseded tariff rather than the new one. Similar to West Deptford's situation where the superseded tariff was in effect when it entered the queue, the generators in *MISO III* also entered the queue prior to the effective date of the amended tariff. FERC responded to MISO's filing by enforcing the tariff in effect when the agreement was executed—that is, the amended tariff. The court also noted that FERC reaffirmed the same position in *MISO IV* where it enforced MISO's right to enforce the tariff "effective and on file on the date that the interconnection agreement" was filed with FERC as either executed or unexecuted.[215] Because FERC's treatment of PJM and West Deptford conflicted with *MISO III* and *MISO IV*, the court concluded that FERC lacked a "reasoned explanation for departing from precedent or treating similar situations differently."[216]

The court also rejected FERC's assertion that it applies a case-by-case review. The court reasoned that FERC must explain how such an approach would satisfy the statutory requirements of the FPA "to protect against the discrimination and unpredictability in rates and charges."[217] Given the FPA's purpose of increasing uniformity in tariff terms, FERC could not justify a case-by-case review.[218] Thus, the court concluded that FERC failed to provide a "reasoned analysis, resting on articulated

213. *Id.*

214. *See* Ariz. Pub. Serv. Co., 137 FERC ¶ 61,099 P.25 (2011) (approving of a grandfather provision facilitating projects to proceed through the interconnection procedure); Edison Mission Energy v. Midwest Indep. Transmission Sys. Operator, Inc., 136 FERC ¶ 61,035 PP 38–40 (2011) (finding interconnection requests were grandfathered into the superseded tariff and not the amended tariff that categorized requests into four groups); Midwest Independent Transmission System Operator, Inc. (MISO IV), 129 FERC ¶ 61,060 P. 62 n. 120 (2009); Midwest Independent Transmission System Operator, Inc. (MISO III), 125 FERC ¶ 61,277 P. 10 (2008).

215. *MISO IV*, 129 FERC ¶ 61,060 at P. 62.

216. ANR Pipeline Co. v. FERC, 71 F.3d 897, 901 (D.C. Cir. 1995).

217. *West Deptford*, 766 F.3d at 20.

218. *See id* at 21 (quoting MidAmerican Energy Co., 116 FERC ¶ 61,018 P. 7 (2006)).

objective, nondiscriminatory, and evenhanded criteria" that explains why a case-by-case review was necessary.[219]

Finally, the court rejected FERC's reliance on notice as an exception to the established filed rate doctrine.[220] The appellate court noted that the exception applied in only two scenarios: (a) when the filed tariff defines the formula for calculating rates, rather than a specific rate, and (b) when the invalidation of a FERC decision causes a retroactive change in the applicable rates. In West Deptford's case, it was not a party to any proceedings before FERC challenging the amended tariff, rather a third party brought the challenge. Moreover, PJM's intent to apply the superseded tariff during its investigation of West Deptford's interconnection request was insufficient due to West Depford's repeated objections. Thus, the court concluded that FERC lacked a reasoned explanation for expanding the scope of the notice exception to include unilateral assertions by transmission organizations, against FERC precedent.[221]

Before remanding the case, the appellate court determined that FERC also failed to provide a reasoned explanation for finding West Deptford's request for auction revenue rights unripe. In the court's view West Deptford was simply "ask[ing] the Commission for a price check on the [u]pgrade."[222] In particular, the court found that FERC had "left entirely unexplained" why it permitted Marcus Hook and Liberty Electric to be reimbursed for $10 million in upgrade costs and yet retain the associated funds received via auction revenue rights.[223] Thus, the court vacated FERC's decision and remanded the case to provide FERC an opportunity to provide a reasoned explanation for why West Deptford's interconnection agreement is subject to the superseded tariff and why West Deptford is not entitled to auction revenue rights. Generators and interconnection organizations should pay particular attention to FERC's reasoned analysis on remand to determine if FERC has shifted course from its filed rate doctrine precedent.

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219. *Id.*

220. *See* Natural Gas Clearinghouse v. FERC, 965 F.2d 1066, 1075 (D.C. Cir. 1992) (stating that the "filed rate doctrine simply does not extend to cases in which buyers are on adequate notice that resolution of some specific issue may cause a later adjustment to the rate being collected at the time of service").

221. Dominion Res. Servs., Inc. v. PJM Interconnection, L.L.C., 123 FERC ¶ 61,025 P. 52 (2008) (noting that the interconnection study only provides a "non-binding estimate of costs").

222. *West Deptford*, 766 F.3d at 25.

223. *Id.*